[2021] UKFTT 127 (TC)

TC08108

Appeal number: TC/2015/07140 and TC/2016/06487

VAT – claim for credit for input tax – whether the provision of free education/vocational training to students where funding was provided by government agencies was a supply of services for consideration made by the appellant as a taxable person (any person who, independently carries out in any place any economic activity) acting as such – yes - whether KMC is entitled to credit for VAT incurred by it as residual input tax as a matter of law and under an agreed special method – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

KINGSTON MAURWARD COLLEGE **Appellant**

- and -

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

TRIBUNAL: JUDGE HARRIET MORGAN

Sitting in public at Taylor House, 88 Rosebery Avenue, London on 28 to 30 May 2019

Elizabeth Kelsey, counsel, instructed by VATangles Consultancy, for the appellant ("KMC")

Peter Mantle, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents ("HMRC")

DECISION

1. KMC appealed against a number of decisions notified by HMRC to KMC in letters dated 1 and 3 September 2015, 20 July 2016, and 2 September 2016 in which HMRC refused its claims for "credit" for "input tax" (as those terms are defined and used in ss 24, 25 and 26 of the Value Added Taxes Act 1994 ("**VATA**")) in respect of its accounting periods for VAT purposes from 1 August 2010 to 30 April 2016 ("**the relevant periods**"). The appeals are made under s 83(1)(c) VATA and for the period 04/15 also under s 83(1)(p)(i) VATA. KMC notified the tribunal of the appeals in notices dated 11 December 2015 and 17 November 2016.

2. In short, KMC's stance is that it is entitled to "credit" for VAT incurred by it in respect of the relevant periods for which it had not previously claimed "credit" when it submitted its VAT returns for those periods ("**the claimed tax**"). KMC makes its claim on the basis that the claimed tax constitutes "residual input tax" (as that term is used for VAT purposes) and that KMC is entitled to full "credit" for all of it under the "partial exemption special method" it has agreed with HMRC in a letter dated 6 May 1998 ("**the 1998 PESM**" and "**the 1998 letter**").

PART A - Background and summary of the issues and conclusions

KMC's activities

3. Unless stated to the contrary, references in this decision in the present tense to law, facts and circumstances are to law, facts and circumstances as in place or as they existed during the relevant period.

4. KMC is a Further Education College, incorporated under the Further and Higher Education Act 1992 with charitable status for the purposes of the Charities Act 2011. It occupies a rural site, including a Grade 1 listed Georgian Manor House, near Dorchester in Dorset. KMC provides education and/or vocational training to students of a range of ages in a variety of full time and part time courses including agriculture, equine studies and other "rural" or "land based" studies, business studies, "military preparation" and sport and leisure (as described in full at [50] and [51] below). I refer to all such services as "**training services**" and to all activities constituting or relating to such services as "**training activities**".

5. Only a minority of students who enrol on KMC's courses are subject to fees for the training services KMC provides to them. For the majority of students, KMC receives funding grants from the Education Funding Agency ("**EFA**") and the Skills Funding Agency ("**SFA**"). EFA and SFA are executive agencies of the government, sponsored by the Department for Education. I refer to these bodies as "**the agencies**" and to KMC's supplies for VAT purposes of training services which (a) are fully funded by the agencies as "**supplies without charge**" and (b) which are not funded by the agencies or are partially funded by the agencies, as "**supplies for fees**".

6. KMC also makes various other supplies of goods and services for VAT purposes, such as sales of produce from KMC's farm and dairy and products from its blacksmith, the provision of a number of services related to its equestrian activities, the hire of its buildings for weddings and conferences, the admission of the public to its visitor park and gardens and the operation of a camping and caravan site (as described in full at [52] below). I refer to all such supplies as "**commercial supplies**" and the activities constituting or relating to such supplies as "**commercial activities**". Some of KMC's students are involved, as part of the courses they undertake, in work which forms part of the commercial activities undertaken by KMC in the course of which it makes commercial supplies.

Relevant VAT law

7. I have set out below the material provisions of the Principal VAT Directive (Council Directive 2006/112/EC) ("**the PVD**") governing the common VAT scheme, which was in place in the European Union throughout the relevant periods and the corresponding UK provisions which give effect to the PVD.

Basis of VAT charge

8. VAT is due on the supply of goods or services for consideration within the territory of a Member State by a "taxable person acting as such" under article 2 PVD. A "taxable person" is "any person who, independently carries out in any place any economic activity, whatever the purpose or results of that activity" (under article 9 PVD). Under article 73 PVD the taxable amount in respect of the supply of goods and services by reference to which VAT is charged:

> "shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply."

9. Under the UK rules:

(1) VAT is to be charged on any taxable supply of goods or services which is made in the UK by a "taxable person in the course or furtherance of any business carried on by him" (under s 4 VATA).

(2) For this purpose:

(a) A "supply" "includes all forms of supply, but not anything done otherwise than for a consideration" (under s 5 VATA).

(b) Anything which "is not a supply of goods but is done for a consideration…… is a supply of services" (under s 5 VATA).

(c) A taxable supply is a supply of goods or services made in the UK other than an exempt supply (under s 4 VATA) as listed in VATA.

10. It was common ground that, as set out in case law, the term "business" used in the above provisions (and in s 24 VATA as set out below) has the same meaning as that given to the term "economic activity" in article 9 PVD. Accordingly, references in this decision to a business activity for the purposes of VATA are to be read as also being to an economic activity for the purposes of article 9 PVD (and vice versa).

