Neutral Citation: [2024] UKUT 27 (TCC)
Case Number: UT/2022/000081

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Hearing venue: Rolls Building, London

VAT – recovery of residual input tax – whether FtT erred in failing to determine whether there was dual use of taxable supplies of entertainment & hospitality also for the non-taxable supplies of gaming in the casino – whether a standard method override, using allocated floorspace, guarantees a more precise determination of economic use and the proportion of recoverable input tax than the standard method using proportion of turnover for taxable and non-taxable supplies

Heard on: 3-4 October 2023
Judgment date: 29 January 2024

Before

JUDGE RUPERT JONES
JUDGE VINESH MANDALIA

Between

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Appellants

and

HIPPODROME CASINO LTD

Respondent

Representation:

For the Appellants: Matthew Donmall, counsel, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

For the Respondent: Andrew Hitchmough KC and Ronan Magee, counsel, instructed by PricewaterhouseCoopers LLP

DECISION

INTRODUCTION

1. His Majesty's Revenue and Customs ('HMRC') appeal against a decision of the First-tier Tribunal (Tax Chamber) ('the FtT' or 'Tribunal') released on 22 March 2022 under neutral citation [2022] UKFTT 110 (TC) ('the Decision'). The FtT allowed appeals by Hippodrome Casino Limited ("HCL") against decisions of HMRC refusing HCL's VAT claims to deduct input tax based upon a Standard Method Override ('SMO'). HCL relied on a floorspace method by way of SMO to displace the standard method of apportioning residual input tax for the tax years 2012/13 to 2018/19.[1]

2. In summary, the FtT concluded that HCL's means of apportioning and recovering input VAT on HCL's overhead expenditure by reference to floorspace more accurately reflected the economic use of that expenditure than the standard turnover-based method of recovery provided by Regulation 101 of the VAT Regulations 1995 (S.I. 1995/2518) ('VAT Regulations'). The FtT decided that the floorspace SMO provided a more fair, reasonable and precise proxy of HCL's economic use of its residual costs than the standard method and allowed its appeals.

3. The FtT granted HMRC permission to appeal to the Upper Tribunal on five grounds of appeal which are set out in more detail below.

4. HMRC's main argument in this appeal (encapsulated in grounds 1-4) is that the FtT erred in law in failing to address, and give any reasons for rejecting, their central contention that floorspace used for taxable supplies such as entertainment were also being used for non-taxable supplies of gaming. Central to HMRC's case before the FtT was that the floor space SMO Method was fundamentally flawed because it proceeded on the false premise the areas allocated under that method to 'bars', 'restaurant' and 'entertainment' were *only* used for the purposes of taxable supplies of hospitality and entertainment (subject to an adjustment in respect of free complimentary supplies). HMRC's case was that these areas were used economically *both* for the purposes of taxable supplies *and* as important amenities for HCL's exempt gaming business ('the Dual Use issue').

5. HMRC submit that nowhere in the Decision did the FtT express a conclusion as to whether the areas for bars, restaurant and theatre (or any of them) were also used economically for the exempt gaming business. Rather, what the FtT did was to express a conclusion on an incorrect test, namely whether or not the hospitality and entertainment businesses were "merely an adjunct to, or amenity for, gaming" (see the Decision at [125]). HMRC argue that this is not the test of economic use.

6. HMRC also contend, as a fifth ground, that the FtT erred in law in its failure to give any or adequate reasons for rejecting HMRC's other points in the appeal.

[1] More precisely, there were two appeals to the FtT from two decisions of HMRC. The first appeal, TC/2018/05373, was against the refusal on review by HMRC dated 11 July 2018 for HCL's claim on the basis of a SMO for the tax years 2012/13 to 2015/16. The second appeal, TC/2021/01140, was against an HMRC decision dated 9 October 2020, upheld on 5 March 2021, rejecting the Appellant's claims for repayment in respect of residual input tax calculated on the basis of a SMO for 2016/2017 and 2017/2018, as well as Capital Goods Scheme adjustments for years 2016/2017, 2017/2018 and 2018/2019.

THE LEGAL FRAMEWORK

7. The FtT set out the relevant legal framework at [6] to [27] of the Decision (references in square brackets are to paragraphs of the Decision). Insofar as is material, the relevant provisions are contained in Articles 168 & 173-175 of Directive 2006/112/EC (the "Principal VAT Directive" or "PVD").

8. Article 173(1) of the Principal VAT Directive provides for the deductibility of VAT in respect of supplies (of goods or services) which are used for both taxable and non-taxable transactions:

> 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.
>
> The deductible proportion shall be determined, in accordance with Articles 174 and 175, for all the transactions carried out by the taxable person.

9. Article 174(1) makes provision for the standard method of calculating the deductible proportion by way of turnover:

> The deductible proportion shall be made up of a fraction comprising the following amounts:
>
> (a) as numerator, the total amount, exclusive of VAT, of turnover per year attributable to transactions in respect of which VAT is deductible pursuant to Articles 168 and 169;
>
> (b) as denominator, the total amount, exclusive of VAT, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible.

10. Article 173(2) makes provision for alternative methods of attribution: Member States may: "authorise or require the taxable person to make the deduction <u>on the basis of the use made</u> of all or part of the goods and services" [Emphasis Added].

11. These articles are implemented into UK law by the Value Added Tax Act 1994 ("VATA") and the Value Added Tax Regulations 1995 ("the VAT Regulations") that are made under that Act.

12. Section 24(1) VATA defines input tax:

> 'Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—
>
> (a) VAT on the supply to him of any goods or services; […] being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him…'

13. Section 25(2) VATA provides that a taxpayer's allowable input tax shall be "credited" against its liability to account for output tax:

> "Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him."

That credit can be restricted by regulations made under section 25(7) VATA to provide that input tax of certain kinds is not deductible, e.g. such as that relating to business entertainment.

14. Section 26 VATA and the regulations made under it, in Part XIV of the VAT Regulations, implement articles 173 – 175 PVD into domestic legislation.

15. Section 26 VATA provides:

> "(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 […] 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; […]
>
> (3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above, and any such regulations may provide for—
>
> (a) determining a proportion by reference to which input tax for any prescribed accounting period is to be provisionally attributed to those supplies;
>
> (b) adjusting, in accordance with a proportion determined in like manner for any longer period comprising two or more prescribed accounting periods or parts thereof, the provisional attribution for any of those periods;
>
> (c) the making of payments in respect of input tax, by the Commissioners to a taxable person (or a person who has been a taxable person) or by a taxable person (or a person who has been a taxable person) to the Commissioners, in cases where events prove inaccurate an estimate on the basis of which an attribution was made; and
>
> (d) preventing input tax on a supply which, under or by virtue of any provision of this Act, a person makes to himself from being allowable as attributable to that supply.
>
> (4) Regulations under subsection (3) above may make different provision for different circumstances and, in particular (but without prejudice to the generality of that subsection) for different descriptions of goods or services; and may contain such incidental, supplementary, consequential and transitional provisions as appear to the Commissioners necessary or expedient."

16. As the FtT identified at [16] of the Decision:

> "It is not disputed that that the supplies of hospitality and of entertainment made by HCL are taxable supplies or that the supplies of gaming are exempt under Group 4 of Schedule 9 VATA (save that, for the period between starting trading and 1 February 2013 the supply of facilities for playing some electronic games of chance was taxable (cf Note 1(d) to Group 4 of Schedule 9 as it stood prior to the amendments made by the Finance Act 2012))."

17. Regulation 101 of the VAT Regulations makes provision for the standard, turnover-based, method of attribution of input tax. In so far as it applies in the present case, regulation 101 provides:

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

(2) … 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,

(c) no part of the input tax on such of those goods or services as are used or to be used by him exclusively in making exempt supplies, or in carrying on any activity other than the making of taxable supplies, shall be attributed to taxable supplies,

(d) … subject to subparagraph (e) below, there shall be attributed to taxable supplies such proportion of the residual input tax as bears the same ratio to the total of such input tax as the value of taxable supplies made by him bears to the value of all supplies made by him in the period.

(e) the attribution required by subparagraph (d) above may be made on the basis of the extent to which the goods or services are used or to be used by him in making taxable supplies,

[…]

(4) The ratio calculated for the purpose of paragraph (2)(d), (e) or (g) above shall be expressed as a percentage and, if that percentage is not a whole number, it shall be rounded up …

[…]

(10) In this regulation "residual input tax" means input tax incurred by a taxable person on goods and services which are used or to be used by him in making both taxable and exempt supplies."

18. One way by which the UK authorises or requires deduction on a basis other than the standard turnover method is where there is a Partial Exemption Special Method ('PESM'). Regulation 102 of the VAT Regulations 1995 enables the Commissioners to approve or direct the use of a method other than the standard method, i.e. by way of a PESM.

19. Another way is by way of the standard method override ('SMO').

20. Regulation 107B sets out the circumstances in which the standard method may be overridden. It provides (so far as material) that:

"(1) … this regulation applies where a taxable person has made an attribution under regulation 107(1)(a) or (d) according to the method specified in regulation 101 and that attribution **differs substantially from one which represents the extent to which the goods or services are used by him** or are to be used by him, or a successor of his, in making taxable supplies.

(2) Where this regulation applies the taxable person shall—

(a) calculate the difference, and

(b) in addition to any amount required to be included under regulation 107(1)(g), account for the amount so calculated on the return for the first prescribed accounting period next following the longer period or the return for the last prescribed accounting period in the longer period if applicable, except where the Commissioners allow another return to be used for this purpose.

(3) [This makes provision for situations where registrations are cancelled]. ”

[Emphasis Added]

21. Regulation 107B(2) requires that where attribution has been made under the standard method (i.e. there is no PESM in place) and by virtue of 107B(1)*“that attribution differs substantially from one which represents the extent to which the goods or services are used by him or are to be used by him”*, the taxable person shall calculate the difference and account for it on his return.

22. A difference is “substantial” if it exceeds £50,000 (regulation 107C(a)) or “50% of the amount of input tax falling to be apportioned under regulation 101(2)(d) within the prescribed accounting period referred to in regulation 107A(1), or longer period, as the case may be, but is not less than £25,000” (regulation 107C(b)). It is the regulation 107(C)(a) figure on which HCL relies in this case.

23. In determining whether the method adopted for calculating the difference under Regulation 107B(2) is a more reliable proxy for the use of overhead costs than the standard method under regulation 101, the calculation need not necessarily be the most precise possible but it must be able to guarantee a more precise result than the result which would arise from the application of the turnover-based standard method (*see HMRC v Volkswagen Financial Services (UK) Limited* (Case C-153/17) (“*VWFS*”) [2018] STC 2217,[2019] 4 W.L.R. 32 at [53]).

24. The CJEU in *VWFS* makes clear that there is only one condition for the use of a method other than the standard method under Art 173(2)(c). It is repeated at [50]-[51] of the judgment in the underlined passage:

> *50. Nevertheless, under art 173(2)(c) of that directive, Member States may authorise or require the taxable person to make the deduction on the basis of the use made of all or part of the goods and services.*
>
> *51. According to the Court’s case-law, Member States may, as a result of that provision, apply, for a given transaction, a method or allocation key other than the turnover-based method, on condition that <u>the method used guarantees a more precise determination of the deductible proportion of the input VAT than that arising from the application of the turnover-based method</u> (judgment of 8 November 2012, Finanzamt Hildesheim v BLC Baumarkt GmbH & Co KG (Case C-511/10) EU:C:2012:689, [2013] STC 521, para 24.”*

<u>THE DECISION OF THE FTT</u>

25. The FtT identified the issue between the parties at [2]-[3] of the Decision as follows:

> “2. HCL contends that the actual economic use of its overhead expenditure in making taxable and exempt supplies, based on a floor space apportionment, differs substantially from the attribution prescribed by the standard method, under regulation 101 of the Value Added Tax Regulations 1995, which is based on turnover. As such, it submits, it is required to carry out an “override calculation”, a standard method override (“SMO”), in accordance with regulation 107B (this, and all subsequent references to regulations, unless otherwise stated, refer to the Value Added Tax Regulations 1995).
>
> 3. However, HM Revenue and Customs (“HMRC”) contend that HCL’s proposed floor space SMO does not represent a more a *(sic)* fair and reasonable proxy for HCL’s economic use of its overhead expenditure than that calculated under the standard method.

If HMRC are correct a further issue arises in relation to the correct treatment of business entertainment under the Capital Goods Scheme ('CGS')."

26. At [32]-[97], the Tribunal made findings of primary fact when considering the applicability of the SMO. We note in particular the following findings which are relevant to the Dual Use issue:

a) There were numerous findings to the effect that the bars and restaurant areas were significant amenities and attractions for gaming customers. Contemporaneous documents repeatedly refer to the Theatre, Heliot Steak House and the various bars as "facilities" and "amenities" (see [66]). This included promotional material on HCL's website "*Casino games are great! The experience gets even better when you have a full-fledged restaurant to satiate your taste buds. However if you smoke, there aren't many facilities like The Hippodrome Casino that have a dedicated smoking terrace for your smoking breaks…*" (see [67]). Mr Thomas agreed that not only did the Hippodrome have a: "… *great gaming offer but also when you have a break we will have great amenities for you to have a meal at a restaurant or a drink at the bar on the terrace, to have a cigarette or a cigar on the terrace*" (see [68]). There was a bar on the ground floor providing waitress service to the gaming tables (see [46]). HCL makes complimentary supplies of food and drink to some of its most valued customers, £1.2m out of £7.2m of hospitality (see [60]). The ground floor bar now only operates as serving the gaming customers (see [89]). The Tribunal recorded Mr Thomas' evidence that he wanted each part of the Hippodrome to "… *operate to the optimum it can. Both as a business in its own right* ***and as an attraction to the business to [pull] in other people who may choose to spend on other … businesses within the Hippodrome***" ((emphasis added) see [79]). These findings demonstrate that those attending a casino to game will often want to have food or drink, and the bars and restaurant are important amenities for gaming customers.

b) The bars, restaurant and theatre gave HCL's gaming business a competitive advantage. "Mr King explained that it was difficult to differentiate one gaming business from another saying that, "a wheel in one casino is a wheel in another casino." However, the fact that the Hippodrome has a "fantastic standalone restaurant, fantastic bars, a fantastic theatre" was, he said, "a help to gaming". He agreed that it was the experience of being in the Hippodrome with the full variety of offers there that set it apart as a gaming venue" (see [64]).

c) Gaming was the primary business at the Hippodrome ([62],[65]), in terms of turnover (see [61]), profit, and customer visits. A customer poll recorded that 70% of customers came to the Hippodrome for gaming purposes, likewise HCL's 2018 statutory declaration to the Gambling Commission estimated that only 33% of visits to the Hippodrome did not involve any gambling (see [61]). Gaming was described in its 2018 accounts as HCL's "*primary business activity"* (see [63]).

d) With regards to entertainment, the December 2014 Board Report refers to an improved focus on using the theatre offer to "… drive gamer visits and dwell time. We expect to see a continued improvement in this business in 2015 **both** in its own right **and** as an important element in supporting the gaming business" (see [72] (emphasis added)). In April 2015 the Board Report noted "This business [the theatre] should be a real asset to the building and our focus is on making it just that - a draw for casino players that no competitor can match" (see [73]). Another document referred to "developing the theatre as a strategic gaming asset as opposed to a London cabaret theatre" (see [74]). In evidence, Mr Thomas confirmed that one

of the objectives of the Theatre was to put people into the casino to gamble (see [77]).

e) Neither the theatre nor the restaurant had made a profit in the relevant period (see [86]). Indeed, once central costs were allocated, hospitality as a whole (i.e. bars and restaurant) as well as the theatre ran at significant losses throughout the relevant period). The Tribunal did not mention this in the Decision but it was not disputed.

