[2019] UKFTT 0329 (TC)

TC07157

VAT – Partial exemption – Standard method override – Production costs accepted as 'residual' – Whether production costs have a direct and immediate link to catering and other taxable supplies – Whether 'break in chain' or separate supplies – Appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/04416

BETWEEN

ROYAL OPERA HOUSE COVENT GARDEN FOUNDATION **Appellant**

-and-

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

TRIBUNAL: JUDGE JOHN BROOKS

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1 on 29 and 30 April 2019

Peter Mantle, counsel, instructed by Crowe UK LLP, for the Appellant

Matthew Donmall counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. The Royal Opera House Covent Garden (the "Opera House"), home of The Royal Opera, The Royal Ballet and The Orchestra of the Royal Opera House, is one of the world's pre-eminent opera houses producing internationally acclaimed opera and ballet. On 15 December 2017 HM Revenue and Customs ("HMRC") denied a claim by the Royal Opera House Covent Garden Foundation (the "ROH") to recover VAT input tax of £532,069 associated with the cost of staging productions at the Opera House between 1 June 2011 and 31 August 2012 (the "Production Costs"). HMRC upheld that decision on 26 April 2017, following a review. This is the appeal of the ROH against that decision.

2. Although admission to the opera or ballet is an exempt supply for VAT purposes (see Group 13 of schedule 9 to the Value Added Tax Act 1994 – cultural services etc) it is common ground that the ROH also makes a number of taxable supplies (eg programme sales and production specific commercial sponsorship) to which the Production Costs have a direct and immediate link. It is also accepted that because of the link to both exempt and taxable supplies the input tax associated with the Production Costs is residual.

3. Having initially contended otherwise, at the commencement of the hearing, the ROH accepted that there was not a direct and immediate link between the Production Costs and third party commercial income, Opus Arte sale of non-ROH titles (while maintaining its argument in respect of ROH titles), licensing income and services recharges. Additionally, although supplies of backstage tours of the Opera House had also been in issue, following the evidence of the ROH Director of Finance and member of is Executive Team, Ms Mindy Kilby, HMRC accepted that there was a direct and immediate link between backstage tours and the Production Costs. It is not therefore necessary to consider these supplies further.

4. The issue between the parties is whether there is a direct and immediate link between the Production Costs and the following taxable supplies (the "Disputed Supplies") made by the ROH:

(1) Catering income (bars and restaurants);

(2) Shop income;

(3) Commercial venue hire;

(4) Production work for other companies; and

(5) Ice cream sales.

5. Mr Peter Mantle appeared for the ROH. HMRC were represented by Mr Matthew Donmall. I am grateful to both for their clear and helpful submissions, both written and oral, although in reaching my conclusions it has not been necessary to refer to every argument they advanced or all of the evidence to which I was taken.

EVIDENCE

6. I was provided with a bundle of documents which included correspondence between the parties, the Memorandum and Articles of Association of the ROH and HMRC visit reports. In addition, as I have already mentioned, I heard from the Director of Finance at ROH and member of its Executive Team, Ms Mindy Kilby, much of whose evidence was not challenged. Also, as it was not disputed, the witness statement of Mr David Gaskell of HMRC was admitted into evidence.

7. However, before turning to the facts, on which there was little if any material dispute, it is first convenient to set out the applicable legislative provisions and how these have been considered and interpreted.

LAW

8. Article 1 of the Principal VAT Directive ("PVD"), EU Directive 2006/112/EC, insofar as material provides:

> … 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."

9. Article 168 PVD provides the right to deduct:

> 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…

10. Article 173(1) PVD sets out the principle of attribution:

> In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.
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> The deductible proportion shall be determined, in accordance with Articles 174 and 175, for all the transactions carried out by the taxable person.

11. Articles 174 and 175 PVD, which deal with apportionment of input tax where supplies are used by a taxable person for both its taxable supplies and its exempt supplies are implemented in domestic law by ss 24 – 26 of the Value Added Tax Act 1994 ("VATA").

12. Section 24(1) VATA provides that:

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

Section 25(2) VATA provides that a taxable person is:

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

13. Section 26(1) and (2) VATA address the amount of input tax for which a taxable person is entitled to credit "as being attributable to … taxable supplies; …".

14. The "standard method" of apportionment where a person makes both taxable and exempt supplies is prescribed by Regulation 101(2)(d) of the Value Added Tax Regulations 1995. This provides:

> where a taxable person does not have an immediately preceding longer period … there shall be attributed to taxable supplies such proportion of the residual input tax as bears the same ratio to the total of such input tax as the value of taxable supplied made by him bears to the value of all supplies made by him in the period.

15. Regulation 107A of the Value Added Tax Regulations 1995 provides for a "standard method override" in circumstances where the attribution under Regulation 101(2)(d), "differs substantially from one which represents the extent to which the goods or services are used by him or are to be used by him … in making taxable supplies" (see Regulation 107A(1) Value Added Tax Regulations 1995).

16. Like the Court of Appeal in *Mayflower Theatre Trust Limited v HMRC* [2007] STC 880 at [9] ("*Mayflower*") I was referred to numerous authorities on the application of the partial exemption rules including *BLP Group plc v Customs and Excise Commissioners* [1995] STC 424 ("*BLP*"); *Card Protection Plan Ltd v Customs and Excise Commissioners* [1999] STC 270 ("*CPP*"); *Abbey National plc v Customs and Excise Commissioners* [2001] STC 297; *Customs and Excise Commissioners v Southern Primary Housing Association Ltd* [2004] STC 209; *Dial-a-Phone Ltd v Customs and Excise Commissioners* [2004] STC 987 at [28]; and *Dr Beynon v Customs and Excise Commissioners* [2004] STC 55, all of which were decided before the Court of decision in *Mayflower*.

17. Although I was also taken to post *Mayflower* decisions, to which I shall subsequently refer, it first worth noting the comments of Carnwath LJ (as he then was) in that case at [9]:

> "The main principles derived from these cases are not controversial. They were helpfully summarised in Miss Whipple's first skeleton for the Trust dated 1 August 2006 (subsequently adopted by Mr David Milne QC). I will refer to this as "the trust's skeleton".) I extract (with minor adaptations) the following points: (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."

He continued:

> "10. Point (v) needs to be read in the light of what was said by the House of Lords in *Beynon* (per Lord Hoffmann):
>
> > 'The courts have not treated VAT classification in the same way as some questions of classification (for example, whether a contract is of service or for services) which, notwithstanding that there are no facts in dispute, are deemed to be questions of fact so as to exclude on appeal on a question of law: see the discussion in *Moyna v Secretary of State for Works and Pensions* [2003] UKHL 44; [2003] 1 WLR 1929, 1935, paras 22-25. On the other hand, as Lord Hope of Craighead said in the *British*

> *Telecommunications Plc* case, at p 1386, the question is one of fact and degree, taking account of all the circumstances. In such cases it is customary for an appellate court to show some circumspection before interfering with the decision of the tribunal merely because it would have put the case on the other side of the line.' (para 27)

> 11. To that list I would add two further points, relied on by [counsel for HMRC], again uncontroversial in principle: (vi) It may be necessary to determine whether, for tax purposes, a number of supplies are to be treated as elements in some over-arching single supply. If so, that supply should not be artificially split:

> > 'The criterion is whether there is a single supply from an economic point of view. The answer will be found by ascertaining the essential features of the transaction under which the taxable person is operating when supplying the consumer, regarded as a typical consumer.' (*College of Estate Management* para 12, per Lord Walker)

> (vii) A transaction which is exempt from VAT will "break the chain" of attribution. In the words of the Advocate-General (Jacobs) in *Abbey National* (para 35):

> > '.. the 'chain-breaking' effect which is an inherent feature of an exempt transaction will always prevent VAT incurred on supplies used for such a transaction from being deductible from VAT to be paid on a subsequent output supply of which the exempt transaction forms a cost component. The need for a 'direct and immediate link' thus does not refer exclusively to the very next link in the chain but serves to exclude situations where the chain has been broken by an exempt supply.'"