Deduction or credit for "input tax"

11. As set out in article 1(2) PVD (a) the principle on which the common system of VAT is based "entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services", and (b), as many transactions take place in the production and distribution process before the stage at which the tax is charged:

> "On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.
>
> The common system of VAT shall be applied up to and including the retail trade stage."

12. In outline, this principle is given effect under the general scheme of VAT accounting whereby a taxable person obtains deduction of or "credit" for "input tax" paid on supplies received to the extent that it is attributable to onward taxed transactions made by the taxable person, namely, transactions on which VAT is charged or is due at a notional zero rate as opposed to exempt transactions. In effect, VAT is charged on the "value added" at each stage in the supply chain until the

relevant goods or services are subject to a final charge in the hands of the consumer who, as a non-taxable person, cannot obtain "credit" for the VAT charged. Hence, under the PVD:

(1) Article 168 provides that "[i]n so far as goods and services received by a taxable person "are used for the purposes of his taxed transaction, the taxable person" is entitled, "in the Member State in which he carries out these [taxed] transactions, to deduct…. 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" (as well as VAT due on "importations" and "acquisitions").

(2) Where goods or services are used by a taxable person both for (i) "transactions in respect of which VAT is deductible pursuant to" article 168 (or under other relevant articles) and (ii) "transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable" to the transactions in (i) is deductible (under article 173) (as determined, in accordance with articles 174 and 175, for all the transactions carried out by the taxable person).

13. These principles are given effect under the UK rules as follows:

(1) A taxable person is required to account for VAT for each accounting period (usually a three-month period) on the basis that, under ss 25 and 26 VATA:

(a) for each such period, a taxable person is entitled to "credit" at the end of the period for "so much of the input tax for the period….as is allowable by or under regulations as being attributable to" taxable supplies "made or to be made the taxable person in the course or furtherance of his business" (or to certain other limited supplies specified in the VAT rules), and

(b) the "credit" is given by way of deduction of the "input tax" from any "output tax" that is due from the taxable person in respect of that period.

(2) For the purpose of these provisions, "input tax" is defined in s 24(1)(a) to (c) VATA in relation to a taxable person as:

> "(a) VAT on the supply to him of goods or services,
>
> (b) VAT on the acquisition by him of goods from another Member State, or
>
> (c) VAT on the importation of any goods from a place outside the Member States,
>
> 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."

I refer to supplies, acquisitions and imports falling within categories (a) to (c) as "inputs".

(3) Broadly, "output tax" is VAT due on taxable supplies made by a taxable person which I refer to in this decision as "outputs".

(4) Under s 24(5) VATA, a taxable person is required to apportion VAT on inputs which "are used or to be used partly for the purposes of a business carried on or to be carried on by him and partly for other purposes" so that "only so much as is referable to the taxable person's business purposes is counted as that person's input tax" (and the remainder generally does not count as "input tax" subject to certain special rules in regulations).

(5) Under regulation 101 of the Value Added Tax Regulations 1995 SI 2518 ("**regulation 101**" and "**the Regulations**"), in respect of each accounting period, "input tax" is to be attributed to the taxable supplies a taxable person makes as follows:

(a) "input tax" incurred by a taxable person on inputs which are used or to be used by that person exclusively in making taxable supplies is attributed to those supplies,

(b) no part of the "input tax" incurred by a taxable person on inputs used or to be used by a taxable person exclusively in making exempt supplies, or in carrying on any activity other than the making of taxable supplies, is attributed to taxable supplies, and

(c) a proportion of "input tax" incurred by a taxable person on inputs which are used or to be used by him in making both taxable and exempt supplies (referred to as "**residual input tax**") is attributed to taxable supplies by reference to the ratio which the value of taxable supplies made by him in the period bears to the value of all supplies made by him in the period (or this attribution may be made on the basis of the extent to which the inputs are used or to be used by him in making taxable supplies).

(6) Under regulation 102 of the Regulations ("**regulation 102**"), (a) HMRC may approve or direct the use by a taxable person of a method for attributing VAT on inputs to taxable supplies other than that specified in regulation 101, and (b) a taxable person using such a method must continue to use that method unless HMRC approve or direct the termination of its use.

14. I refer to a person's entitlement to claim "credit" for or to deduct VAT charged on inputs made to that person under the above provisions in the PVD and VATA as an "**entitlement to credit**" and to those provisions as "**the input tax provisions**". In the extensive case law on the topic, it is established that for a taxable person to be entitled to "credit" for VAT incurred on inputs there must be a "direct and immediate link" between the relevant input and the taxable person's onward taxed transactions/taxable supplies or, if there is no such link with a specific output, the VAT must be a cost component of its overall business. Details of this case law are set out in Part D.

Dispute

15. It is common ground that for VAT purposes:

(1) the supplies of training services made by KMC are exempt supplies under item 1 of group 6 (Education) of schedule 9 VATA which applies to the provision by an "eligible body" of "education" or "vocational training",

(2) the commercial supplies are taxable supplies, and

(3) the commercial supplies and supplies for fees are made for consideration and are made by KMC acting in the course of an economic activity (for the purposes of articles 2 and 9 PVD and the corresponding provisions in VATA) so that (a) they are within the scope of VAT, and (b) under the UK input tax provisions, VAT incurred on inputs which is properly attributable to those supplies counts as "input tax".

