Neutral Citation: [2014] IEHC 685

THE HIGH COURT

[2013 No. 672 R]

BETWEEN

LAST PASSIVE LIMITED

(Trading as Aircoach)

APPELLANT

AND

THE REVENUE COMMISSIONERS

RESPONDENT

JUDGMENT of Mr. Justice Michael White delivered on the 24th day of October 2014

1. The appellant to these proceedings, Last Passive Ltd. is a private limited liability company which trades as "Aircoach" and operates various bus routes servicing Dublin Airport from different locations within the State and Northern Ireland.

2. The respondent to these proceedings refused to accede to the appellant's claim for a refund of Value Added Tax (VAT) in the amount of €873, 268.30. The Appeals Commissioner heard the appeal of this decision between November, 2010 and May, 2012.

3. This case stated arises from the determination of the Appeals Commissioner on hearing that appeal and is brought under s. 941 of the Taxes Consolidation Act 1997 as applied to VAT by s. 119(4)(k) of the Value Added Tax Consolidation Act 2010 (as amended) ("the VATCA"). A number of questions of law arise in these circumstances.

4. The Appeal Commissioner found a number of facts admitted or proved. The appellant operates 59 coaches on its bus routes and employs approximately 200 staff. The appellant entered a contract ("the Contract") with Viacom Ltd. (now CBS Outdoor Limited) in relation to 43 of these coaches. Under the terms of this contract CBS Outdoor Limited obtained the right to sell to its customers the entitlement to place advertising on the exterior of the appellant's coaches, on the back of seats inside the coaches and in certain places at Aircoach bus stops. This contractual right was extended until April, 2014.

5. During the period of the contract the buses displayed advertisements on their exterior and interior while being driven on their various routes. The income derived from this advertising is considered by the appellant to be an important element of its turnover, however, the overall value of the contract with CBS Outdoor Ltd to the appellant, when compared to the income derived from passenger transport, is small. For example, for the year ended 31st March, 2009, 2% of the appellant's turnover was derived from advertising but 98% from the transport of passengers.

Relevant Legislation

6. The claim made in this case relates to a period before the enactment of the Value Added Tax Consolidation Act 2010 ("VATCA 2010"). The relevant applicable legislation is the VAT Act 1972 ("VATA") which has now been revoked by the VATCA 2010. Under s. 6 of the VATA and para. (xiv)(3) of the First Schedule to the VATA the appellant's supply of passenger transport is exempt from VAT. This provision was inserted in order to ensure the State's compliance with Art 371 of Council Directive No. 2006/112/EC. Sections 2 and 5 of the VATA however provide that the appellants' supplies of advertising are taxable.

7. Section 12(1)(a) of the VATA 1972 provides:-

> "In computing the amount of tax payable by him in respect of a taxable period, a taxable person may, insofar as the goods and services are used by him for the purposes of his taxable supplies or of any of the qualifying activities, deduct…
>
> (i) the tax charged to him during the period by other taxable persons by means of invoices, prepared in the manner prescribed by regulations, in respect of supplies of goods or services to him…"

8. Section 12(4) of the VATA 1972, as inserted by s.112(b) of the Finance Act 2000, provides:-

> "(a) 'deductible supplies or activities' means the supply of taxable goods or taxable services, or the carrying out of qualifying activities as defined in subsection (1)(b);
>
> 'dual-use inputs' means goods or services (other than goods or services on the purchase or acquisition of which, by virtue of subsection (3), a deduction of tax shall not be made) which are not used solely for the purposes of either deductible supplies or activities or non-deductible supplies or activities;
>
> 'non-deductible supplies or activities' means the supply of goods or services or the carrying out of activities other than deductible supplies or activities;
>
> 'total supplies and activities' means deductible supplies or activities and non-deductible supplies or activities.
>
> (b) Where a taxable person engages in both deductible supplies or activities and non-deductible supplies or activities then, in relation to that person's acquisition of dual-use inputs for the purpose of that person's business for a period, that person shall be entitled to deduct in accordance with subsection (1) only such proportion of tax, borne or payable on that acquisition, which is calculated in accordance with the provisions of this subsection and regulations, as being attributable to that person's deductible supplies or activities and such proportion of tax is, for the purposes of this subsection, referred to as the 'proportion of tax deductible'.
>
> (c) For the purposes of this subsection and regulations, the proportion of tax deductible by a taxable person for a period shall be calculated on any basis which results in a proportion of tax deductible which correctly reflects the extent to which the dual-use inputs are used for the purposes of that person's deductible supplies or activities and has due regard to the range of that person's total supplies and activities.

(d) The proportion of tax deductible may be calculated on the basis of the ratio which the amount of a person's tax-exclusive turnover from deductible supplies or activities for a period bears to the amount of that person's tax-exclusive turnover from total supplies and activities for that period but only if that basis results in a proportion of tax deductible which is in accordance with paragraph (c)."

9. Section 12(4) of the VATA aims to transpose Article 17(5) of Council Directive 77/388/E.E.C. or the "Sixth Directive" which provides:-

> "As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible, only such proportion of the value added tax shall be deductible as is attributable to the former transactions.
>
> The proportion shall be determined, in accordance with Article 19 for all the transactions carried out by the taxable person.
>
> However, Member States may:-
>
> (a) authorise the taxable person to determine a proportion for each sector of his business, provided that separate accounts are kept for each sector;
>
> (b) compel the taxable person to determine a proportion for each sector of his business and to keep separate accounts for each sector;
>
> (c) authorise or compel the taxable person to make the deduction on the basis of the use of all or part of the goods and services;
>
> (d) authorise or compel the taxable person to make the deduction in accordance with the rule laid down in the first subparagraph of paragraph 1, in respect of all goods and services used for all transactions referred to therein;
>
> (e) provide that, where the VAT which is not deductible by the taxable person is insignificant, it is to be treated as nil."

10. Regulation 18(2)(a) of the Value-Added Tax Regulations 2006 S.I. No. 548 of 2006 provide:-

> "Where a taxable person deducts, in accordance with subsections (1) and (4) of section 12 of the Act, a proportion of the tax borne or payable on the taxable person's acquisition of dual-use inputs for a taxable period, then that proportion of tax deductible by that person for a taxable period is-
>
> (i) the proportion which –
>
> (I) correctly reflects the extent to which the dual-use inputs are used for the purposes of that person's deductible supplies or activities, and
>
> (II) has due regard to the range of that person's total supplies and activities,
>
> for that taxable period."

