Trinity Term
[2019] UKSC 39
On appeal from: [2017] CSIH 77

JUDGMENT

Commissioners for Her Majesty's Revenue and Customs (Appellant) *v* Frank A Smart & Son Ltd (Respondent) (Scotland)

before

Lord Reed, Deputy President
Lord Wilson
Lord Hodge
Lord Briggs
Lady Arden

JUDGMENT GIVEN ON

29 July 2019

Heard on 6 March 2019

Appellant
Kieron Beal QC
Ross Anderson
(Instructed by Office of the Advocate General for Scotland (Edinburgh))

Respondent
David Small

(Instructed by Addleshaw Goddard LLP (Edinburgh))

LORD HODGE: (with whom Lord Reed, Lord Wilson, Lord Briggs and Lady Arden agree)

1. This appeal is concerned with the entitlement of a taxpayer to deduct input VAT and claim repayment of surplus input VAT. It concerns the interpretation of articles 167 and 168(1) of Council Directive (EC) 2006/112/EC of 28 November 2006 on the common system of value added tax ("the Principal VAT Directive" or "the PVD") and the case law of the Court of Justice of the European Union ("CJEU") relating to those articles. In short, the question is whether a taxpayer can deduct as input tax the VAT which it has incurred in purchasing entitlements to an EU farm subsidy, the Single Farm Payment ("SFP"). The taxpayer has used those entitlements to annual subsidies over several years and intends to use money resulting from the receipt of those subsidies to fund its current and future business activities, which currently involve only taxable supplies.

2. The factual background to this appeal involves an interesting business model. Frank A Smart & Son Ltd ("FASL") is a Scottish company which carries on a farming business in Aberdeenshire. FASL is wholly-owned by Mr Frank Smart, who is its sole director. Mr Smart and his wife are the partners in a partnership which owns Tolmauds Farm, a farm of about 200 hectares which the partnership leases to FASL for a rent of £30,000 per year. FASL produces beef cattle and certain crops at Tolmauds Farm. FASL's whole output from its business was and is taxable under the VAT regime.

3. FASL received SFPs from the Scottish Government. SFPs were agricultural subsidies which between 2005 and 2014 were paid to farmers who had eligible land at their disposal on 15 May of each year and who met the requirements of ensuring plant and animal health and maintaining the land in question in "Good Agricultural and Environmental Condition" ("GAEC"). The farmer did not have to cultivate the land or stock it with animals in order to meet the GAEC requirement. When the scheme was initiated in 2005, farmers in the United Kingdom were allocated initial units of entitlement to single farm payments ("SFPEs") for no consideration. The SFPEs were tradeable and a market in them developed over time.

4. FASL took advantage of the market in SFPE units to accumulate a fund for the development of its business. With the assistance of bank funding, it spent about £7.7m between 2007 and 2012 on purchasing 34,477 SFPE units in addition to its initial allocation of 194.98 units for Tolmauds Farm. In this period FASL paid VAT on the SFPE units which it purchased and it has sought to deduct that VAT as input tax. In order to receive the SFPs to which the purchased SFPE units entitled it, FASL

leased a further 35,150 hectares of land under seasonal lets. FASL did not cultivate or stock this land. The leases were typically qualified by an agreement, entered into after the lease, which allowed the landlord to stock the land or cultivate it himself, provided that the ground was kept in GAEC. This was done to preserve FASL's entitlement to SFPs. The rent payable for the seasonal lets was generally about £1 per acre but could be up to £10 per acre.

5. The result of this business model was that between 2010 and 2013 (in each case FASL's financial year ending on 30 September) FASL's income from subsidies, which were principally SFPs, dwarfed its income from cattle sales from Tolmauds Farm. FASL received SFPs of £1,166,290 in 2010, £1,761,205 in 2011, £2,488,949 in 2012 and £3,285,650 in 2013. The parties presented the court with agreed figures derived from the profit and loss accounts of FASL in those financial years:

	2010	2011	2012	2013
Cattle Sales	99,284	48,601	97,530	280,997
Cattle subsidies (incl SFPs)	1,202,908	1,795,589	2,515,057	3,312,597
Costs of Sales	(53,925)	(38,666)	(111,885)	(275,389)
SFP Amortisation	(1,141,159)	(1,766,118)	(1,835,693)	(917,840)
Net Profits	(37,079)	(41,812)	534,910	2,499,085

6. During the years 2010 to 2013, Mr Frank Smart was paid no director's salary or bonus but FASL paid him dividends of £20,000 in each of 2010 and 2012 and of £15,000 in each of 2011 and 2013. None of the SFPs have been withdrawn from FASL's bank account for Mr Smart's personal use or for his benefit.

7. The First-tier Tribunal ("FTT"), to whom FASL appealed against HMRC's refusal to allow it to deduct VAT of £1,054,852.28 in its quarterly VAT returns between December 2008 and June 2012, made important findings of fact (in para 38 of its decision) which have a bearing on the outcome of this appeal. The FTT found that when it purchased the SFPE units, FASL intended to apply the income which it received from the SFPs to pay off its overdraft and to develop its business operations. The SFPs were accumulated in FASL's bank account and have been used to pay off its overdraft. Tolmauds Farm was worked during the relevant period

by Mr Smart and one of his sons, Roderick, on a full-time basis and another son assisted for part of that period. FASL had no other employees. During the relevant period FASL did not increase its stock numbers on the farm significantly. But FASL had been contemplating three principal developments of its business. First, from about 2011, FASL was considering establishing a windfarm. It spent over £119,000 on preliminary investigations, including technical information and costings, on investigating community responses and on a planning application and enquiries. Secondly, other proposed developments have included the construction of further farm buildings, including cattle courts and a Dutch barn. FASL has undertaken site preparation works for an additional cattle court and has made the needed planning applications. Thirdly, FASL has been considering the purchase of neighbouring farms, which were expected to come on to the market for sale.

8. Based on those findings of fact, the FTT concluded (para 39) that the acquisition of the SFPE units was a funding exercise which related to FASL's business overheads in its farming enterprise. FASL had raised finance for its future economic activities as a whole. There was a direct and immediate link between the expenditure and FASL's future taxable supplies. The FTT stated the conclusion based on its findings of primary fact that the funding opportunity afforded by the purchase of the SFPE units did not form a separate business activity of FASL but was "a wholly integrated feature of the farming enterprise" and not a separate enterprise (para 42). The FTT therefore allowed FASL's appeal.

9. HMRC appealed to the Upper Tribunal (Lord Tyre), which confirmed the FTT's findings of fact, which were by then uncontroversial, and refused the appeal, finding that the FTT had not erred in law. HMRC then appealed with the permission of the Upper Tribunal to the Inner House of the Court of Session. An Extra Division of the Inner House (Lord Menzies, Lord Brodie and Lord Drummond Young) in a judgment delivered by Lord Drummond Young dated 8 December 2017 ([2017] CSIH 77) dismissed HMRC's appeal. HMRC now appeals to this court with its permission.

The VAT system

10. Before setting out HMRC's challenge it may be useful to discuss the basic structure of the VAT system so far as relevant. In order to understand the case law, which I will discuss, it is necessary also to set out relevant provisions of the PVD as they show the central importance to the question of deductibility, which arises in this appeal, of the connection between input expenditure and the economic activity which a taxable person is carrying on or intends to carry on.