18. In that case it was accepted that the Mayflower Theatre Trust, like the ROH in the present case, was within the terms of the cultural exemption from VAT and that the supply of tickets for performances were exempt supplies for VAT purposes. However, the Trust claimed it was entitled to a repayment representing a proportion of input tax it could have deducted in respect of the consideration paid to production companies which it contended was not exclusively attributable to the exempt supply of theatre tickets but also in part to taxable supplies including the sale of programmes which contained details of productions at the theatre, eg information about the show, cast members, director, writer and other information specific to the production, confectionary, drinks, merchandise, sundry items and corporate entertainment.

19. For the Theatre it was argued that the programme uses the production and that there was therefore a direct and immediate link between them. However, HMRC contended that the production costs were not direct cost components of the programmes; the mere fact that they contained information about a performance did not create a direct and immediate link as what was being "used" was the commercial opportunity which arose out of the existence of an audience that had paid for the right to see the performance. The Tribunal, which considered that taxable supplies as a whole, accepted HMRC's argument that, as patrons could choose whether to purchase a programme, confectionary etc., the prior purchase of a ticket would break any link with the consideration the Theatre paid to the production company because of the exempt nature of the supply of the ticket.

20. However, the Court of Appeal disagreed with this analysis. Carnwath LJ said, at [40]:

> "By dealing compendiously with all these items, the tribunal has, in my view, failed adequately to address the particular characteristics of the programme

sales, as distinct from the other items, for example, sales of confectionery and drinks. Rightly in my view, the Trust has not sought in this court to claim a sufficient link between such sales and the production services. Such sales are the same in character whether they are in an ordinary shop, a theatre kiosk, or a railway station. As with the bar sales in the *Royal Agricultural College* case (cited in *Dial-a-Phone*, see above), any link with the activities of the particular location is "indirect and not immediate". The programme sales were distinguishable, because of the necessary link between the contents of a programme and the particular production for which it was sold. The question for the tribunal was whether this link was "sufficiently close" to meet the *BLP* test. Failure by the tribunal to recognise and address this distinction was in my view itself an error of law, which entitles us to reconsider the primary facts."

He continued:

"42. Without disrespect to the tribunal, I find none of these points persuasive: (i) The lack of a direct relationship between the price of the output supply and the consideration paid for the input is not determinative. I would adopt Hart J's comment (see [2006] STC 1607 at [44]), based on *Dial-a-Phone*:

> '44. …, in finding that… the *BLP* test was satisfied in that case, no reliance was placed either by the Tribunal or the higher courts on any finding that the price charged for the insurance intermediary services had been calculated by reference to the cost of the advertising and marketing inputs. These were nonetheless found to have been "used for" supplying those services. A sufficient nexus existed without it being necessary to show that those inputs were a "cost component" of the price charged for the relevant outputs in the very narrow sense adopted by the Tribunal in the present case.'

(ii) The company's accounts may be of some relevance, but they are unlikely to be conclusive. Their purpose is to give a fair view of the business, not of the relationships between particular inputs and outputs for VAT purposes. (iii) That the patron has a choice whether to buy is true of any retail sale, but seems to me irrelevant to the question of attribution. That might have been relevant to an argument (which has not been advanced) that there was one composite supply of the ticket and the programme, but not to the nature of the link within any particular supplies. (iv) The tribunal seems to have misunderstood the "breaking the chain" rule. That would only come into play if the two transactions were links in the same chain, in the sense that one was "a cost component" of the other (see point (viii) in para 11 above). However, the ticket sales and the programme sales are not linked in that way; they are separate transactions. The mere fact that one precedes the other in time, as Miss Hall accepts, is not enough. The question is, not whether they are links in the same chain, but whether each of them has a sufficiently direct link with the production supplies to satisfy the *BLP* test. The misapplication of the "breaking the chain" rule was another error of law, which entitles us to re-open the tribunal's conclusion.

43. On this point I accept the Trust's submissions. Applying the *Beynon* approach (see para 10 above), I think we are entitled to draw our own inference from the primary facts which are not in dispute. I would in any event be prepared to go further, if necessary, and say that, applying the *BLP* test correctly, the only reasonable view is that there was a direct and immediate link between the production services and the programmes. It is true that the production companies were not directly responsible for the programmes, other than the provision of information. But the productions for which they were

> responsible, and which provided the subject-matter of the contracts, also provided the subject-matter of the programmes. To that extent, they were as much part of the raw material used in preparing the programmes, as the paper and ink from which they were physically made. That in my view is an objective link, sufficiently close to satisfy the test."

21. In a judgement agreeing with Carnwath LJ, Chadwick LJ observed, at [62]:

> "In the present case it is not, I think, in dispute that each production contract must be treated as a separate supply of services. So, if the trust is to be entitled to deduct the input tax which it pays in respect of any given production contract from output tax on taxable supplies which it makes in the course of its business, it must establish the necessary link between the services supplied to it under that production contract and some taxable supply which it makes. It is not enough for the trust to assert that all the taxable supplies which it makes in the course of its business are linked, in a general sense, to its ability to stage performances of productions which it has 'bought in' under production contracts."

22. The issue of partial exemption also arose in *HMRC v London Clubs Management Limited* [2012] STC 388 in which Etherton LJ (as he then was) noted, at [33], that the need for a process of attribution only arises where an item is a cost component of two supplies one taxable and one exempt. At [34] he said:

> "A fair and reasonable attribution to a taxable supply must, for the purposes of Article 17(2) and (5) of the Sixth Directive and regulation 101(2)(d) of the Regulations, reflect the use of a relevant asset in making that supply. In assessing that use, and its extent, consideration is not limited to physical use. The assessment must be of the real economic use of the asset, that is to say having regard to economic reality, in the light of the observable terms and features of the taxpayer's business."

23. In *The Roald Dhal Museum and Story Centre v HMRC* [2014] UKFTT 308 (TC) ("*The Roald Dhal Museum*") the Tribunal rejected the Museum's argument that, if it decided not to charge an entry fee, the costs of its exhibits would be attributable to the taxable supplies of its shop sales. It considered, at [89] that:

> "… sales in the shop and admissions to the Museum are separate and "freestanding" supplies. If a person makes two separate supplies, one at a profit and one at a loss, and uses the profits from the former to finance the loss on the latter, that does not mean that the costs of supplying the former are a cost component of the supply of the latter. It is simply a case of profits from one activity being spent for the purpose of subsidising or financing a separate activity."

24. However, the Tribunal took a different approach in *North Of England Zoological Society v HMRC* [2015] SFTD 841 ("*Chester Zoo*"). The issue before the Tribunal in *Chester Zoo* was whether there was a direct and immediate link between the animal related costs (ie the costs of keeping and maintaining animals at the Zoo and in respect of improving and building new animal habitats) and catering and retail supplies. It is necessary to refer to this decision in some detail as it ultimately led to the ROH making its input tax claim which resulted in this appeal.

25. Having noted, at [20], that some of the authorities were decided in the context of "attribution", ie determining whether there is right to deduct input tax at all, and others in the context of "apportionment", ie the apportionment of residual input tax between taxable and exempt supplies the Tribunal observed, at [22], that while it was important to maintain the distinction, indeed Patten LJ warned of the "danger" of doing otherwise in *Volkswagen*

Financial Services (UK) Ltd v HMRC [2016] STC 417 at [62], authorities in relation to one issue may be relevant in relation to the other.