Determination and Case Stated by Appeal Commissioner

11. This appeal relates to the entitlement of the appellant to deduct VAT incurred in relation to expenditure on its business or "input VAT." The Appeal Commissioner determined the appeal from the refusal of the Revenue Commissioners by finding that, though the appellant made two supplies of services, a supply of advertising to CBS Outdoor Ltd. under the terms of the Contract and a supply of passenger transport to the public, this did not make inputs for either or both of those purposes "dual-use inputs" pursuant to s. 12(4)(a) of the VATA. It was also determined that the costs incurred by the appellant in operating the coaches were incurred solely and not principally by the company in order to provide the passenger transport service and this service had to be performed irrespective of any advertising services which were also supplied. The Appeal Commissioner also determined that in order to be deductible there must be a link between the inputs and the taxable supply of services in question and therefore costs necessarily incurred through the provision of the transport service could not be seen as constituting a dual-use input in relation to the provision of the advertising space. Any costs in VAT incurred by the appellant through running the transport service, such as maintenance and fuel for buses, were used solely, as opposed to principally, for the appellant's supplies of transport services to passengers and therefore could not be considered to be dual-use inputs for the purposes of s. 12(4) of the VATA. The VAT incurred by the appellant on running costs directly related to the operation of buses was not therefore deductible. The Appeal Commissioner determined that costs which were related to the business of the appellant as a whole and which did not have a direct and immediate link with its exempt supplies such as audit fees for example were "overheads" and were "dual use inputs" in respect of which the appellant was entitled to recovery. It was determined permissible to have regard to turnover in calculating the deductible proportion in order to achieve a result which has due regard to the range of the appellant's supplies. The Appeal Commissioner determined that 2% of the VAT on costs claimed by the appellant, which was the relative turnover of the taxable and exempt activity, amounting to €1,897.99 was recoverable for costs not directly and immediately attributable to running the buses. VAT incurred exclusively for the purposes of concluding the advertising contract (such as legal fees) would have been fully recoverable but there were no costs of this nature and therefore this determination is not strictly relevant.

12. Counsel for the appellant issued a notice requiring the Appeal Commissioner to sign a case for determination by this Court on a point of law. The questions raised for the determination of this Court are:-

> "(i) Was [the Appeal Commissioner] correct in determining that the 'running costs' of the appellant's buses were not dual use inputs giving rise to deduction pursuant to section 12(4) VATA 1972 and/or Article 17 of the Sixth VAT Directive because they were being used solely for passenger transport?
>
> (ii) Was [the Appeal Commissioner] correct in determining that the foregoing conclusion was not to be called into question by reason of the principles of fiscal neutrality and equal treatment?
>
> (iii) Was [the Appeal Commissioner] correct in determining the recoverability of VAT in relation to overheads on the basis

of the relative turnover of the advertising and passenger transport businesses."

Legal Submissions on Behalf of the Appellant and Respondent.

13. The VATA transposed the Sixth VAT Directive into Irish law. This directive was repealed from 1st January, 2007, and replaced by Council Directive 2006/112/E.E.C. or the "recast VAT Directive." However, though the transactions at issue here both pre-date and post-date this change, the provisions of both instruments are identical in all relevant respects and it is the VATA 1972 which is applicable.

14. Section 12(1) VATA provides that where VAT is incurred on costs used exclusively for the purposes of making taxable supplies it is fully recoverable from the Revenue Commissioners but where the costs are used exclusively for the making of supplies which are exempt from the payment of VAT under the terms of the VATA 1972 it is irrecoverable. But under the terms of s. 12(4) of the VATA 1972 where VAT incurred is used both for the making of taxable and for the making of exempt supplies ("dual-use inputs" within the meaning of s. 12(4)(a) VATA 1972) the VAT is recoverable in part according to the ratio set out therein. Therefore the appellant submits that this appeal requires the determination of two key issues:-

(i) Is the VAT incurred by the Appellant used for making both taxable and exempt supplies and

(ii) If so, what proportion of such VAT may be recovered by the Appellant?

15. The Appellant submits that in both the Sixth Directive and the Recast Directive turnover is the default method of calculating the deductible proportion of the VAT on the supplies of the taxable person but that both of these instruments also empower the Member State to 'require the taxable person to make the deduction on the basis of "use"' under the terms of Article 17(5)(c) of the Sixth Directive for example. It is the appellant's submission that the State has elected to determine the right to recover VAT on the basis of "use" under s. 12(4) of the VATA rather than on the basis of the turnover of the company. This in effect precludes consideration of turnover as a basis for VAT deduction other than where turnover correlates to the use of the assets in question.

16. The appellant submits that the main distinction between these two methods of calculation is that the "use" basis of measurement involves looking at the inputs and the goods and services one acquires for one's business and the use to which they are put whereas turnover involves looking at the amount of money that one makes on the output side from undertaking those activities. So therefore not only are these two options mutually exclusive in the relevant legislation, they are also conceptually very different the one from the other.

17. In relation to the first issue of whether the costs incurred by the appellant in relation to its business are used solely for the making of exempt supplies, or whether they can be characterised as "dual-use inputs" under s. 12(4) VATA, the appellant submits that "use" must be given its ordinary meaning and that the right to deduction can be precluded only if the appellant uses the costs solely in the provision of transport rather than advertising. The appellant submits that the running of its buses is integral to the supply of both services as without the buses neither the transport element nor the advertising element of the company's income stream would be possible as neither type of supply would be made. Therefore the costs of running the buses in question, such as the maintenance and fuel costs, are dual-use inputs as they are used for the supply of both taxable and exempt services. The appellant submits that this reading of the legislation is supported by first principles of statutory interpretation and that this meaning is also clear from a contextual reading of the text of the VATA 1972.

18. The appellant makes two main submissions. It is submitted that there is (i) a direct link between the taxable supply and the input VAT or in the alternative (ii) there is a direct link between the VAT inputs of the appellant and the general costs of its business rendering 50% of the VAT inputs of the appellant recoverable since part of the services provided by the appellant, though not all of the services provided, are taxable.

19. The appellant relied on a number of authorities in support of his submissions. These are:-

? *Abbey National plc v. Commissioners of Customs and Excise Case* C408/98[2001] ECR 1-1361.

? *Dial-a phone Ltd v. Customs and Excise Commissioners* [2004] EWCA Civ 603.

? *Portugal Telecom v Fazenda Publica* Case C-496/11[2013] STC 158.

? *Lennartz v Finanzamt Munchen 111* Case C-97/90[1991] ECR 1-3795, [1995] STC 514.

? *Finanzamt Friesadt Rohrbach Urfhar v. Unabhangiger Finanzsenat Aussentelle Linz* Case C -219/12.