11. Article 2(1) of the PVD imposes VAT on:

> "(a) the supply of goods for consideration within the territory of a member state by a taxable person acting as such …
>
> (c) the supply of services for consideration within the territory of a member state by a taxable person acting as such; …"

12. Article 9(1) of the PVD defines "taxable person" and "economic activity":

> "1. 'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.
>
> Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity."

13. In the provision of goods or services for consideration there is often a chain of production or supply from raw material to finished product. At its simplest, VAT is a tax on the value added by a supplier of goods to its purchases of raw materials or goods upon sale of the product. The same principle extends to the supply of services. Under the common system of VAT in the United Kingdom and throughout the European Union, the taxation of the value so added by the particular supplier is achieved by calculating the tax due on the output of the supplier at the specified rate ("output tax") and deducting from that sum the VAT which that supplier has paid on the components of that output or on general overheads of the business which are cost components of its taxable outputs ("input tax").

14. The principle is articulated in article 1(2) of the PVD which provides:

> "The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.

> On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components."

15. The mechanism, by which the deductions mentioned in article 1(2) are effected, is set out, so far as relevant, in articles 167 and 168, which provide:

> "Article 167
>
> A right of deduction shall arise at the time the deductible tax becomes chargeable.
>
> Article 168
>
> In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the member state in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:
>
> > (a) the VAT due or paid in that member state in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person …"

16. If a taxable person uses goods and services, on which it has paid VAT, both for its own transactions in respect of which VAT is deductible and for its own transactions in respect of which VAT is not deductible, article 173 provides that only the proportion of the VAT that is attributable to the former transactions may be deducted.

17. The PVD and its predecessor directives have been implemented in the United Kingdom by the Value Added Tax Act 1994, which in section 1(1) charges VAT on the supply of goods and services in the United Kingdom. Section 4 provides:

> "(1) VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.

(2) A taxable supply is a supply of goods or services in the United Kingdom other than an exempt supply."

Sections 24 to 26 implement the regime for deduction of input tax which is now set out in the PVD. Section 24 provides:

"(1) 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 … goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

(2) … '*output tax*', in relation to a taxable person, means VAT on supplies which he makes …

(5) Where goods or services supplied to a taxable person … are used or to be used partly for the purposes of a business carried on or to be carried on by him and partly for other purposes -

(a) VAT on supplies … shall be apportioned so that only so much as is referable to the taxable person's business purposes is counted as that person's input tax …"

18. Section 25(2) empowers the taxable person to take credit at the end of each prescribed accounting period for the input tax which is allowable under section 26 and to deduct that amount from any output tax due from it. The prescribed accounting periods are quarterly. Section 26 provides:

"(1) The amount of input tax on which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for that period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by

> or under regulations as being attributable to supplies within subsection (2) below.
>
> (2) The supplies within this subsection are the following supplies made by the taxable person in the course or furtherance of his business -
>
> (a) taxable supplies …"

19. Accordingly, the VAT legislation provides for the taxable person to make "taxable supplies", the cost components of which may give rise to input tax which is deductible from the output tax due on those taxable supplies. The taxable person may also make "exempt supplies", defined in section 31 and Schedule 9, which do not give rise to a right to deduct input tax. Further, the taxable person may engage in activities which are not "economic activities" under article 9 of the PVD and are outside the scope of the VAT regime. VAT incurred by the taxable person on supplies which are used as components of such non-economic activities are not deductible.

20. With that introduction, I turn to HMRC's challenge.

HMRC's challenge

21. HMRC submit that the Inner House erred in law because, on a proper analysis, FASL acquired the SFPE units to generate the receipt of SFPs, which was a form of investment income outside the scope of VAT. The receipt of the SFPs was a non-economic activity. Input tax incurred in acquiring the SFPE units was not recoverable because there was a direct and immediate link between the expenditure on those units and the receipt of the SFPs. There was no direct and immediate link between the acquisition of the SFPE units and a taxable output transaction by FASL. Secondly, HMRC submit that the Inner House erred in treating the VAT incurred on the purchase of the SFPE units as deductible on the basis that it was a general overhead of FASL's business. This is again because the expenditure was directly and immediately related to the receipt of the SFPs, which was outside the scope of the VAT system. Thirdly, HMRC submit that the FTT, the Upper Tribunal and the Inner House each erred in taking into account an irrelevant consideration, namely the evidence of Mr Smart's intention, as the director of FASL, to use the funds generated by the receipt of the SFPs to fund the development of FASL's business which would involve the making of taxable supplies in future.

22. Mr Kieron Beal QC, who presented the case for HMRC skilfully, makes two central submissions. First, he relies on the judgment of the CJEU in *BLP Group plc v Customs and Excise Comrs* (Case C-4/94) [1996] 1 WLR 174 ("*BLP*") in support of the proposition that VAT which a taxable person has paid on costs incurred directly and immediately in relation to an exempt supply cannot be reclaimed as input VAT even if the outcome of the expenditure is to produce funds which are used or will be used to subsidise the taxable person's downstream taxable activities. Secondly, he submits that there is no reason in fact or law for reaching a different conclusion in relation to costs incurred directly and immediately in relation to a transaction which is outside the scope of VAT. If there is any doubt on this matter, HMRC invite the court to refer a question or questions to the CJEU under article 267 of the Treaty on the Functioning of the European Union ("the TFEU").

FASL's response

23. Mr David Small, advocate, in a succinct and skilful submission, founds on the principle of neutrality: the VAT system gives fully taxable traders, in other words people, such as FASL, who make only taxable supplies, a right to recover all input tax incurred in raising finance for their business so long as (i) the finance which they raise is spent on funding the business which goes on to make further taxable supplies and (ii) the financing exercise itself remains outside the scope of VAT because it does not involve the taxable person in making any taxable or exempt supplies. FASL does not dispute that if it were in the future to use part of the funds, which it has obtained through the receipt of SFPs and kept in its bank account, on downstream activities which were outside the scope of VAT, that use would restrict the input tax to which it had been entitled and might give rise to an obligation to repay a proportionate part of any deduction which it had made or any repayment of VAT which it had received from HMRC. Disagreeing with HMRC, FASL submits that the case law of the CJEU is clear and supports its position.

Discussion

(i) Overview

24. I am persuaded that Mr Small is correct in his submission that FASL is entitled to deduct input VAT incurred in its acquisition of the SFPE units and that the tribunals and the Inner House did not err in law in so concluding. Because the answer to the question lies in an analysis of the jurisprudence of the CJEU in relevant cases, and because HMRC submit that the matter is not acte clair, it is necessary to examine the relevant cases with care.

25. Before turning to the cases about which there is a dispute, it is necessary to set the scene by considering *Mohr v Finanzamt Bad Segeberg* (Case C-215/94) [1996] ECR I-959; [1996] STC 328, in which the CJEU held that an undertaking by a farmer to discontinue milk production, for which he received compensation, did not constitute a supply of services by him to the EC institutions or the competent national authorities with the result that the compensation was not subject to VAT. The CJEU in its judgment (paras 19-23) observed that VAT was a tax on consumption, and that the authorities on payment of compensation obtained no goods or services for their own use from the farmer but acted in the common interest of promoting the proper functioning of the Community's milk market.