16. In outline, the dispute centres on:

(1) Whether the supplies without charge are supplies made for consideration and are made by KMC acting in the course of an economic activity (within the meaning of articles 2 and 9 PVD and the related provisions in VATA) so that (a) those supplies are within the scope of VAT, and (b) VAT incurred on inputs

used in making those supplies is not disqualified from counting as "input tax" under s 24(5) VATA. By way of shorthand, I refer to supplies which satisfy the requirements of articles 2 and 9 PVD (and the related UK provisions) as supplies which constitute or form part of a business or economic activity.

(2) Whether the claimed tax constitutes "residual input tax" on the basis that it was incurred on inputs used or be used in making both taxable and exempt supplies.

(3) If so, whether KMC is entitled to "credit" for the claimed tax under the terms of the 1998 PESM. The parties disagree on how the1998 letter is to be interpreted.

17. As explained in further detail in Part E, it appears that when the parties agreed the 1998 PESM, they were were acting on the assumption that KMC is in what may be termed a partial "input tax" recovery position. The assumption appears to have been that, for any accounting period, typically:

(1) The VAT which KMC incurs on inputs comprises VAT on inputs which are used or to be used by it:

(a) exclusively in making taxable supplies;

(b) exclusively in making supplies of training services (comprising both supplies without charge and supplies for fees); and

(c) in making both taxable supplies and supplies of training services (comprising supplies without charge and supplies for fees) (or possibly which comprise a cost component of KMC's overall activity).

(2) KMC is not entitled to "credit" for a portion of the VAT falling within (1) (b) and (c) on the basis that:

(a) the supplies without charge are not made for business purposes and, accordingly, VAT incurred on inputs which is attributable to those supplies does not count as "input tax" (under s 24(5) VATA); and

(b) the supplies for fees are made for business purposes so that any VAT which is attributable to those supplies counts as "input tax" but, as the supplies are exempt, KMC is not entitled to "credit" for that "input tax" under the input tax provisions.

I note that the terms of the 1998 letter indicate that in fact the parties assumed, broadly, that only supplies of training services made to students under the age of 19 are made for non-business purposes. However, as set out in Part B, some of KMC's supplies of training services made to students aged over 19 are fully funded by the agencies and so also count as supplies without charge.

18. Hence, on the basis of these assumptions, in the 1998 letter, the parties agreed:

(1) As provided for in regulation 102, the 1998 PESM, as a special method for attributing, for each accounting period, a portion of KMC's "residual input tax" to KMC's taxable supplies based on the ratio which, for that period, (a) the amount of "input tax" incurred by KMC on inputs used or to be used by it exclusively in making taxable supplies bears to (b) the aggregate of the amount in (a) and the "input tax" incurred by KMC on inputs used or to be used by it exclusively in making exempt supplies.

As explained in Part E and as KMC argued, on the face of it, under this formula, if for any period there is no "input tax" attributable exclusively to exempt supplies, KMC is entitled to "credit" for all of the "residual input tax" for that period. However, it is clear that, when they agreed the 1998 PESM, the parties

assumed that generally KMC would be in the position of incurring such "input tax".

(2) As set out in annex 1 to the 1998 letter ("**annex 1**"), an agreed method for determining the VAT incurred by KMC on inputs which are used or to be used by it for:

(a) business purposes, as assumed at the time to comprise, broadly, (i) VAT incurred on inputs used in making taxable supplies and (ii) VAT incurred on inputs used in making supplies for fees, and

(b) other purposes, as assumed at the time to comprise, broadly, VAT incurred on inputs used in making supplies without charge (subject to the note at the end of [17] above).

It appears this method was agreed on the basis that, as accords with s 24(5) VATA, only the VAT within (a) is to be taken into account in the figures for "input tax" and "residual input tax" used in the 1998 PESM. Under this method the relevant VAT is apportioned according to the ratio of "guided learning hours which relate to students under the age of 19" to the "total guided learning hours".

At no time during the relevant period did HMRC approve or direct the termination of the use of the 1998 PESM.

19. It appears from the correspondence between HMRC and KMC in the bundles that, when it submitted its VAT returns for the relevant accounting periods, typically KMC claimed "credit" for only a portion of the sum which it identified as "residual input tax". Essentially, KMC appears to have applied the 1998 PESM throughout the relevant periods acting on the assumptions set out in [17] and [18] above.

20. However, KMC has now made its claims for "credit" for the claimed tax on the basis that it has realised that (a) its supplies without charge (whether made to students aged under or over 19) constitute or form part of a business activity for the purposes of VATA and PVD, and (b) none of the VAT incurred by KMC in respect of the relevant periods relates to inputs which were used or were to be used by it exclusively in making supplies of training services. KMC submitted that:

(1) It is clear from the decision in *Wakefield College v Commissioners for HM Revenue & Customs* [2018] EWCA Civ 952 ("*Wakefield*") that the supplies without charge are made for consideration within article 2 PVD and so are made by KMC in the course or for the purposes of an economic/business activity for the purposes of article 9 PVD and the relevant provisions in VATA.

(2) In any event, if that is not correct, the test in article 9 PVD is met because, on the required fact specific objective enquiry and having regard to business reality:

(a) there can only be one educational activity constituting a business activity given that (i) KMC's supplies without charge are made on precisely the same basis as the supplies for fees, and (ii) the supplies for fees clearly constitute business activities, and/or

(b) all of KMC's training activities are inherently linked to and integrated with its business activity comprising KMC's commercial supplies such that they all constitute a single overall activity as a rural studies college. As KMC put it in its notices of appeal dated 11 December 2015, 17 November 2016 and in its skeleton argument respectively:

(i) the education and training courses supplied by KMC are "supported by both the grant funding and commercial activity";

(ii) as KMC is a "rural studies college all of its educational and training activities are also tied up with its taxable activities of farming, dairy, equestrian and the blacksmith shop. As such although there is input tax that is directly attributable to the appellant's taxable activities there is none that is so applicable to its exempt, or, using HMRC's definition, "non-business activities""; and

(iii) the supplies without charge are "integral" to KMC's overall business.