26. As Henderson J (as he then was) recognised in *HMRC v Lok'nStore Group Plc* [2015] STC 112, at [40],

> "… it does not follow from this, in my judgment, that the two stages always have to be treated as rigidly distinct from each other. Depending on the precise facts, considerations which are relevant at the first (attribution) stage may also be relevant when examining the economic use made of the overheads at the second (apportionment) stage."

27. After summarising the principles that emerge from the authorities, at [47], the Tribunal noted, at [52], that Chester Zoo or the Society, as it was referred to in the decision, was a charity with "most of its funding" derived from the Zoo and that its control and management rested with its trustees. It also noted that everything it does, including its support for over 60 projects worldwide, is "geared towards promoting its charitable objects." As described at [80], the charity is also the sole shareholder in Chester Zoo Enterprises Limited which was formed in 1991 to carry out the commercial operations which were not within the charitable objects of the Zoo. It is the company, which is part of the same VAT Group as the Zoo, that makes catering and retail supplies at the Zoo with any profits being gift aided to the Zoo.

28. At [56] the Tribunal observed that in 2010 Chester Zoo had over 1.2 million visitors increasing to 1.4 million in 2011 and that it had attributed the increase to investment in new animal exhibits, major events and fully refurbishing the restaurants.

29. Having described the Zoo's attractions and facilities the Tribunal observed, at [61]:

> "Not surprisingly the attractions and facilities including catering and retail facilities all have animal themes, to a greater or lesser extent. The sight lines of restaurants are carefully planned to interact with the animal exhibits, more so in recent years. The Zoo aims to create in so far as possible a seamless animal experience with themed zones flowing easily into one another. That approach was embodied in what is called the "*Natural Vision Master Plan*" produced in August 2010. It made provision for substantial capital investment in the Zoo in the period 2012 to 2024. Extending the dwell time of customers is fundamental to that plan. The long term aim of the Zoo is to become what Mr Iles [the Zoo's finance director until January 2014] described as a "super zoo". By that expression he meant a zoo which, amongst other attributes, gives an "all-immersive experience".

It continued:

> "69. Catering and retail offerings are both affected by changes in the Zoo's animal exhibits. For example when a new elephant was born in the Zoo in July 2010 sales of soft toy elephants increased significantly. Similarly when the African painted dog exhibit opened, sales of painted dog merchandise increased significantly.
>
> 70. The Society seeks to maximise income streams. For example when the African painted dogs exhibit opened, a kiosk selling relevant merchandise was located close to the enclosure. The merchandise was also displayed prominently in the Gift Shop. Meal offerings are also themed around new exhibits.
>
> 71. The Zoo seeks to ensure that the retail offering has strong messaging about animals at the Zoo. However the Zoo does sell or has sold ranges that are not related to animals at the Zoo. For example it has in the past sold model planes, helium balloons and white tigers which are not exhibited at the Zoo. In 2011

> approximately 12% of retail ranges were not driven by the Zoo animals or its exhibits, events and conservation messages. Helium balloons accounted for 8% of retail sales in 2010 but have since been dropped because of the environmental damage they cause.
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> …
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> 74. It is clear from the approach the Zoo takes to investment in animal exhibits and facilities generally that its aims are not just to increase admission income, but also to increase catering and retail income."

30. At [82] the Tribunal recorded that in the 10-year period from 2003 to 2013 retail and catering contributed 67% of the overall surpluses of the Zoo and that if it had not been for those surpluses the Zoo would have reported a net operating deficit in five of those years. As such the Tribunal was satisfied that without the contribution to profits of retail and catering supplies the Zoo would have been forced to substantially contract its operations. It was noted, at [87], that the animal related costs were not reflected in the prices charged for catering and retail offerings, "or indeed the price of admission". Rather, as Chester Zoo is classed as such, prices were based on the UK market rate for "Large Visitor Attractions" such as Alton Towers, Legoland, the Eden Project, London Zoo and Bristol Zoo.

31. Having discussed the parties submissions the Tribunal considered, at [116], that:

> "… the existence of a direct and immediate link in a case such as the present is a matter of degree involving various factors relevant to economic use."

It continued:

> "117. The extent of integration experienced by visitors observing the animals and enjoying the catering and retail offerings is a relevant factor. Mr Chapman [counsel for HMRC] effectively took a step towards recognising as much when he said that HMRC's position might be different if the Zoo was what was described by Mr Iles as a "super zoo" involving an all-immersive experience incorporating catering and retail offerings. However he submitted that in any event on the facts the Zoo was not, during the periods of the Assessments, sufficiently all-immersive. For example the catering offering was not such that the restaurants themselves were almost like an exhibit. He gave as an example a Disney theme park. In the period 2003 to 2012 he submitted that the Zoo was nowhere near such an all-immersive experience.
>
> 118. We are satisfied that "*the core of the Zoo's commercial proposition*" to use Mr Cordara's [counsel for the Zoo] words is the animals. To a greater or lesser extent everything is driven by the animals. We accept that there are or were some products where the link to animals is weak or non-existent. For example helium balloons. However we consider that looked at in the round there is a strong economic link between the catering and retail offerings and the animals. Catering outlets and shops are carefully positioned and themed by reference to the animals. The Zoo is operated in a way designed to increase dwell time. This is done by improving and renewing animal exhibits and the other facilities offered by the Zoo, including catering and retail facilities. This is what Mr Iles described as a "virtuous circle". The better the collection of animals and habitats the greater the income from all income streams. In turn, that provides funding to improve the animal collections and habitats.
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> …
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> 120. Mr Cordara submitted that it was impossible to try and disentangle all the income streams. Each feeds upon the others. This was what he described as a "unitary commercial model". In making that submission he described the

animals as the "central draw" which was thereby a cost component of all economic activity at the Zoo.

…

122. We must focus on the extent to which the animal related costs are economically linked to particular supplies. The extent to which particular supplies make economic use of the animal related costs. Both parties accept that a "but for" link is present. If it were not for the animals and the animal related costs there would be no or much reduced catering and retail outputs. However that is not the test. The link must be closer than that. Whether one uses the term "cost component" or looks for the economic use that is made of the animal related costs.

…

124. For the reasons given above one cannot say that the sole purpose of the Society in incurring the animal related costs is the furtherance of its educational objects. The purposes, objectively ascertained, include maintaining the income streams of the Zoo from all sources. Even if one could say that the principal commercial purpose was to generate admission income, the position would not be dissimilar to *Dial-a-Phone*. At [75] to [77] of the judgment in *Dial-a-Phone* the fact that insurance intermediary services may be viewed as secondary in a commercial sense was said to be irrelevant. What is relevant is the existence of a direct and immediate link.

125. Mr Chapman submitted that the Society would still incur the animal related costs even if there were no catering and retail facilities. Again we consider that is an artificial argument which does not accord with economic reality. It is clear that if there were no catering and retail facilities then the Zoo would have to operate on a much smaller scale. In that sense it supports the Society's case that the Zoo as an economic activity relies heavily on the income stream from catering and retail outlets, which in turn rely on the animal exhibits.

126. It is significant in our view that the catering and retail supplies were profitable, in the sense that they made a significant contribution to expenditure of the Society in all years under consideration. That is highlighted by the fact that in 5 out of the 10 years to 2013 the Society would have made a deficit without that contribution. During the course of those 10 years, catering and retail supplies made a contribution of some £18m to a surplus of some £27m.