26. It is not contested in this appeal that the sales on the market of the SFPE units to FASL were transactions which fell to be treated as taxable supplies. It is also not contested that a farmer's actions to qualify himself to receive SFPs did not amount to the provision of a service to the relevant authorities and that the receipt of SFPs was outside the scope of VAT. The central question in the appeal therefore is whether the receipt of the SFPs, which were transactions outside the scope of VAT, prevented FASL from deducting the VAT which it has paid on the purchase of the SFPE units.

(ii) The disputed case law

27. In *BLP* a management holding company sold shares in a subsidiary company and sought to recover as input tax the VAT which it had paid on invoices for professional services connected to the sale. The share sale was an exempt transaction. But BLP argued that it was entitled to deduct the VAT as input tax because the purpose of the sale was to raise funds to pay off debts which had arisen as a result of its taxable transactions. The legal question turned on the interpretation of the predecessors of articles 1(2), 168 and 173 of the PVD, namely article 2(2) of EC Council Directive 67/227 ("the First Directive") and article 17(2) and (5) of the EC Council Directive 77/388 ("the Sixth Directive") and in particular the words "goods and services are used for the purposes of his taxable transactions" in article 17(2), which remain in article 168 of the PVD (para 15 above). The CJEU held in para 19 of its judgment:

> "The use [in article 17(5)] of the words 'for transactions' shows that to give the right to deduct under [article 17(2)], the goods or services in question must have a direct and immediate link with the taxable transactions, and that the ultimate aim pursued by the taxable person is irrelevant in that respect."

The CJEU went on to point out that the Sixth Directive provided a right to deduct VAT on goods and services used for exempt transactions only by way of exception. It recognised (para 25) that if BLP had taken out a bank loan, instead of selling shares, it would have been able to deduct VAT on accountants' professional services required for that purpose because the costs of those services would form part of the company's overheads and hence of the cost components of its products. Thus it held (in para 28):

> "article 2 of the First Directive and article 17 of the Sixth Directive are to be interpreted as meaning that, except in the cases expressly provided for by those Directives, where a taxable person supplies services to another taxable person who uses them for an exempt transaction, the latter person is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction."

28. It is clear that this ruling in terms relates only to the use of services on exempt transactions. But as HMRC set great store by this case and submit that its reasoning extends to services used on a form of fund-raising which is outside the scope of VAT, it is necessary also to cite para 24 of the CJEU's judgment in *BLP*, which suggests that policy considerations might point to a wider exclusion of the right to deduct:

> "Moreover, if BLP's interpretation were accepted, the authorities, when confronted with supplies which, as in the present case, are not objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT system's objectives of ensuring certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question."

In *BLP*, the objective character of the transactions was that the services were used for an exempt transaction, namely the sale of shares in a subsidiary by a holding management company. When addressing the subsequent case law of the CJEU I will have to consider how, when a taxable person legitimately claims that costs of services are part of its overheads, the tax authorities are to ascertain that those costs are eventually cost components of its products or activities in taxable transactions.

29. In *Midland Bank plc v Customs and Excise Comrs* (Case C-98/98) [2000] 1 WLR 2080, the bank was the representative member of a group of companies, one

of which, Samuel Montagu & Co Ltd, provided taxable services to one of its clients in relation to a proposed corporate takeover and engaged a firm of solicitors to provide legal services in that connection. To simplify matters I will present Samuel Montagu & Co Ltd as the bank because the group was treated as a single person for the purposes of VAT. In a dispute in relation to the proposed takeover, the bank was sued for damages for negligence and the bank engaged the same firm of solicitors to represent it in the legal proceedings. The bank then sought to deduct as input tax the whole of the VAT which it paid in respect of its legal fees on the ground that it was to be attributed to its taxable supplies to its client in the takeover. The Customs and Excise Commissioners ("CEC") argued that the VAT incurred on the legal fees relating to the claim for damages was attributable to the bank's business generally and, as the bank made both taxable and exempt supplies, fell to be apportioned in accordance with article 17(5) of the Sixth Directive (now article 173 of the PVD). The dispute gave rise to questions (i) whether there needed to be a direct and immediate link between a particular input transaction and particular output transactions in order to entitle the taxable person to deduct VAT as input tax and (ii) if so, what was the nature of that link. In relation to the first question the CJEU applied *BLP* but (in paras 22 and 23) confirmed, as an exception to the rule in *BLP*, that:

> "entitlement to deduct, once it has arisen, is retained even if the economic activity envisaged does not give rise to taxed transactions or the taxable person has been unable to use the goods or services which gave rise to the deduction in the context of taxable transactions by reason of circumstances beyond his control."

In support of that exception it cited *Intercommunale voor Zeewaterontzilting (INZO) v Belgian State* (Case C-110/94) [1996] ECR I-857, paras 20 and 21 and *Belgian State v Ghent Coal Terminal NV* (Case C-37/95) [1998] ECR I-1, para 24. It held (in para 24 and dispositif (1) of its judgment) that:

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

In relation to the second question the CJEU declined to define what amounted to a direct and immediate link because of the diversity of professional and commercial transactions and left it to national courts to apply the test to the facts of the individual case. But it stated (para 33 and dispositif 2) that a taxable person which carries out taxable and non-taxable transactions could deduct the entirety of VAT as input tax

only if it could show by objective evidence that the expenditure involved in the acquisition of the services was part of the various cost components of the taxable output transaction.

30. In *Abbey National plc v Customs and Excise Comrs* (Case C-408/98) [2001] 1 WLR 769, a life assurance company, Scottish Mutual Assurance plc ("SM"), in addition to its life assurance business, carried on business leasing premises for professional and commercial use. SM opted to charge VAT on the rent received from its commercial tenants. SM later sold a property in Aberdeen to a third party in a transaction which CEC, in accordance with domestic legislation, treated as a transfer as a going concern so that no supply of goods or services had taken place. As a result, the transfer was not a taxable transaction. SM sought to deduct as input tax the whole of the VAT which it had paid on professional services relating to the sale, while CEC took the view that only part of the tax was deductible and sought to apportion the VAT in accordance with article 17(5) of the Sixth Directive. The case is important because, like the present appeal, it concerns a claim to deduct as input tax VAT incurred on a transaction outside the scope of VAT.

31. In his opinion Advocate General Jacobs contrasted the CJEU's approach in *BLP* in relation to an exempt transaction with other case law which recognised a right to deduct as input tax VAT incurred as part of the overheads of a taxable person's business. In his view, what mattered was whether the taxed supply was a cost component of a taxable output, and not whether the most closely-linked transaction was itself taxable. It was inherent in an exempt transaction that it broke the chain between a supply and the taxable person's taxable economic activities. As a result, VAT incurred on supplies used by the taxable person for an exempt transaction could not be deducted from VAT paid on a subsequent output supply by that person (para 35). Where no supply of goods or services had taken place in a transaction outside the scope of VAT, the chain between a supply to the taxable person and that person's subsequent taxable economic activity was not broken. One was required to look beyond the immediate transaction to see whether the supply, in respect of which a claim to deduct VAT was made, formed a cost component of some other taxable transaction, including in the form of general overheads (paras 38, 42 and 46).

32. I will consider below whether Mr Small is correct in his contention that the CJEU has in its later case law adopted the reasoning of the Advocate General. To simplify the later discussion of the case law concerning fund-raising transactions, I will refer to the transaction on which the supply was used, such as the sale of the subsidiary in *BLP*, the transfer of the office in *Abbey National*, and the purchase of SFPEs and the steps taken to obtain the SFPs in this case as "the initial transaction" and, adopting the phrase which Mr Small derived from later CJEU case law, will call the taxable person's subsequent transaction or transactions, of which he asserts the relevant supply is a cost component, as "the downstream transaction". It is,

admittedly, a simplification to speak of "subsequent transactions" because, as the Advocate General recognised, there may not always be such a chronological sequence in economic reality or inherent in the VAT system (para 41). But it is nonetheless the norm.