? *Mayflower Theatre Trust Ltd v. Revenue and Customs Commissioners* [2006] EWCA Civ.116.

? *Varzim Sol v. Fazenda Publica* Case C-25/11.

? *Royal Bank of Scotland v. HMRC* Case C-488/07[2008] ECR 1-10409.

? *Marks & Spencer plc v. Commissioners of Customs & Excise* Case C-62/00 [2002] ECR 1-6325

? *NCC Construction Danmark A/S v. Skatteministereit* Case C-174/08[2009] ECR. 1-10567.

20. The appellant took issue with the decision in *Volkswagen Financial Services (UK) Ltd v. Revenue and Customs Commissioners* [2013] STC.716 arguing it is not strong authority given that it is a decision of the Upper Tribunal currently subject to appeal.

21. The respondent argued that the discussion of the jurisprudence in *Volkswagen Financial Services (UK) Ltd. v. Revenue and Customs Commissioners [*2013] S.T.C. 716, serves as a sound summary of the case law in this area. The respondent submits that it is incorrect to say that the "direct and immediate link" test has been abandoned or modified since it was set down in *BLP Group plc v. Commissioners of Customs and Excise Case C-4/94* [1995] E.C.R. I-983 but rather has been repeated ad nauseam in the jurisprudence of the E.C.J since. Counsel submits that the nature of the test was not substantially changed by the decision in *Midland Bank plc v. Customs and Excise Commissioners Case C-98/98* [2000] E.C.R. I-4177, [2000] S.T.C. 501 where consequential costs of an anterior supply were held to be deductible since they met the cost component test. This case introduced the concept of a direct

and immediate link being either directly between the input expenses and an output supply or with the taxable person's business as a whole.

22. The Respondent submits that the running costs of the buses are not dual-use inputs but that they were incurred solely and not principally to provide the passenger transport service and that it is clear from a plain reading of the Sixth VAT Directive and of s. 12 of the VATA 1972 that the right to VAT deduction on inputs only applies insofar as the input goods and services are used for the making of taxable supplies rather than exempt supplies. Otherwise no right to VAT deduction arises. The respondent submits that a taxable person may provide both deductible and non-deductible supplies without incurring dual-use inputs or substantial dual-use inputs. Should dual use inputs occur, there is only a right of deduction in relation to the amount of tax borne or payable on costs which are actually attributable to the deductible supplies. The respondent submits that the inputs into the appellant's business were solely related to the provision of its passenger transport service and that the advertising service is in fact "parasitic" upon this other primary supply. There is no "direct and immediate link" between the input running costs and the output advertising service in this instance though such a link does exist between the input and the passenger service output.

23. Counsel for the respondent relies on the decision of the E.C.J. in *BLP Group v. Commissioners for Customs & Excise Case C-4/94* [1995] ECR I-983 in which it was held at paras. 19-21 that:-

> "19. Paragraph 5 [of Article 17 of the Sixth Directive] lays down the rules applicable to the right to deduct VAT where the VAT relates to goods or services used by the taxable person 'both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible'. The use in that provision of the words 'for transactions' shows that to give the right to deduct under para. 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 this respect.
>
> …
>
> 21. Article 2 of the First Directive states that only the amount of tax borne directly by the various cost components of a taxable transaction may be deducted."

24. The appellant argues that in line with the judgments in *Lennartz and Portugal Telecom*, the Court of Appeal's judgment in Mayflower theatre implicitly rejects any notion that one must have regard to the ancillary or incidental nature of an activity when considering whether costs have been used for the purpose of that activity. In that case the VAT incurred in acquiring the theatre production clearly had a direct and immediate link to the exempt sale of tickets which was patently the principle source of the theatre's income. The appellant further submitted that the Court of Appeal considered that there was also a direct and immediate link between the VAT incurred and the programmes which were sold to attendees notwithstanding the fact that the sale of those programmes was a by product of the ticket sales. The respondent submits that the facts of *Mayflower Theatre Trust Limited v. Revenue and Customs Commissioners* [2007] S.T.C. 880 actually support the position of the respondents in that the direct and immediate link test was upheld by the Court of Appeal in that case. It was held that there was a link between VAT on production costs of performances purchased from theatre companies and programme sales. However there was no such link between production costs and the sale of production linked merchandise and sponsorship. In addition counsel also relies on the statement of Jonathan Parker L.J. in the decision of the Court of Appeal in *Dial-a-Phone Ltd. v. Customs and Excise Commissioners* at para. 72 that:-

> "…[b]y its very nature the [direct and immediate link/cost component] test is fact-sensitive, in the sense that its application inevitably requires a qualitative judgment to be made on the basis of the facts (as found or admitted) relating to the transactions in question…whilst I accept that the question whether the…test…has been correctly applied in any particular case is a question of mixed fact and law, the factual element in that question is bound to be a substantial one. And since the facts are essentially for the VAT Tribunal, it follows, in my judgment, that, absent any misdirection as to the…test itself, the scope for successfully challenging a VAT tribunal's decision in applying the…test is likely to be limited."

25. The respondent submits that the Sixth VAT Directive does not make "use" and "turnover" mutually exclusive. There is nothing in the authorities which says one cannot use turnover as a proxy or a measure for use, merely that one cannot apply article 19 of the Directive if the option in article 17(5) of the sixth VAT directive is taken by the Member State in its domestic legislation. The respondents do not rely on turnover as a basis for this measure, the statute mandates the "use" basis of measurement but also states that turnover may be used to evaluate "use." "Use" for these purposes is economic use and not physical use, otherwise the legislation would result in an absurdity. The respondent refers to a decision of the High Court, Chancery Division of England and Wales in *St Helen's School Northwood Ltd v. Revenue and Customs Commissioners* [2006] EWHC 3306 (Ch), [2007] S.T.C. 633 in which it was held by Warren J. at para. 75 that:-

> "…the search in the present case is for a fair and reasonable proxy for the 'use' of the [facility] in making the exempt and taxable supplies…However I also agree…that the physical use of the complex is not necessarily a fair and reasonable proxy for that use. I consider that…the phrase 'economic use' is a helpful approach to establishing what the search is for."