127. Mr Chapman accepted that profit was relevant for the purposes of the present analysis, however he submitted that it was not particularly significant because the Society is a charity. We do not see how that affects the significance of profit in the present analysis. It may be more accurate to talk of catering and retail supplies making a contribution to the expenditure of the Society in pursuing its charitable objects. However the fact that the contribution is necessary for the Society to fulfil its objects at the level at which it does remains a significant factor in the analysis. The source of funding was certainly a significant factor in *St Helens School*.

128. We accept that there is a closer link between the animal related costs and the exempt supply of admission to the Zoo. The Society wants people to come to see the animals. It also wants people to come and spend a day at the Zoo using the facilities to the fullest extent possible. The more people come to see the animals and the longer their dwell time, the more money will be spent on catering and retail.

> 129. The degree to which the animal related costs are borne by the catering and retail supplies is a key factor.
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> 130. It is true that the animal related costs are not directly reflected in the prices charged for catering and retail offerings. Nor are they directly reflected in the prices charged for admission. Prices are set by reference to the market for large visitor attractions rather than the costs incurred. Having said that, of course it is necessary for the Society to cover its costs from all its income streams. That is a factor highlighted by Mr Cordara. The Society's business model, in commercial terms exploits the animals in order to achieve various income streams, the most significant of which are admissions, catering and retail. In that sense the animal related costs are borne by all those supplies.
>
> 131. Standing back to look at the overall picture, it seems to us that in the particular circumstances of the Society's economic activities the animal related costs have a direct and immediate link to the catering and retail supplies. We are satisfied that economically the animal related costs are a cost component of the catering and retail supplies."

32. *Chester Zoo* was applied in *The Berkshire Golf Club and others v HMRC* [2016] SFTD 244 which concluded that there was of a direct and immediate link between the supply of tee advertising and golf buggy hire to the maintenance costs of golf courses.

33. In '*Sveda' UAB v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2016] STC 447 ("*Sveda*"), the Court of Justice of the European Union ("CJEU") stated, at [32]. that:

> "… 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 *Aset Menidjmunt*, 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."

However, whether there was a direct and immediate link was, the CJEU said at [37], "a matter for the referring court to determine on the basis if objective evidence."

34. *HMRC v Associated Newspapers Limited* [2017] STC 843 ("*ANL*") was concerned with the the recovery of input tax in relation to two promotional schemes which, in essence, involved purchases by ANL of vouchers from retailers which were provided, subject to conditions, to readers of the newspapers concerned free of charge. An issue before the Court of Appeal was whether the supplies of vouchers to ANL were cost components of a taxable supply.

35. Having considered the authorities Patten LJ (with whom Jackson and Black LJJ agreed) said:

> "42. The most recent consideration of this issue by the CJEU seems to be its decision in *'Sveda' UAB v Valstybine mokesciu inspekcija prie Lietuvos Respublikos finansu ministerijos* (Case C-126/14) [2016] STC 447) which was relied on by the Upper Tribunal in reaching its conclusion that the supplies of vouchers to ANL were linked economically to the sale of newspapers rather than to the provision of free vouchers as part of the two schemes. *Sveda* was concerned with the recoverability of input tax on the supply of goods purchased in connection with the construction of a 'Baltic mythology recreational/discovery path'. The project was subsidised by the government of Lithuania on the basis that there would be free public access to it but Sveda did intend to carry out some economic activities at the discovery path in the form of the sale of food or souvenirs.

43. The question therefore was whether the goods purchased for the construction of the facility had a direct and immediate link for the purposes of Article 168 with the commercial activities I have described or were cost components of the construction of the discovery path which was to be made available to the public free of charge.

44. In her Opinion Advocate General Kokott, after referring to *BLP*, set out the direct and immediate link test in similar terms to the judgment in *Skatteverket*:

> ’33. However, the Court has further developed its case-law since that case. It still remains the case that for Article 168 of the VAT Directive to apply a direct and immediate link must have been found between a given input transaction under examination and a particular output transaction or transactions giving rise to the right of deduction. Such a link may nevertheless also exist with the economic activity of the taxable person as a whole if the costs of the input transactions form part of the general costs of the taxable person and are therefore cost components of all goods or services delivered or provided by him.
>
> 34. According to recent case-law, the decisive factor for a direct and immediate link is consistently that the cost of the input transactions be incorporated in the cost of individual output transactions or of all goods and services supplied by the taxable person. This applies irrespective of whether the use of goods or services by the taxable person is at issue.
>
> 35. Consequently, there is a right of deduction in the present case if the cost of acquiring or manufacturing the capital goods of the recreational path is incorporated, in accordance with case-law, in the cost of the output transactions, taxed under the VAT Directive.’

…

46. The Court in its judgment largely adopted the approach of looking for what it describes as an objective link between the expenditure and the taxpayer's subsequent economic activity whilst making no distinction for these purposes between exempt and non-taxable supplies:

> ‘22. In the present case, the referring court has described the expenses relating to the capital goods at issue in the main proceedings as being ultimately intended for carrying out the economic activities planned by Sveda. According to that court's findings, supported by objective evidence from the file it submitted, the recreational path concerned may be regarded as a means of attracting visitors with a view to providing them with goods and services, such as souvenirs, food and drinks as well as access to attractions and paid-for bathing.
>
> 23. Therefore, it would appear from those findings that Sveda acquired or produced the capital goods concerned 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 VAT Directive.
>
> …..
>
> 29. It is apparent from the case-law of the Court that, in the context of the direct-link test that is to be applied by the tax

> authorities and national courts, they should consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the taxable person's taxable activity. The existence of such a link must thus be assessed in the light of the objective content of the transaction in question (see, to that effect, judgment in *Becker*, C-104/12, EU:C:2013:99, paragraphs 22, 23 and 33 and the case-law cited).
>
> …'
>
> 47. It seems to me that the CJEU has clearly moved away in these recent decisions from any disregard of the ultimate economic purpose of the relevant expenditure in considering whether it should be treated as linked to the taxpayer's wider economic activities. This is not a question of subjective intent but requires an objective analysis in terms of the taxpayer's identifiable economic activities of why the input supplies were acquired. Although there must, I think, be some evidence that the cost of the input supplies was passed on as part of the cost of the supplies which the taxable person subsequently makes, the absorption of those costs as part of the expenditure of running the business is not to be ignored merely because they also facilitated the making of supplies which in themselves were either exempt or outside the scope of the PVD.
>
> 48. So in the present case the cost to ANL of acquiring the vouchers can be treated in purely causal terms as attributable to the onward supply of the vouchers. Without the purchase of the vouchers their free distribution could not have taken place. However, in economic terms, the cost of purchasing the vouchers was also part of ANL's overall expenditure in the production and sale of its newspapers which the vouchers were intended to promote. The fact that the vouchers were provided free to buyers of the newspapers merely serves to confirm that they were cost components of the business rather than the onward supply of the vouchers."

36. Patten LJ also observed that:

> "54. … The *Mayflower Theatre Trust* case is more pertinent because there it was held that the expenses were linked to the exempt supply of tickets even though the purpose of the performance was in part to enable the Trust to make taxable supplies of refreshments.
>
> 55. In the *Mayflower Theatre Trust* case Carnwath LJ seems to have been concerned to remain true to the reasoning in *BLP* as he understood it by not extending the test of what constitutes a direct and immediate link: see the references at [33] of the judgment to a slippery slope. But, in the light of the judgment in *Sveda*, a different approach seems now to be required. The fact that services in the form of the vouchers were acquired in order to make non-taxable output supplies of the same items to ANL's customers is not determinative if the cost of those supplies is in fact a component of ANL's taxable business: see *Sveda* at [34].