33. The CJEU in its judgment did not expressly adopt the Advocate General's distinction between the chain-breaking effect of the use of a supply in an initial transaction which is an exempt transaction and the absence of that break in an initial transaction outside the scope of VAT. But the CJEU's reasoning in this case is not only consistent with the Advocate General's approach but also difficult to reconcile with its reasoning in *BLP* unless it was accepting his approach. In particular, the court rejected the principal position of the United Kingdom Government (para 20) that, since the costs incurred to effect the transfer were used for the purposes of an initial transaction which was not taxable, there was no right to deduct the input VAT paid on those costs. The CJEU's reasoning started (para 24) with the principle of neutrality, namely that the deduction system is meant to relieve the taxable person entirely of the burden of the VAT payable or paid in the course of all his economic activities (ie his activities that are themselves subject in principle to VAT paid by the recipient of his goods or services and accounted to the tax authorities by the taxable person). Referring to *BLP* and *Midland Bank*, the CJEU held (para 28) that the right to deduct VAT borne by goods and services presupposed that the expenditure incurred in acquiring them was part of the cost components of taxable output transactions (ie including taxable downstream transactions). The CJEU found no direct and immediate link between the professional services and one or more taxable outputs because it rejected Abbey National's arguments, including that the transfer of the property should be treated as if it were a taxable transaction. But that was not the end of the matter as the CJEU held that the costs of the professional services formed part of the taxable person's overheads and as such were cost components of the products of a business. The services used by SM for the purposes of the transfer thus had a direct and immediate link with the whole economic activity of that taxable person (para 36). As the taxable person effected downstream transactions which were subject to VAT and exempt transactions, it could only deduct (under article 17(5) of the Sixth Directive) the proportion of the VAT which was attributable to the taxable transactions (para 42 and dispositif). The CJEU thus looked through the initial transaction and recognised a right to deduct by reference to such downstream transactions as were economic activities.

34. In *Kretztechnik AG v Finanzamt Linz* (Case C-465/03) [2005] 1 WLR 3755; [2005] ECR I-4357, an Austrian company, which developed and distributed medical equipment, raised capital by a share issue on the Frankfurt Stock Exchange. The Austrian tax authority disallowed a deduction of input tax which Kretztechnik had paid on the supply to it of services linked to the share issue, which the national tax authority treated as exempt from VAT. The company challenged the assessment to tax and this gave rise to questions whether the share issue was within the scope of

VAT and, if not, whether there was a right to deduct input tax on the ground that the services in respect of which the deduction of input tax was claimed were used for the purposes of the company's downstream taxable transactions.

35. As I will show, the CJEU treated the share issue as being outside the scope of VAT and supported the right to deduct the VAT charged on the expenses incurred for the supplies acquired in connection with a share issue.

36. In his opinion Advocate General Jacobs repeated the analysis which he had adopted in his opinion in *Abbey National* (paras 35 and 46). He stated:

> "73. … if a trader uses the services of a broker or valuator when acquiring a commodity, the cost of those services may be said to be directly, immediately and exclusively linked to the acquisition. That does not however determine whether the VAT on the services is deductible. The right to deduct must be determined by the output transactions for the purposes of which the services are used. The transactions in question will usually be the onward supply of the commodity or the goods or services for which it is used or in which it is incorporated. The right to deduct will depend on whether that supply is taxed or not.
>
> 74. Thus, if the transaction with which the input is most closely linked is one which falls entirely outside the scope of VAT because it is in any event not a supply of goods or services, it is irrelevant for the purpose of determining deductibility. What matters is the link, if any, with such output supplies, and whether they are taxed or exempt …
>
> 75. The question to be asked in [Kretztechnik's] case is therefore whether the capital raised by the share issue was used for the purposes of one or more taxed output transactions."

37. The CJEU's judgment on the deductibility of VAT on the services provided to Kretztechnik is wholly consistent with the Advocate General's approach in its disregard for an initial transaction which is outside the scope of the VAT system. The court stated:

> "34. The deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT

> consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT: see, to that effect *Rompelman v Minister van Financiën* (Case C-268/83) [1985] ECR 655 … para 19; *Belgian State v Ghent Coal Terminal NV* … para 15; *Gabalfrisa* [*SL v Agencia Estatal de Administración Tributaria*] (Joined Cases C-110/98 to C-147/98) [2000] ECR I-1577, para 44; the *Midland Bank* case [2000] 1 WLR 2080, 2097-2098, para 19, and the *Abbey National* case [2001] 1 WLR 769, 785, para 24.
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> 35. It is clear from the last-mentioned condition that, for VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions giving rise to a right of deduction. Thus, the right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct (see the *Midland Bank* case, para 30, and the *Abbey National* case, para 28, and also *Cibo Participations SA v Directeur regional des impôts du Nord-Pas-de-Calais* (Case C-16/00) [2001] ECR I-6663, para 31).
>
> 36. In this case, regard being had to the fact that, first, a share issue is an operation not falling within the scope of the Sixth Directive and, second, that operation was carried out by [Kretztechnik] in order to increase its capital for the benefit of its economic activity in general, it must be considered that the costs of the supplies acquired by that company in connection with the operation concerned form part of its overheads and are therefore, as such, component parts of the price of its products. Those supplies have a direct and immediate link with the whole economic activity of the taxable person (see the *BLP Group* case … para 25; the *Midland Bank* case, para 31; the *Abbey National* case, paras 35 and 36, and the *Cibo Participations* case, para 33)."

38. The CJEU, disregarding the share issue itself, held that article 17(1) and (2) of the Sixth Directive conferred the right to deduct in its entirety the VAT charged on the expenses incurred by a taxable person for the various supplies acquired by him in connection with a share issue, provided that all the transactions undertaken by the taxable person in the context of his economic activity constitute taxed transactions (para 38 and dispositif 2).

39. The next relevant case in chronological sequence was *Investrand BV v Staatssecretaris van Financiën* (Case C-435/05) [2007] ECR I-1315 which concerned the sale by a company in 1989 of a substantial shareholding in another company ("company A"). The CJEU decided the case without the assistance of an opinion from the Advocate General and followed its decisions in *Midland Bank*, *Abbey National* and *Kretztechnik*. The sale of the shares was treated as an activity outside the scope of VAT and the central question was whether the relevant costs were overheads related to the taxpayer company's economic activity as a whole (para 24). It is nonetheless of interest because in my view it casts light on later judgments of the CJEU and I will return to the case in this judgment. The consideration for the 1989 sale was a fixed sum and a further sum which depended upon the profits earned by company A between 1989 and 1992. At the time of the sale and until 1 January 1993 the taxpayer company was a passive holding company which took no part in the management of the companies in which it invested. From 1 January 1993 the taxpayer company provided management services to company A. A dispute arose between the taxpayer company and the purchaser of company A over the calculation of the sum due by reference to company A's profits. The taxpayer company incurred professional costs in an arbitration on that matter and sought to deduct the VAT which it paid on those costs in the financial year 1996, which was at a time that it was carrying on economic activity. The CJEU rejected the taxpayer's claim in essence because the taxpayer company would have incurred the professional costs whether or not it had commenced economic activity after 1 January 1993 (paras 32-33). It distinguished *Kretztechnik* on the basis that in that case the costs were incurred in relation to a share issue intended to increase the taxable person's capital for the benefit of its economic activity (paras 35-37). Accordingly, the CJEU held (para 38 and dispositif):

> "… the costs for advisory services which a taxable person obtains with a view to establishing the amount of a claim forming part of his company's assets and relating to a sale of shares prior to his becoming liable to VAT do not, in the absence of evidence establishing that the exclusive reason for those services is to be found in the economic activity, within the meaning of [the Sixth] Directive, carried out by the taxable person, have a direct and immediate link with that activity and, consequently, do not give rise to a right to deduct the VAT charged on them."