(3) It follows from the fact that KMC carries on a single overall economic activity that:

(a) For the purposes of the input tax provisions, the claimed tax was incurred on inputs which were used or to be used by KMC in making both supplies of training services and taxable supplies (and/or that the claimed tax comprises a cost component of its overall activity). Given that all of KMC's activity forms an integrated whole, all its inputs, other than those which are identified as attributable exclusively to taxable supplies, must relate to that whole.

(b) As all of the KMC's supplies constitute or form part of a business activity, none of the claimed tax is prevented from counting as "input tax" under s 24(5) VATA and it, therefore, constitutes "residual input tax" in its entirety.

(4) Under the 1998 PESM, KMC is entitled to "credit" for the full amount of the claimed tax. As noted, under the formula in the 1998 PESM, there is no restriction on KMC's ability to obtain "credit" for "residual input tax" unless and to the extent that, for the relevant period, KMC has incurred "input tax" on inputs which were used or were to be used by it exclusively in making exempt supplies. For the reasons already set out, KMC cannot have incurred any such "input tax" in respect of the relevant periods.

21. In support of its view that it carries on a single integrated business, KMC submitted that:

(1) Its training activities and commercial activities are interlinked in the sense that (a) practical hands-on training is a key part of what KMC's offers to students on its courses and the students are extensively involved in practical work which relates to KMC's commercial supplies, (b) some of KMC's staff are involved in both training and commercial supplies (such as the head of equine who is involved in teaching students and also in management in the commercial side of the equestrian activities and the equine "yard" staff), (c) the commercial aspects of students' work on courses, such as, in particular, the equine and agricultural courses, is essential to their development and an integral part of their courses, (d) to some extent both supplies of training services and commercial supplies take place in the same physical location at KMC's site (for example, at the equestrian facilities), (e) some of the same equipment (such as farm equipment) may be used for both training and commercial activities, and (f) only one set of management accounts is prepared for all activities and some of the costs centres shown in them cover both sets of activities.

(2) Whilst the required enquiry is fact specific the decisions of the tribunal in *Nottinghamshire Wildlife Trust* VATD V19540 (2006) ("*NWT*") and *British Dental Association v HMRC* [2010] UKFTT 176 ("*BDA*") provide useful guidance and support KMC's analysis (see, in particular, [38] and [39] of *BDA*).

22. During the hearing:

(1) KMC appeared to accept that, contrary to its initial stance, (a) in fact, some of the relevant VAT was incurred on inputs which KMC used exclusively in making supplies of training services given that it transpired from the evidence that students on a number of its courses have no involvement in work relating to KMC's commercial supplies, and (b) accordingly, KMC is not entitled to "credit" for all of the claimed tax under the 1998 PESM. In submissions made after the hearing, KMC maintained that any sums for which KMC is not entitled to "credit" are minimal and that working out the precise figures is simply a quantification issue which is to be left to the parties to determine following the tribunal's decision in principle.

(2) KMC added that, if it is not correct that the supplies without charge constitute or form part of a business activity, due to the way the formula in the 1998 PESM works, it is entitled to "credit" for all the claimed tax. In its view, in this situation, none of the claimed tax can be identified as "input tax" attributable exclusively to exempt supplies for the purposes of the formula. KMC seemed to base this on the fact that, so it says, it is not possible to distinguish between VAT on inputs used in making supplies without charge (which, on this analysis, do not constitute a business activity) and those used in making supplies for fees (which, do constitute a business activity) given that all of the students were taught side by side in a single cohort. This is explained further in Part E.

23. HMRC submitted that it appears that in fact KMC's original claims for credit for "residual input tax" were correct when made and KMC has not demonstrated that they were not correct on the basis of its arguments. They disagreed with all of KMC's points set out above for the following main reasons:

(1) The supplies without charge do not constitute or form part of an economic activity and, accordingly, VAT attributable to those supplies (as it appears the claimed tax is) does not count as "input tax":

(a) The tribunal should follow and apply the reasoning of the earlier decision of the tribunal in *Colchester Institute Corporation v HMRC* [2013] UKFTT 45 (TC) ("*Colchester*") to the indistinguishable facts of this case. In *Colchester* it was held that supplies of education and training made by the Colchester Institute Corporation ("**CIC**") which are fully funded by the agencies are not supplies of services made for consideration within the meaning of article 2 PVD and, accordingly, do not constitute an economic/business activity.

(b) There is no foundation in law for the view that the supplies without charge constitute a business activity even if they are not made for consideration. On the required factual objective enquiry (see *Wakefield*), it would be wholly out of kilter with economic and business reality to view the supplies without charge as somehow subsumed within KMC's commercial activities comprising a variety of different supplies made to different persons.

(2) On that basis contrary to KMC's view (as set out at [22(2)]), the 1998 letter plainly operates to restrict any "credit" for "residual input tax" and does not operate as KMC argues it does (as further explained in Part E).

(3) Even if the tribunal finds that the supplies without charge are made for consideration and constitute or form part of a business activity, KMC's appeal must fail nevertheless because KMC has not demonstrated that the claimed tax comprises "residual input tax" as opposed to input tax which is attributable exclusively to exempt supplies:

(a) KMC's stance is wholly out of kilter with the "direct and immediate link" or "cost component" tests set out in the caselaw for determining whether inputs are used for the purposes of its taxed transactions.