27. The 'Discussion and conclusion' of the FtT is set out at [104] to [132] of the Decision. The FtT began its consideration by focusing upon the SMO advanced by HCL, noting that the standard method is the default position (see Regulation 101 of the VAT Regulations above). The Tribunal noted, at [105], that it is for HCL to establish that the SMO based on a floor space apportionment, provides a more fair, reasonable and precise (although not necessarily the most precise possible) proxy for identifying economic use than the standard method. The Tribunal noted, at [107], that it is clear from the authorities to which it had referred, that this is a very fact sensitive issue.

28. We consider [108]-[127] of the Decision in detail below.

29. The FtT reached the conclusion at [127] that the floor space method, as set out in HCL's SMO calculation, does provide a more fair, reasonable and precise proxy of its economic use of its overhead expenditure than the turnover-based standard method conclusion. Having decided this, the FtT did not go on to address the further issue that arose as to the correct treatment of business entertainment - the provision of complimentary food and drink - under the Capital Goods Scheme ('CGS'). It was accepted by HMRC that the SMO that had been contended for by HCL had taken into account business entertainment and identified the entitlement to deduction in respect of capital goods for subsequent intervals, and as such the FtT decided at [121] that the CGS issue did not arise.

THE APPEAL TO THE UPPER TRIBUNAL: GROUNDS OF APPEAL AND RESPONSE

30. HMRC submit that the FtT erred in law in five respects as set out in the grounds of appeal. The five grounds of appeal can be summarised as follows:

1. The Tribunal failed to address the Dual Use Issue. That is, not only did HCL make economic use of the areas in the Hippodrome allocated to hospitality and entertainment for those purposes but also used those areas for its gaming supplies, i.e. there was dual use of these areas. If the FtT rejected HMRC's contentions on this issue, it did not give any reasons why it did so: *Ground 1.*

2. The Tribunal erred in law by adopting a mistaken test, namely whether the supplies of entertainment and hospitality were "merely an adjunct to, or an amenity for, gaming": see [125] of the Decision: *Ground 2.*

3. The Tribunal failed to address HMRC's contention that the lack of profitability of the hospitality and entertainment businesses was relevant evidence as to economic use: *Ground 3.*

4. As an alternative to ground 1 above, if (contrary to HMRC's contention) the Tribunal implicitly found that there was no economic use of areas allocated to hospitality and/or entertainment for the purposes of its gaming supplies, such a finding amounted to an error of law per *Edwards v. Bairstow* [1956] AC 14: *Ground 4.*

5. The Tribunal failed to give any (alternatively, any sufficient) reasons why it rejected HMRC's other points. That is, the claims made by HMRC in the Amended Statement of Case and relied upon in their skeleton argument that:

a. The unreliability of allocations, by relying upon the only floor plan provided to evidence the allocations that was for 2013-2014.

b. The majority of the floor area was not allocated to either exempt or taxable supplies. The SMO was not reasonable because it assumed that the use of the non-allocated areas, which comprised the majority of the floor space, was in the same proportion as the proposed allocations for taxable/exempt areas.

c. A significant amount of the residual costs at issue were not property related, and the SMO was not a reasonable proxy for apportioning them: *Ground 5*.

31. Permission to appeal was granted by the FtT Judge on all five grounds on 29 June 2022.

32. HCL filed a response to the Notice of Appeal (under Rule 24 of the Tribunal Procedure (Upper Tribunal) Rules 2008 ('the Upper Tribunal Rules')). HCL opposes the appeal and contends the FtT reached the right decision for broadly the right reasons. In addition, HCL's response deals with two issues:

a) Although immaterial to its conclusion, the Tribunal erred at [104] to [106] in deciding that the correct approach is to start with the override calculations proposed by HCL rather than with the standard method.

b) In the light of the decision reached by the Tribunal on the principal issue before it, it was common ground that a further issue (relating to how the provision of complimentary supplies should be taken into account for the Capital Goods Scheme) did not arise. Should the Upper Tribunal reach a different conclusion on the principal issue, HCL maintain that the Business Entertainment Block can operate, if at all, only in relation to a small portion of HCL's input tax. This is because the Business Entertainment Block only operates in so far as the input tax in question is otherwise allowable input tax – whereas, as the Tribunal held at [60] that HCL's complimentary supplies of food and drink are made predominantly to gaming customers. This was an issue ("the CGS issue") which clearly would have arisen for the Tribunal in circumstances where the Tribunal had found in HMRC's favour on the principal issue.

33. HMRC has filed a reply under rule 25 of the Upper Tribunal Rules, addressing the claim made by HCL that the FtT erred in stating that the correct approach is to start with the override calculations proposed by the HCL rather than with the standard method. HMRC maintain that the focus of the appeal before the FtT must be on the proposed method contended for by HCL, with HCL bearing the burden of proof in showing that this guarantees a more precise determination than the standard method. As to the CGS issue, HMRC repeats its position as it was before the FtT.

34. In addition, we have received detailed skeleton arguments from counsel for both parties. We are grateful to counsel for their clear and helpful submissions, both in writing and at the hearing before us although we have not found it necessary to refer to each and every point which they raised.

OUTLINE OF THE PARTIES' ARGUMENTS

Submissions on behalf of the Appellants, HMRC

35. Mr Donmall, for HMRC, submits that central to their case before the FtT was that 'bars', 'restaurant' and 'entertainment' areas were used by HCL economically both for the purposes of taxable supplies and as important amenities for HCL's exempt gaming business ('the Dual

Use issue'). Although identified as four grounds (*grounds 1 to 4),* HMRC's main complaint in this appeal is that the FtT erred in law in failing to address the Dual Use issue.

36. Mr Donmall claims the FtT did not express a conclusion, let alone give any reasons, as to whether the areas for bars, restaurant and theatre (or any of them) were also used economically for the exempt gaming business (Ground 1).

37. Mr Donmall argues that central to HMRC's case before the FtT was that the floor space SMO method contended for by HCL was fundamentally flawed because it proceeded on the false premise the areas allocated under that method to 'bars', 'restaurant' and 'entertainment' were only used for the purposes of taxable supplies of hospitality and entertainment (subject to an adjustment in respect of free complimentary supplies). HMRC's case was that these areas were used economically both for the purposes of taxable supplies and as important amenities for HCL's exempt gaming business. He submits it was contrary to the evidence to consider the gaming business at the Hippodrome as totally independent of the drinks and food that were provided there, as though that gaming business would be unaffected were there to be no bar, eating or smoking areas at all. Gaming customers did want the ability to have a break, drink, eat some food or smoke a cigarette, and so those 'non-gaming' areas were, in part, used economically for the gaming business.

38. Rather, he contends that what the FtT did was to express a conclusion on an incorrect test, namely whether or not the hospitality and entertainment businesses were "merely an adjunct to, or amenity for, gaming" [125]. He submits that is not the test of economic use (Ground 2).

39. The focus of the fifth ground of appeal is that the FtT erred in law in its failure to give any or adequate reasons for rejecting HMRC's other points in the appeal. In particular, the majority of the floor area was 'general' area, which on the evidence was not used in the same proportion as the allocations for taxable / exempt areas (even leaving aside the Dual Use issue), as the SMO Method falsely assumed.

Submissions on behalf of the Respondent, HCL

40. In response, Mr Hitchmough KC submits HMRC's appeal portrays a dissatisfaction with the outcome of an evaluative fact-sensitive exercise carried out properly by the FtT which they are wrongly attempting to categorise as an error of law. He contends that the FtT rightly addressed the question of whether the calculation under the SMO adequately addressed the economic use of 'general' space in the premises and rightly rejected the claim made by HMRC in that respect. Mr Hitchmough argues that the question for the Upper Tribunal is not whether we agree with the decision of the FtT but whether the decision was one that was open to the FtT. In reply to all five grounds of appeal he contends that the Decision in this case was rational and sufficient reasons were given.

41. In his submissions, Mr Hitchmough referred us to the relevant authorities that highlight the particular caution that should be exercised by an appellate tribunal before interfering with factual findings of a first-instance tribunal.

42. The Upper Tribunal is not entitled to find an error of law simply because it does not agree with the decision, or because the Tribunal thinks the decision could be more clearly expressed or another judge can produce a better one. Baroness Hale put it in this way in *AH (Sudan) v SSHD* [2007] UKHL 49 [2008] 1 AC 678), at [30]:

> "Appellate courts should not rush to find such misdirection simply because they might have reached a different conclusion on the facts or expressed themselves differently."

43. As to the Tribunal's assessment of the evidence, the Court of Appeal in *Fage UK Ltd v Chobani UK Ltd* [2014] EWCA Civ 5 ,at [114] to [115] (per Lewison LJ), provided the following guidance;

> "i. The expertise of a trial judge is in determining what facts are relevant to the legal issues to be decided, and what those facts are if they are disputed;
>
> ii. The trial is not a dress rehearsal. It is the first and last night of the show;
>
> iii. Duplication of the trial judge's role on appeal is a disproportionate use of the limited resources of an appellate court, and will seldom lead to a different outcome in an individual case;
>
> iv) In making his decisions the trial judge will have regard to the whole of the sea of evidence presented to him, whereas an appellate court will only be island hopping;
>
> v) The atmosphere of the courtroom cannot, in any event, be recreated by reference to documents (including transcripts of evidence);
>
> vi) Thus even it were possible to duplicate the role of the trial judge, it cannot in practice be done."

44. He argues that the Decision followed a five-day hearing before the FtT, involving a site visit of the premises in question and the cross-examination of witnesses, which was not a mere "dress rehearsal"; *see* [114(ii)] above.

45. In *Volpi v Volpi* [2022] EWCA Civ 464, [2022] 4 W.L.R. 48, in dismissing an appeal against findings of fact, the Court of Appeal emphasised that it was not for an appeal court to come to an independent conclusion as a result of its own consideration of the evidence; the question is whether the trial judge's conclusion was rationally insupportable. Lewison LJ said:

> "2. The appeal is therefore an appeal on a pure question of fact. The approach of an appeal court to that kind of appeal is a well-trodden path. It is unnecessary to refer in detail to the many cases that have discussed it; but the following principles are well-settled:
>
> i) An appeal court should not interfere with the trial judge's conclusions on primary facts unless it is satisfied that he was plainly wrong.
>
> ii) The adverb "plainly" does not refer to the degree of confidence felt by the appeal court that it would not have reached the same conclusion as the trial judge. It does not matter, with whatever degree of certainty, that the appeal court considers that it would have reached a different conclusion. What matters is whether the decision under appeal is one that no reasonable judge could have reached.
>
> iii) An appeal court is bound, unless there is compelling reason to the contrary, to assume that the trial judge has taken the whole of the evidence into his consideration. The mere fact that a judge does not mention a specific piece of evidence does not mean that he overlooked it.
>
> iv) The validity of the findings of fact made by a trial judge is not aptly tested by considering whether the judgment presents a balanced account of the evidence. The trial judge must of course consider all the material evidence (although it need not all be discussed in his judgment). The weight which he gives to it is however pre-eminently a matter for him.
>
> v) An appeal court can therefore set aside a judgment on the basis that the judge failed to give the evidence a balanced consideration only if the judge's conclusion was rationally insupportable.
>
> vi) Reasons for judgment will always be capable of having been better expressed. An appeal court should not subject a judgment to narrow textual analysis. Nor should it be picked over or construed as though it was a piece of legislation or a contract."

46. In *The Commissioners for Her Majesty's Revenue & Customs v Procter & Gamble UK* [2009] EWCA Civ 407 (a case relating to the classification for VAT purposes of Pringles) Jacob LJ addressed the question of adequacy of reasons at [19]:

> "…It was not incumbent on the Tribunal in making its multifactorial assessment not only to identify each and every aspect of similarity and dissimilarity (as this Tribunal so meticulously did) but to go on and spell out item by item how each was weighed as if it were using a real scientist's balance. In the end it was a matter of overall impression. All that is required is that "the judgment must enable the appellate court to understand why the judge reached his decision" (*per* Lord Phillips MR in *English v Emery [2002] EWCA Civ 605, [2002] 1 WLR 2409* at 19]) and that the decision "must contain … a summary of the Tribunal's basic factual conclusion and statement of the reasons which have led them to reach the conclusion which they do on those basic facts" (*per* Thomas Bingham MR in *Meek v Birmingham City Council [1987] IRLR 250*). It is quite clear how this Tribunal reached its decision. In the words of Sir Thomas Bingham in *Meek* the parties have been told "why they have won or lost.""

47. Mr Hitchmough contends that the FtT correctly set out the relevant statutory provisions and the law relating to the recovery of input tax together with the basis for apportioning VAT on overhead costs between taxable and exempt supplies in the Decision at [6] to [27]. The Tribunal noted, at [107] of the Decision, the highly fact sensitive nature of the exercise with which it was faced, and that very little, if any, assistance can be derived from the cases cited by the parties.

48. Mr Hitchmough submits that in a 'floorspace apportionment', dual use is not necessarily a fundamental flaw as illustrated in the decisions of Henderson J in *Revenue and Customs Commissioners v Lok'nStore Group Plc* [2014] UKUT 288 and Proudman J in *Revenue and Customs Commissioners v London Clubs Management Ltd* [2012] UKUT 365. He submits that as 'dual use' is not a "fundamental flaw", the correct approach is that it forms one of the observable terms and features of the business to which close attention must be paid.

49. He submits that the Tribunal must include in the balance, the degree of any such dual use in its multi-factorial assessment of the economic and commercial reality of the business in order to evaluate whether the extent of any such dual use is to render the floorspace-based apportionment an unreliable proxy and in particular a less reliable proxy than the turnover-based standard method. That, he contends, is the approach that was adopted here by the FtT.

50. Mr Hitchmough argues that the entire Decision is predicated upon the FtT accepting some degree of Dual Use and it was accepted by HCL in its closing submissions that the hospitality on offer in the Hippodrome is also an amenity for the appellant's gaming clientele that they will make use of, but they will make use of it in the same way as any other visitor to the Hippodrome.

51. What was in issue before the FtT was the extent of the Dual Use of the areas treated as taxable, and whether that made HCL's override calculation unreliable and, as a corollary, less reliable than the standard turnover-based method of attribution.

52. Mr Hitchmough therefore submits that the FtT's analysis of these issues found at [115] to [123] of the Decision betrays no error of law. In summary, he submits the Tribunal found the bars and restaurant are deliberately branded so that the substantial economic use of the inputs is the need to create a theatre, restaurant and bars which compete with the other theatres, restaurants and bars in the West End. The Tribunal examined the extent of crossover between the restaurant and gaming and the theatre and gaming, and concluded at [120]:

> "Not only are the Theatre, restaurant and bars identifiable features of the Hippodrome but each is operated from clearly recognisable and defined spaces – as indeed are the

> gaming areas. As Mr King said in evidence "if everything was just about the gaming" the Hippodrome "wouldn't look anything like what it looks today. It would be a different animal" (see paragraph 64, above)."

53. That, Mr Hitchmough contends, is an evaluation of the extent of dual use and a conclusion that; (a) the theatre, restaurant, bars and gaming operate from their recognisable and defined spaces rather than from the premises more broadly and (b), the extent of the 'dual use' is limited – it is not gaming which drives this expenditure.

54. Mr Hitchmough submits that having evaluated the 'dual use', and found (contrary to the analysis favoured by HMRC) that that dual use was limited, the FtT dealt properly with HMRC's principal objection.

55. The FtT then went on to consider whether the standard method was nevertheless a more reliable proxy. It therefore applied the correct test – contrary to HMRC's second ground of appeal. To that end, the FtT referred to the hypothetical posed in *St Helen's Northwood Ltd v Revenue and Customs Commissioners* [2006] EWHC 3306 (Ch) and found that the Hippodrome would look very different if it did not make taxable supplies. It also considered the decision of the Court of Appeal in *Revenue and Customs Commissioners v London Clubs Management Ltd* [2011] EWCA Civ 1323, where the use of a floorspace-based apportionment by a casino was in issue. Etherton LJ considered the decision in *Aspinall's Club Ltd v Revenue and Customs Comrs* (2002) VAT Decision 17797 to be good illustration of the application of the relevant principles in the context of gaming and associated catering. There, the standard method was found to be a more reliable proxy for the economic use of the club's overhead costs than the floorspace-based apportionment. The FtT quite properly, Mr Hitchmough submits, asked itself whether the same was true in the case of the Hippodrome, but concluded it was not. The FtT concludes on the evidence before it that, unlike *Aspinall's*, the expenditure on the bars, restaurant and theatre in the Hippodrome was not driven by a desire to promote or enhance the lucrative gaming. That, he submits, is an evaluative finding by the Tribunal based on the evidence before it that it was entitled to make.