In other words, the VAT on inputs which were incurred in relation to a company's non-economic activity and which had no link to its subsequent economic activities would not be deductible.

40. The CJEU returned to the issue of deductibility of VAT in the context of fund-raising by a taxable person in *Securenta Göttinger Immobilienanlagen und*

Vermögensmanagement AG v Finanzamt Göttingen (Case C-437/06) [2008] ECR I-4177; [2008] STC 3473. In this case the taxpayer company, Securenta, carried out both economic and non-economic activities. It acquired capital for its business by the issue of shares and atypical silent partnerships and sought to deduct the input tax which it had paid for services relating to its raising of capital in this way. A dispute about the extent of its entitlement to deduct resulted in a reference to the CJEU. The relevant question, as reformulated by the court, was how the right to deduct input tax was to be determined in the case of a taxpayer who carries out both economic and non-economic activities. The CJEU observed (para 26) that Securenta carried on three downstream activities, namely (i) non-economic activities outside the scope of VAT, (ii) economic activities which were within the scope of the Sixth Directive but were exempt and (iii) taxed economic activities. The court repeated its ruling (in *Abbey National* para 28 and other cited cases) that in order for the input VAT to give rise to a right to deduct the expenditure incurred on the fund-raising must be a component of the cost of the output transactions that gave rise to the right to deduct (para 27). If Securenta's downstream activities had been solely economic activities, the supplies of services would have had a direct and immediate link with those economic activities, but part of Securenta's downstream activities were non-economic (para 29). The CJEU therefore held (para 31 and dispositif 1):

> "… where a taxpayer simultaneously carries out economic activities, taxed or exempt, and non-economic activities outside the scope of the Sixth Directive, deduction of the VAT relating to expenditure connected with the issue of shares and atypical silent partnerships is allowed only to the extent that that expenditure is attributable to the taxpayer's economic activity within the meaning of article 2(1) of that Directive."

41. More recently, the CJEU has called into question its ruling in *BLP* in the light of its developing jurisprudence attributing input expenditure on the raising of capital to the general overheads of an undertaking. In *Skatteverket v AB SKF* (Case C-29/08) [2009] ECR I-10413; [2010] STC 419 (*"SKF"*), the parent company which managed an industrial group proposed to sell a wholly-owned subsidiary and a minority stake in another company, which had formerly been a wholly-owned subsidiary, to obtain funds to finance other activities of the group. It proposed to engage professional services in the sale and sought a ruling from the Swedish Revenue Law Commission on whether it would be entitled to deduct input VAT paid on those services. The tax authority challenged the affirmative answer given by the Commission and the Swedish Court made a reference to the CJEU.

42. In his opinion, Advocate General Mengozzi endorsed the distinction which Advocate General Jacobs made in *Abbey National* between the chain-breaking effect of an exempt transaction and the absence of such an effect where the fund-raising transaction is outside the scope of VAT (paras 69 and 79). He opined (para 89(3))

that where the taxable person acquires supplies of services in order to carry out a share disposal which is an exempt transaction, he does not have the right to deduct input VAT on those services, even when the disposal of shares is a transaction which contributes to the restructuring of the taxable person's industrial activities.

43. The CJEU disagreed with his conclusion in relation to an exempt transaction involving a sale of shares in circumstances which were analogous to the facts of the case and held (para 73) that there was a right to deduct input VAT paid on services acquired for the purposes of a disposal of shares "if there is a direct and immediate link between the costs associated with the input services and the overall economic activities of the taxable person". It held that the referring court should take account of all the circumstances surrounding the transactions to determine whether the costs incurred were likely to be incorporated in the price of the shares sold or whether they were among only the cost components of transactions within the scope of the taxable person's economic activities.

44. The CJEU's reasoning, based on prior case law, on the way to this conclusion is instructive. It reasoned:

> i) The right of deduction is an integral part of the VAT scheme and is necessary to achieve neutrality of taxation of all economic activities (paras 55-56);
>
> ii) In principle there needs to be a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to an entitlement to deduct before a taxable person is entitled to deduct input VAT to determine the extent of that entitlement: the expenditure incurred in acquiring the supplies must be a component of the cost of the output transactions that gave rise to the right to deduct (para 57);
>
> iii) But, absent that link between an input transaction and specific output transactions, the taxable person has a right to deduct where the costs of the services in question are part of his general costs and, as such, components of the price of the goods or services which he supplies, there thus being a direct and immediate link between the costs and the person's economic activity as a whole (para 58);
>
> iv) On the other hand, where the taxable person acquires goods or services and uses them for the purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted (para 59).

45. The CJEU stated (para 60):

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

46. Applying this reasoning to the circumstances of SKF's proposed transaction, the CJEU advised that the referring court would have to ascertain whether the costs incurred were likely to be incorporated in the price of the shares which SFK intended to sell or whether they were only among the cost components of SKF's products (para 62). It referred to the cases which I have discussed (*Midland Bank*, *Abbey National*, *Kretztechnik* and *Securenta*), acknowledging that they concerned financial output transactions which were outside the scope of VAT. But it went on to observe that the main difference between an exempt share sale and a share sale which was outside the scope of VAT was whether the taxable company was or was not involved in the management of the companies whose shares were being sold. There was therefore a risk of infringement of the principle of fiscal neutrality through treating objectively similar transactions differently for tax purposes. It held (para 68) that if the costs relating to the disposals of shareholdings are considered to form part of a taxable person's general costs in cases where the disposal itself is outside the scope of VAT, the same tax treatment must be allowed where the disposal is classified as an exempt transaction. In my view it is implicit in the CJEU's reasoning that it accepted the distinction which Advocate General Jacobs made in his opinions in *Abbey National* and *Kretztechnik* but recognised the need to modify the result for the purpose of VAT of an exempt initial transaction in order to avoid discriminatory fiscal treatment.

47. It is important to consider further the statement in para 59 of the judgment, summarised in para 44(iv) above. It was that in contrast to the circumstance where the costs of services are part of a taxable person's general costs and components of the price of the goods and services which he supplies (para 58).

> "… where goods and services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted …" (para 59)

In order to be consistent with the CJEU's reasoning outlined above, that statement, when applied in the context of a fund-raising transaction such as a sale of shares, must be a reference to the downstream transactions of which the input costs form a cost component, and not the initial fundraising transaction, unless the cost of the inputs was a component of the price of the shares in the initial transaction.