37. In *HMRC v Chancellor, Masters and Scholars of the University of Cambridge* [2018] STC 848 ("*Cambridge University*") the issue before the Court of Appeal was the attribution of input tax it had paid in respect of the professional fees for management of an endowment between its exempt supplies of education and its taxable supplies which included commercial research, sale of publications, catering, accommodation and the hiring of facilities and equipment. Patten LJ, giving the judgment of the Court said, at [42]:

> "42. As I indicated in [47] of my judgment in *Associated Newspapers*, the Court seems to have rejected the view expressed by Advocate General Jacobs that a non-taxable transaction can be ignored in determining the output supply to which the expenditure is directly linked for the purposes of Article 168. We therefore accept the submission of the Commissioners that a finding of a direct link to such a supply will render the input tax irrecoverable just as in the case of an exempt output supply. But the decision also, we think, confirms that in appropriate cases expenditure which is factually attributable to a more immediate (non-taxable) activity such as the creation of the free discovery path facility can for VAT purposes be treated as linked to the economic activity which will follow. It appears from the judgment in *Sveda* that this falls to be determined not by reference to what might be said to be the purpose of the expenditure because that approach was rejected in *BLP* and that question is in any case capable of more than one answer depending on how wide a view of the consequences of the transaction one takes. On one view the construction of the path in *Sveda* was the purpose behind the expenditure. Nor is it resolved simply by establishing a causal connection. Instead the question seems to be whether one can link the expenditure to the ultimate economic activity by treating it as a cost component of a specific taxable supply or as an overhead of the business, i.e. are the costs incorporated in the cost of the taxpayer's economic activities to use the test suggested by the Advocate General."

Having referred to the decision of the CJEU in *Iberdrola Inmobiliaria Real Estate Investments EOOD* EU:C:2017:683, [2017] All ER (D) 114 (Sep), Patten LJ continued:

> "44. The CJEU adopted the same reasoning as in *Sveda*, holding that input tax was irrecoverable if directly linked to either an exempt or a non-taxable transaction and that in applying the direct link test national courts should consider and take account only of the transactions which are objectively linked to a person's taxable activity:
>
> > '31. It is apparent from the case-law of the Court that, in the context of the direct-link test that is to be applied by the tax authorities and national courts, they should consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the taxable person's taxable activity. The existence of such a link must thus be assessed in the light of the objective content of the transaction in question (see, to that effect, judgment of 22 October 2015, *Sveda*, C-126/14, EU:C:2015:712, paragraph 29).
> >
> > 32. In the appraisal of the question as to whether, in circumstances such as those at issue in the main proceedings, Iberdrola has the right to deduct input VAT for the reconstruction of the waste-water pump station, it is therefore necessary to determine whether there is a direct and immediate link between, on the one hand, that reconstruction service and, on the other hand, a taxed output transaction by Iberdrola or that undertaking's economic activity.
> >
> > 33. It is clear from the order for reference that, without the reconstruction of that pump station, it would have been impossible to connect the buildings which Iberdrola planned to build to that pump station, with the result that that reconstruction was essential for completing that project and that, consequently, in the absence of such reconstruction, Iberdrola would not have been able to carry out its economic activity.

> 34. Those circumstances are likely to demonstrate the existence of a direct and immediate link between the reconstruction service in respect of the pump station belonging to the municipality of Tsarevo and a taxed output transaction by Iberdrola, since it appears that the service was supplied in order to allow the latter to carry out the construction project at issue in the main proceedings.
>
> 35. The fact that the municipality of Tsarevo also benefits from that service cannot justify the right to deduct corresponding to that service being denied to Iberdrola if the existence of such a direct and immediate link is established, which is a matter for the referring court to determine.'"

38. The Court of Appeal also recognised, at [51], the trend in recent cases to find the "necessary economic link between the initial expenditure and the economic activities which follow unless compelled by the particular circumstances of the case to conclude that the costs are linked to a more immediate exempt or non-taxable supply". However, unlike *ANL* where it was "difficult to treat the purchase of an incentive to buy the newspapers as anything but part of the promotion of the taxpayer's business", at [52], the Court considered the link in transactional terms *Cambridge University* to be more remote and as the issue was not acte clair referred the matter to the CJEU.

39. The question of attribution if input tax was also considered by the CJEU in *HMRC v Volkswagen Financial Services (UK) Limited* [2018] STC 2217 ("*VWFS*") the facts of which, were described by Advocate General Szpunar in his Opinion:

> "15. VWFS purchases vehicles from dealerships and then supplies those vehicles, in its own name, to customers to whom it also provides certain related services. The consideration paid by the customer under a hire purchase agreement is divided into two parts: the price of the vehicle, which is equal to the price paid by VWFS to the dealership, and the 'finance charges', which include all the other fees and provisions as well as a profit margin.
>
> 16. For VAT purposes, those hire purchase agreements are treated as two distinct transactions: a taxable supply of goods and an exempt supply of credit. In the context of the supply of goods, only the price of the vehicle, as paid by VWFS and charged to the customer, is regarded as consideration. That price therefore includes VAT, the amount of which is equal to the input VAT paid by VWFS on the purchase of the vehicle. The remainder of the amount charged to the customer does not include VAT.
>
> 17. The input VAT paid by VWFS on the purchase of the vehicles is fully deducted from the output VAT charged to customers. The dispute between VWFS and the tax authority concerns the right to deduct the input VAT on VWFS' various overhead costs in so far as the goods and services in respect of which those costs were incurred have been used for the purposes of VWFS' taxable transactions, namely, supplies of vehicles."

40. In its judgment, in relation to the method of calculating the deductible proportion of VAT the CJEU stated:

> "38. The Court has already held that it is apparent from art 168 of the VAT Directive that a taxable person is, in principle, entitled to deduct input tax where it is established that the goods and services relied on to give entitlement to that right are used by that taxable person for the purposes of his own taxed transactions, and that, as inputs, those goods or services are supplied by another taxable person (see, to that effect, judgment of 22 June 2016,

Gemeente Woerden v Staatsecretaris van Financiën (Case C-267/15) EU:C:2016:466, [2016] SWTI 2206, [2016] All ER (D) 153 (Jun), paras 34 and 35).

39. According to settled case-law of the Court, that right of taxable persons is a fundamental principle of the common system of VAT established by EU law, so that that right is an integral part of the VAT scheme and in principle may not be limited (see, to that effect, judgment of 22 June 2016, *Gemeente Woerden* (Case C-267/15) EU:C:2016:466, paras 30 and 31 and the case-law cited).

40. The deduction system is intended 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 the purpose or results of those activities, provided that they are themselves subject to VAT (judgment of 22 June 2016, *Gemeente Woerden* (Case C-267/15) EU:C:2016:466, para 32).

41. In accordance also with the Court's settled case-law, the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to the right to deduct is necessary, in principle, before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement. 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 (judgment of 14 September 2017, *Iberdrola Inmobiliaria Real Estate Investments*, C-132/16, EU:C:2017:683, para 28 and the case-law cited).

42 A taxable person also 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 (judgment of 14 September 2017, *Iberdrola Inmobiliaria Real Estate Investments*, C-132/16, EU:C:2017:683, para 29 and the case-law cited).

43. In this case, it is apparent from the order for reference that the general costs at issue in the main proceedings have a direct and immediate link with the activities of VWFS as a whole, and not merely with some of them. In that regard, the fact that VWFS decided to include those costs not in the price of the taxable transactions, but solely in the price of the exempt transactions, can have no effect whatsoever on such a finding of fact."

41. It should also be remembered, as Lord Neuberger said, citing *HMRC v Newey (trading as Ocean Finance)* [2013] 24332 at [42] – [43], said in *HMRC v Airtours Holidays Transport Limited* [2016] STC 1509 at [49] that, "consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT."