26. In response, in relation to *St Helen's School Northwood Ltd v. Revenue and Customs Commissioners* [2006] EWHC 3306 (Ch), [2007] S.T.C. 633, the appellant submitted that this case directly contradicts the case made by the Revenue Commissioners in the within proceedings since the *St Helen's* decision did not deal with the gateway principle or the entitlement to deduction as the respondent submits is at issue here, but rather dealt with the proportion or amount of deduction to which the plaintiff in *St Helen's* was entitled. The appellant also stated in response that the term "economic use" is only to be found in the jurisprudence from England and Wales and is not present in the Irish case law or the European case law, and by contrast that there is no authority for the proposition that an input which is physically used to provide two supplies can be found only to have a direct and immediate link with one of those supplies. The respondent submits that the wording of s. 12(d) of the VATA 1972 permits the use of turnover as a proxy for "use". The respondent also submits that the decision of the Appeal Commissioner in relation to the first question in the case stated was not inconsistent with the principles of fiscal neutrality and equal treatment which are key components of EU law in this area.

27. The respondent submits that here is no breach of fiscal neutrality here as there is no direct and immediate link between the VAT inputs and the supplies made by the appellant. There is also no factual or economic basis for the 50% recovery claimed. The appellant submits in response that if the interpretation of the Revenue Commissioners is followed by the court there would be a breach of fiscal neutrality as other suppliers of advertising who supply this activity alone and do not supply an exempt service in addition to the taxable service, would benefit from a larger amount of VAT recovery and would therefore receive more favourable treatment than the appellant.

28. The respondent submits that the basis of calculating the proportion of VAT deductible must reflect the extent to which the dual use inputs are used for the purpose of making deductible supplies by a taxable person and must have due regard to the range of that person's total supplies and activities. The respondent submits that account must be taken of the relative importance of the activities in which the taxpayer is engaged and since the majority of the appellant taxpayer's income comes from the provision of transport services and since this is the primary aim and purpose of its business, the claim for a 50% refund on tax inputs based on a small proportion of its income coming from an exempt supply is not factually sustainable. The respondent submits that the tax deductible should be calculated on the basis of the ratio which the amount of a taxable person's tax exclusive turnover from deductible supplies for the period concerned bears to the amount of the person's tax exclusive turnover from total supplies for the period, provided that this correctly reflects the extent to which dual use inputs are used for the making of deductible as opposed to exempt supplies and has regard to the range of the taxable person's total supplies. Apportionment on the basis of turnover is the most appropriate method of calculation in this instance as it most closely meets the criteria in s. 12(1)(c) VATA 1972. The third question in the case stated should be answered in the affirmative.

29. The applicant relies on para 4.4 of the respondents own guide *Value Added Tax: A Guide to Apportionment of Input Tax*, October, 2001, to make the case that it is the utilisation of the inputs for the taxable and exempt transactions which determines the basis of the deduction, regardless of the value of those transactions. The respondent submits that the guide is not relevant to the issue before the court in any way. There has been no evidence adduced of unequal treatment and this document cannot be seen as such evidence. The respondent refers to the decision of Hardiman J. in *Campus and Stadium Ireland Development Limited v. Dublin Waterworld Limited* [2010] IESC 25 in which the Court held that a similar Revenue document relating to VAT and property transactions did not have binding effect since it was merely a guide. Counsel submits that the same view must be taken of the guidelines adduced in these proceedings, particularly given the disclaimer as to legal effect which is included at the start of the document. In relation to the decision in *Metropol Treuhand Wirtschaftstreuhand GmbH v. Finanzlandesdirektion fur Vorarlberg Case C-409/99* [2002] ECR I-81, which the appellant submitted was authority for the proposition that such documents could be seen as evidence of the proper implementation of legislation, the respondent submits that the document in that case was clearly binding on public authorities and therefore, since that is not the case here, this case is wholly distinguishable. Counsel notes that the decision in *Commission v. France Case C-404/99* [2001] E.C.R. I-2667 is similarly distinguishable given that the documents in that question were also legally binding. In relation to *Marks & Spencer v. Commissioners of Customs & Excise Case C-62/00* [2002] E.C.R. I-6325 it was also submitted that this authority is not applicable to the Irish situation but can be confined to its own particular facts in its own particular jurisdiction.

The Approach of the Court When Considering a Case Stated

30. In *Mara (Inspector of Taxes) .v. Hummingbird Limited* 1982 ILRM 421 at 426 Kenny J. set out the approach of the Court when considering a case stated, as regards an Appeal Commissioner's (or Circuit Court Judge's) conclusions or inferences from primary facts:-

> "If, however, they are not based on a mistaken view of the law or a wrong interpretation of documents, they should not be set aside unless the inferences which he made from the primary facts were ones that no reasonable commissioner could draw".

31. In that regard, Kenny J. quoted with approval from the speech of Lord Radcliffe in *Edwards .v. Bairstow* [1956] AC 14 on the approach of the higher court on a case stated: unless there was a legal misconception appearing *ex facie* then the test was one of reasonableness. These principles were affirmed in *O'Culachain v McMullan Brothers* [1995] 2 ILRM 498 at 501-504 and in *Brosnan v Mutual Enterprises* [1997] 2 IR 257 at 285.

32. This Court also approves of the passage in the English Court of Appeal decision *The Commissioner for Customs & Excise v. Southwern Primary Housing Limited* (2003) EWCA CW1662:-

> "It is for the Tribunal to determine the primary facts (i.e. as to the commercial transactions). …. Whether or not those facts amount to a "use" within the meaning of Article 17 (2) as interpreted by the Court is a question of law arising on those primary facts".

33. In *James Mara Inspector of Taxes V Hummingbird Limited* 1982 ILRM at Page 426 Kenny J. stated:-

> "A case stated consists in part of findings on questions of primary fact, e.g. with what intention did the taxpayers purchase the Baggot Street premises. These findings on primary facts should not be set aside by the Courts unless there was no evidence whatever to support them. The Commissioner then goes on in the case stated to give its conclusions or inferences from these primary facts. These are mixed questions of fact and law and the Court should approach these in a different way. If they are based on the interpretation of documents, the Court should reverse them if they are incorrect for it is in as good a position to determine the meaning of documents as is the Commissioner. If the conclusions from the primary facts are one which no reasonable Commissioner could draw, the court should set aside its findings on the ground that he must be assumed to have misdirected himself as to the law or made a mistake in reasoning. Finally if his conclusions show that he has adopted a wrong view of the law they should be set aside. If however they are not based on a mistaken view of the law or a wrong interpretation of documents they should not be set aside unless the inferences which he made from the primary facts were ones that no reasonable Commissioner could draw".

34. The essence of the issue in the first two questions posed for determination by the Court is the decision by the Appeal's Commissioner to find that:-

> "The costs incurred by the company in directly operating the coaches were incurred solely and not principally by it in order to provide the passenger transport service."

And furthermore:-

> "In order to be deductible a link must be established between the inputs and taxable supply in question".