DISCUSSION AND ANALYSIS OF GROUNDS OF APPEAL

GROUND 1

56. We begin by considering the principal complaint made by HMRC regarding the FtT's failure to engage with the case made by HMRC on the Dual Use Issue. That is, the floor space SMO Method was fundamentally flawed because it proceeded on the false premise the areas allocated under that method to 'bars', 'restaurant' and 'entertainment' were only used for the purposes of taxable supplies of hospitality and entertainment (subject to an adjustment in respect of free complimentary supplies).

57. The core of HMRC's case before the FtT was that the SMO Method contended for by HCL was critically flawed, because it proceeded on the false premise that the economic use of the area allocated to hospitality or entertainment was exclusively limited to taxable supplies, when the economic reality was of dual use, i.e. the bars, restaurant and theatre areas were also used economically to support and promote Gaming ('the Dual Use Issue').

58. HMRC had filed and served an Amended Statement of Case on 10 March 2021. They set out the perceived problems with the SMO contended for by HCL, which they claimed individually and collectively prevent the SMO providing a fair and reasonable apportionment of the residual input tax. Four particular issues were identified:

a) The allocation proceeds on the false premise that the economic use of the area allocated to Hospitality or Entertainment is exclusively limited to taxable supplies, when the economic reality is of dual use (i.e. also for exempt Gaming supplies).

b) The accuracy of the allocation is uncertain both at any given moment in time, and across the Relevant Years.

c) Over 50% of the floor area is not allocated either to taxable or exempt supplies.

d) The Final SMO Method uses its floor-based methodology to apportion a large proportion of residual input tax which is not even property-related – estimated by the appellant at 32% of the VAT on all residual costs, or £447,280.

59. The FtT recorded at [108]-[110] of the Decision the closing submission made by Mr Donmall for HMRC that not only did HCL make economic use of the areas in the Hippodrome allocated to hospitality and entertainment for those purposes but also used those areas for its gaming supplies, (i.e. there was dual use of these areas):

> '108. For HMRC, Mr Donmall contends that not only did HCL make economic use of the areas in the Hippodrome allocated to hospitality and entertainment for those purposes but also used those areas for its gaming supplies, ie there was dual use of these areas. He says this was because gaming customers were attracted to the Hippodrome and encouraged to stay there because of the entertainment and particularly the hospitality and that this strengthened its gaming proposition over that provided by its competitors. This not only complied with the letter and spirit of the regulations requiring non-gaming areas to be available in a casino and for gamblers to take breaks, which Mr Thomas accepted (see paragraph 68, above), but also gave HCL the opportunity to cross-sell gaming to customers who initially came for other purposes.
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> 109. Mr Donmall submits that such economic use is reflected by the fact that HCL, between 2012 and 2019, pursued both hospitality and entertainment despite these being unprofitable. He also refers to the customer poll and statutory declaration to the Gambling Commission which estimates that 30% to a third of HCL's customers do not go the Hippodrome for gaming purposes (see paragraph 61, above) and asks how this equates with the almost 50% recovery rate of the overhead VAT produced by the SMO (see paragraph 99, above) advanced by HCL.
>
> 110. In addition Mr Donmall contends that it is clear from the contemporaneous documents that HCL's principal activity is the operation of a casino which, he says, is supported by the reference to the Theatre and various bars in the Hippodrome in HCL's accounts as "facilities" (see paragraph 66, above), the reference in its Business Plan as the "operation of a casino" as its "principal activity" and the "entertainment facilities" being "an important part of the overall offer of the casino" (see paragraph 62, above) and indeed by its very name, the Hippodrome Casino.'

60. We accept that it is now well established from the authorities Mr Hitchmough refers to, set out above, that judicial caution and restraint is required when considering whether to set aside a decision of a specialist fact finding tribunal on the basis of a finding of fact or adequacy of reasons. In particular: The FtT alone is the judge of the facts. Its decisions should be respected unless it is apparent that the tribunal has misdirected itself in law. It is likely that in interpreting and applying the law in its specialised field, the tribunal will have got it right. Appellate tribunals should not rush to find errors of law simply because they might have reached a different conclusion on the facts or expressed themselves differently.

61. Having said all that, we are satisfied that this ground of appeal is not a complaint regarding perverse or unreasonable findings of fact, evaluative judgments or *adequacy* of reasons given. This ground concentrates upon the FtT's *failure* to address a central issue in the appeal and *lack of* reasons.

62. It is an error of law to fail to give reasons for a conclusion which is essential to a decision. As the Upper Tribunal put it in *Awards Drinks Ltd v Revenue and Customs Commissioners* - [2020] STC 2336:

> [85] It is well established that a failure to give reasons or sufficient reasons for a conclusion which is essential to the decision may constitute a free-standing ground of appeal. In *Flannery v Halifax Estate Agencies Ltd* [2000] 1 All ER 373 at 377, [2000] 1 WLR 377 at 381 onwards, the Court of Appeal explained the duty to give reasons was a function of due process and that its rationale of fairness 'requires that the parties—especially the losing party—should be left in no doubt why they have won or lost.' Lack of reasons was explained to be a self-standing ground as follows:
>
> *'Where because no reasons are given it is impossible to tell whether the judge has gone wrong on the law or the facts, the losing party would be altogether deprived of his chance of an appeal unless the court entertains an appeal based on the lack of reasons itself.'*

63. We are satisfied that, when the decision of the FtT is read as a whole, the FtT has failed to address or to engage with the case advanced by HMRC that there was dual economic use by which the bars, restaurant and theatre areas were also significantly used economically to support and promote gaming. It therefore failed to give any reasons for rejecting the core of the case advanced by HMRC and for reaching the decision that it did.

64. Despite his attractive submissions, Mr Hitchmough did not persuade us that the FtT had impliedly accepted that there was some dual use and was simply considering the extent or degree of that dual use within its Decision – finding that it was insignificant. Nowhere in its Decision did the FtT expressly or explicitly say that it had come to any conclusion on the Dual Use issue and it cannot be reasonably inferred from its reasons. It did not find that despite a degree of dual use, and contrary to HMRC's submissions, the SMO nonetheless provided a more precise method of calculating economic use than the standard method.

65. Not only did the issue arise because the FtT expressly identified the argument at [108]-[110] but there was an obvious factual basis for HMRC's submissions in the findings of primary fact that the FtT made at [46]-[89] of the Decision which we have identified above at paragraph 26 of this decision. There were findings of primary fact capable of supporting HMRC's case on the Dual Use issue: such as a) the bar and restaurant areas provided important amenities and attractions to gaming customers; b) the bars, restaurant and theatre gave HCL's gaming business a competitive advantage; c) gaming was the primary business at the Hippodrome, in terms of turnover, profit, and customer visits; d) offering the theatre was to drive gamer visits and dwell time as an important element in supporting the gaming business; e) neither the theatre nor the restaurant had made a profit in the relevant period.

66. At [111] of the Decision the FtT noted that Mr Hitchmough accepted that gaming is clearly important to HCL, he referred to the hospitality and entertainment being operated from separate discrete areas of the Hippodrome and, as such, should be regarded as standalone attractions in their own right. At [113], the FtT noted that although profitability is one factor to be taken into account, it is not determinative. At [114] the FtT noted that the observable terms, features and context in which the input tax was incurred should not be disregarded.

67. The FtT gave the following further reasons for its Decision:

a) HCL was seeking to create a "Las Vegas experience" at the Hippodrome for a variety of customers and provide a range of products under one roof. In this context, the offerings of the Hippodrome can be contrasted with those of other casinos with which it is in competition in that it is not a private members' club

type of casino, like in Aspinall's Club, or a mass-market casino such as those described by Mr Thomas ([115]).

b) In addition to those other casinos the Hippodrome is also in competition with "hundreds" of restaurants and bars and "dozens" of theatres in London's West End. In this respect its bars are not generic but have their own particular branding, e.g. the Penny Bar and the Boozy Tea Room with its particular brand of vodka which is only available there ([116]).

c) The restaurant, the Heliot Steak House, with its celebrity chef, was similarly deliberately branded as a standalone feature of the Hippodrome. The restaurant competes with other similar steak restaurants, particularly the nearby Hawksmoor restaurant whose advertising, promotions and digital footprint is monitored and used as a benchmark by HCL ([117]).

d) There is a limited crossover between restaurant and gaming which is apparent from the 2014 promotion in which restaurant customers, who did not understand the operation of the casino, disrupted experienced gamers when using their free £5 gaming chips. Another illustration of the limited crossover by restaurant customers to gaming is the limited use of the "free bet" vouchers in 2015 of which 44% were not redeemed ([118]).

e) Notwithstanding the aspiration, as stated in the Board Reports, to use the Theatre to "drive gamer visits and dwell time" and making it a "draw for casino players", this was not the case and "nowhere near" the 5% crossover from the theatre audience to gaming had been achieved ([119]).

f) Not only are the Theatre, restaurant and bars identifiable features of the Hippodrome but each is operated from clearly recognisable and defined spaces – as indeed are the gaming areas. As Mr King said in evidence "if everything was just about the gaming" the Hippodrome "wouldn't look anything like what it looks today. It would be a different animal" ([120]).

68. At [113] to [120] of the Tribunal's reasoning, the Dual Use issue is not engaged with. Rather, the Tribunal seems to have addressed itself to a separate question, namely whether "everything was just about the gaming". That was not HMRC's point, which was never that the bars, restaurant or theatre were entirely subservient to the gaming proposition, but that there was an element of dual economic use by which such areas supported the gaming business. Thus, the existence of dual use rendered the SMO a less precise measure of economic use than the standard method.

69. The FtT further observed that: the absence of the 'taxable activity' (Theatre, bars and restaurant) would have made a difference ([121]); and the expenditure incurred by HCL was not merely to provide an attractive atmosphere to gamers but to promote and gain additional income from the theatre, bars and restaurant ([123]).

70. However, the observation at [121] that there would have been a difference without the theatre, bars and restaurant does not answer the Dual Use issue. One of the points made by HMRC in favour of the Dual Use contention was that the logic of the SMO Method presupposed that the gaming areas and the bars and restaurant areas were mutually exclusive and could be completely split up, physically, so that (for example) they could be located in entirely different buildings, yet this was plainly contrary to the economic reality of the situation. So from that perspective, the observation that the Hippodrome would be different without, say, any bars is potentially a factor in support of HMRC's argument, rather than the reverse: the Hippodrome would lose one of the key amenities for its gaming business.

71. At [122]-[123] of the Decision, the FtT seems to have addressed its mind to the question of why the expenditure was incurred and concluded "the expenditure incurred by HCL was not merely to provide an attractive atmosphere to gamers but to promote and gain additional income from the theatre, bars and restaurant which are of an altogether different nature from the hospitality supplied in Aspinall's Clubs." In other words, the Tribunal concluded that the use was "not merely" for gaming. But that does not mean that there is no dual use of the areas allocated to gaming and hospitality. Indeed, by implication of "not merely", the FtT was implicitly accepting that some of the purpose of the expenditure was to provide an attractive atmosphere to gamers.

72. At [124] of the Decision, the FtT accepted that being funded by gambling does not in itself make the expenditure, cost components of exempt gaming supplies. It noted that the complimentary hospitality (complimentary food and drink for gamblers) is recognised in the SMO advanced by HCL. HMRC accepted this, and never argued otherwise. However, it does not address the Dual Use issue. A second point, that there was a complimentary food adjustment in the SMO Method, is likewise uncontroversial, but it does not address the broader Dual Use issue either.

73. At [125] to [127], the FtT concluded:

> "125. For the reasons above, and having regard to all the circumstances, we have come to the conclusion that, given their extent and nature, the supplies of entertainment and hospitality from discrete and defined areas of the Hippodrome by HCL cannot be regarded as merely an adjunct to, or an amenity for, gaming.
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> 126. We also consider that the general space, ie corridors, lavatories, staircases, lifts, walkways etc, is used to serve the building as a whole and that it therefore follows that it is appropriate to consider its use in the same way. We also take account of the fact, as is apparent from Mr King's comparison of an electronic roulette terminal and table in the Heliot Steak House (see paragraph 103, above), that gaming generates higher turnover per square foot than hospitality.
>
> 127. As such, we find that the floor space method, as set out in HCL's SMO calculation, does provide a more fair, reasonable and precise proxy of its economic use of its overhead expenditure than the turnover based standard method, particularly given that most of those overheads are property related. Accordingly HCL's appeal succeeds on this issue."

74. Again, these paragraphs do not address the Dual Use issue. Paragraph [125] seems to address a different question, which is whether the entertainment and hospitality was 'merely' an adjunct to, or amenity for, gaming. We address this in Ground 2 below.

75. Similarly, at [126] and [127] of the Decision the FtT does not address the case that had been advanced by HMRC (that the SMO did not provide a more precise measure of economic use given the existence of Dual Use) but simply relied upon what it had said in the preceding paragraphs.

76. HMRC did not contend before the FtT that the bars, restaurant or theatre were entirely subservient to the gaming. The core of HMRC's case before the FtT was that the SMO proposed by HCL was critically flawed because it proceeded on the false premise that the economic use of the area allocated to hospitality or entertainment was exclusively limited to taxable supplies, when the economic reality was of dual use.

77. There were plainly findings of primary fact made by the FtT, as addressed above, that were capable of supporting the case advanced by HMRC that the economic reality was of dual use.

78. We therefore accept, as Mr Donmall submits, that at [113] to [127] of the Decision, the Tribunal failed to address and give reasons for rejecting HMRC's contention that the areas allocated to the bars, restaurant and theatre were also used in part for the purposes of HCL's gaming business, such that there was dual use of those areas, or why if there was such dual use, the SMO guarantees a more precise result than the result which would arise from the application of the turnover-based standard method.

79. Nowhere in the Decision did the Tribunal give reasons for rejecting HMRC's contention that the areas allocated to bars, restaurant and theatre were also used *in part* for the purposes of its gaming business, such that there was dual use of those areas, or why if there was such dual use, the SMO Method (which assumed exclusivity of use) could be more precise than the standard turnover method (or fair, reasonable and precise).

80. We agree that the FtT did not explain why, if there was such dual use, the SMO (which assumed exclusivity of use) guarantees a more precise result than the result which would arise from the application of the turnover-based standard method. The onus was on HCL to displace the use of the standard method.

81. This is a material error of law. This ground succeeds. It follows that in our judgement the Decision of the FtT is vitiated by a material error of law – a failure to address a core issue and give any reasons - and must be set aside on this ground.

GROUND 2

82. In light of our conclusion on Ground 1, there is no need to determine Ground 2. Nonetheless, we consider that it may be useful to express a view on some of the principles which were subject to argument.

83. As is recorded above, Mr Donmall argues that the FtT at [125] considered the wrong question as to whether the entertainment and hospitality was 'merely' an adjunct to, or amenity for, gaming, rather than address whether the economic reality was of dual use and therefore whether the SMO guaranteed a more precise measure of economic use than the standard method.

84. Mr Hitchmough submits that, fairly read, in the context of the Decision as a whole (which should not be construed as it were a statute or contract), the FtT at [125] of the Decision does no more than re-affirm its conclusion that, whatever dual use there might be in the case before it, expenditure by HCL on its bars, restaurant and theatre was not driven (at least in any material sense) by a desire to promote gaming. He argues that this is a conclusion that the Tribunal was reasonably and fairly entitled to reach on the basis of the evidence before it. It gave sufficient reasons for finding so.