42. Also, as Lord Reed said in *WHA Limited v HMRC* [2013] STC 943 (which was cited by Lord Neuberger at [59] of *Airtours*), that "decisions about the application of the VAT system are highly dependent on the factual situations involved. A small modification of the facts can render the legal solution in one case inapplicable to another."

43. On that note it is now appropriate to turn the facts of this case.

FACTS

Background

44. The ROH is a charitable company limited by guarantee. As is clear from Article 3 of its Memorandum of Association, it was established:

> "… to promote and assist in the advancement of education so far as such promotion and assistance shall be of a charitable nature and in particular, so far as of a charitable nature, to raise the artistic tastes of the country, and to procure and increase the appreciation and understanding of the musical art in all its forms. And, as ancillary to the foregoing objects or incidental or conducive to attainment of such objects but so and it is hereby declared that all objects of the [ROH] shall be of a charitable nature:
>
> (A) To present, produce, organise, manage, or conduct or procure to be presented, produced, organised, managed or conducted such performances or shows of operas, dramas, plays, choreography, ballets, concerts, music and other representation and performances in any medium, whether the stage or concert-hall or cinematograph or gramophone recording or broadcasting or television or any other form of reproduction, mechanical, digital or otherwise, and such exhibitions, lectures, displays, debates and courses of instruction produced in any form and by any medium, as the [ROH] may think fit for the purpose of furthering its objects.
>
> …
>
> (I) To establish, operate and carry on at the Royal Opera House, Covent Garden, bars, refreshment rooms and shops for the supply thereat, and in the auditorium of the said Opera House, of food, drink, any other refreshments and any forms of merchandising related to the Opera House or the performances taking place there of any kind by way of sale, and for the purposes aforesaid (but for no other purpose) to carry on the business as caterers, victuallers (whether licensed or not) restaurateurs and suppliers of goods, … Provided this power shall only be exercisable in a way which is compatible with the [ROH's] charitable status."

45. The catering and retail operations at the Opera House are undertaken by Royal Opera House Enterprises Limited, a subsidiary of, and part of the same VAT Group as the ROH which is the Representative Member of the Group. The Board of Trustees of the ROH is the ultimate decision making body and, with the support of the Executive Team, is responsible for overseeing the Opera House in support of the charity.

46. Ms Kilby's description of a visit to the Opera House as being "a fully integrated visitor experience", beginning when booking a ticket on the website, by telephone or in person to the night of a performance, was not challenged. She said that unlike a West End show, "where there might be a cramped bar or just ice creams available", the facilities of the Opera House were a key element for anyone attending a performance who, at the time of booking would be offered the opportunity to purchase champagne, ice cream and programme vouchers which resulted in considerable advance sales of champagne (£250,550 in 2010-11 and £171,990 in 2011-12).

47. Ms Kilby also confirmed that although as a charity the ROH does not expect to make a profit, the income from catering and retail sales, in addition to box office receipts and funding from Arts Council England, was required to support its artistic output. Ms Kilby said:

> "The investment in our [the ROH] artistic output, including our direct production costs enables us to generate the necessary income from all sources – including box office and catering/retail. If our productions were not

> perceived to be of the highest artistic quality by the public, we would not be able to generate the revenues to support our business."

However, she accepted in cross examination that, as stated in the financial statements of the ROH, the Production Costs are not treated in the ROH accounts or in business terms as a direct cost of the Disputed Supplies.

Production Costs

48. The Production Costs with which this appeal is concerned are those related to each production and not the costs of the ROH permanent staff or its fixed overhead costs.

49. These include the fees for guest performers and conductors, creative teams, music costs (for music still in copyright), the cost of sets, props, costumes, transportation, extras and actors. As such, these can vary from one production to another depending on, for example, the number of performers, the size of chorus (if any) and whether it is a new production requiring an initial outlay in relation to the set, costumes and props or a revival, for which only repairs, alterations and adjustments to existing sets etc. are needed.

Disputed Supplies

Catering

50. There has been a theatre in Covent Garden since 1732, with the Opera House, built in 1858, being the third on the site. The Opera House went through a programme of extensive modernisation of its facilities in the late 1990s. This included the acquisition of the adjacent old Floral Hall to provide a new dining area, the Paul Hamlyn Hall Balconies Restaurant and Paul Hamlyn Hall Champagne Bar. In addition, the Opera House has the Amphitheatre Restaurant and Amphitheatre Bar at the top level of the theatre, the Crush Room for dining and Conservatory (now Dorfman) Bar at the Grand Tier level for drinks and bar snacks and the Linbury Bar (which is currently closed for construction) adjacent to the Linbury Studio Theatre. Ms Kilby explained that, "these locations are crucial to offering food and beverages to our audience members when they come to attend performances".

51. The Opera House opens its doors 90 minutes before evening performances and some matinees to give ticket holders an opportunity to arrive at their leisure and have access to the bars and restaurants both before a performance and during the intervals. The proximity of the bars and restaurants to the auditorium enables audiences to have convenient access to their seats which results in most staying within the building during intervals rather than leaving to purchase drinks and snacks from nearby establishments.

52. Although the Opera House has a 2,204 seat auditorium, with an overall dining capacity of between 265 – 365 it is unable to provide a table for every ticket holder. However, the restaurants, which are open before and during a performance to those who have purchased tickets, are not always filled to capacity. While there is no requirement to pre-book for drinks or snacks from the bar menus, advance booking is recommended for the restaurants. This is explained to customers who, after booking a ticket are sent an introductory email detailing the various catering options including restaurant menus and recommendations. The restaurants can be booked up to 72 hours before a performance and a reminder email is sent 48 hours beforehand with what Ms Kilby described as a "catering prompt".

53. Once booked, a table is made available for the entire evening. This enables a customer to dine around the performance. For example, if attending the ballet, which will typically have two 25 minute intervals, he or she could have a first and second course before the performance, dessert in the first interval and tea/coffee in the second interval. The bars and restaurants are not open after a performance. At the time of booking there are a range of options and the customer chooses when the different course are taken but, in any event, the table is available

from when the doors open until the end of the last interval. Ms Kilby explained that most patrons chose to spread their dining before curtain up and during the intervals.

54. Different menus are offered for different productions offering a number of choices for each course. Although dishes are not normally linked to a production there is some limited theming of food and drink. An example, on the ROH website, in relation to a production of La Bohéme states:

> "We have a wonderful cast of dishes for this revival of Puccini's masterpiece. Salute its Parisian setting with French-influenced mains such as braised artichokes with white wine, fennel, basil and aioli in the Crush Room, or fillet steak duxelles with glazed shallots in Balconies Restaurant. Whichever you prefer, silky vanilla bavaraois with summer berry compote and brandy snap makes a fabulous finale."

55. Ms Kilby said that menu prices reflected the costs of production. She gave an example of opera menus being higher than, for example, a menu to coincide with a ballet triple bill which would cost less than an opera to stage and produced sample menus which show that, during a production of La Bohéme, a fixed priced three course menu in the Balconies Restaurant was £75 compared with £70 for a very similar menu when Swan Lake was being performed.

56. Ms Kilby agreed that the Opera House repertoire each season was chosen by the ROH for artistic reasons and not to maximise catering revenue.

Shop

57. During the period with which this appeal is concerned (1 June 2011 and 31 August 2012) the entrance to the shop was near the Covent Garden Piazza entrance to the Opera House, a prime position to capture the millions of tourists who visit the area. The shop itself was adjacent to the box office where visitors came either to purchase tickets or collect pre-paid tickets.