35. In *Volkswagen Financial Services (UK Limited .v. Revenue & Customs Commissioners* [2012] UKUT 394 (TCC)), the judgment recites chronologically the authorities of the Court of Justice of the European Union and its application by the English Courts. It is useful to quote in full the relevant extract from the judgment, even though the extract is lengthy and there is some question mark over the accuracy of paragraph 78 which refers to a CJEU decision, while it seems to be the opinion of the Advocate General.

Extract from VW case summarising case law.

"CHRONOLOGICAL TREATMENT OF THE AUTHORITIES

[48] It is, in our judgment, hard to understand the true principles that are to be derived from the authorities without looking at them in chronological order in order to see how the jurisprudence has developed.

[49] *Rompelman v Minister van Financien* (Case C-268/83) [1985] ECR 655 is still frequently cited. In that case, the CJEU considered the purpose and objective of the VAT system. The CJEU had to decide whether the acquisition of a right to the future transfer of ownership of part of a building, yet to be constructed, with a view to letting such premises, might be regarded as an 'economic activity' within the meaning of art 4(1) of the Sixth Directive. The CJEU considered the general characteristics of the VAT system and the rules on deductibility of set-up costs, and said this at para 16:

> '[A] basic element of the VAT system is that VAT is chargeable on each transaction only after deduction of the amount of the VAT borne directly by the cost of the various components of the price of the goods and services …'

[50] Mr. Thomas relies on this passage as showing that input tax is deductible only so far as it is a cost component of the price of the goods. The CJEU also made an important reference to fiscal neutrality in para 19 where it said 'the common system of value-added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way'…

[51] In *BLP Group plc v Customs and Excise Comrs* (Case C-4/94 [1995] STC 424, [1995] ECR I-983, BLP sought to deduct input tax on invoices for the professional services it had used in connection with the sale of shares in its subsidiary company (an exempt output). BLP appealed against the Commissioners' refusal to allow the deduction, contending that the purpose of the share sale was to raise funds to pay off debts which had arisen from its taxable transactions, so that the professional services should be treated as having been 'used for' the purposes of its taxable transactions.

[52] Advocate General Lenz considered the principles of deductibility in paras 30-37 of his opinion. He said this:

> '31. On the question whether the goods or services supplied to taxable persons, on which the input tax has been charged, can be *attributed* to a transaction by the taxable person in such a way that deduction on input tax is justified, the Community legislature decided on a criterion corresponding to the system: the amount which is to be deducted as input tax must have been "borne directly by the various cost components" (see art 2 of the First Directive) …
>
> 33. Those details logically do not change the fact that input tax can be deducted only to the extent that the goods or services on which it has been paid are "cost components" of a taxable transaction …
>
> 36. With respect to the present case, the High Court found … that the services in question on which input tax had been paid were "used … for an exempt transaction" by the taxable person … It is thus established that those services form a cost component precisely of the exempt supply (effected by the sale of the shares).
>
> 37. That is not affected by the argument put forward by BLP at the hearing that the costs of the services on which input tax has been paid … are ultimately incorporated into the price of the goods and services which it sells by means of its taxable transactions … That circumstance does not make the services in question into costs components of the taxable transactions and cannot therefore alter the attribution stated above".

[53] The CJEU said this in *BLP Group*, *paras* 18-25:

> '18. Paragraph 2 of art 17 of the Sixth Directive must be interpreted in the light of para 5 of that article.
>
> 19. Paragraph 5 lays down the rules applicable to the right to deduct VAT where the VAT relates to goods or services used by the taxable person "both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible". The use in that provision of the words "for transactions" shows that to give the right to deduct under para 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 this respect.
>
> 20. That interpretation is confirmed both by art 2 of the First Directive and by art 17(3) (c) of the Sixth Directive [art 169 of the Principal Directive] …
>
> 25. It is true that an undertaking whose activity is subject to VAT is entitled to deduct the tax on the services supplied by accountants or legal advisers for the taxable person's transactions … However, *that is a consequence of the fact that those services, whose costs form part of the undertaking's overheads and hence of the cost components of the products, are used by the taxable person for taxable transactions*.' (Emphasis added).

[54] Thus, in BLP, the CJEU decided that the professional services were used for an exempt output, the sale of the shares. BLP was not able to deduct the input tax even though the ultimate purpose of the transaction was the carrying out of taxable outputs. The direct and immediate link was with the exempt output.

[55] In *Midland Bank plc v Customs and Excise Comrs* (Case C-98/98) [2000] STC 501, [2000] ECR I-4177, Samuel Montagu & Co Ltd ('Samuel Montagu') was a merchant bank and part of the Midland Bank Group ('Midland'). Samuel Montagu provided financial services to Quadrex Holdings Inc ('Quadrex'). Quadrex then sued Samuel Montagu alleging negligent misrepresentation. Samuel Montagu retained solicitors who invoiced them in respect of work relating (i) to the provision by Samuel Montagu of its services to Quadrex and (ii) the subsequent litigation. Midland sought to deduct all the VAT charged on the solicitors' fees. The CJEU decided that the solicitors' fees relating to the litigation were attributable to Samuel Montagu's business generally and that the business comprised both taxable and non-taxable transactions. The

input tax relating to the litigation, therefore, needed to be apportioned in accordance with art 17(5) of the Sixth Directive (art 173 of the Principle Directive). When considering the issue of a 'direct and immediate link' the CJEU referred to *BLP* at para 20, and then continued at para 24 as follows:

> ' 24 … art 2 of the First Directive and art 17 (2), (3) of the Sixth Directive [arts 168,, 169 and 173 of the Principal Directive] must be interpreted as meaning 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.'

[56] At paras 30-32, the CJEU considered the 'cost component' test as follows:

> '30. It follows from that principle as well as from the rule *enshrined in the judgment* in BLP, para 19 *according to which, in order to give rise to the right to deduct, the goods or services acquired must have a direct and immediate link with the taxable transactions, that the right to deduct the VAT charged on such goods or services presupposes that the expenditure incurred in obtaining them was part of the cost components of the taxable transactions*,. Such expenditure must therefore be part of the costs of the output transactions which utilise the goods and services acquired. That is why those cost components must generally have arisen before the taxable person carried out the taxable transactions to which they relate.

31. It follows that, contrary to what the Midland claims, there is in general no direct and immediate link in the sense intended in *BLP Group*, between an output transaction and services used by a taxable person as a consequence of and following completion of the said transaction. Although the expenditure incurred in order to obtain the aforementioned services is the consequence of the output transactions, the fact remains that it is not generally part of the cost component of the output transaction, which art 2 of the First Directive none the less requires. Such services do not therefore have any direct and immediate link with the output transactions. *On the other hand, the costs of those services are part of the taxable person's general costs and are, as such, components of the price of an undertaking's products. Such services therefore do have a direct and immediate link with the taxable person's business as a whole, so that the right to deduct VAT falls within art 17(5) of the Sixth Directive and the VAT is, according to that provision, deductible only in part.*' (Emphasis added).