85. He argues that the FtT did not apply the wrong legal test. He contends that the FtT clearly had in mind the key finding made by the FtT at [48] of its Decision in *HMRC v London Clubs Management [2009] UKFtT 201 (TC)* (*'LCM')*:

> In [Aspinall's] the Tribunal found that the catering activities were not conducted for profit. By contrast, in the Appellant's case, although the catering activities are not currently profitable, we are satisfied that they are businesses in their own right and are not merely ancillary to the gaming business. Unlike Aspinall's Club, we have found that the business costs are not primarily incurred to facilitate the gaming, but to facilitate all parts of the Appellant's business.

86. Mr Hitchmough suggests that *LCM* was a case where the arguments being advanced on behalf of HMRC were in all material aspects identical to those advanced by them before the Tribunal in this case. Moreover, it was that key finding that Etherton LJ held could not be disturbed on appeal in the Court of Appeal judgment: [2012] STC 388 at [69]-[74] & [77].

87. We do not accept Mr Hitchmough's arguments.

88. First, for the same reasons set out in relation to Ground 1, we are satisfied that the FtT did not address or come to a conclusion on whether there was any dual use. Second it did not address the degree or extent of any dual use and whether it was material or significant.

89. The touchstone for the purposes of the apportionment of residual input tax is use (or economic use). There is no dispute that in assessing that use, and its extent, consideration is not limited to physical use. The assessment must be of the real economic use of the input, having regard to economic reality in the light of the observable terms and features of the taxpayer's business, per Etherton LJ in *LCM* at [34].

90. There is no need to put any further gloss on this test of 'economic use'. The task of a tribunal, faced with an appeal about a proposed method of partial exemption, is to address the factual question of how those residual input costs are economically used.

91. As Mr Donmall contended, there is no test when addressing the apportionment of residual input tax of whether the taxable supply is "merely ancillary" to the exempt supply. In VAT law, it is well recognised that there can arise a dispute as to whether transactions constitute a single (composite) supply for VAT purposes, or multiple supplies. In *Card Protection Plan v CEC* [1999] STC 270, the ECJ concluded that there is a single supply in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded as *ancillary* to the principal service. But that is not relevant to any question of the apportionment of residual input costs: such costs are residual precisely because it is accepted that there are *multiple* supplies, i.e. both exempt supplies, and taxable supplies.

92. As Mr Donmall submitted, caution must be exercised when considering the decisions in the partial exemption appeal brought by London Clubs Management Ltd. There the FtT found in favour of a floor-space method contended for by that gambling business (LCM), and where the Upper Tribunal ('UT'[2]) and then the Court of Appeal (CA[3]) concluded that there was no error of law in the FtT's approach (albeit that the CA considered that the FtT's finding of fact was "remarkably benign" [71]).

93. Before the UT and CA in that case, HMRC's argument was different to that in the present case, contrary to Mr Hitchmough's submission. Counsel for HMRC in that case contended that "*LCM's business is essentially one of gaming to which catering and other non-gaming facilities are ancillary"* [UT 18]; the catering facilities were *"entirely subservient to the gambling"* [UT 25]; LCM *"was not actually running a catering business in its own right"* [CA 61], such that the FtT had been wrong in concluding that the catering activities were "*businesses in their own right*" [FtT 48].

94. The CA considered [85] that this was a relevant question in that case, as if the catering activity was not capable of generating a profit in the reasonable future, then there would be no commercial purpose to the catering activity (LCM being a commercial undertaking), so the true economic use of the residual costs would be the gaming activity. However, the references to catering being 'ancillary', or to whether the catering business was 'entirely subservient' to the gambling or (conversely) to a degree a business in its own right, are not in any way legal tests or principles to be imported to the present case.

95. As Mr Donmall argues, HMRC have not argued here that the bars, restaurant and theatre offers in this case were "merely ancillary" or "entirely subservient" to gaming. Rather, HMRC have made a distinct contention of dual use of the bar, restaurant and theatre areas. So this case

[2] [2010] STC 2789
[3] [2012] STC 388

does not involve a dichotomy of whether (say) the bar areas of the Hippodrome premises are 'only' for the purposes of the gaming (because hospitality is somehow 'merely ancillary to' or 'entirely subservient' to gaming), or conversely 'only' for the purposes of hospitality supplies (because hospitality is not merely ancillary to gaming in that way). There is the obvious possibility that bar areas can serve two purposes, both for the purposes of a taxable bar business, and for the exempt gaming business, and this is what HMRC argued was established on the facts of this case.

96. Having said all of the above, we are not satisfied that this ground materially adds to Ground 1. The FtT's material error of law was in relation to the Dual Use issue. Even though it considered the wrong question at [125], it ultimately applied the correct test as to which method guaranteed the more precise measure of economic use at [127]. Therefore, any error in relation to this ground is not material.

GROUNDS 3-5

97. In the circumstances, we do not need to address the particular criticisms raised in the third and fifth grounds of appeal regarding the FtT's consideration of the lack of profitability of the hospitality and entertainment businesses as evidentially relevant to economic use and its failure to give any or adequate reasons for rejecting HMRC's other points in the appeal. The fourth ground of appeal that is premised upon HMRC not succeeding on the first three grounds of appeal falls away.

CONCLUSION

98. For these reasons we set aside the Decision made by the FtT because it was based upon a material error of law.

REMAKING THE DECISION

99. Having found that the Decision involved the making of an error on a point of law, we have set it aside pursuant to section 12(2)(a) of the Tribunals, Courts and Enforcement Act 2007 ('the Act'). Together with the FtT's findings of fact, we have before us the evidence which was before the FtT on which we can re-make the decision in relation to HCL's appeals pursuant to section 12(2)(b)(ii) of the Act.

100. By virtue of section 12(4) of the Act, we may make any decision which the FtT could make if it were re-making the decision and may make such findings of fact as we consider appropriate.

101. We begin by considering our approach to deciding HCL's appeals against HMRC's decisions. This requires us first to consider HCL's response in the appeal to the Upper Tribunal.

HCL'S RESPONSE TO THE NOTICE OF APPEAL

102. The FtT rejected the submission made by Mr Hitchmough that it should first consider whether the standard method, as prescribed by Regulation 101, attributes HCL's residual overhead expenditure to its taxable supplies in a manner that reflects the economic use it makes of that expenditure in making those supplies.

103. The FtT agreed with Mr Donmall that its focus should be on the SMO advanced by HCL. It said that it is necessary to determine whether the SMO rather than the standard method should be applied, and that such an approach is consistent with the view of the Upper Tribunal in *HMRC v Temple Finance Limited* [2017] STC 1781 ('*Temple Finance'*).

104. In its response to the Notice of Appeal (under Rule 24 of the Upper Tribunal Rules), HCL claims the FtT erred, at [104] to [106] in deciding that the correct approach is to start with the override calculations proposed by the HCL rather than with the standard method.

105. HCL's case before the FtT and maintained before us is that the legislation is plain in directing a trader (and thus the tribunal on appeal) to take the following steps:

> (a) First, consider whether the attribution produced by the standard method in Regulation 101 reflected the extent to which the goods and services were used or to be used in making taxable supplies; and
>
> (b) Second, if not, the trader must calculate the difference between the result produced by the standard method and one which actually reflects the use by the trader of its overheads and if that difference is substantial, make corresponding adjustments to its VAT account.

106. Mr Hitchmough submits the tribunal must therefore, having first considered the standard method and found it to be deficient, then consider whether the method employed by the trader to calculate the difference is indeed a more reliable proxy for the use made by the trader of its overhead costs in making taxable supplies. HCL's case on the jurisdiction of the Tribunal is:

> (a) If the tribunal finds the standard method does not attribute the overhead costs in accordance with their use;
>
> (b) But also does not consider that the trader's override calculation sufficiently accords with their use; then
>
> (c) The tribunal should, if it considers there are specific problems with the calculation which are capable of obvious correction, make those corrections.

107. HCL accepts that Regulation 101 makes provision for the standard, turnover-based, method of attribution of input tax as the default position and to be the starting point. Mr Hitchmough argues that Regulation 107B prescribes the situation where a departure from that starting position is mandatory. That situation is where the standard method does not reflect the extent to which the goods and services are used in making taxable supplies.

108. Mr Hitchmough contends that in considering the proper approach, a parallel might be drawn with the application of materially identical legislation when the continued suitability of a PESM is in issue. HMRC have the power to serve a taxpayer using a PESM with an override notice obliging a taxpayer to re-calculate its recoverable input tax in accordance with its "use" of its inputs. He refers to the decision of McCombe J in *Vision Express (UK) Ltd v Revenue and Customs Commissioners* [2009] EWHC 3245 (Ch) *("Vision Express")* in which he held that the tribunal made no error of law in dismissing the appeal by Vision Express against an override notice. As far as the assessment was concerned, the tribunal gave informal views and McCombe J did not consider it open or desirable to express views on the underlying calculations. The tribunal's view appeared to be that, if the parties could not agree upon a method of calculation, the matter would have to be determined at the further hearing.

109. Mr Hitchmough also referred us to the decision of the FtT in *St Johns College Oxford* [2010] UKFtT 113 (TC) ('*St John's College Oxford'*) in which it considered its jurisdiction in relation to an 'override notice'. The tribunal considered that in an appeal against tax due or input tax re-payable, it must determine the figures on the basis of an appropriate attribution. The FtT there had insufficient evidence to make a precise calculation and adjourned the appeal with leave to the parties to seek a further hearing, if necessary. The tribunal went on to offer guidance to the parties that may provide a foundation for an apportionment of input tax. Mr Hitchmough submits that these decisions highlight that one option available to the tribunal is

to give general guidance on the sorts of points which would need to be reflected in an override calculation, and leave it to the parties to seek to agree such a revised calculation with a further hearing if necessary.

110. Mr Hitchmough argues that the FtT's reliance on *Temple Finance* was misplaced. The Upper Tribunal there rejected HMRC's case that the correct approach for the FtT to have adopted was to: (a) decide what the use of the input tax was; (b) consider the standard method and whether the SMO applied; (c) if the SMO applied, consider whether TFL's calculation fairly and reasonably reflected use; (d) if it did not, consider whether HMRC's calculation did so; and (e) if neither calculation fairly and reasonably reflected use, impose its own use-based calculation. The Upper Tribunal explained (at [60]) that there were only two calculations in issue before the FtT and held that the FtT was not required to itself enquire whether there might be a third more suitable calculation. Mr Hitchmough submits that the Upper Tribunal did not set out any jurisdictional bar to consideration of amendments or adjustments to an override calculation. The rejection by the FtT of HMRC's case on the need for an override calculation *"effectively left the default standard method contended for by [Temple Finance] as the applicable one"*. Mr Hitchmough submits that here, the question of jurisdiction would only have arisen in circumstances where the Tribunal had rejected the standard method as a reliable proxy for use. The FtT and Upper Tribunal in *Temple Finance* both agreed that the standard method did itself in any event reflect Temple Finance's economic use of its residual inputs.

111. Mr Hitchmough submits the FtT here should have found that it enjoyed an untrammelled jurisdiction to consider whether the conditions for the application of Regulation 107B were satisfied in the present case, and if so, to decide upon the recalculation necessary in order to ensure that HCL's residual input tax was attributed to its taxable supplies in accordance with the economic use by it of its overhead costs in making those supplies.

112. Mr Hitchmough contends that HMRC's reliance upon the jurisdiction of the tribunal in an appeal against the decision of HMRC to refuse the use of a PESM is misconceived. He accepts that in an appeal against the decision of HMRC to refuse the use of a PESM, it is well settled that the tribunal cannot itself put forward its own partial exemption method, but he submits, the use of a PESM is discretionary and thus a restricted jurisdiction makes sense. Otherwise, the tribunal would be stepping into HMRC's shoes, exercising HMRC's discretion not only to approve a special method but also to direct one. By contrast, Mr Hitchmough submits that in circumstances where the requirements of Regulation 107B are satisfied (which must be considered annually) the recalculation of the taxpayer's attribution of residual input tax is mandatory, as is the basis upon which that recalculation must be made. He submits that there is no principled reason why the jurisdiction of the FtT should be restricted in cases of this nature.

OUR APPROACH WHEN REMAKING THE DECISION

113. Articles 173 to 175 of the Principal VAT Directive prescribe allowable methods for determining the extent of taxable use of residual input tax. Article 173 addresses the extent to which residual input tax may be deducted. Insofar as is relevant, in domestic law, Regulations 101 to 107C of the VAT Regulations set out the mechanics of input tax attribution and input tax is recoverable to the extent that it is attributable to taxable supplies and not to exempt supplies.

114. The apportionment of residual input tax is made in accordance with one of the following methods:

a) The standard method;

b) A partial exemption special method ("PESM").

c) The standard method override ("SMO")

115. The standard method set out in Regulation 101 is used to determine how much input tax is attributable to taxable supplies. It is the default method, based on the value of supplies (Regulation 101(2)(d), VAT Regulations) and permission is not needed to use it.

116. Regulation 102 of the VAT Regulations operates so that HMRC may approve or direct the use by a taxable person of a method other than the standard method, i.e. by way of a PESM. HMRC have the power to serve a taxpayer using a PESM with an 'override notice' if the taxpayer is using a method approved or directed under Regulation 102, and that method does not fairly and reasonably represent the extent to which goods or services are used by him or are to be used by him in making taxable supplies: (Regulations 102A and 102B).

117. Regulation 107B(2) requires that where an attribution has been made under the standard method, and that attribution differs substantially from one which represents the extent to which the goods or services are used or to be used in making taxable supplies, the taxable person shall calculate the difference, and account for the amount so calculated. The SMO applies if the attribution of input tax under the standard method fails to fairly reflect the extent to which the input tax is used in making taxable supplies.

118. The European Court of Justice in *VWFS* (as cited above), was requested to provide a preliminary ruling concerning the interpretation of Articles 168 and 173 of the Principal VAT Directive in proceedings between HMRC and VWFS concerning the method applicable for determining the recoverable part of the input VAT incurred by that company in the supply of motor vehicles by hire purchase. Insofar as is material to this appeal, the Court said:

> "49. As a general rule, under the second paragraph of Article 173(1) of the VAT Directive, the deductible proportion is to be determined, in accordance with Articles 174 and 175 of that directive, for all the transactions carried out by the taxable person by reference to turnover.
>
> 50. Nevertheless, under Article 173(2)(c) of that directive, Member States may authorise or require the taxable person to make the deduction on the basis of the use made of all or part of the goods and services.
>
> 51. According to the Court's case-law, Member States may, as a result of that provision, apply, for a given transaction, a method or allocation key other than the turnover-based method, on condition that the method used guarantees a more precise determination of the deductible proportion of the input VAT than that arising from the application of the turnover-based method (judgment of 8 November 2012, BLC Baumarkt , C-511/10, EU:C:2012:689, paragraph 24).
>
> 52. Thus, any Member State which decides to authorise or compel the taxable person to make the deduction on the basis of the use made of all or part of the goods and services must ensure that the method for calculating the right to deduct makes it possible to ascertain with the greatest possible precision the portion of VAT relating to transactions in respect of which VAT is deductible. The principle of neutrality, which forms an integral part of the common system of VAT, requires that the method by which the deduction is calculated objectively reflects the actual share of the expenditure resulting from the acquisition of mixed use goods and services that may be attributed to transactions in respect of which VAT is deductible (see, to that effect, judgment of 10 July 2014, Banco Mais , C-183/13, EU:C:2014:2056, paragraphs 30 and 31).
>
> 53. In that regard, the Court has nevertheless specified that the method chosen must not necessarily be the most precise possible, but that, as is apparent from paragraph 51 of this judgment, it must be able to guarantee a more precise result than the result which would arise from the application of the turnover-based allocation key (see, to that effect, judgment

of 9 June 2016, Wolfgang und Dr. Wilfried Rey Grundstücksgemeinschaft , C-332/14, EU:C:2016:417, paragraph 33)."