48. It is also noteworthy that the cases to which the CJEU referred in para 59 of its judgment as vouching its proposition of law did not involve an initial fund-raising transaction and a downstream transaction. *Proceedings brought by Uudenkaupungin kaupunki* (Case C-184/04) [2006] ECR I-3039; [2008] STC 2329 concerned the costs of a building which was initially used in a non-taxable activity but later was used in a taxable activity. The relevant questions concerned the meaning of article 20 of the Sixth Directive and, in particular, whether during the adjustment period for which it provided the taxable person could seek to deduct input tax, when there was no entitlement to deduct at the outset. In *Hausgemeinschaft Jörg und Stephanie Wollny v Finanzamt Landshut* (Case C-72/05) [2006] ECR I-8297; [2008] STC 1617, a household business had constructed a building as a business asset and made private use of rooms within the building. The business had deducted as input tax the VAT it had paid on its construction and the dispute with the German tax authorities was over the mechanism for calculating the liability to VAT for the private use under articles 6(2)(a) and 11A(1)(c) of the Sixth Directive. *Vereniging Noordelijke Land- en Tuinbouw Organisatie v Staatssecretaris van Financiën* (Case C-515/07) [2009] ECR I-839; [2009] STC 935 concerned an organisation which promoted the interest of the agricultural sector, a non-taxable activity, and provided taxable services to its members. The case concerned the extent to which VAT relating to the goods and services which the organisation acquired could be deducted from the VAT which it paid on its taxable services.

49. In my view, it is clear that in *SFK* the CJEU has not extended the reasoning of *BLP* to apply it to fund-raising transactions which are outside the scope of VAT. On the contrary, in order to avoid discriminatory treatment of taxable persons, it has extended the reasoning in the cases about share disposals that are outside the scope of VAT to share disposals which are exempt, by requiring an examination as to whether the costs associated with the input services are incorporated in the price of the shares sold in the initial transaction or in the prices of the taxable person's products in downstream transactions. If the latter, the costs would be "among only the cost components of transactions within the scope of the taxable person's economic activities".

50. The next case which I have to consider is also important because it vouches the direct and immediate link between an input incurred in the context of an initial transaction, which is not an economic activity, and the taxable person's general economic activity in downstream transactions. It also confirms the CJEU's approach to that link where there is a significant time lapse between the input transaction and the downstream activity. In *"Sveda" UAB v VMI* (Case C-126/14) EU:C:2015:712; [2016] STC 447, a Lithuanian company, Sveda, entered into an agreement with the Lithuanian Ministry of Agriculture in which it undertook to construct a Baltic mythology recreational and discovery path and to offer it to the public free of charge. The Ministry undertook to pay 90% of the construction costs and Sveda was to pay the balance. Sveda undertook to provide the path to the public free of charge for five years. Sveda sought to deduct as input tax VAT which it paid on the acquisition or production of capital goods for the construction of the path. The Lithuanian tax authorities refused to allow the deduction and Sveda appealed that decision. On appeal the Supreme Administrative Court found that Sveda intended to carry out economic activities in the future as it would sell food or souvenirs to visitors to the recreational path. It referred to the CJEU the question (as re-formulated by the CJEU) whether article 168 of the PVD must be interpreted as granting a taxable person the right to deduct input VAT paid for the production or acquisition of capital goods, for the purposes of a planned economic activity related to rural and recreational tourism, which (i) are directly intended for use by the public free of charge, and (ii) may be a means of carrying out taxed transactions.

51. The CJEU answered the question in the affirmative, "provided that a direct and immediate link is established between the expenses associated with the input transactions and an output transaction or transactions giving rise to the right to deduct or with the taxable person's economic activity as a whole" and stated that this was a matter for the referring court to determine on the basis of objective evidence (para 37 and dispositif). In reaching this conclusion, the CJEU stated (para 19) that a taxable person may be acting for the purposes of an economic activity within the meaning of article 9(1) of the PVD when it acquires goods for the purposes of an economic activity even if the goods are not used immediately for that economic activity. If the taxable person is so acting, the right to deduct arises immediately when the goods or services are delivered (para 20), but their use in an economic activity may occur some time later. The CJEU continued (para 21):

> "Whether a taxable person acts as such for the purposes of an economic activity is a question of fact which must be assessed in the light of all the circumstances of the case, including the nature of the asset concerned and the period between the acquisition of the asset and its use for the purposes of the taxable person's economic activity (see inter alia, to that effect, the judgment in *Klub OOD v Direktor na Direktsia 'Obzhalvane I upravlenie na izpalnenieto' - Varna pri*

> *Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-153/11), paras 40 and 41 and the case law cited). It is for the referring court to make that assessment."

52. The CJEU held that the court has to determine whether there is a direct and immediate link between the particular input transaction and either (i) a particular output transaction or transactions, or (ii) the taxable person's economic activity as a whole because the expenditure incurred on the input transaction is part of its general costs and as such is a component of the price of the goods or services which it supplies in a downstream transaction. In so doing, the court must consider all the circumstances and take account only of transactions that are objectively linked to the taxable person's economic activity (paras 27-29). See also *Finanzamt Köln-Nord v Becker* (Case C-104/12) EU:C:2013:99 (21 February 2013, unreported), paras 22, 23, 33 and 35.

53. The CJEU (para 23) concluded from the Lithuanian court's findings of fact that Sveda acquired or produced capital goods for the recreational path

> "with the intention, confirmed by objective evidence, of carrying out an economic activity and did, consequently, act as a taxable person within the meaning of article 9(1) of the Directive."

It also recorded (para 30) the finding of fact by the Lithuanian court that Sveda's expenditure incurred on the construction of the recreational path would come partly within the price of the goods and services which it would provide in the context of its planned economic activity. The CJEU went on to comment on the doubts of the referring court whether there was a direct link between the input transactions and the planned economic activity as a whole because the path was intended to be used by the public free of charge. It stated:

> "32. In that regard, the case law of the court makes it clear that, where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted (judgment in *Eon Aset Menidjmunt OOD v Direktor na Direktsia 'Obzhalvane I upravlenie na izpalnenieto' - Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-118/11) EU:C:2012:97, para 44 and the case law cited). In both cases, the direct and immediate link between the input expenditure

> incurred and the economic activities subsequently carried out by the taxable person is severed.
>
> 33. First, in no way does it follow from the order for reference that the making available of the recreational path to the public is covered by any exemption under the VAT Directive. Second, given that the expenditure incurred by Sveda in creating that path can be linked, as is apparent from para 23 of this judgment, to the economic activity planned by the taxable person, that expenditure does not relate to activities that are outside the scope of VAT.
>
> 34. Therefore, immediate use of capital goods free of charge does not, in circumstances such as those in the main proceedings, affect the existence of the direct and immediate link between input and output transactions or with the taxable person's economic activities as a whole and, consequently, that use has no effect on whether a right to deduct VAT exists.
>
> 35. Thus, there does appear to be a direct and immediate link between the expenditure incurred by Sveda and its planned economic activity as a whole, which is, however, a matter for the referring court to determine."

I observe that in para 32 the CJEU repeated the interpretation, which it gave in *SKF* at para 59, which I have discussed in paras 47 and 48 above and to which I return below.

54. The CJEU also recognised that a taxable person having obtained a deduction might later use the goods or services acquired in the input transaction for purposes other than its economic activity. If that were shown to have occurred, the taxable person would have to repay the relevant input VAT to the tax authorities (para 36).