58. Unlike the restaurants and bars, which were the preserve of ticket holders only, the shop was open to the public from 10am on Mondays to Saturdays and most evenings closed either at curtain, which was shortly after 7:30pm, or when there was not a performance at 6:00pm. Occasionally the shop would open on a Sunday but this would depend on performances or other activities. Ms Kilby was unable to provide any information in relation to the proportion of the shop's customers who had purchased tickets for a performance and those who had not

59. The shop sold a range of giftware that reflected the ROH brand. These include Children's Gifts and Books, Stationery, Royal Opera House and Royal Ballet Gifts, Prints, Publications, Productions and Recordings. Most of the shop's turnover (60%) was generated by the sale of Productions and Recordings with Gifts providing approximately 12% and production specific ranges (eg Swan Lake, Alice in Wonderland) contributing around 4% of the total. Recordings are evenly split between opera and ballet and gifts more generically branded with the Opera House logo.

60. In addition to recordings of ROH productions the shop sold recordings of the artists appearing in its productions and those which support its repertoire, eg recordings of artists appearing at the Opera House in other roles and/or productions by different companies of the operas and ballets being performed at the Opera House that season.

61. The shop also has an online presence which accounts for approximately 25% of its turnover. Although, as Ms Kilby put it, there is a "more selective" range of gifts the online retail offers a more comprehensive range of recordings than sold in the shop.

Commercial venue hire

62. Commercial venue hire comprises the provision of Opera House facilities for private events and functions. Ms Kilby gave an example of a private event for a production sponsor or a Gala dinner in support of a production which can occur "before a season is up and running". However, not all commercial hire has such a link to ROH productions, eg the Wimbledon Champions Dinner which was held at the Opera House in 2014.

Production work for other companies

63. Ms Kilby explained that because of its reputation the ROH receives requests from other opera, ballet and theatre companies to construct sets and make costumes for use in their productions. Such work is generally undertaken on a fixed price basis to include materials and labour.

Ice cream sales

64. As in most theatres, ice creams are sold during intervals at front of house and near entrances to the auditorium. No ice creams are sold in the restaurants.

Dispute with HMRC

65. The ROH has been registered for VAT with effect from 1 March 2001. From before 2007 until December 2010 Production Costs were treated as having a direct and immediate link to its exempt supplies of admission to opera and ballet performances. This treatment was challenged by the ROH following the decision of the Tribunal in *Garsington Opera Limited v HMRC* [2009] UKFTT 77 (TC) when it made retrospective claims for the recovery of input tax by applying the standard method of partial exemption to the Production Costs and reclaiming the difference.

66. In a letter, dated 23 December 2010, HMRC accepted that Production Costs were residual as they have a "direct and immediate link with specific taxable supplies as well as exempt admissions."

67. The letter stated:

> "Where a theatres costs are residual because they have a direct and immediate link with specific taxable supplies as well as the exempt admissions to the show, the standard method over ride may be triggered because the value of the taxable supplies which have a direct and immediate link with production costs will be small in relation production costs in comparison with the total supplies made by the theatre.
>
> The court of appeal in Mayflower Theatre Trust Ltd (Mayflower) indicated that certain supplies (catering, general sponsorship and merchandising) did not have a direct and immediate link to production costs.
>
> HMRC's view is that in general terms, theatres should apply the SMO [the standard method over ride] adjustment to production costs using a broad-brush approach by removing the categories of supplies that were mentioned in the Court of Appeal decision in Mayflower as not having sufficient link with production costs and any other obviously distortive supplies."

The letter went on to say that the income streams which remain in dispute together with other income streams "should be excluded" when the ROH applied the "SMO calculation". The letter continued:

> "Please note that HMRC has taken a pragmatic approach and excluded the obviously distortive income streams that it considers not to have a direct and immediate link to the productions costs."

68. Following the release, in June 2015, of the decision in *Chester Zoo* (see above), the ROH submitted error correction notices to HMRC in respect of under-recovered residual input tax on 28 August 2015, 27 November 2015, 30 March 2016, 24 May 2016 and 24 August 2016 seeking repayment of £87,204, £108,884, £89,334, £121,916 and £124,731 respectively over its five prescribed VAT accounting periods from 1 June 2011 to 31 August 2012.

69. These repayment claims were refused by David Gaskell of HMRC on 15 December 2016. On 27 February 2017 the ROH wrote to HMRC (Mr Gaskell) requesting a review of his decision.

70. The ROH letter explained:

> "The budgeting for each year itemises each production and looks at the costs that are likely to be incurred in putting on the production. Offset against the costs is the box office income as well as the additional income from catering, merchandise, programmes, ice creams and others, that allows ROH to be able to be operated as a viable business. Without the receipt of this additional income from people enjoying the entire experience, ROH would need to consider increases to ticket prices. This point was highlight in [*Chester Zoo*] as being 'economically significant' when deciding whether the incurring of the disputed costs did have a direct and immediate link to all the income received by the charity."

After responding to specific questions raised by HMRC the letter continued:

> "The performance is the 'main event' in terms of ROH's charitable objects but we would submit that all the main overheads are funded by the catering/bar operations as well as ticket sales.
>
> If these catering and retail facilities operated on a smaller scale (and at ROH there are now plans to expand these facilities) then the level of the performances would also have to be scaled down. ROH is an economic activity which relies heavily on the income stream from catering and retail outlets which in turn rely upon the operatic performance."

71. However, following a review by Mrs S Barrow of HMRC, on 26 April 2017 Mr Gaskell's decision was upheld. The ROH appealed to the Tribunal on 17 May 2017.

72. Although HMRC filed and served its statement of case on 7 August 2017, following the exchange of witness statements and the provision of further information by the ROH as requested by HMRC, on 8 March 2019 HMRC made an application to amend its statement of case to enable it to "set out more clearly its primary position" and also to advance an alternative case in the event that the ROH succeeded in its appeal in relation to the apportionment of input tax.

73. On 28 March 2019 I endorsed a joint application by the parties giving HMRC permission to amend the statement of case and for this hearing to consider only the primary issue, ie the direct and immediate link between the Production Costs and the Disputed Supplies, leaving the parties to settle the apportionment issues raised by HMRC in the amended statement of case with the opportunity to refer the matter to the Tribunal should they be unable to do so.

DISCUSSION AND CONCLUSION

74. There was little, if any, dispute between the parties as to the legal principles applicable in this appeal. It is the application of these principles to the facts that separates them.

75. For the ROH, Mr Mantle contends that, as in *Chester Zoo*, there is a kind of 'virtuous circle' in operation with Production Costs producing high quality artistic productions and performances allowing ROH to generate more income from commercial sources thus

producing a financial contribution which can be ploughed back into Production Costs to support and enhance the artistic product. Additionally, and taking an economically realistic view, he says that it would not make commercial sense for the ROH to incur Production Cots at the levels it does if it relied solely on ticket sales, rather the business model depends on its productions as a 'hook' with an integrated experience leading audience members to spend on its wider commercial activities allowing the ROH to operate sustainably.

76. Mr Donmall, for HMRC, accepts that the profits from the Disputed Supplies contribute to the deficit the ROH would otherwise face in respect of its productions, as does the funding from the Arts Council on England, if it relied solely on box office receipts but contends that the Disputed Supplies rather than being cost components of the Production Costs are in fact subsidising them. As such the 'virtuous circle' argument should be rejected as it was in *The Roald Dhal Museum*. Also, he says that, unlike in *Sveda* or *ANL* the 'hook' in the present case is an exempt supply, the very essence of the ROH as an organisation. Additionally Mr Donmall contends that the Disputed Supplies are linked to the Production Costs through or via the ballet or opera and there is therefore a break in the chain, an issue which was not considered in *Chester Zoo*.