[Emphasis added]

119. In *Temple Finance*, HMRC appealed to the Upper Tribunal against a decision of the FtT that, *inter alia*, the standard method for determining the proportion of input tax recoverable on TFL's overheads was fair and reasonable. HMRC claimed that the FtT had adopted the wrong approach in asking itself whether it preferred TFL's approach or HMRC's approach to the calculation of recoverable input tax on overheads. The Upper Tribunal disagreed. At paragraphs [60] and [61] it said:

"60. …Only two methods were before the FtT, TFL's and HMRC's. The FtT was not required to make its own enquiry as to whether there might be another method that was preferable. As Lord Carnwath said in the Supreme Court's decision in *VWFS, [2017] UKSC 26* at [7], where the parties are substantial litigants represented by experienced counsel the tribunal "is entitled to assume that the parties will have identified with some care what they regard as relevant issues for decision."

61. HMRC's arguments also do not take sufficient account of the fact that the starting point is the standard method. As discussed further below in relation to Ground 7, that method is the appropriate method unless a special method applies or the proportion of recoverable input tax "differs substantially" from what would be recoverable under a use-based method, so that the SMO applies. The FtT rejected HMRC's approach for the reasons set out at paragraphs [231] to [235], including that TFL's residual input tax is incurred to collect the weekly payments that relate to the sale price of the goods as well as the finance element. This effectively left the default standard method contended for by TFL as the applicable one. In fact, the FtT also went on to consider whether TFL's approach was correct and concluded at [235] that it was, on the basis that TFL's business involves the making of taxable supplies of goods as well as exempt supplies, that the supplies are inextricably linked and, therefore, that TFL uses its overheads in the course of its entire business."

[Emphasis Added]

120. That approach is consistent with the approach adopted by Warren J .in *St Helen's School Northwood Ltd v Revenue and Customs Commissioners* [2006] EWHC 3306 (Ch) in which the school appealed a decision to refuse the school's request to adopt a SMO on the ground that it would not give a 'fair and reasonable' recovery of residual input tax. The VAT and Duties Tribunal found HMRC had acted lawfully. As to the jurisdiction of the Tribunal, Warren J said:

"26. The decision of Customs refusing to approve a proposed partial exemption special method or to apply a standard method override can be appealed to a tribunal under section 83 VATA (see paragraph (e) of that section). The nature of such an appeal was considered by Etherton J in *Banbury Visionplus Ltd v Revenue and Customs Commissioners [2006] STC 1568*. He concluded that an appeal was not "limited" in the sense identified by him (*ie* an appeal where the tribunal is confined to considering whether Custom's decision was reasonable, in the sense that they did not take into account any irrelevant matters, they took into account all relevant matters and made no error of law and reached a decision which they could properly have reached); instead, the appeal was "full" in the sense that, "even if the disputed decision was a reasonable one, the tribunal should itself decide whether it secured a fair and reasonable attribution of input tax within the meaning of [section 26 VATA]". In other words, the tribunal can substitute its own view of what is fair and reasonable, in the context of the question before it, for that of Customs notwithstanding that Customs decision was within the range of decisions which a body properly directing itself could reach. I propose to follow that approach without any further discussion.

> 27. This is not to say that the tribunal is able to put forward its own version of a more reasonable special method (if there is one). It cannot do so, as the Tribunal recognised in paragraph 43 of the Decision. Accordingly, a tribunal can substitute its own view for that of Customs in deciding whether a proposed special method is fair and reasonable. If on an appeal by a taxable person from a refusal of Customs to allow a proposed special method the tribunal decides that the method is fair and reasonable and also that it is more fair and reasonable than the method in operation (be it the standard method or some other special method), the appeal should be allowed. But if the tribunal thinks that both the existing method and the proposed method are unfair or unreasonable, it could not allow the appeal even if it considers that the proposed special method is less unfair and unreasonable than the existing method."
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> [Emphasis Added]

121. We gain little assistance from the decisions in *Vision Express* and *St John's College Oxford* that are relied upon by Mr Hitchmough. In *Vision Express* the Tribunal held that the partial exemption special method used by Vision Express based on the supposed use of different areas of the shops for taxable, exempt and mixed supplies did not achieve a fair and reasonable attribution of inputs to taxable supplies within Regulation 102A of the VAT Regulations. McCombe J confirmed that the statutory criteria in Regulation 102A for the service of the notice were satisfied. Once it was found that the special method did not fairly and reasonably represent the extent to which goods or services were used by Vision Express in making taxable supplies, it followed that the notice was valid and the appeal had to be dismissed. McCombe J also confirmed the Tribunal did not err in law in concluding that the use of the previous year's figures in the special method was inconsistent with the principle of fair and reasonable representation and that the appeal against the assessment also had to be dismissed.

122. Here, the Tribunal is concerned with the altogether different question as to whether the SMO contended for guarantees a more precise determination of the deductible proportion of the input VAT than that arising from the application of the turnover-based method. The SMO must be able to guarantee a more precise result than the result which would arise from the application of the turnover-based method.

123. The standard method is the default method, based on the value of supplies (Regulation 101(2)(d)) and by definition will provide for a fair and reasonable deduction based on the use or intended use of purchases. Permission is not needed to use it. Regulation 107B(2) expressly requires that the taxable person shall calculate the difference and to account for the amount so calculated where an attribution has been made under the standard method, and that attribution differs substantially from one which represents the extent to which the goods or services are used or to be used in making taxable supplies. It is therefore for the taxpayer to displace the standard method.

124. We agree with the approach that was set out by the Upper Tribunal in *Temple Finance*. Although the Upper Tribunal there was concerned with the need for a single simple adjustment to the standard turnover-based calculation (the removal of Temple's taxable vehicle sales from that calculation), it clearly accepted, relying upon what was said by Lord Carnwath in the Supreme Court's decision in *VWFS, [2017] UKSC 26,* that the FtT was not required to make its own enquiry as to whether there might be another method that was preferable.

125. We accept, as Mr Donmall submits, that the Tribunal can only direct a method other than the turnover-based method if it guarantees a more precise determination of the deductible proportion of input VAT than that arising from the application of the turnover-based method and to that end, a parallel can be drawn with the approach taken in an appeal against a refusal of a PESM. As Mr Donmall submits, HCL's appeal under a SMO involves a contention for a

method (the floor space SMO Method) just as an appeal concerning the refusal of a PESM would do.

126. The focus of the appeal must therefore be on the proposed method, with the taxpayer bearing the burden of proof to establish that the SMO guarantees a more precise determination than the standard method. The standard method is the lawful and mandated method of apportionment up until the point that it is determined that a proposed method displaces it. In our judgment the starting point is therefore to consider whether or not the test set out in *VWFS* is met. If it is, then the standard method is displaced and the SMO applies. If it is not, then the standard method continues to apply.

HCL'S APPEAL AGAINST THE REFUSAL OF A STANDARD METHOD OVERRIDE

127. We now turn to HCL's appeal against HMRC's decision to refuse the SMO proposed by HCL. HCL has a mix of input tax which is attributable to taxable and exempt supplies, and residual input tax relating to its general overheads. There can be no doubt that HCL is entitled to credit for input on supplies where there is a direct and immediate link between the input cost in question and the supply or supplies in question.

128. It is uncontroversial that there can be a direct and immediate link between one set of input costs and two or more output supplies, and that those supplies may comprise both exempt and taxable supplies. In *Dial-a-Phone Ltd v Customs and Excise Commissioners* [2004] EWCA Civ 603, the Court of Appeal confirmed that advertising and marketing costs for the sale of mobile phones were directly and immediately linked both to the sale of airtime contracts, which were taxable supplies, and to the provision of insurance intermediary services, which were exempt. Parker LJ, (with whom Waller and Dyson LJJ agreed) said:

> "As to Mr Anderson's submissions directed at the factual relationship between the insurance intermediary services and the taxable supplies made by DaP (and in particular his submissions regarding timing), it is important to bear in mind that (as the Advocate-General observed in Abbey National (see paragraph 29 above)) a 'direct and immediate link' may exist between the marketing and advertising costs and the insurance intermediary services despite the fact that there may be an even closer link between those costs and DaP's taxable supplies. In other words, the quest is not for the closest link, but for a sufficient link."

129. What is therefore required is a 'sufficient link', and not the closest link. It does not matter that one supply may be viewed in a commercial sense as secondary to another supply.

130. The concept of 'attribution' arises where as here, there is a mix of input tax that is attributable to taxable and exempt supplies, and residual input tax relating to the general overheads. The standard method determines how much residual input tax is attributable to taxable supplies based on the value of supplies (i.e. turnover). HCL claims the crude assumption upon which the standard method is based to determine how much residual input tax is attributable to taxable supplies, based on the value of supplies, cannot be applied to its business.

131. Mr Hitchmough submits that although the deduction of residual input tax depends on the economic use of VAT bearing overheads, it appears well-settled that such use might in an appropriate case be measured most accurately by means of a physical proxy. He refers to the decision of the Upper Tribunal in *RCC v Lok'nStore* [2014] UKUT 288 [2015] STC 112 *("Lok'nStore")*, in which the use of a PESM involving a floor-space based calculation by which the storage space was attributed exclusively to the taxpayer's taxable supplies was approved by the FtT and upheld by the Upper Tribunal.

132. Mr Hitchmough also referred to the decision of the Court of Appeal in *LCM,* [2011] EWCA Civ 1323 [2012] STC 388, in which the taxpayer operated a number of casinos around

the country. The premises in each case had mixed use of gaming, restaurants, bars and entertainment, all within a casino context. The taxpayer applied to use a floor-space based PESM which HMRC rejected arguing that the standard method provided a more reliable proxy for the taxpayer's use of its VAT bearing overhead costs. The taxpayer succeeded in each of the FtT ([2009] UKFtT 201, the UT ([2010] UKUT 36 and the Court of Appeal.

133. In *LCM*, Etherton LJ set out the relevant legal principles and said:

> "33. The need for a process of attribution only arises where an item is a cost component (within Article 2 of the First Directive) of two supplies, one taxable and one exempt: *Dial-a-Phone Ltd v Customs and Excise Commissioners [2004] STC 987* (especially at [28] and [71]). If the standard (turnover) method does not result in a fair and reasonable attribution of the cost component, the search is for a more fair and reasonable method of attribution. The onus is on the taxpayer to show that the proposed PESM is more fair and reasonable, that is to say, more accurate: Case C-488/07 Royal Bank of Scotland Group plc v Revenue and Customs Commissioners [2009] STS 461 at [24].
>
> 34. A fair and reasonable attribution to a taxable supply must, for the purposes of Article 17(2) and (5) of the Sixth Directive and regulation 101(2)(d) of the Regulations, reflect the use of a relevant asset in making that supply. In assessing that use, and its extent, consideration is not limited to physical use. The assessment must be of the real economic use of the asset, that is to say having regard to economic reality, in the light of the observable terms and features of the taxpayer's business."

134. Etherton LJ cited, with approval, at [35], the approach adopted by Warren J in *St Helen's School* that although the motive of a person in making a supply is not relevant to, and cannot dictate, the correct VAT treatment of a transaction, the exclusion of motive or purpose did not allow the Tribunal to disregard the observable terms and features of the transaction and the wider context in which it came to be carried out. Warren J said that applied in the context of establishing the use (for VAT purposes) to which an item of property is put and in deciding whether a proposed PESM is fair and reasonable when determining what is or is not a valid proxy for that use. Warren J also accepted that physical use may reflect economic use, but does not necessarily do so, and that any allocation or special method must give a credible result in economic terms. Etherton LJ went on to say:

> "39. Warren J's endorsement of a test of economic use anticipated the emphasis of the Court of Justice of the European Union ("the ECJ") on "economic reality" in *Joined Cases C-53/09 and C-55/09 Revenue and Customs Commissioners v Loyalty Management UK Ltd, Baxi Group Ltd v Revenue and Customs Commissioners [2010] STC 2651* , which concerned the VAT treatment of supplies under customer loyalty reward schemes. The ECJ said at [39]:
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> > "It must also be recalled that consideration of economic realities is a fundamental criterion for the application of the common system of VAT."
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> 40. The decision of the Tribunal in *Aspinall's Club Ltd (2002) (No. 17797)* is another good illustration of the application of the relevant principles in the context of gaming and associated catering. The taxpayer ("Aspinall's") was the proprietor of a licensed gaming club, available for use by members and their guests. It was a particularly high-class casino, with all the ambience and appearance of an exclusive private club where members and their guests could enjoy luxurious facilities. Those facilities included dining room and bar areas in which there were VAT standard rated supplies, although 90 per cent of the food and drinks were not charged for. The areas devoted to gaming were small as compared to those used for dining and bars, but Aspinall's derived its income overwhelmingly from its VAT exempt licensed gaming activities. The common areas contributed to the feeling of luxury and opulence. Some £6.5 million was spent on refurbishing the premises, including the creation of a new dining area, staff areas and office space, in respect of which VAT of nearly £1.2 million was incurred. Aspinall's wished to have a PESM which would

apportion residual input tax in the ratio of the floor area used to make taxable supplies to the sum of that area and the area used to make exempt supplies. The Commissioners refused, and Aspinall's appealed. The Tribunal dismissed the appeal. The core of its reasoning was as follows:

> "48. What is very apparent to us is that the catering activities by themselves are not conducted with a view to profit. No board of directors could have permitted the catering business to continue for its own sake. It could only be justified in conjunction with other activities, i.e. gaming. Consequently we do not find it credible that the board could have regarded the refurbishment expenditure as a profitable project for the catering business, since clearly there would be a negative return on such an investment. Yet Aspinall's would claim that, nevertheless, up to 55% or more of the VAT on that expenditure is recoverable.
>
> 49. …Most, if not all, the floor areas of the Club are of mixed use; they are used to make all the supplies of the business, both taxable supplies and exempt supplies. Furthermore, in running the business costs are primarily incurred to facilitate exempt gaming. This does not mean that exempt supplies are physically made from areas such as the bar and restaurant or, on the other hand, that taxable supplies are physically made from the gaming rooms. Nor, we would add, does it mean that there is for VAT purposes a single supply of gaming to which the catering is merely ancillary. But those factors do not rule out costs incurred in one area being incurred to make supplies in another area. This applies even more so in relation to costs incurred in respect of the common areas from which no supplies are directly made. Such costs are incurred and are truly 'cost components' of the exempt supplies which physically take place in the small gaming area. Those costs are funded by the gaming. That in itself does not make them cost components of those exempt supplies. But in this case it is additional proof, if any is needed, that gaming is the foundation of the business and it is the furtherance of that gaming which causes and is seen as justifying commercially the decisions to incur the expenditure. Here there is capital expenditure and ongoing expenditure incurred specifically to create and maintain the opulence and luxury, especially in the creation of spacious surroundings and general ambiance, which is seen as commercially necessary to promote the highly profitable gaming business. For these reasons, in our judgment, the Commissioners in considering the methods proposed have not confused use with purpose and have not acted unreasonably in deciding to reject them. Indeed for our part, if it is open to us to decide whether the floor area methods put forward by the Appellants are capable of achieving a fair and reasonable attribution of input tax, we have not been satisfied that they do."

41. That case and the reasoning of the Tribunal, with which I agree, is illustrative of three points of principle. First, it shows the importance in these cases of close attention to the facts in order to understand the economic or commercial reality underlying the use of the relevant VAT inputs. Secondly, identification of the source or potential source of profit in a business may be an important feature of a business throwing light on whether or not the standard method or a PESM is a more fair, reasonable and accurate method of attribution. It all depends on the facts of each case: cf. *Banbury Visionplus Ltd v Revenue and Customs Commissioners [2006] STC 1568* at [68]. Thirdly, depending again on the precise factual situation under consideration, the approach of the Tribunal in *Aspinall's Club* at [49] may well be appropriate in a case where the taxable supplies are not, in themselves, a source of profit:

> "Those costs are funded by the gaming. That in itself does not make them cost components of those exempt supplies. But in this case it is additional proof, if any is needed, that gaming is the foundation of the business and it is the furtherance of that gaming which causes and is seen as justifying commercially the decisions to incur the expenditure."