(b) In any event, KMC's stance is unsustainable given that KMC conceded at the hearing that VAT incurred on at least some of its inputs must be attributable exclusively to its exempt supplies of training services and that is the basis on which KMC originally submitted its VAT returns.

(c) Whilst KMC has continued to maintain that there is only a minimal amount of VAT within (b) it has not provided any evidence on precisely what inputs the claimed tax relates to and what those inputs were used for.

(4) If it were to be the case that, as KMC argues, none of the claimed tax is properly attributable exclusively to KMC's exempt supplies:

(a) The formula in the 1998 PESM does not operate, as KMC asserts (as set out at [20(4)]), to give the effect that there is no restriction at all on the amount of "residual input tax" for which KMC can claim "credit" (again, see Part E).

(b) If that is not correct and the formula operates as KMC argues it does, then the 1998 PESM must be invalid on the basis that it gives an effect which is entirely contrary to the intended effect of the input tax provisions. HMRC does not have power to make an agreement which operates contrary to VAT law. However, in submissions made following the hearing, HMRC said that they did not wish to pursue this point on the basis that KMC accepts that at least some of the claimed tax is attributable wholly to exempt supplies. In view of that and given my conclusions on the other issues, I have not considered this argument and KMC's representations in response.

24. KMC said that the tribunal's decision in *Colchester* is not correct and/or that the facts considered material by the tribunal in that case do not correspond in some respects with the facts of this case. KMC appeared to be of the view that its' stance is not inconsistent with the "direct and immediate link" test.

Scope of the decision and summary of conclusions

25. Following the hearing, the Upper Tribunal ("**UT**") has, in effect, reversed the tribunal's decision in *Colchester* (see [2020] UKUT 368 (TCC)). In the UT's view, CIC's supplies of training and education are made for consideration for the purposes of article 2 PVD; the tribunal erred in law in its opposite conclusion. Following the release of the UT's decision in December 2020, the parties were invited to make written representations on the effect of that decision on these proceedings and I have taken account of those representations in making this decision.

26. On the evidence (as set out in Part B of this decision), as the parties seem to be agreed, there are no material differences between the relevant circumstances of the *Colchester* case on which the UT based its decision (as the facts are set out at [21] to

[54] of the tribunal's decision and summarised by the UT at [13] to [30] of its decision) and those of this case. On that basis, the tribunal is obliged to follow the UT's decision in *Colchester* in holding that the supplies without charge are supplies of services made for consideration for the purposes of article 2 PVD. Details of the decision of the UT in *Colchester* and of the other relevant cases on which the decision in *Colchester* is based, are set out in Part C.

27. In *Colchester* HMRC accepted that on the basis of the UT's conclusion that the relevant supplies were made for consideration, there was no further issue as to whether CIC made the supplies in the course of an "economic activity" (see [4] of the UT's decision). HMRC have confirmed that in this case also that they do not seek to contend that the supplies without charge are non-business activity on any other basis than the consideration point.

28. As regards the other issues in this appeal, as set out in the outline of the parties' submissions set out above:

(1) Given the position set out at [25] to [27] above, in order to determine this appeal, I do not need to consider KMC's argument that the supplies without charge constitute an economic/business activity even if they are not made for consideration. However, as the point was argued and KMC's argument on this is related to its stance on some of the other issues in this appeal, I have considered this argument briefly in Part C. In short, I have concluded that KMC's argument that this requirement is satisfied on the basis that it carries on a single integrated activity is not well founded.

(2) It follows from the acceptance that all of KMC's supplies of training services constitute an economic/business activity that all of the claimed tax counts as "input tax" within the meaning of s 24 VATA. However, for all the reasons set out in Part D, my view is that KMC has not established, as is required for its appeal to succeed, that the claimed tax constitutes "residual input tax" which is subject to apportionment under the 1998 PESM and not "input tax" which is attributable exclusively to its exempt supplies. Therefore, its appeal must fail.

(3) Given my conclusion in (2), I do not need to consider precisely how the 1998 letter is intended to operate but, as its effects were disputed and fully argued before me, I have commented on this in Part E.

Part B – Law and Facts

Law - Provision of funding

29. Section 14 of the Education Act 2002 gives the Secretary of State for Education (in relation to England) the power to give, or make arrangements for the giving of, financial assistance to any person in connection with (amongst other things):

> "(a) the provision, or proposed provision, in the United Kingdom or elsewhere, of education or of educational services:
>
> […]
>
> (c) enabling any person to undertake any course of education, or any course of higher education provided by an institution within the further education sector…"

30. For these purposes, "education" includes vocational training.

31. Section 16 of the Education Act 2002 gives the Secretary of State power to determine the terms on which financial assistance will be given, and requires persons receiving financial assistance to comply with such terms.

32. The Secretary of State for Education delegates to EFA its responsibilities under s14 for the provision of financial assistance in the further education sector. SFA is an agency of the Department of Business, Innovation and Skills.

33. It was not disputed that KMC is an institution within the further education sector for the purposes of these provisions.

Facts

34. The facts set out below are based on the evidence of the witnesses for the appellant, Mr Pedder and Ms Hannam, who attended the hearing and were cross examined, and the documents in the bundles presented at the hearing. Mr Pedder is the Deputy Principal (Finance and Corporate Services) of KMC and has held that role since 2014. Prior to that he held a similar post at Brockenhurst College for 6.5 years. Mr Pedder is qualified as a chartered management accountant and within KMC is responsible for finance, human resources, management information, commercial activities and information technology. He reports directly to the principal of KMC. Details of Ms Hannam's role at KMC are set out below.