77. Before considering each of the Disputed Supplies in turn it is convenient to make some general observations:

(1) Like the animals in *Chester Zoo*, everything in the present case "is driven" by the ROH's operatic and ballet productions with such productions being the "central draw", "main event" or the "core" of its commercial proposition.

(2) It is not disputed that the profits from the Disputed Supplies enable the ROH to produce its highly acclaimed productions.

(3) Were it not for its artistic reputation the ROH would not be able to generate as much income from its commercial activities as it does.

(4) Therefore, as is clear on the evidence, there is a commercial and/or 'but for' link between the Production Costs and the Disputed Supplies.

(5) It also clear that such a link is not sufficient (see *Mayflower* at [9] and *Cambridge University* at [42]).

(6) The issue is the extent of that link – Why, on an objective analysis in terms of the ROH's identifiable activities, were the Productions Costs incurred and whether there is evidence that the Production Costs were a cost component of and/or have a direct and immediate link with the Disputed Supplies (see *ANL* at [47] and *VWFS* at [41]).

(7) The test is not identifying the most direct and immediate link but whether there is a sufficiently direct and immediate link with a taxable economic activity (see *Mayflower* at [9]).

(8) Although a transaction which is exempt from VAT will break the chain of attribution that will "only come into play" where two transactions are links in the same chain (ie one being a cost component of the other) there will not be a chain to break if the transactions are, like the programmes and production costs in *Mayflower*, not linked but separate transactions.

(9) It is necessary to consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the ROH's taxable activity. The existence of such a link must be assessed in the light of objective content of the transaction in question (see *Sveda* at [31] cited by Patten LJ in *Cambridge University* at [44]).

(10) Finally, as Lord Reed said in *WHA Limited* which Lord Neuberger cited in *Airtours*, decisions about the application of the VAT system are highly dependent on the factual situations involved and a small modification of the facts can render the legal solution in one case inapplicable to another thus limiting the assistance that can be derived from any factual similarities between this case and the authorities to which I was referred, particularly *Chester Zoo*.

78. With this in mind I now turn to the Disputed Supplies.

Catering income (bars and restaurants)

79. Clearly there are material differences between the taxable bar and restaurant supplies in this case and the animal themed catering, with sight lines of restaurants designed to interact with the animal exhibits and the intention to increase the "dwell time" of visitors, in *Chester Zoo*. In this case the time spent in the restaurants and bars of the Opera House is inextricably linked to the performance a ticket holder attends and any theme connecting the restaurant to the production is, if it exists at all, tenuous, as illustrated by the example in paragraph 54, above (the La Bohéme menu). Also, although Ms Kilby's evidence was that the prices reflected the lower costs of ballet to opera this was not borne out by the example menus produced where there the difference was only £5 (see paragraph 55, above).

80. This is consistent with the evidence of Ms Kilby that the Production Costs are not treated in business terms as a direct costs of catering and are not shown as such in the financial statements of the ROH. As a result Mr Donmall contends that the Productions Costs cannot be a cost component of the catering supplies especially as the choice of repertoire is an artistic matter made without reference to its effect on catering revenue. He also says that as purchases in the bars and restaurants are purchased "through" or "via" an exempt supply of ticket for a performance (the evidence is that only ticket holders use bars and restaurants) there is therefore a chain breaking event.

81. However, I consider that like programmes in *Mayflower*, which were also purchased by ticket holders, the catering in the bars and restaurants of the Opera House are separate supplies rather than links in the same chain. The question being whether each has a sufficient direct and immediate link with the Production Costs.

82. I agree with Mr Mantle that the comments of Carnwath LJ in relation to the "indirect and not immediate" link sales of confectionary and drink to the activities of a particular location at [40] in *Mayflower* even though the purpose of the performance was "in part" to allow the Trust to make taxable supplies of refreshments (see para 20, above), should be read in the light of the decision of the CJEU in *Sveda* and the remarks of Patten LJ in *ANL* at [55] (see para 36, above) where he considered a different approach to be required.

83. That approach, as is apparent from *ANL* and *Cambridge University*, is to objectively consider whether there is a "necessary economic link between the initial expenditure and the economic activities which follow". Adopting such an approach I have come to the conclusion that there is such a link between the Production Costs and taxable catering supplies in this case.

84. As with the animals in *Chester Zoo*, in this case, as I have already mentioned, it is the opera or ballet that is central to everything the ROH does. It is these performances that bring the restaurants and bars of the Opera House their clientele. Such a connection between the productions and catering supplies is, in my judgment, more than a "but for" link. Taking an economically realistic view the performances at the Opera House, and therefore the Production Costs, are essential for the ROH to make its catering supplies. It therefore follows that the purpose of the Production Costs, objectively ascertained, is not solely for the productions of opera and ballet at the Opera House but also to enable the ROH to maintain its catering income.

85. As such I am satisfied that the Production Costs do have a direct and immediate with the catering supplies of the ROH in the bars and restaurants of the Opera House. Given, given the "different approach" which is now required, and notwithstanding the comments of Carnwath LJ in *Mayflower*, I am able to derive some support for such a conclusion in the observation of Patten LJ at [54] of *ANL* that the purpose of the performance in *Mayflower* was in part to enable the Trust in that case was "to make taxable supplies of refreshments".

Shop income

86. Like the shop in *The Roald Dhal Museum* I consider the sales from the ROH shop, at its premises and online, and the sale of tickets for performances at the Opera House to be "separate and 'freestanding' supplies."

87. It is not disputed that the Production Costs do have a direct and immediate link to the sale of recordings, both audio and visual, of ROH productions. However, in my judgment, the same cannot be said of the remaining supplies that the shop makes which although there is a connection to the repertoire of the Opera House and therefore the Production Costs is no more than a commercial and/or "but for" rather than a direct and immediate link.

Commercial venue hire

88. Although I consider that there is a direct and immediate link between the Production Costs and production specific events, such as the example given by Ms Kilby of a Gala Dinner in support of a production by a sponsor, that cannot be the case for other commercial events such as the Wimbledon Champions Dinner. In such circumstances there is no connection or link with any specific production and the location and capacity of the Opera House would, in addition to its reputation, appear to be a factor in its appeal as a commercial venue.

89. Therefore, other than production specific events I am unable to find that there is a direct and immediate link to the Production Costs so as to enable the ROH to recover any input tax on commercial venue hire.

Production work for other companies

90. Undoubtedly the reputation of the ROH and the productions at the Opera House play a significant part in the ROH receiving orders from other opera and ballet companies to construct scenery and make costumes.

91. However, in my judgment, this is a "but for" link and not sufficient to enable me to find a direct and immediate link with the Production Costs. This is because this work is undertaken by the ROH at a fixed price, which includes materials and labour, and as such the Production Costs cannot be a cost component of these supplies.

Ice cream sales

92. Mr Donmall relies on the dicta of Carnwath LJ in *Mayflower* cited above in support of HMRC's argument that there is not a direct and immediate link between the Production Costs and ice cream sales. However, given the different approach now required following *Sveda* and *ANL*, to which I have referred above, I consider that, as with catering, the Opera House productions, with their associated costs, are essential for the sale of ice creams. Accordingly I consider the Production Costs do have a direct and immediate link to the sale of ice creams.

Summary of conclusions

93. For the reasons above, I have concluded that there is a direct and immediate link between the Production Costs and the taxable catering supplies of the ROH in its bars and restaurants, sales of ice cream, shop (including online) sales of recordings of ROH productions and production specific commercial venue hire. However, I do not consider there to be such a link in the case of the remaining Disputed Supplies.

94. As such, the appeal succeeds in part.

Right to apply for permission to appeal

95. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JOHN BROOKS
TRIBUNAL JUDGE

RELEASE DATE: 24 MAY 2019