> 42. As both St Helen's School and Aspinall's Club show, and as was emphasised in *Dial-a-Phone v Customs and Excise Commissioners [2004] STC 987* at [72] by Parker LJ (with whom the other members of the Court agreed), analysis of attribution for the purposes of Article 2 of the First Directive, Article 17 of the Sixth Directive and Regulation 101 is highly fact sensitive."
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> [Emphasis added]

135. At the core of HMRC's case before us, as it was before the FtT, is the claim that the SMO claimed by HCL is critically flawed because it proceeds on the false premise that the economic use of the area allocated to hospitality or entertainment was exclusively limited to taxable supplies, when the economic reality was of dual use, i.e. the bars, restaurant and theatre areas were also used economically to support and promote Gaming. That is, there was dual use.

136. As the FtT noted, at [100], although allocations based on use of the floor space have been made by HCL for all of the years under appeal, the only floor plan that has been provided, and on which Mr Thomas was cross-examined, was for the allocation as at 2013-14.

137. We remind ourselves that the decision of HMRC under appeal relates to the refusal of a SMO proposed by HCL to displace the standard method of apportioning residual input tax for the tax years 2012/12 to 2015/16. Whilst evidence that post-dates the relevant periods is capable of providing some assistance, we treat that evidence with a degree of caution in circumstances where HCL's activities at the premises have developed over the passage of time.

138. In reaching our decision on HCL's appeals, we have had regard to the uncontested evidence and findings of fact referred to in the decision of the FtT relating to the observable terms and features of HCL's business and its output supplies and inputs, and the wider context. Although we focus our findings upon the evidence referred to in the decision of the FtT, for the avoidance of any doubt, we have had regard to all the evidence that is before us and set out in the bundles that we have been provided with. We are not required to, and we do not refer to each piece of evidence or submission made on behalf of the parties, but we have looked at all the evidence before us and considered the submissions made both in writing and orally, before standing back and reaching our decision.

139. We rely upon findings of fact made by the FtT on the features of HCL's business and the economic use of goods and services supplied. We then make additional findings based upon the evidence available to the FtT and us. We then come to an evaluative judgment on the Dual Use issue. Finally, we consider the arguments and arrive at a conclusion on whether the floorspace SMO should displace the standard turnover method.

FINDINGS OF FACT ON HCL'S BUSINESS & ECONOMIC USE IN THE FTT'S DECISION

140. The evidence received by the FtT is set out at some considerable length in the Decision. The FtT heard evidence from Mr Simon Thomas, the Chief Executive and Chairman of HCL and Mr Matthew King, its Managing Director. The Tribunal also visited the Hippodrome on the first afternoon of the hearing and were given a guided tour by Mr Thomas. The FtT found that both Mr Thomas and Mr King were credible and truthful witnesses who sought to assist the Tribunal at all times.

141. Insofar as is relevant, the evidence before the FtT was that HCL was established in 2005. The Hippodrome was acquired by HCL in 2005 and an extensive refurbishment of the premises commenced in 2009 taking three years to complete.

142. Mr Thomas explained that HCL's intention was for the Hippodrome to be different from any of the existing casinos and provide, as he described it:

> "A Las Vegas style experience within the boundaries of the UK legislation and the space available".

143. At [42] of the Decision the FtT recorded:

> "To create such an "experience" for its customers the Hippodrome includes over, its five floors, areas for live gaming, higher-stake and lower-stake gaming machines, electronic gaming, poker, eight bars, a restaurant – the Heliot Steak House, private dining/meeting rooms, conference and event areas, outdoor terraces, an entertainment and conference space (Lola's), lounges, and a theatre which currently hosts Magic Mike Live. The premises are currently being extended to add a coffee shop and a Chinese restaurant, as well as a creperie on the outside of the Hippodrome building aimed at passers-by in Leicester Square."

144. At [43] to [54] of the Decision, the FtT describes at some length the layout of the premises and the various strands of the business. At [56], the Tribunal referred to the evidence of Mr Thomas that he accepted that the gaming was the "greatest" contributor to the Hippodrome's overheads. He said that hospitality and entertainment were "equally important" as they work very hard to improve all aspects of the business. The Tribunal then turned to the evidence regarding what it described as the individual "products". It noted that gaming is currently offered at the Hippodrome 24 hours a day and at [60]-[68] found that:

> "60. HCL makes complimentary supplies of food and drink to some of its most valued customers. These are predominantly gaming customers but complimentary food and drink may also be given to others, eg restaurant customers on their birthday. In evidence Mr Thomas said, in relation to 2013-14, that:
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> > "We give away £1.2 million out of £7.2 million hospitality. So it's circa 20% of the business, 16% or whatever."
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> "61. The importance of gaming to HCL is clear. Not only does it provide the greatest source of income but it is reflected in the name of the company and its premises, ie the "Hippodrome Casino". A customer poll taken between 20 December 2016 and 15 February 2017 recorded that 70% of them had come to the Hippodrome for gaming purposes, a number reflected in HCL's 2018 statutory declaration to the Gambling Commission which estimated that 33% of visits to the Hippodrome did not involve any gambling.
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> 62. Gaming is described as the "principal" activity of HCL in various documents. For example, in its pre-opening Business Plan for the Hippodrome recorded that:
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> > "The principal activity of the business is the operation of a casino, providing a broad mix of casino games, both live table and electronic. The entertainment facilities will be an important part of the overall offer of the casino – the ethos is to provide a fun experience in a safe and welcoming environment."
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> 63. In a similar vein HCL's accounts for the year ended 31 December 2018 notes that "The gaming licence is fundamental to our primary business activity". The Executive Summary of the 2019 five-year strategy plan, Reaching for Greatness, states:
>
> > "We are a casino based entertainment complex that amazes, surprises and entertains London. Our venue is fun and accessible and we seek to create an extraordinary leisure experience that is both magical and memorable."
>
> It continues:
>
> > "Our uniqueness is the experience we provide to customers. This is our primary competitive advantage and source of long term value. The Hippodrome experience is created by the effective deployment of the following assets."
>
> 64. The assets to which it refers are the building (its location and "physical aspect"), staff and offer portfolio ("choice and quality and value"). Mr King explained that it was difficult to differentiate one gaming business from another saying that "a wheel in one casino is a wheel in another casino." However, the fact that the Hippodrome has a

"fantastic standalone restaurant, fantastic bars, a fantastic theatre" was, he said, "a help to gaming". He agreed that it was the experience of being in the Hippodrome with the full variety of offers there that set it apart as a gaming venue. However, he said that:

> "If one looks at the building, the building almost writes for itself. If everything was just about the gaming, that building [the Hippodrome] wouldn't look anything like what it looks like today. It would be a different animal."

65. The significance of gaming was also accepted by Mr Thomas who agreed in evidence that it was intended at the commencement of its business that gaming would be HCL's principal activity. When referred to documents which stated that this remained the case at 2018, he said:

> "And it remains that now, you can see the figures, the greatest contribution to our overheads is from gaming."

66. Contemporaneous documents repeatedly refer to the Theatre, Heliot Steak House and the various bars as "facilities" and "amenities". HCL's accounts for the year ended 31 December 2018 state:

> "Consumers are increasingly seeking an experience, not simply direct product purchase and the multi-faceted Hippodrome operations - 3 live gaming areas, electronics, slots, high quality restaurant, bars and live theatre shows provide consumers with multiple reasons to visit.
>
> We continue to focus on improving facilities for customers and reinforcing our unique position in the marketplace …
>
> The casino market in the early part of 2019 remains challenging. The Hippodrome business is well placed to meet these challenges. We continue to invest in improving facilities for customers and believe that future prospects for the business are strong."

67. This is also the case with promotional material on the HCL's website:

> "Casino games are great! The experience gets even better when you have a full-fledged restaurant to satiate your taste buds. However if you smoke, there aren't many facilities like The Hippodrome Casino that have a dedicated smoking terrace for your smoking breaks. The casino houses a two-level smoking terrace that's equipped with a dedicated bar, and offers a wide range of cigars. You can smoke and drink while sharing your life experiences or just spontaneous laughter with like-minded people at our rooftop smoking terrace.
>
> > When you're at The Hippodrome Casino, you don't have to ever worry about getting bored, thanks to the wide assortment of games we have to offer. However when you feel like taking a break, visit the smoking terrace for a quick breather. You can do this without having to worry about getting chilly on winter evenings too, as you can enjoy summer vibes all year long with our heated roof terrace. This smoking oasis is indeed one-of-a-kind and is certain to be a welcome haven in the centre of London's West End entertainment.
> >
> > So why not sip on your favourite drink and smoke at the rooftop smoking terrace, all the while soaking in the excitement and energy that The Hippodrome Casino exudes. And that's not all; if you want to try out the house special drinks, make sure you ask for a specially designed cocktail from our exclusive list. Now you know why The Hippodrome Casino is one of the most popular, multi award winning casino in the country.
> >
> > Come visit now and let us lavish you with our specialities and hospitality.

68. Mr Thomas agreed that this confirmed that not only did the Hippodrome have a:

> "… great gaming offer but also when you have a break we will have great amenities for you to have a meal at a restaurant or a drink at the bar on the terrace, to have a cigarette or a cigar on the terrace."

He explained that it was "good" for casino customers to have space to have a break and that this was "positively encouraged" as it is "good social responsibility for gamblers to take a break from gambling". He added that if a person is gambling for a long period of time:

> "… from a social responsibility point of view we will have an interaction with them and suggest they take a break. It may just be ten minutes away from the tables or having a coffee or whatever but it's quite sensible."

145. At [70] to [79] of the Decision the FtT referred to the entertainment offered by the Hippodrome's 326 seat Theatre, which is the London venue for Magic Mike Live, which opened in November 2018. The Tribunal referred to the success of the show, but noted the challenges previously faced by the Theatre in previous years citing the Board Reports for September 2014, December 2014, April 2015 and December 2015 and November 2016.

146. At [77] to [79], of the Decision, the FtT found:

> "77. In evidence, Mr Thomas confirmed that one of the objectives of the Theatre was to put people into the casino to gamble. However, he explained that was is also an objective of the Theatre to pull people into the Hippodrome to eat or to drink as "part of the mix of products"…
>
> 78. Mr King explained that because of the close relationship with the Cosmopolitan in Las Vegas, whose marketing manager worked for HCL in London for a time, he was able confirm that the benchmark for a Los Vegas casino is for a crossover of 10% of their theatre tickets to gaming. He said that HCL "internally throughout the entire budget process" had considered that they could be "half as good as Vegas because they had been around a long time." As such, in terms of budgeting HCL's aspirations were to turn 5% of the theatre goers into gaming customers. When asked if this had ever been achieved, Mr King said it had not, "nowhere near in fact."
>
> 79. Although in 2019 (outside the period with which the appeal is concerned) the Theatre did make a small profit following the success of Magic Mike Live, this was the first time it had done so notwithstanding the intention, described by Mr Thomas, of wanting each part of the Hippodrome to:
>
> > "… operate to the optimum it can. Both as a business in its own right and as an attraction to the business to [pull] in other people who may choose to spend on other … businesses within the Hippodrome."

147. The FtT addressed the hospitality on offer at the restaurant at [80] to [86] of the Decision. The evidence, in summary, was that the Heliot Steak House had 120 covers and was on three levels. Following a re-brand, and adopting a different approach, the number of covers increased from 300-500 a week to 1,300 a week by 2017. In 2019 the Heliot Steak House had 71,000 customers and sold some 33,000 steaks and the average spend per customer had increased from £33 in 2017 to £35 by 2019.

148. At [83] to [85], the FtT found:

> "83. While a proportion of these customers would have been at the Hippodrome for gaming purposes, Mr Thomas considered that, as food was also available 24 hours a day at the bars and served at the gaming tables, most of the restaurant customers were not there for that reason but accepted that there had been attempts to cross-sell the Heliot Steak House with the Hippodrome's other products.

84. An example of this was a 2014 promotion by the Heliot Steak House to generate business from its gaming clients by giving customers a £5 gaming chip if they bought a steak. Although this was considered to be the fastest and most effective means of generating revenue it did not work. Mr Thomas explained that the customers who received the promotional £5 gaming chip went onto the gaming floor at busy times (both the restaurant and gaming floor are busy in the evenings) and disrupted experienced gamers as they did not know what they were doing. This, he said, demonstrated not only that customers who were not gamblers were already visiting the Hippodrome in order to use the Heliot Steak House in its own right but that also there was limited potential for cross-over between these business activities

85. Similar promotions which incorporated a gaming deal, eg a fixed priced meal and drink and a £50 win chip have resulted in the gaming chips often not being redeemed. A 2015 transaction report showed that 44% of such vouchers issued were returned unused. When asked if this meant that 56% of gaming vouchers were used Mr Thomas said:

> "That's absolutely correct, but given it was effectively a free bet, it was quite surprising there was only 56%, we were giving people who were going to the restaurant a chip they could put down on roulette number and if it comes up they win £50. You would think logically you'd just do it, but it obviously showed the lack of interest in [gaming by] those customers."

149. The FtT addressed the eight bars at the Hippodrome at [87] to [97] of the Decision. It found:

> "87. There are, in total, eight bars at the Hippodrome. However, as Mr King explained the these are not "generic" bars. Each, he said, has to be:
>
> > "… very, very carefully thought through, not only price position point but actual product, what mix. Take Champagne for example, what brands of Champagne, because that speaks to the brand of the bar."

150. At [88] to [97], the FtT referred to the evidence regarding each of the bars separately.

Substantial difference between the SMO and standard method

151. The FtT outlined the floorspace SMO contended for by HCL and its various elements at [98] of the Decision. At [99] the FtT said:

> "Applying such a method there is, as the following table illustrates, a substantial difference (ie greater than £50,000) between the HCL's SMO and the standard method ("SM"):

Year	Total Overhead VAT £	Recoverable under SMO (£)	Recoverable under SM (£)	Difference (£)
2012-13	1,629,304.28	870,054.37	276,981.73	593,072.64
2013-14	1,677,077.82	859,198.01	218,020.12	641,177.89
2014-15	1,232,885.61	648,707.29	172,603.99	476,103.30
2015-16	1,361,765.19	520,900.90	163,411.82	357,489.08
2016-17	1,705,065.27	815,620.23	221,658.49	593961.74
2017-18	1,803,814.70	846,011.02	216,457.76	629,553.26

ADDITIONAL FINDINGS OF FACT BASED UPON THE EVIDENCE BEFORE THE FTT

152. Having considered the wide canvas of evidence before the FtT and us[4] it is clear that the Hippodrome is, as Mr Thomas said in his evidence, an iconic entertainment venue with a luxury environment. The evidence of Mr Thomas was that HCL's intention was to provide *"A Las Vegas style experience within the boundaries of the UK legislation and the space available"* with a restaurant, bars, gaming floors, a theatre, and a terrace. In his evidence, [D2/13/24], Mr Thomas explained that HCL would like its customers stay as long as they are happy to stay and spend money with them rather than going to spend money elsewhere.

153. We accept that the supplies made by HCL comprise three business activities: Gaming, Hospitality (comprising the restaurant and the bars) and Entertainment. It is common ground between the parties that as well as the charged-for supplies, HCL also makes complimentary supplies of food and drink to some of its most valued customers, predominantly gaming customers, but they may also be given to others e.g. restaurant customers on their birthday.