Funding - overview

35. EFA funds the provision of education and vocational training for students aged 19 and under, certain categories of students aged over 19, and students with learning difficulties aged between 19 and 25. SFA funds all or part of the provision of education and vocational training for students aged 19 and over who have not achieved a specified level of academic qualification, or who are entitled to free education or training due to their personal circumstances in areas of the economy that are treated as priority areas for learning.

36. Mr Pedder said that:

(1) KMC receives grants from EFA generally for students on its courses aged under 19 (although EFA may provide some funding for students over 19 with learning difficulties) and from SFA for students on its courses over the age of 19 (as at the start of the relevant term) who have not achieved a required level of academic qualification in areas of the economy which the government considers to be priority areas for learning.

(2) Many students on KMC courses aged over 19 do not obtain full funding from SFA and, therefore, some tuition fees are often payable by or on behalf of the students. SFA may provide such students with loans to pay these fees. Mr Pedder could not provide precise numbers.

(3) In addition, SFA funds apprenticeships training at all ages which is provided in a similar way to the other grants made by SFA.

(4) KMC's courses are also open to students aged over 19 who do not fulfil SFA's funding criteria; those students are required to pay fees for the courses.

(5) Students apply to enrol on courses offered by KMC online. Students are invited for interview, and are made a written course offer which, if accepted, and assuming that any conditions are satisfied (such as the achievement of specified academic grades) leads to enrolment. As part of that process, the college completes an "Individualised Learner Record Data" ("**ILR**") for the student. As a condition of both EFA and SFA funding, KMC is required to upload the ILR for each student on a monthly basis to a national Data Service Hub and at the end of each year. There are many fields of data for each student. If the funding agencies did an audit and found gaps in the ILRs provided, KMC could lose its funding. If KMC received funding from the funding agencies but

KM did not provide the relevant courses, EFA would claw back the funding the next year.

(6) There is no difference in the training services which KMC provides to students depending on whether they pay tuition fees or are fully or partially funded by EFA or SFA.

(7) KMC issues a policy for setting and revising fees which is reviewed each year.

37. KMC enters into agreements with EFA and SFA each year in a standard form. The agreements with EFA and SFA are described as a "Conditions of Funding Agreement" and a "Financial Memorandum" respectively. The agreements are lengthy and refer to (and incorporate by reference) a series of other documents (some of which are in electronic form and are published on the internet). Taken together, these agreements and the other associated documents set out the basis on which EFA and SFA agree to fund KMC, and the obligations placed on KMC to deliver education and vocational training, and to provide information to the funding agencies.

38. KMC did not provide a full set of its agreements with EFA and SFA in place for the whole of the relevant periods. However, on the basis of Mr Pedder's evidence, I accept that (a) substantially the same form of documentation was in place for all the relevant periods as that described below, and (b) the description provided by CIC of how it was funded by the funding agencies, as recorded in the decisions of the tribunal and UT in *Colchester*, in general terms applies equally to the funding provided by the funding agencies to KMC in the relevant periods. KMC provided a document produced by CIC's witness for the purposes of the *Colchester* hearing which sets out the funding process details of which are set out below (see [49]).

Agreements with the agencies

39. The agreements with the agencies do not set out the courses that KMC must provide. However, KMC is only funded by these agencies for the provision of courses leading to qualifications that have been approved by the Government and which are listed on a website maintained by the Government. As Mr Pedder indicated, subject to the other requirements of the funding agreements and KMC's own requirements, students are free to choose which of KMC's courses they wish to follow.

40. The amount paid by EFA to KMC for a year is calculated on the basis of a national funding formula which incorporates various factors including student numbers in prior years, student retention, provision of higher cost subjects, disadvantaged students and area costs. This is supplemented by additional funding for high needs students, bursaries and other financial support awarded to individual students and transitional protection and formula protection.

41. The basic funding allocation provided by EFA to KMC is determined by the following funding formula:

> [(Student numbers) x (National funding rate per student) x (Programme cost weighting)] + (Disadvantage funding) + (Large programme funding)
>
> This amount is then multiplied by the area cost allowance.

42. The bundles contain an allocation statement which appears to be attached to a letter dated 16 March 2016 from EFA to KMC relating to the provision of funding for the period from 1 August 2015 to 31 July 2016, Contract Variation". This statement shows details of the elements of the funding formula as applied for this period:

(1) Student numbers were 715. This is not the number of students enrolled on EFA funded courses in 2015/16 but the number determined by reference to "lagged student numbers" – being the number of students funded by EFA in the preceding year which is then adjusted by various factors.

(2) The national funding rate per student was £4,000 per student as a basis (for a full-time course with 540+ hours of tuition) which is then adjusted by reference to bands reflecting the planned hours per course and the lagged student numbers in each band.

(3) The retention factor was 0.953 based on the number of students who do not drop out and attend their course to the anticipated end date. Mr Pedder said that KMC has a good history of student retention but does not receive additional grants in respect of social deprivation.

(4) The programme cost weighting (of 1.398) reflects the fact that some courses are more expensive to deliver than others. Mr Pedder said that KMC receives a higher grant income when compared with its traditional college competitors as far as programme weighting is concerned. This is due to the high cost of the capital equipment involved and the necessary small class sizes.

(5) Disadvantage funding of £425,918. This relates to economic deprivation, students who are leaving care and students with learning difficulties and disabilities.

(6) There was no data for large programme funding which applies where study programmes are larger than 600 hours.