[57] The *Midland Bank* case, therefore, introduced the concept of the 'direct and immediate link' being either, directly between the input expenses and a particular output supply, or with the taxable person's business as a whole. The CJEU indicated that such a link existed if the inputs were a cost component of either the specific taxable supplies or of the price of the taxable persons' products generally.

[58] In *Abbey National plc v Customs and Excise Comrs* (Case C-408/98) [2001] STC 297, [2001] ECR I-361, Abbey National sought to deduct input tax on professional services it had employed in relation to a transfer of its rights under a lease and sublease. The transfer was not a taxable transaction. Abbey National's insurance business effected both taxable and non-taxable transactions. It was held that the input professional costs were part of the Abbey National's overheads and therefore had a direct and immediate link with the whole of its economic activity, so that it could deduct the proportion of VAT attributable to its taxable transactions.

[59] Advocate General Jacobs said this about overheads in his opinion:

> '42. According to a broader approach, where a taxable person pursues an economic activity in which he makes wholly taxable supplies, all the goods and services supplied to him for the purposes of that activity are cost components of his outputs and all the VAT borne by them should be deductible. The fact that, from a strict bookkeeping point of view, inputs are not attributed to or even apportioned among particular outputs is of no import here. Clearly not all goods and services consumed by a taxable person will be incorporated directly into an identifiable output. Some will be of the nature of general overheads and, to the extent that those overheads are components of taxable supplies, VAT levied on them may be deducted (see [BLP], para 25). Many types of overhead may be absorbed by the business as a whole, simply influencing indirectly the range of profit margins sought.

[60] The FTT cited para 35 of the CJEU's decision, where it held that the professional services used to effect the transfer were overheads that were costs component of the products of a business. In para 36, the CJEU decided that 'in principle the various services used by the transferor for the purposes of the transfer … have a direct and immediate link with the whole economic activity of that taxable person'.

[61] The CJEU continued as follows:

> '38. However as the court held in para 26 of the *Midland Bank* judgment ([2000] STC 501 at 519), *a taxable person who effects transactions in respect of which VAT is deductible and transactions in respect of which it is not may nevertheless deduct the VAT charged on the goods or services acquired by him, where those goods or services have a direct and immediate link with the output transactions in respect of which VAT is deductible*, without it being necessary to differentiate according to whether art 17(2), (3) or (5) of the Sixth Directive applies.
>
> 39. *That rule must apply also to the costs of the goods and services which form part of the overheads relating to a part of a taxable person's economic activities which is clearly defined and in which all the transactions are subject to VAT*, since those goods and services thus have a direct and immediate link with that part of his economic activities.
>
> 40. So if the various services acquired by the transferor in order to effect the transfer of a totality of assets or part thereof have a direct and immediate link with a clearly defined part of his economic activities, so that the costs of those services form part of the overheads of that part of the business, and all the transactions relating to that part are subject to VAT, he may deduct all the VAT charged on his costs of acquiring those services.

41. It is for the national court to determine whether those criteria are satisfied in the case in point in the main proceedings.' (Emphasis added).

[62] In *Dial-a-Phone Ltd v Customs and Excise Comrs* [2004] STC 987, the Court of Appeal considered the CJEU decisions that we have already mentioned.

[63] Jonathan Parker LJ (with whom Dyson and Waller LJJ agreed expressed the view that there was no material difference between the 'direct and immediate link' test and the 'cost component' test. He said this at para [28] of his judgment:

> 'Hence, on the authority of *BLP* and *Midland Bank*, in applying the '*used for'* test prescribed by art 17(2) of the Sixth Directive the relevant inquiry is whether there is a 'direct and immediate link' between the input costs in question and the supply or supplies in question; alternatively whether the input cost is a "cost component" of that supply or those supplies. It is clear from the judgements of the ECJ in *BLP* and *Midland Bank*, as I read them, that there is no material difference between these alternative ways of expressing the basis test." (Original emphasis.)

[64] In *Kretztechnik AG v Finanzamt Linz* (Case C-465/03) [2005} STC 1118, [2005] ECR I-4357, the taxpayer's ('KAG') main business was the development and distribution of taxable supplies of medical equipment, KAG applied for admission to the Frankfurt Stock Exchange and was subsequently listed, its capital was increased by the issue of shares, an exempt transaction. The tax authority refused to allow KAG to deduct input tax paid on the services it had used in relation to the admission to the stock exchange. The CJEU decided that these services had a direct and immediate link with KAG's whole economic activity, so that it was entitled to deduct the input tax charged. The CJEU said this:

> '36. In this case, in view of 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 BLP Group, para 25; Midland Bank, para 31; Abbey National, paras 35 and 36, and Cibo Participations*, para 33).
>
> 37. It follows that, under art 17(1) and (2) of the Sixth Directive, Kretztechnik is entitled to deduct all the VAT charged on the expenses incurred by that company for the various supplies which it acquired in the context of the share issue carried out by it, provided, however, that all the transaction carried out by that company in the context of its economic activity constitute taxed transactions.

[65] It will be observed that the CJEU decided that the overheads in question were 'component parts of the price of [KAG's] products'.

[66] In *Halifax plc v Customs and Excise Comrs* (Case C-255/02) [2006] STC 919, [2006] ECR I-609, Advocate General Poiares Maduro (with whom the CJEU appeared to agree) said this about the entitlement to deduct input tax on supplies received for exempt output transactions:

> '93 … VAT is, in effect, an indirect general tax on consumption meant to be borne by the individual consumers. Correspondingly the same principle requires that a taxable person must not be entitled to deduct or recover the input VAT paid on supplies received for its exempted transactions. As long as no VAT is charged on the goods or services provided by taxable persons, the Sixth Directive necessarily seeks to prevent them from recovering the corresponding input VAT …'

[67] In *St. Helen's School Northwood Ltd v Revenue and Customs Comrs* [2006] EWHC 3306 (Ch), [2007] STC 633, Warren J had to consider the deductibility of input VAT on the cost of building a school swimming pool and sports hall. The facilities were used by the school pupils (exempt for VAT purposes), but also commercially outside school hours by parents and others (a taxable output). The commercial use of the complex was contemplated in the application for planning permission. The school sought to recover a proportion of the VAT on the building of the complex by reference to a comparison between the hours of use for school and commercial purposes. Warren J decided that the provision of the exempt supply of education was the primary purpose of the complex, and the taxable supplies were a secondary use. Accordingly, the Revenue's proposed application of the standard method was preferable to the school's PESM. He said this:

> '[75] I agree with Mr. Thomas (counsel for the school) that the search in the present case is for a fair and reasonable proxy for the "use" of the sports complex in making the exempt and taxable supplies made by the School. However, I also agree with Miss Simor [counsel for HMRC] that the physical use of the complex is not necessarily a fair and reasonable proxy for that use. *I consider that her use of the phrase 'economic use' is a helpful approach to establishing what the search is for*.
>
> [76] *In that context, it is instructive, I consider, to look at the position had the `School not granted the licence at all and had not allowed any out-of-hours use. In those circumstances, there would have been no taxable supply at all*. In consequence, none of the input tax would fall to be attributed to taxable supplies as a result of regs 101(2)(b) and (c), reg 101(2)(d) not applying. However, the sports complex is used for the purposes of the School's (exempt) business. It is so used not because there is a supply to parents of the physical use (by their daughters) of the sports complex to their children, but because the availability of the complex is part of the package of benefits which is acquired by parents for the fees they pay and which constitutes the exempt supply by the School. The use made by the School, for VAT purposes, of the sports complex is its use in providing that package of services, a single supply. There is, of course, no need to identify a proxy for use when there is only an exempt supply since questions of allocation under reg 101(2)(d) do not then arise. Nonetheless, one can see that the 'use' referred in reg 101 (as elsewhere) is not physical use but some special VAT use. It is, I think, the same as what Miss Simor terms 'economic use'.

> [77] On the facts of the present case, it seems to me that the overwhelming economic use of the sports complex by the School is in relation to the provision of educational services. In that context, I agree with Miss Simor that the source of funds and the purposes of constructing the sports complex are relevant considerations. To regard those factors as relevant is not, in my judgment, to fall into the error, as Mr. Thomas would say it is, of categorising the nature of a supply by reference to the purpose or motive in making it. There is no doubt that in the present case, the supplies are distinct and readily identifiable, that is to say the taxable supply of the licence to [the company] and the exempt supply of education. Nor, in my judgment, is there any question, in taking those factors into account of treating a taxable supply as an exempt supply or vice versa. The question is what "use" is being made of the inputs in producing the outputs. It seems to me that the purpose of the School, objectively ascertained, in constructing the sports complex is a highly relevant factor in attributing cost components between the relevant outputs and is an entirely different issue from identifying the nature of the output by reference to purpose or motive (which is inadmissible), the issue addressed by Patten J in *Customs and Excise Comrs v Yarburgh Children's Trust* [2002] STC 207.' (Emphasis added).

[68] In *Invstrand BV v Staatssecretaris van Financien* (Case C-435/05) [2008] STC 518, [2007] ECR I-1315, the input tax in question was VAT on the cost of advisory services paid by Investrand in relation to arbitration proceedings to establish the amount of a claim that formed part of its assets, but which arose before Investrand became liable to VAT. The CJEU held that Investrand did not have the right to deduct the input tax saying this:

> '23. According to settled case law, the existence of a direct and immediate ink between a particular input transaction and a particular output transaction giving rise to entitlement to deduct is, in principle, necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement (see *Midland Bank*, para 24, *Abbey National*, para 26, and *I/S Fini H v Skatteministeriet* (Case C-32/03) [2005] STC 903, [2005] ECR I-1599, para 26). 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 *Midland Bank*, para 30; *Abbey National*, para 28; and *Cibo Participations SA v Directeur regional des impost du Nord-Pas-de-Calais* (Case C-16/00) [2002] STC 460, [2001] ECR I-6663, para 31).
>
> 24. It is however also accepted that a taxable person has a right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do have a direct and immediate link with the taxable person's economic activity as a whole (see, inter alia, *Midland Bank*, paras 23 and 31, and *Kretztechnik*, para 36).'

[69] This seems to have been a clear reiteration of the principles previously espoused in the cases we have cited above without any significant elaboration.

[70] In *Mayflower Theatre Trust Ltd v Revenue and Customs Comrs* [2007 STC 880, the Court of Appeal looked again at the principles of the CJEU cases. Carnwath LJ (with whom Chadwick and Auld LJJ agreed as to the result) adopted counsel's summary of the main principles to be derived from the cases at para [9] of his judgment as follows:

> ` … (i) input tax is directly attributable to a given output if it has a "direct and immediate link" with that output (referred to as "the BLP test"); (ii) that test has been formulated in different ways over the years, for example: whether the input is a "cost component" of the output; or whether the input is "essential" to the particular output. Such formulations are the same in substance as the "direct and immediate link" test; (iii) the application of the BLP test is a matter of objective analysis as to how particular inputs are used and is not dependent upon establishing what is the ultimate aim pursued by the taxable person. It requires more than mere commercial links between transactions, or a "but for" approach; (iv) the test is not one of identifying what is the transaction with which the input has the most direct and immediate link, but whether there is a sufficiently direct and immediate link with a taxable economic activity; and (v) the test is one of mixed fact and law, and is therefore amenable to review in the higher courts, albeit the test is fact sensitive.'

[71] The CJEU considered the overall economic activity of the taxable person in *Skatteverket v AB SKF* (Case C-29/08) [2010] STC 419, [2009] ECR I-10413, where it said this:

> `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 or 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 will depend on whether 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 ...
>
> 62. ... In order to establish whether there is such a direct and immediate link, *it is necessary to ascertain whether the costs incurred are likely to be incorporated in the prices of the shares [in its subsidiary--an exempt supply] which SKF intends to sell or whether they are only among the cost components of SKF's products [taxable supplies].*' (Emphasis added.)

[72] In *London Clubs Management Ltd v Revenue and Customs Comrs* [2012] STC 388, the Court of Appeal had another opportunity to consider the principles applicable where a taxpayer made both taxable and exempt supplies. The taxpayer casino sought to apportion its input tax according to a PESM that was based on the relative use of the floor space for taxable (restaurants and bars, for example) versus exempt (gambling) purposes. The catering services were hugely loss making. HMRC argued that apportionment based on a turnover method was more fair and reasonable. The Court of Appeal ultimately found in favour of the taxpayer, on the basis of a critical finding of fact made by the First-tier Tribunal to the

effect that, although the catering business was not currently profitable, it was a business in its own right and not merely ancillary to the gaming business (see para [69] in the judgment of Etherton LJ, with whom Pitchford and Ward LJJ agreed).