154. As far as the particular areas of the premises are concerned, we accept by reference to the evidence:

> (a) The basement (the 'Gold room', then 'Lola's underground casino'), was during all relevant periods predominantly a gaming space. In 2013/14, the allocation of the customer areas was 300.2 m2 area of gaming, and a 40.7 m2 bar [D2/38/12]; there was no significant seating area. We accept that the bar was therefore predominantly serving the gaming area, and Mr Thomas' evidence that it was "totally independent" [D2/44/12] is to overstate the reality. In 2014/15, there was an increase in the area allocated to hospitality of 61 m2 [D2/40/12, and J/13/199]. Although Mr Thomas thought there had been a shift to 50:50 in 2014/15, the claimed floor allocation is only 100m2 hospitality to 240m2 gaming, in the customer area at the time [D2/48/12]. That remained the case to 2018/19. A document of 2014 or 2015 described it as follows, [S/137/573] "*For casino customers, Lola's Underground casino at The Hippodrome is the highest energy casino environment in the UK. Unlike other casinos Lola's has a dice table and live dance entertainment placed at the centre of the gaming, all within a setting based on the under-stage world of 1900's London, where Lola Mcguire ran her original illicit casino*". Board minutes also recorded "*It was noted that dice players particularly like the new environment and that this was driving demand for the game*". It was reported that "*the operating costs for Lola's are likely to be higher than the Gold Room's due to the dancers, but the current business performance is justifying these increased costs*".
>
> (b) The basement also houses an area for CCTV/administration for the casino and hospitality area, a food store, a chilled cellar, a cellar, an ice machine, a secure cellar and pantry. There is also a lift, stairs, transformer, IT hub room, switch room, CCTV rack, cold water break tank and booster, gas meter, incoming gas and electricity as well as staircases and hallways, refuse and recycling stores, rubbish compactor, stores, toilets, lobby, pavement hatch and staff areas (lockers, changing rooms, staff lounge and showers).
>
> (c) The ground floor bar served the gaming customers on the ground floor. In his witness statement, Mr Thomas confirmed it is "not advertised separately as it is

1. [4] References to the transcript of the FtT hearing are [Day/Internal Page/Line], References to the Joint Hearing bundle before the FtT are [J/Page], Exhibits Bundle [E /Page]; Supplementary Bundle [S / Page]; second Supplementary Bundle [S2/Page].

part of the main gaming floor". It serves to service ground floor customers. A board meeting of July 2018 records "the ground floor bar is busy and provides the food and drink service for the entire ground floor" [E/18/295]. In his evidence before the FtT, Mr Thomas accepted [D2/75/7] that the purpose of the bar was predominantly to serve gaming customers.

(d) On the first floor, there was the Penny Bar that is used 'by everyone', a lounge without a bar, and two small gaming areas, now with six tables. There were also areas of kitchens for the Heliot restaurant, and a separate kitchen for the 24 hour menu, and part of the Heliot restaurant. The main floor of the Matcham theatre was also here, which before the changes with the Magic Mike show had a retractable curtain.

(e) On the second floor, there was the theatre gallery, more Heliot restaurant space and two private dining rooms.

(f) On the third floor, the terrace was the first smoking terrace. Mr Thomas conceded that a customer (including a gamer) could go there without having a drink, just to have a smoke; [D2/60/7]. There were also four gaming rooms, which were initially the high end rooms, but were later swapped with poker. The area was branded the Cranbourn Club, and the area was conceived in a document as follows "For gamblers who like to smoke no other premises in the UK can match the combination of bar casino space and smoking environments contained within the [name] Club." [S/137/573]. This third floor was discussed in a strategy document as one of the "unique and distinct offers" in the building. [E/1/10].

(g) On the fourth floor, there was a further terrace, subsequently enlarged (and with a fifth floor added) in 2020. Mr Thomas accepted [D2/63/4] that someone wanting outdoor space might go up there.

155. Visitors to the Hippodrome at the relevant times were able to enjoy the facilities throughout the premises including the restaurant, bars and theatre. However, we find that the gaming business was the principal/core part of HCL's business at the premises at the relevant times for the following reasons:

a) Gaming is described as the 'principal' activity of HCL in various documents as referred to in [61] to [68] of the Decision of the FtT. See also [144] above.

b) It is also reflected in the name of the company and its premises, ie the "Hippodrome Casino".

c) The theatre and restaurants are not open 24 hours, whereas gaming and certain bars are. In his oral evidence, Mr Thomas said [D2/116 ff] the restaurant is not open outside of 5:00pm until midnight, and that there was no show every night in the theatre until March 2019. They aimed to have a show but sometimes the theatre was being used for other events such as a poker tournament, conferences, meetings and parties.

d) HCL's own estimations were that 33% of visits did not involve any gambling. We accept that 67% of visitors come primarily for gambling. In his oral evidence [D2/119/11 to D2/126/11] Mr Thomas was referred to a customer poll, for the period December 2016 to February 2017. He said that for about a third of customers, the primary purpose is to go to the bars and restaurants. Of the people going to the gaming, they could have a secondary purpose and enjoy other assets in the business. See also the oral evidence of Mr King at [D3/50/17 – D3/64/6].

e) In his evidence Mr King accepted [D3/17/13] that the facilities on offer at the Hippodrome – building, staff and offer portfolio – provide a strategic advantage over other casinos; see also [D3/20 – 21]. He accepted that gaming is a difficult business to differentiate because "a wheel in one casino is a wheel in another casino".

f) In his oral evidence, [D2/76/22] Mr Thomas was asked about attendance at the Hippodrome in November 2014. He said that in November 2014 they were "*flexing the building depending on where the demand is, looking to optimise it….the balance was wrong – getting too many people coming from for hospitality, so we were trying to rebalance it to get more gaming people.".* He also accepted [D2/76/22] that in June 2015 they had restricted drinking space on the third floor to accommodate more gaming and that had hit income. There were reduced promotions on the bars etc for a number of months to ensure a better environment overall for customers and particularly gamers.

156. In his witness statement, Mr Thomas confirmed that the ability to cross-sell the various business activities to customers in the building is a large part of the Hippodrome's success. Whilst we are prepared to accept that attendance and marketing may often focus upon individual activities and separate strands of the business, we find that for the most part, the intended purpose of those activities is to increase the prospects of those going into the Hippodrome, to make use of the gaming at the premises.

157. HMRC accept that the bars, restaurant and theatre offers in this case were not "merely ancillary" or "entirely subservient" to gaming. There will undoubtedly be some customers that visit the venue for the sole purpose of visiting the theatre, having a drink at one of the bars or enjoying dinner at the Heliot Steak House, but that is not to say each of those strands of the business operates on their own such that the space occupied by each of those strands of the business (either individually or cumulatively) can be attributed exclusively to the taxable supplies made.

158. There is plainly some overlap between HCL's several offerings. In some cases, that may be more limited than others. We accept that some elements of the business are likely to have greater appeal to a distinct customer-base, but we do not accept that this can be entirely separated out from gaming customers. Although the theatre, restaurant and bars may have their own customer base, that is not to say that all of that customer base attends the premises solely to attend the theatre, bars and restaurant.

a) As the FtT noted at [77] of the Decision, in evidence, Mr Thomas confirmed that one of the objectives of the Theatre was to put people into the casino to gamble. Equally, the 2014 promotion by the Heliot Steak House to give customers a £5 gaming chip if they brought a steak, demonstrates that objective. The evidence was that 44% of the vouchers issued were returned unused. Mr Thomas accepts this means that 56% of the gaming vouchers were used. We find that this is evidence of an overlap and cross-over between the business activities of HCL. There may be any number of reasons why 44% of the vouchers were returned unused and that does not, we find, show a lack of interest in gaming by all the customers who attended the restaurant.

b) In his evidence, [D2/13/8], Mr Thomas accepted it is critical that each business activity maintains a good reputation and a large part of the Hippodrome's success is the ability to have someone come into the restaurant and then be cross-sold other aspects of the Hippodrome's offer, including gaming.

159. It is more difficult to determine the degree of success in the strategy of introducing gaming to theatre customers. It does not however follow that there has been no such cross-over. We accept that the numbers may potentially be small on any particular night, and may be difficult to track but in his evidence [D3/6 and following] Mr King accepted that the attraction of even 10 people from a theatre audience who had not gamed before, but game for the first time, was potentially of value.

160. In his oral evidence [D2/89 and following], Mr Thomas was referred to a Board report from September 2014 in which reference was made to putting on shows in the theatre "appealing to the higher end gamers". Mr Thomas explained that "*The subset (sic) of any show would obviously be to attract gamblers…we wanted to drive people into the cabaret, to make money out of them, and we would like them to use other facilities in the business; and in a utopian world we would actually have the perfect act that would bring in somebody who will gamble, eat, drink, as well as go to the show"*. Later in his evidence [D2/99/23], Mr Thomas accepted "the focus was on people who would enjoy all the other products in the building, because that's how we make money, not just from pure cabaret product but from people spending elsewhere when they're there. It doesn't always work but overall it's okay".

161. We find that the bars, smoking terraces, restaurant and theatre provide important amenities to gaming customers, for instance:

a) The evidence of Mr Thomas that was referred to at [68] of the Decision of the FtT acknowledged the importance of areas in which casino customers could take a break, to the overall business. It is good for social responsibility and 'breaks' are positively encouraged. At [69] of the Decision, the FtT referred to the mandatory requirement for casinos to have non-gambling areas that must not consist exclusively of lobbies and lavatory areas. It noted that the non-gambling area in the Hippodrome is much greater than the required 20 square metres and the evidence of Mr Thomas that the relatively small requirement was because the Hippodrome was originally licenced under the Gaming Act 1968 rather than the Gambling Act 2005 and has what is described as a "converted licence".

b) As the FtT noted at [60] of the Decision, HCL makes complimentary supplies of food and drink to some of its most valued customers. The evidence of Mr Thomas was that in 2013/14, HCL gave away *"£1.2 million out of £7.2 million hospitality. So it's circa 20% of the business, 16% or whatever"*.

c) The fact that the Hippodrome Casino offers a restaurant, terrace, and bar is of value in attracting gaming customers is reflected in promotional material on its website as set out in [67] of the Decision; see paragraph [144] above.

d) In his evidence, [D2/32/1], Mr Thomas accepted that the totality of the offers, so including the bar, restaurant and theatre offers, encourages some people to come to the Hippodrome to game. He said *"..having a casino will encourage some bar people to come and ditto restaurant people. It is a unique situation to have all of those different products under one roof. And it's something we use to our advantage."*

162. We accept HMRC's case on the evidence and find that hospitality and entertainment areas were also used economically for the gaming business in the following ways:

a) The bar and restaurant areas provided important amenities to gaming customers, as people coming to a casino to game will often want to have a drink or something to eat or have a cigarette on one of the outside terraces (allocated as bar areas) or otherwise take a break away from the gambling areas. This was accepted on

multiple occasions in witness evidence and was reflected in promotional and other corporate material.[5]

b) The bar, restaurant and entertainment areas provided strategic competitive advantage over other live casinos[6].

c) These amenities also were part of what differentiated the experience of coming to the Hippodrome to game rather than play online.[7]

d) It was necessary to the gaming business for regulatory reasons, as well as important for social responsibility reasons, to provide non-gaming areas in the casino.[8] HCL relied on these amenities in its Assurance Statement to the Gambling Commission: "*By providing a rich and varied range of non-gaming entertainments, customers are provided with positive incentives to take breaks from play.*"[9]

e) The bars, restaurant and theatre help to increase dwell time of gamers, and therefore increase the length of time they spent gaming.[10] This has long been a strategy with casinos (WS Thomas para 11 "*The purpose of the bars and restaurant in [average casinos] was to provide sustenance to players with the primary aim of keeping them within the premises for as long as possible*.")

f) Part of the Hospitality Director role was to work with gaming management to develop the gaming offer of the business for high worth gamers and *"to fully integrate the Hospitality services with other operational areas to ensure it fully supports such areas"*, including gaming areas.[11]

g) The attractiveness of the bars or restaurants 'in their own right' served to enhance the attractiveness of the same as an amenity for those who are gaming.[12] It obviously does not preclude such economic use.

h) Neither hospitality nor entertainment businesses were profitable for the entirety of the period. For calendar year 2015, according to PWC's analysis, gaming made £8.3 million in EBITDA profit; whereas the hospitality and entertainment businesses were all unprofitable, making a combined loss of £2.1 million.[13]

163. Mr Donmall accepts that there is no legal principle that for an input cost to be used for an output supply, that output supply must be profitable. However, he submits, that does not mean that profitability is not capable of being evidentially relevant to the question of how an input is used, and depending on the facts, very significantly so. As Etherton LJ observed in *LCM* at [86], business is carried on with a view to profit. If a commercial business incurs costs, a tribunal can properly ask itself why it did so and make inferences in respect of use. If the immediate use of those costs is for a business activity X which is not itself profitable but also supports another business activity Y which is profitable, a tribunal can properly place weight on the evidence of profitability to support a finding that at least part of the economic use of those costs is to further the profitable activity Y.

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[5] D2/3/9-12 [U/116], D2/12/4-9 [U/118], D2/3/22-4/14 [U/116], D2/5/14-6/6 [U/117], D2/7/8-11 [U/117], D2/8/18-9/23 [U/117-118], D3/27/2-9 [U/185]
[6] D3/20/18-21-1 [U183-184]; D3/21/15-20 [U184]
[7] D2/31/22-32/5 [U/123]: D3/18/18 [U/183]
[8] D2/4/15-19 [U/116]; D2/28/20-D2/30/12 [U122-123]
[9] S/143/615
[10] D2/12/18-14/1 [U/118-119]
[11] D2/78/11-81/6 [U/135-136]
[12] D2/12/18-13/8 [U/118-119]
[13] J/491, J/492: -£120,695 (Bars), -£1,287,035 (Restaurant), -£657,956 (Entertainment), -£2,065,686 in all.

164. In his evidence, Mr Thomas said [D2/81/] that HCL is unashamedly a hospitality business and all parts of the business should support all other parts. He was asked about the loss made by the restaurant in particular and said [D2/82/4] that they want to maximise the contribution of every part of the business; "*we're not doing any part of the business for fun".* We accept this.

165. However, the evidence before the Tribunal is that neither hospitality nor entertainment businesses were profitable for the entirety of the relevant period. As set out above, for calendar year 2015, according to PWC's analysis, gaming made £8.3 million in EBITDA profit; whereas the hospitality and entertainment businesses were all unprofitable, making a combined loss of circa £2.1 million. HMRC does not claim that the lack of profitability of the hospitality or entertainment businesses is determinative of the appeal, but does maintain that that lack of profitability is evidentially significant and is to be weighed alongside other evidence of a duality of use. We agree that lack of profitability is relevant, albeit not determinative.

166. When we refer to dual use, we accept that in some parts of the premises, such as the theatre for example, there is no gaming and so no exempt supply is made. Equally, we accept that there are parts of the premises such as the Heliot Steak restaurant in which gaming supplies are not made. That, however, does not mean that no economic use is being made of the entertainment and hospitality areas for gaming supplies for the reasons we have explained above.

167. Therefore, the costs incurred in the hospitality and entertainment areas from which taxable supplies are made are also costs incurred to make non-taxable gaming supplies in other areas. Therefore, some of these costs are being used to make non-taxable supplies. Further, there are plainly costs incurred in respect of the common areas from which no supplies are directly made, including the areas in the basement of the premises. Such costs are incurred and are 'cost components' of the exempt gaming supplies, and on the evidence before us, are funded by the profitable gaming supplies.

168. HMRC do not contend, quite properly in our judgment, that given the real economic use of the premises, there is a single supply of gaming to which either the hospitality or entertainment is ancillary.

169. Although the way in which those costs are funded does not in itself establish that they are cost components of the exempt supply, they do demonstrate that it is the gaming that justifies the ongoing expenditure that is intended to make the Hippodrome different from other Casinos and to promote the profitable gaming business. As the FtT noted at [44] of the Decision, the main atrium, the central feature of the Hippodrome, has a 62-foot-high ceiling which has been returned to its original state as part of the refurbishment undertaken by HCL. Although the main entrance leads directly to the atrium, via a foyer which has a cloakroom and corridor with memorabilia on the walls reflecting the Hippodrome's history, it can be accessed from anywhere in the building via each entrance. The atrium was described by Mr Thomas as one of the Hippodrome's key draws, something, he said, that makes people "go Wow!".

170. We do not accept on the evidence before the Tribunal that the hospitality and entertainment can properly be described as being independent offerings that are entirely separate or bear no relation to the gaming. We have found that HCL made significant economic use of areas allocated to hospitality and entertainment for the purposes of its gaming supplies. We accept that the economic use was made partly by attracting customers to come to the premises and encouraging them to stay, thereby strengthening the gaming proposition offered by HCL over its competitors.