55. The final case which I must consider is *Direktor na Direktsia "Obzhalvane i danacho-osiguritelna praktica" - Sofia v "Iberdrola Inmobiliaria Real Estate Investments" EOOD* (Case C-132/16) EU:C:2017:683; [2017] BVC 39 ("*Iberdrola*"). In this case the property developer, Iberdrola, which wished to construct 300 apartments in a holiday village, entered into an undertaking with the municipality to reconstruct a wastewater pump station, which the municipality owned, to serve both its proposed development and the wider holiday village. Without that reconstruction, Iberdrola would not have been able to connect its

development to the pump station. A dispute arose with the Bulgarian tax authorities as to whether Iberdrola could deduct as input tax the VAT which it incurred on paying a third party construction company for the works on the pump station.

56. The CJEU held that a taxable person has the right to deduct input VAT in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and when those services are used both by the taxable person and the third party in the context of their economic activity, in so far as those services do not exceed that which is necessary to allow that taxable person to carry out the taxable output transactions and where their costs are included in the price of those transactions (para 40 and dispositif). In so holding, the CJEU followed its reasoning in *SKF* and *Sveda* in recognising that there could be a direct and immediate link between an input and either (i) particular output transactions or (ii) the taxable person's economic activity as a whole. This link would exist if the cost of the input was in the first case a cost component of the particular transactions and in the second case if it was a cost component of the price of goods and services which it supplies (paras 27-32).

57. In this review of the CJEU's case law I have sought to set out the development of the jurisprudence and have focussed attention on the proposition recorded in *SKF* (para 59) and *Sveda* (para 32) that where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted. This is because Mr Beal invites the court to make a reference to the CJEU under article 267 of the TFEU if it disagrees with his submission which I have recorded in paras 21 and 22 above.

58. He supports that invitation by referring to the judgment of the Court of Appeal of England and Wales in *Revenue and Customs Comrs v Chancellor, Masters and Scholars of the University of Cambridge* [2018] EWCA Civ 568; [2018] STC 848, in which the court decided to make a reference to the CJEU because it concluded that the correct approach to be taken to the issue of attribution in that case was not acte clair.

59. I am satisfied that there is no need for a reference in the present appeal. This is because, as I will seek to show, there are findings of fact that entitled the FTT to conclude that FASL when it acquired the SPFEs was acting as a taxable person because of its aim of accumulating sums to develop its taxable business through capital expenditure on assets which it would use to generate taxable output transactions.

60. The statements in para 59 of *SKF* and para 32 of *Sveda* are wholly consistent with the principle of the neutrality of VAT enshrined in article 2(2) of the PVD. Thus in *Investrand*, which I discussed in para 39 above, the expenditure on the arbitration related to a financial claim arising out of a transaction carried out while Investrand was not a taxable person and the fact that the costs relating to the arbitration were incurred after it had become a taxable person was irrelevant because the expenditure had no connection with Investrand's activities as a taxable person. Similarly, on the facts in *Uudenkaupungin kaupunki* (para 48 above), absent the arrangements under article 20 of the Sixth Directive, the intention to use and initial use of the building for a non-taxable activity would have prevented the recovery as input tax of VAT incurred on its construction notwithstanding the later decision to use it for a taxable activity because when the costs were incurred they were not incurred by a taxable person acting as such. Similarly, in *Wellcome Trust Ltd v Customs and Excise Comrs* (Case C-155/94) [1996] ECR I-3013; [1996] STC 945, it was because the purchase and sale of shares by a charitable trust was not an economic activity that the VAT paid on the fees for professional services relating to those transactions were not recoverable; there was no downstream economic activity to which the costs could be linked.

61. Since the hearing in this appeal and the preparation of this judgment in draft, the Eighth Chamber of the CJEU has issued its judgment on the Court of Appeal's reference in the *University of Cambridge* case on 3 July 2019 (Case C-316/18) EU:C:2019:559. As the CJEU records (para 9) the university is a not-for-profit educational institution whose principal activity is the provision of educational services, which are VAT exempt, but which also makes taxable supplies including commercial research, the sale of publications, etc. The university's activities are financed in part by charitable donations and endowments, which it places in a fund and invests. The university has claimed a right to deduct input VAT relating to fees which it has paid to third party managers of the fund on the basis that the income generated by the fund has been used to finance the whole range of its activities.

62. The CJEU (para 19) interpreted the questions of the Court of Appeal in the reference as asking, in essence:

> "whether article 168(a) of the VAT Directive must be interpreted as meaning that a taxable person that (i) is carrying out both taxable and exempt activities, (ii) invests the donations and endowments that it receives by placing them in a fund, and (iii) uses the income generated by that fund to cover the costs of all of those activities is entitled to deduct, as an overhead, input VAT paid in respect of the costs associated with that investment."

63. The CJEU answered that question in the negative. Its reasoning is as follows. First, the collection of donations and endowments is not an economic activity and is outside the scope of the PVD. VAT paid in respect of costs incurred in connection with such collection is not deductible, regardless of the reason for the receipt (para 29). Secondly, the activity of collection and the activity of the investment of the collected funds are treated for VAT purposes as one non-economic activity as the investment is merely a direct continuation of the non-economic activity of collection. Accordingly, input VAT paid in respect of costs associated with the investment is also non-deductible (para 30). Thirdly, and in my view critically, the CJEU distinguished the case on its facts from the line of authority which I have discussed and of which *Kretztechnik* is a part. It stated (para 31):

> "It is true that the fact that costs are incurred in the acquisition of a service in the context of a non-economic activity does not, in itself, preclude those costs giving rise to a right to deduct in the context of the taxable person's economic activity, if they are incorporated into the price of particular output transactions or into the price of goods and services provided by the taxable person in the context of that economic activity (see, to that effect, judgment of 26 May 2005, *Kretztechnik*, C-465/03, EU:C:2005:320, para 36)."

But, referring to the documents before the court, it concluded that the costs of management of the funds were not incorporated into the price of a particular output transaction. It also concluded, by reference to those documents, that the costs were incurred to generate resources to finance all of the university's output transactions, thereby allowing the price of its goods and services to be reduced. The costs therefore were not components of the price of goods and services provided by the university and could not form part of its overheads. The VAT therefore was not deductible (para 32).

64. In my view, the ruling that the income was used to reduce all of the costs of the university's goods and services prevented the fund managers' fees from being a component of the costs of those goods and services and thus part of the university's overheads, which is the second alternative in *Kretztechnik*. The *University of Cambridge* judgment, which the CJEU has delivered without requiring an opinion from an Advocate General, is therefore an application of established CJEU jurisprudence which I have discussed above and summarise below.