[73] At para [33], Etherton LJ made clear that the need for a process of attribution only arose when an item is a cost component of both taxable and exempt supplies, so that if the standard method does not result in a fair and reasonable attribution, the search is for a more fair and reasonable method.

[74] Etherton LJ continued:

> `[34] A fair and reasonable attribution to a taxable supply must, for the purposes of art 17(2) and (5) of the Sixth Directive and reg 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.'

[75] Etherton LJ then endorsed the passages in Warren J's judgment in St Helen's School Northwood, which we have set out above, and cited the CJEU in *Revenue and Customs Comrs v Loyalty Management UK Ltd, Baxi Group Ltd v Revenue and Customs Comrs Qoined* cases C-53/09 and C-55/09) [2010] STC 2651, [2010] ECR 1-9187, where it had said that `[i]t must be recalled that consideration of economic realities is a fundamental criterion for the application of the common system of VAT'. He continued as follows:

> "[41] That case [St Helen's School Northwood] 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 Comrs* [2006] EWHC 1024 (Ch) at [68], [2006] STC 1568 at [68]. Thirdly, depending again on the precise factual situation under consideration, the approach of the tribunal in *Aspinall's Club* (see para 49) may well be appropriate in a case where the taxable supplies are not, in themselves, a source of profit:
>
> > '49. ... 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 ...'"

[76] Etherton LJ also considered what the position would have been without he critical finding of fact. He concluded that he was very doubtful if it would have been possible to uphold the FTT's decision (para [83]), because, in looking at economic reality `profit may be an important factor' (though profit might in some cases be irrelevant). He held that the absence of a realistic expectation that the catering business would be profitable in the foreseeable future would have been likely to have been a critical factor against the proposed floor area PESM. He concluded that he found it difficult to see how in the absence of such an expectation 'as a matter of economic reality, any significant weight in support of the proposed PESM could legitimately be given to the avowed strategy of the respondent to run the catering activity as a separate business, making a positive contribution towards overheads'. Finally, Etherton LJ referred to the `startling consequence' that the loss-making activity would serve to boost the respondent's profits as a result of payments from HMRC (para [88]).

[77] The FTT's decision in *Aspinall's Club Ltd v Revenue and Customs Comrs* (2002 VAT Decision 17797 arose from similar factual circumstances to *London Clubs Management ltd.* The taxpayer ran a casino with catering facilities and the dispute concerned a floor space PESM. The tribunal decided that the catering facilities were so heavily funded by the exempt and profitable gaming activities that a PESM based on floor use was not fair and reasonable. The distinguishing factor between the two cases was the finding of fact in *London Clubs Management Ltd* that the catering business was a business in its own right and was carried on independently of the gaming activities.

[78] In *TETS haskovo AD v Direktor na Direktsia 'Obzhalvane I upravlenie na izpalnenieto' – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-234/11) [2013] STC 243 is the CJEU's most recent decision on this issue. It reiterated the position as follows:

> '32. Moreover, the court has consistently held that for there to be the direct and immediate link required by the court, *the costs incurred in acquiring the input transactions must be part of the cost components of the taxable output transactions, that is to say they must be incorporated into their price*. The court has also made it clear that this also covers the input transactions attributable to the taxable person's general overheads. In the case of such input transactions the required link exists not with certain output transactions but rather with the taxable person's economic activity as a whole, that is to say all of his output transactions.'"
>
> **End of extract from Volkswagen Financial Services UK Ltd v**
>
> **Revenue & Customs Commissioners [2012] UKUT 394 (TCC)**

36. I conclude from that judgment which I approve that the test laid down in *BLP Group plc v. Customs & Excise Commissioners* (Case C-4/94) [1995] STC424 and [1995] ECR1-983 at para 19 still applies.

37. I accept use as the appropriate method of determination in a situation where dual use has to be considered, but I do not accept that in determining use, turnover cannot be considered. Many of these cases are fact specific. It may well be in many cases use can be determined without any reference to turnover, but in a case where dual use arises and the Revenue Commissioners have to apportion same I do not see any reason why turnover should be completely disregarded? I cannot see how turnover is never relevant in determining use or that the Sixth Directive and the Irish legislation, binds the Respondent to such an extent that in considering use it cannot consider turnover. If the Respondent were to consider turnover exclusively to the exclusion of use then that would be impermissible. The Appeal Commissioner in having due regard to turnover in seeking to produce a result which had due regard to the

range of the Appellant's supplies acted correctly.

38. In respect of the guide published by the Respondent, I do not consider the submissions by the appellant on the extracts have any bearing on the judgment of this Court.

39. The Court approves of the dicta in South Primary Housing 2003 AER 2310 at Page 37 when the Court of Appeal stated:-

> "Turning back to the Tribunal, it concluded that there was a direct and immediate link between the land purchase and both the land sale and development contract, with both an exempt and a non-exempt transaction. VAT law does not work in such a generalised way. You have to look at transactions individually, component transaction by component transaction. They may be linked in the sense that one would not have happened without the other, but they remain distinct transactions nonetheless. Only if one transaction is merely ancillary to a main transaction can one disregard the distinct nature of each transaction (see Card Protection Plan v CCE Case C-349/96) [1999] STC 270 ,para. 29). If that were not so, the principle of neutrality would be violated. Moreover there would be intractable problems as to which input was being attributed to which part of the "overall transaction"

40. The goods or services in question must have a direct and immediate link with the taxable transactions and that only the amount of tax borne directly by the various costs components of a taxable transaction may be deducted. It is primarily a matter of fact in particular circumstances whether the direct and immediate link which exists is with an exempt activity only or will it cover an ancillary activity which is not exempt.

41. There is no conflict between a wide interpretation of use and the finding by the Appeal Commissioner that the advertising was not a dual use within the meaning of the legislation.

42. I have come to the conclusion that the Appeal Commissioner did not misdirect himself in applying the legislation or the Case Law. He was correct to assert that for deductibility a link must be established between the inputs and taxable supply in question.

43. While certainly from the submission of the Appellant in this Court it was open to the Appeal Commissioner on the facts to establish such a connection he chose not to do so, and held that the inputs for either or both purposes were not dual inputs for the purposes of s. 12(4)(a) of the VTA.

44. The conclusions from the primary facts are not such that no reasonable Commissioner could draw them, so as he did not misdirect himself in law and made conclusions on the facts which were open to him, it is not open to this Court even though the arguments as to an alternative approach were persuasive, to substitute the Appeal Commissioner's findings from primary facts, for conclusions drawn by this Court.

45. I must therefore answer all three questions in the affirmative.