171. The facilities on offer enabled HCL to comply with the letter and spirit of regulations requiring non-gaming areas to be available in a casino and by trying to cross-sell gaming to

customers who initially came to the premises for other purposes. Although not determinative on its own, we accept that the economic use is reflected by the fact that between 2012 and 2019, HCL pursued both hospitality and entertainment despite those offerings being unprofitable, on a full cost absorption basis. The hospitality and entertainment, we find, were provided to enable the profitable gaming to flourish, irrespective of whether or not they were financially independent or profitable.

172. Standing back and having considered the evidence before us holistically, we find that the economic reality is that the floor areas of the Hippodrome allocated for hospitality and entertainment have significant dual use for gaming as well. Most importantly, we find that the hospitality and entertainment areas were significantly used economically for the gaming business. That is, they were used to make all the supplies of the various strands of the business, both taxable supplies (hospitality and entertainment) and the exempt gaming supplies. The residual costs for these areas are also incurred in order to provide the necessary premises and facilities for carrying out the non-taxable strand to HCL's business.

173. We find that HMRC's case on the Dual Use issue is made out.

DISCUSSION AND ANALYSIS: SMO OR STANDARD METHOD

174. Finally, we must determine whether the floorspace SMO proposed by HCL guarantees a more precise determination of the deductible proportion of the input VAT than that arising from the application of the standard turnover-based method.

175. Mr Hitchmough submits that one way to test whether a departure from the standard method is appropriate or required is to adopt the counterfactual analysis applied by Warren J in *St Helen's* at [76] – what would the position have been without any taxable use ([FtT/25, 121ff]).

176. In *St Helen's*, Warren J was not setting out a particular test that can be applied in all cases but was considering the position as it applied to the facts of that case. Where, as here, the evidence all points to 'dual use' we do not accept that the premises are the way they are, because their economic use is for only one particular facet of the business. On an objective assessment of the evidence, a substantial, although not sole, purpose of providing hospitality and entertainment was for the furtherance and use of the gaming. With some taxable supplies of hospitality and entertainment, even if provided on an entirely complimentary or unprofitable basis, the Hippodrome would still be able to operate.

177. Mr Hitchmough has always accepted there is some dual use of the areas making taxable supplies of hospitality and entertainment (although he downplays its significance or the extent). However, he also argues that in the present case the standard method is an entirely unreliable proxy for the economic use by HCL of its overhead expenditure in making taxable supplies. As a result, significant (measurable) deficiencies with an override calculation would have to be identified before the conclusion could be reached that the standard method should prevail. His reasons for this are as follows.

178. He argues that the principal flaw in the standard method (which compares a trader's taxable turnover to its total turnover) is its crude assumption that the economic use of VAT bearing overhead costs in producing £1 of taxable income is identical to the economic use of those costs in producing £1 of exempt income. On the facts found by the FtT, this assumption does not apply to HCL's business. This is demonstrated by the comparison at [103] (endorsed by the findings and conclusion at [126]) of an electronic roulette terminal generating turnover of £400,000 a year from 1.5 square feet with a steak-house restaurant table which needs 1.9 square feet for the table and chairs and a bar, kitchen and point of sale machine taking up a further 115 square metres in order to generate its £50,000 a year.

179. He contends that the standard method does not accurately reflect the economic use of HCL's overhead costs which can also be seen by a comparison of the result of the standard method's recovery rate (between 12% and 22%) and the fact that a third of visits to the Hippodrome do not involve any gaming. Moreover, that figure of a third is not in itself a reliable measure of the use of the Hippodrome's overhead expenditure to make taxable supplies in relation specifically to 'general' areas. In brief, HCL's economic use of its overheads in order to serve the two-thirds of customers whose visit involves some gaming is also to make taxable supplies to those customers. The one-third figure is, rather, a baseline above which the true extent of HCL's economic use to make taxable supplies lies.

180. We do not accept that this means the floorspace SMO is a more precise measure of use than the standard turnover method for the recovery of residual input tax.

181. The burden was on HCL to displace the standard method as being less precise than the SMO and it has not displaced it.

182. In reality, although the Hippodrome had a commercial drive to provide hospitality and entertainment, we have found the core part of HCL's business at the premises is gaming, and the other hospitality and entertainment facilities were also used for it. They significantly supported that core business activity and were used to provide the venue with a luxury environment designed to ensure it remained not only competitive but retained a competitive advantage in the gaming industry.

183. In 2014 the residual costs were summarised by HCL. The five largest items for the business were rent, building maintenance (which includes costs of utilities and air conditioning), cleaning, marketing, and security which amounts to some 73% of the whole. A table relied upon by HCL showed that between 2012 and 2018, 67% to 87% of HCL's fixed costs related to property.

184. Although we accept that gaming is able to generate a higher turnover and profit for each square foot of the premises that it occupies as compared with the restaurants in particular, it does not follow that the proposed floor space method provides a fair and reasonable allocation of such costs, as directly reflecting the use of those costs. As we have explained when addressing dual use, there are plainly costs incurred in respect of the common areas from which no supplies are directly made, or from hospitality and entertainment areas where lesser turnover and profit is made. Such costs are still incurred and are significant 'cost components' of the exempt gaming supplies as part of the dual use conclusion.

185. We accept a SMO can be no more than a method of approximation of estimated or assumed use of, to take the most obvious example, general overheads in making taxable supplies. We also accept that a floor space-based method may, in principle, be more reliable than a turnover method. However, if the floor space method is to displace the standard method, it must be capable of fairly (and more precisely than turnover) reflecting the use made of the premises for the different types of business in the ratio it produces.

186. We have accepted that the SMO is critically flawed as HMRC claim. Whilst the premise of the floorspace SMO was that the gaming business was entirely separate, for the reasons that we have already set out, that was not the economic reality. We find that here, there is substantial dual use such that the residual costs were incurred to facilitate the taxable supplies of hospitality and entertainment and the exempt gaming supplies.

187. The FtT set out the five elements to HCL's floor space SMO Method at [98] of the Decision. The first stage is the allocation for each area of floor space to taxable supplies ('Hospitality' and 'Entertainment'), exempt Gaming supplies, and other areas ('the Allocations'). Stage 2 then reduces the bar and restaurant areas by reference to the proportion

of food and drink provided to customers for free out of all food and drink. Stage 3 then reduces the entertainment areas by a proxy for the use of the theatre for exempt poker tournaments. The resulting ratio between taxable and exempt areas was then 47.4% exempt, 52.6% taxable, which is the recovery percentage applied under the SMO Method to the residual costs.

188. For that year 2014-15, the result under the SMO Method is therefore that HCL would recover 52.6% of its costs in each quarter.

189. Under the standard turnover method for that year, HCL would only be able to recover 13% - 14%.

190. The turnover method does not distort the economic use of the space and the residual costs attributable.

191. We accept HMRC's argument that the floorspace SMO was distortive because it assumed that the unallocated floor area of the premises (which formed the majority of the floor area) was used in the same proportion as the exempt and taxable areas, when this was not the case.

a) By far the largest element of the unallocated areas were the "general" areas, which totalled 2,640m2[14] or over 37% of the entire floor area of the premises in 2014-2015. The large majority of this general area was comprised of customer facing areas[15]; the rest were staff areas.

b) As to the customer areas, the FtT had recorded at [61] the evidence that 70% of customers had come to the Hippodrome for at least some gaming purposes, and its 2018 statutory declaration to the Gambling Commission had estimated that 33% of visits to the Hippodrome did not involve any gambling.

c) As for the (very much smaller) staff areas, the position on the evidence was to similar effect. Correspondence from PWC on behalf of HCL of 31 January 2017 stated "*We consider that it is reasonable to use staff numbers to measure the use of these areas… c.33% of these staff members work in the taxable businesses",* which was roughly the same as under the SMO recovery percentage then being contended for (30-33%, rather than the much higher amounts sought under the final SMO Method).[16] Mr King thought it "must follow" that the use of staff areas was related to the number of staff, [D3/50/2].

d) Therefore. the evidence in respect of these general areas (37% of the whole) was that 33% was used for only taxable businesses. Even accepting that some of the 70% who did gamble may also have used taxable supplies of hospitality and entertainment, that does not mean that the percentage of deductible costs should be added to raise the figure above 33%. Our finding of dual use includes a finding that there was significant economic use of the floorspace allocated to entertainment and hospitality (taxable supplies) also for gaming (non-taxable supplies) but not vice versa. We did not find that there was significant economic use of the areas allocated to gaming also for the purpose of hospitality and entertainment.

192. The floorspace SMO dictates a proportion of 53% taxable use of unallocated areas, which is significantly higher than 33% which would otherwise be allocated. It again points to the floorspace SMO being a less precise measure of the deductible proportion of input tax than the standard turnover method.

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[14] Appendix 1 to the Decision.

[15] See J/221-226: there was significant staff area within the general areas in the basement and on the top floor, but otherwise were almost entirely customer facing.

[16] J/487

193. Even if the burden had been on HMRC to satisfy us that the standard turnover method guarantees a more precise determination of the deductible proportion of the input VAT than the floorspace SMO proposed by HCL, we would have been so satisfied.

194. In addition to the points addressed above, the following reasons support the turnover method providing a fairer, more reasonable and precise determination of the proportion of recoverable input VAT.

195. First, the SMO does not allow for any dual use of floorspace. The standard method does not deny an element of non-taxable gaming use for the taxable supplies made from the hospitality areas but proportionate to the turnover generated. Second, the dual use does not go both ways – there is no evidence that the gaming floorspace significantly drives or is used for the hospitality and entertainment floorspace. Third, the turnover method assumes and allows for overheads that are producing turnover and in proportion to the turnover generated. It can fairly reflect the dual use of the gaming areas by fairly accounting for the premises costs being used to generate turnover – a rational basis for the approximation, having regard to the fact that the business is primarily directed to revenue as the KPI. The example of each square metre of roulette table generating far greater turnover and profit than each square metre of dining space is not invalidated by the turnover method because the costs of the building are enabling each square metre to generate the sales. We have found that a third of customers do not gamble and that is a physical proxy for the economic use but it is not a good proxy for economic use when gambling customers are spending considerably more – floorspace or customer numbers do not more fairly reflect economic use. Fourth, the turnover method allows for fluctuating turnover and fluctuating proportions of taxable and non-taxable supplies (and attributable costs) where the floorspace method does not.

196. In conclusion, we find there was significant economic use of areas allocated to hospitality and/or entertainment for the purposes of gaming supplies, and as Mr Donmall submits, this duality of use means that the floor-based SMO Method is fundamentally flawed. The floorspace SMO proposed by HCL does not guarantee a more precise determination of the economic use and deductible proportion of the input VAT than that arising from the application of the standard turnover method.

197. It follows that we dismiss HCL's appeals against HMRC's decisions to refuse the SMO proposed by HCL.

THE CGS ISSUE

198. One of HCL's appeals[17] also involved an appeal against HMRC's rejection of CGS interval adjustments arising out of capital expenditure on the refurbishment of the Hippodrome, mostly prior to its opening in 2012, for the years 2016/2017, 2017/2018 and 2018/2019.

199. The primary issue in this CGS appeal was essentially the same as in the main appeals, namely whether HCL's Method is to be used in preference to the standard method in the determination of the use of the capital goods in question. Having found for HMRC on that point, there is a further narrow secondary dispute, which is about how the use of the Hippodrome Casino premises for the purposes of business entertainment should be dealt with under the CGS.

200. Part XV of the VAT Regulations provides for adjustments to the deduction of input tax on capital items. In summary, there is an initial apportionment of the input tax on the capital items, but then the ongoing use of those items is monitored (in the case of a building, over 10

[17] TC/2021/01140

years), and adjustments are made to the initial apportionment to reflect any changes in use over that time.

201. Additionally, Article 5(1) of the Value Added Tax (Input Tax) Order 1992 (SI 1992/3222) ('the Input Tax Order') makes provision for expenditure on business entertainment. It provides that:

> *"Tax charged on any goods or services supplied to a taxable person, […], is to be excluded from any credit under section 25 of the Act, where the goods or services in question are used or to be used by the taxable person for the purposes of business entertainment …"*

202. The point between the parties on the CGS issue is this. In respect to the apportionment of the VAT incurred on a capital item, is that VAT first subject to a restriction for use for the purposes of business entertainment, with the residual amount then apportioned under the standard method?

203. HCL contend that there is no prior restriction to exclude use for business entertainment, and the full amount of VAT is apportioned under the standard method alone.

204. Mr Hitchmough submits that the input tax allowable under section 26 of VATA as set out above (that are determined under the provisions of Part XIV of the VAT Regulations) feeds into section 25(2) to provide a credit, to be set against the taxpayer's output tax. However, section 25(2) is "*subject to the provisions of this section*", and in particular to section 25(7) which provides for the vires for the Input Tax Order. It follows that the amount of allowable input tax (ie that attributed to taxable supplies) is further restricted insofar as the goods and services to which that input tax relates have been used or will be used to provide business entertainment.

205. Mr Hitchmough contends that the mandatory order of this approach set out in sections 25-26 VATA determines this part of the appeal in HCL's favour. Following the application of Part XIV of the VAT Regulations, whether under the standard method or another form of calculation, there is no longer any allowable input tax to the extent that that input tax is used for the purposes of exempt activities. The only allowable input tax left is that used for the purposes of taxable activities. It is only to this that the Input Tax Order can apply.

206. In other words, he argues that the taxpayer first determines the amount of input tax which the VAT Regulations provide is allowable. That amount is then checked against the restrictions in section 25 – here, only the business entertainment block might be applicable. Those restrictions reduce the credit to the extent prescribed. That (reduced) credit may then be deducted against output tax due from the taxpayer.

207. We reject these submissions. We agree with Mr Donmall's interpretation as to how Article 5(1) of the Input Tax Order is to be applied. VAT is first subject to a restriction for use for the purposes of business entertainment, with the residual amount then apportioned under the standard method[18]. The statutory apportionment of input tax under Regulation 101(2) is as

[18] The methodology would therefore be that the Total CGS VAT of £9,146,904 is then divided by 10 for the years in question (so £914,690); then an amount is to be blocked corresponding to business entertainment use, calculated as the ratio of the estimated total value of the complimentary food, drink and tickets to all turnover; and then to the residual amount, the difference between the standard method recovery percentage and the baseline initial recovery rate is applied. These two steps generate the total difference between the entitlement to deduction for each interval, and the original basis for deduction.

between input tax used for taxable supplies, and input tax used for exempt supplies. However, input tax used for gratuitous business entertainment is neither.

208. We agree with the hypothetical example Mr Donmall gave that supports this interpretation: £30,000 in VAT is incurred in capital expenditure on a building. That building is used in a particular year for the purposes of making a) taxable supplies of £1,000; b) exempt supplies of £1,000, and c) gratuitously-provided business entertainment valued at £1,000.

209. Under HMRC's approach, of the £30,000 VAT, there would be an initial block of 33% reflecting the amount of free business use. The residual £20,000 would then fall to be apportioned as between taxable and exempt supplies under the standard method, with the result that £10,000 of the VAT would be apportioned to taxable supplies. That outcome is in keeping with the use of the CGS cost for taxable supplies, at 33%.

210. Conversely under HCL's approach, the recovery percentage of the CGS cost would be 50% (£1,000 of taxable turnover / £2,000 of all turnover), so £15,000 would be recovered. That is plainly contrary to its actual use: 50% of its use has *not* been for taxable supplies, only 33% of it was. HCL's approach has the effect of ignoring the use for free business entertainment entirely, and in effect renders the Input Tax Order nugatory in any partial exemption situation.

DISPOSITION

211. For these reasons we allow HMRC's appeal to the Upper Tribunal, set aside the decision of the FtT, and dismiss HCL's underlying appeals against HMRC's decisions.

COSTS

212. Any application for costs in relation to this appeal must be made in writing and served on the Tribunal and the person against whom it is made within one month after the date of release of this decision as required by rule 10(5)(a) and (6) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

JUDGE RUPERT JONES
JUDGE VINESH MANDALIA

Release date:

29 January 2024