(iii) Summary of the case law

65. I derive the following propositions which are relevant to this appeal from the case law:

i) As VAT is a tax on the value added by the taxable person, the VAT system relieves the taxable person of the burden of VAT payable or paid in the course of that person's economic activity and thus avoids double taxation. This is the principle of deduction set out in article 1(2) and operated in article 168 of the PVD and vouched, for example, in *Rompelman v Minister van Financien* (Case C-268/83) [1985] ECR 655, para 19; *Abbey National*, para 24; *Kretztechnik*, para 34 and *SKF*, paras 55-56.

ii) There must be a direct and immediate link between the goods and services which the taxable person has acquired (in other words the particular input transaction) and the taxable supplies which that person makes (in other words its particular output transaction or transactions). This link gives rise to the right to deduct. The needed link exists if the acquired goods and services are part of the cost components of that person's taxable transactions which utilise those goods and services: see for example *Midland Bank*, paras 24 and 30; *Abbey National*, para 28; *Kretztechnik*, para 35; *Securenta*, para 27; *SFK*, para 57 and *HMRC v University of Cambridge*, para 31.

iii) Alternatively, there must be a direct and immediate link between those acquired goods and services and the whole of the taxable person's economic activity because their cost forms part of that business's overheads and thus a component part of the price of its products: see for example *BLP*, para 25; *Midland Bank*, para 31; *Abbey National*, paras 35 and 36; *Kretztechnik*, para 36; *SKF*, para 58 and *HMRC v University of Cambridge*, para 31.

iv) Where the taxable person acquires professional services for an initial fund-raising transaction which is outside the scope of VAT, that use of the services does not prevent it from deducting the VAT payable on those services as input tax and retaining that deduction if its purpose in fund-raising, objectively ascertained, was to fund its economic activity and it later uses the funds raised to develop its business of providing taxable supplies. See, for example, *Abbey National*, paras 34-36; *Kretztechnik*, paras 36-38; *Securenta*, paras 27-29 and *SKF*, para 64. The same may apply if an analogous transaction involving the sale of shares is classified as an exempt transaction: *SKF*, para 68.

v) Where the cost of the acquired services, including services relating to fund-raising, are a cost component of downstream activities of the taxable person which are either exempt transactions or transactions outside the scope of VAT, the VAT paid on such services is not deductible as input tax. See for example *Securenta*, paras 29 and 31; *SKF*, paras 58-60 and *Sveda*, para 32. Where the taxable person carries on taxable transactions, exempt transactions and transactions outside the scope of VAT, the VAT paid on the services it has acquired has to be apportioned under article 173 of the PVD.

vi) The right to deduct VAT as input tax arises immediately when the deductible tax becomes chargeable: article 167 of the PVD, *Securenta*, paras 24 and 30 and *SKF*, para 55. As a result, there may be a time lapse between the deduction of the input tax and the use of the acquired goods or services in an output transaction, as occurred in *Sveda*. Further, if the taxable person acquired the goods and services for its economic activity but, as a result of circumstances beyond its control, it is unable to use them in the context of taxable transactions, the taxable person retains its entitlement to deduct: *Midland Bank*, paras 22 and 23.

vii) The purpose of the taxable person in carrying out the fund-raising is a question of fact which the court determines by having regard to objective evidence. The CJEU states that the existence of a link between the fund-raising transaction and the person's taxable activity is to be assessed in the light of the objective content of the transaction: *Sveda*, para 29; *Iberdrola*, para 31. The ultimate question is whether the taxable person is acting as such for the purposes of an economic activity. This is a question of fact which must be assessed in the light of all the circumstances of the case, including the nature of the asset concerned and the period between its acquisition and its use for the purposes of the taxable person's economic activity: *Eon Aset Menidjmunt OOD v Direktor na Direktsia "Obzhalvane I upravlenie na izpalnenieto" - Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-118/11) EU:C:2012:97; [2012] STC 982, para 58; *Klub OOD v Direktor na Direktsia "Obzhalvane I upravlenie na izpalnenieto" - Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-153/11) EU:C:2012:163; [2012] STC 1129, paras 40-41 and *Sveda*, para 21.

Application to the facts of this case

66. I have set out the factual background in paras 2-7 above. There was objective evidence that FASL when carrying out its fund-raising activity was carrying out a taxable business and was contemplating using the funds raised on three principal

developments - a windfarm, the construction of further farm buildings and the acquisition of neighbouring farmland.

67. I do not detect in the jurisprudence of the CJEU any basis for distinguishing expenditure incurred in a fund-raising exercise which takes the form of a sale of shares from a fund-raising exercise that involves the receipt of a subsidy over several years. The fact that the subsidies were included in FASL's profit and loss account and counted as the business's income for income tax purposes is not a basis for distinguishing the share sale cases such as *Kretztechnik* and *Securenta*. I do not view the annual payment of the subsidies under the SFP scheme as a separate transaction from the acquisition of the entitlement to those subsidies which is capable of breaking the link between the purchase of the SFPE units and the deployment of the net proceeds of the subsidies in FASL's subsequent economic activities. In any event the FTT was not bound to hold that the acquisition of the SFPE units and the receipt of the subsidies were separate transactions. On the FTT's findings of fact, the purchase of the SFPE units was part of an exercise raising funds for FASL's economic activities. The underlying principle is the principle of neutrality which relieves the taxable person of the burden of VAT payable and paid in the course of all its economic activities: *Rompelman*, para 19; *Belgian State v Ghent Coal Terminal NV*, para 15; *Gabalfrisa SL v Agencia Estatal de Administración Tributaria* (Cases C-110/98 to C-147/98) EU:C:2000:145; [2000] ECR I-1577; [2002] STC 535, para 44.

68. While it is not clear from the FTT's findings when any of FASL's projects will come to fruition, I am persuaded that the FTT was entitled to conclude that FASL when it incurred the costs of the purchase of the SFPE units was acting as a taxable person because it was acquiring assets in support of its current and planned economic activities, namely farming and the windfarm. On that basis FASL was entitled to an immediate right of deduction of the VAT paid on the purchase of the SFPE units and is entitled to retain that deduction or repayment so long as it uses the SFPs which it received as cost components of its economic activities. A start-up business can acquire goods and services to support its future taxable supplies and claim VAT paid on those acquisitions as input tax; so too in principle can an existing business which proposes to expand its economic activity. On the facts found, FASL does not carry out and does not propose to carry out downstream non-economic activities or exempt transactions. Therefore, no question of apportionment under article 173 of the PVD arises.

The task for HMRC

69. I recognise that a claim for deduction which depends on the future behaviour of the taxable person, such as the claim in this case, may create practical difficulties for HMRC in administering the VAT system fairly and, in particular, in avoiding

unwarranted repayments of VAT. But it is an established part of the VAT system that a taxable person is entitled to an immediate deduction of the VAT which it has paid (para 60(vi) above). It is also well-established that a taxable person can claim to deduct as input tax VAT which it has paid on the acquisition of goods or services although it will not use those goods and services as components of taxable transactions immediately: *Rompelman*, para 22; *Lennartz v Finanzamt München III* (Case C-97/90) [1991] ECR I-3795, paras 13-16 and *Sveda*, para 20.

70. The recognition that fund-raising costs may, where the evidence permits, be treated as general overheads of a taxable person's business means that the taxable person must be able to provide objective evidence to support the connection between the fund-raising transaction and its proposed economic activities. The taxpayer also needs to maintain adequate banking arrangements and records to vouch the later use of the funds so raised to demonstrate its entitlement to deduct and to retain the deduction, if investigated. As the CJEU recorded in *Sveda* (para 36) the taxpayer will have to repay input VAT if it does not use the input goods or services for the purposes of its economic activity. HMRC has power to charge VAT under regulation 3 of the Value Added Tax (Supply of Services) Order 1993 (SI 1993/1507), where a taxable person uses services supplied to it for its business for a purpose other than a business use, by treating that use as a supply of services in the course of its business. This may involve HMRC in more investigations than the CJEU envisaged in *BLP* (para 24). But this supervision of the subsequent use of the raised funds, with which the services were associated, seems to me to be an inevitable consequence of the CJEU's interpretation of the PVD.

Conclusion

71. I would dismiss the appeal.