(7) The area cost allowance addresses the additional cost of providing education in London and the South-east of England. This uplift was not applied to KMC.

43. For 2015/16 the total programme funding under the above formula was £3,999,358, the high needs student funding was £258,000 and student financial support funding was £153,393 giving a total funding allocation of £4,410,751.

44. The only scope for negotiation in relation to the funding provided by EFA relates to student numbers. Negotiation would be required if, for example, KMC were to open a new campus for the college. In such a case, as the lagged student number formula would not reflect fairly the likely additional students, EFA might be prepared to increase the number of students for the purposes of the formula. The bundles contained a document entitled "Conditions of Funding Agreement" for 2016/17 dated 1 August 2016. In this the provision of funding by EFA is expressed to be in consideration of the college's performance of its obligations as set out in that agreement.

45. Mr Pedder said that SFA's grant is based upon a "per capita" sum payable for all students signed up on the qualification framework. Initially this is calculated using the student numbers for the previous academic year but an "in-year adjustment is made to reflect the actual enrolled student numbers". The amount paid by SFA is, therefore, subject to a claw-back for under-delivery against allocation, which is reconciled at the end of the year (and repayable in the following January). No additional payments are made for over-delivery. Mr Pedder said that the sum payable by SFA to KMC is greater than say the sum it would pay for other types of training, for example, hairdressing courses, due to the increased cost to the college of providing the type of courses it provides.

46. The bundles contained SFA's "Financial Memorandum" for the 2014/2015 year. This included the following provisions:

(1) At clause 6:

> "6.1 The breakdown of funds which the Chief Executive agrees to pay to the College is set out in Appendix 1 of the Financial Memorandum.
>
> 6.2 The College is free to spend its funding as it sees fit providing it fulfils the conditions of funding imposed by the Chief Executive. The College shall ensure that public funds are not used for the purpose of delivering learning provision in respect of which the College has already received other funding, public or otherwise, unless the Chief Executive so specifies. In the event that the Chief Executive identifies that the College has used public funds in a way not specified by her she may deduct the value of such funding from the funds she pays to the College is require it to be repaid…
>
> The detailed requirements in respect of each Learning Programme are set out in the Funding Rules 2014/15 as amended and updated from time to time and which form part of the terms and conditions of this Financial Memorandum."

(2) (a) The "Maximum Value" of each "Learning Programme" as shown in appendix 1 to that document, may not be exceeded for any reasons, (b) the college must supply the Chief Executive with data on each individual learner in accordance with the data collections framework set out in the "ILR specification, validation rules and appendices 2014 to 2015" as amended and updated, and (c) the Chief Executive will not be liable to make any payment in excess of the Maximum Value of each Learning Programme unless this has been agreed and evidenced by a variation in writing.

47. An SFA document entitled "Funding Rules 2015 to 2016" dated March 2015 includes the following provisions:

(1) SFA will review whether the education and training a college provides represents good value for money and if they consider that the funding is significantly more than the cost of the education and training, they may, after consulting the college, reduce the amount of funding.

(2) SFA set out the age and other criteria for students eligible for funding.

(3) There are three levels of funding available for learners within the adult skills budget: (a) full funding for the full costs of learning in line with the qualification rates detailed in the "Learning Aim Reference Service", (b) co-funding, where SFA share responsibility for funding the costs of learning which may mean that the college passes on the remaining costs to the learner or their employer, and (c) no funding but the student may be eligible to apply for a loan.

(4) The adult skills funding is provided only for education and training that leads to the qualifications, units and other learning aims that SFA approves.

(5) The college is required to provide evidence of learning reported in the ILR or claimed funding may have to be repaid.

(6) The college has to provide evidence that it has delivered education and training in line with the funding agreement and the funding rules. The evidence must show that the learner exists, that the learner is eligible for funding and at the rate of funding being claimed, that the education and training is being delivered is eligible for funding, that the learning activity is taking place or has taken place, that the achievement of learning aims is certified, if applicable and why other funding has been claimed.

(7) A learning agreement (whether in the form of a single document or collection or information relating to the learning taking place) must show the

evidence needed to support that funding claim and must be available to SFA if required. The learning agreement must confirm at least all information reported in the ILR. The ILR is not evidence but is the basis on which payments are made. The information contained in the learning agreement must support the ILR data provided and SFA uses the ILR to monitor the funding rules and if the data does not support the funding claim, SFA will take action to get this corrected, which could include reclaiming funding.

48. The details required to be included in an ILR include the learner's personal details, planned learning hours, any learning support cost for all high needs students, planned employability, enrichment and pastoral hours, GCSE maths and English qualifications.

Overview of funding process

49. As noted, the bundles contained a document prepared by Mr Gary Horne of CIC setting out a simplified overview of the annual funding allocation process for further education colleges in England. In summary, this set out the following main points:

(1) Funding provided by EFA is calculated using a funding formula as described above. Colleges are required to supply monthly ILRs to EFA in order that their allocation for the following year can be calculated on the following timeline.

(2) Enrolment data is captured by EFA from the college's "R04 (December) ILR" and "student number statements" are calculated based on the "lagged learner" methodology. That allows for a provisional allocation of student numbers for the next academic year and sets the funding factors which are applied in calculating the allocation. At that time EFA provides to colleges a spreadsheet that shows how the "student number statement" was calculated.

(3) In February/March each year EFA sends colleges the final funding allocation for students aged 16 to 19, high needs students aged 16 to 24 and bursary funding. In some cases, colleges are permitted to submit a business case where there are errors in allocations affecting lagged student numbers, 5% of students or a minimum of 50 students, whichever is lower.

(4) In October of each year EFA publishes a full list of allocations for all individual further education institutions, schools and academies.

(5) For 2016/17 the "lagged learner "methodology involves as the starting point the number of valid students with a census date of 1 November 2015 based on "R04" for 2015 to 2016. This is multiplied by the ratio of the 1 November number of students to the all year students number based on the "R04" return for 2014/15 and the final "R14" for that year. EFA also compare this figure with the student number calculated from "R06" both for the year to date (as at 1 February) figure and the number recruited by 1 November. Where there is a significant increase or decrease in student numbers the allocation can be revised accordingly.

(6) As regards SFA funding, in December of each year the Minister of State for Skills or Business Secretary sends out an annual skills funding letter to the SFA Chief Executive setting out the government's priorities for the skills system. It includes information for SFA to set provider allocations for the following year.

(7) In January/February of each year the SFA uses "baselines" of current performance data to inform the calculation of allocation for the following year. As colleges are funded via a grant, SFA require all colleges to submit a mid-

year funding claim based on the college's in year performance from "R06" for February. Colleges are required to project forward as to what they believe will be their usage of current year allocation knowing the number of students currently enrolled and assumptions based on likely retention and success rates using historical trends.

(8) In March each year following an assessment of "baseline" performance and using the mid-year estimate provided by the college, SFA issues a batch of documents to the SFA portal. These include the funding allocation statement for the following year, a skills funding letter, funding rules for the following year, any other contextual funding reform notifications normally providing a rationale for funding reduction.

(9) Funding allocation statements from SFA normally include comparative year date and in the case of 2016/17 separate lines for the adult education budget and adult apprenticeships. The allocation for apprenticeships for those aged 16 to18 are also included as they are paid by SFA on behalf of the Department for Education.

(10) Within SFA's funding statements there is generally a caveat to state that the allocations are subject to change ahead of the year commencing. On 28 July 2015, the colleges' allocation was further reduced by 3% ahead of the 1 August start date.

(11) From August onwards each year colleges are sent a set of documents to confirm final allocation. Variations throughout the year are also sent in where "in year" over performance or under performance can be reflected in increased or decreased "in-year" allocations for apprenticeships subject to business case review.

(12) At the end of the year, a final ILR return determines the basis of reconciliation against the funding allocation of SFA and is used to calculate any claw-back.

KMC's prospectus

50. The bundles contained a prospectus for KMC for 2017/18. Mr Pedder indicated that the prospectuses relating to the relevant period would have been similar to that for 2017/18. The prospectus for 2017/18 included the following information:

(1) The campus is set in 750 acres of "stunning parkland", the landscaped gardens and lake are overlooked by a Georgian manor house and surrounded by an animal park, working farm, equestrian centre and a "range of first class facilities".

(2) On the opening page of the prospectus, there is a picture of a learning resources centre, laboratories, the Georgian Manor house and lake, restaurants and cafes, an "AgriTech Centre", a "Centre for Foundation Learning", "Stinsford Farm", the "Higher Dairy", the forge and welding workshop, the Stafford centre for construction, the animal science centre, the animal park, the manor stables, the equine arena, the horticultural production unit, grade II listed gardens, an outdoor adventure centre and peak fitness centre.

(3) "All study programmes are specifically designed to provide students with a practical hands-on approach as well as the essential classroom learning. You can begin studying with us at any level provided that you meet all of the entry requirements of the course and attend a successful interview."

(4) KMC offers "entry level" courses for those who do not feel ready for GCSEs or other qualifications for those who have not studied in a long time of have additional support needs or learning disabilities or difficulties comprising:

(a) Level 1 diplomas and certificates giving a qualification equivalent to 4 GCSEs at grades 3 to 1 or D to G.

(b) Level 2 diplomas or certificates for a qualification equivalent to 4 GCSEs at grades 9 to 4 or A to C.

(c) Level 3 diplomas and extended diplomas suited to students who enjoy practical learning and mature learners looking for a career change providing an alternative entry route to university through an access course to higher education.

(d) An access to higher education (science route) which is an intensive full-time course that provides a grounding in basic science as well as the required UCAS entry tariffs and, if required, additional English and Maths to GCSE 9 to 4 or A to C.

(e) Level, 4, 5 and 6 higher education courses – a range of level 4 qualifications, foundation degrees and BCS (Hons) "To-Up Degrees" accredited by the Royal Agricultural University, Bournemouth University and Plymouth University.

(f) Traineeships designed to help young people aged 16 to 24 who not yet have the appropriate experience – providing essential work preparation, English, maths and work experience needed to secure an apprenticeship or employment.

(g) Intermediate and advanced apprenticeships which provide "real jobs with training which allow you to earn while you learn and gain a nationally recognised qualification". These take a minimum of one year and could take up to two. Intermediate apprenticeships offer a level 2 qualification equivalent to 5 GCSEs at grade 9 to 4 or A to C and advanced apprenticeships offer a level 3 qualification which is equivalent to 1.5 A levels.

51. The prospectus sets out detailed information on the various courses which KMC offers. In outline, the courses and summaries of what they involve are as follows:

(1) Various level of courses in agriculture as follows:

(a) A level 1 course for agriculture which involves: farm animal husbandry, introduction to crop production, tractor driving, machinery operation and maintenance, practical countryside skills, conservation and woodland management and estate maintenance.

(b) A level 2 course which involves farm animal production, forage crop production, estate maintenance, land based machinery operation (including tractor driving), environmental and land based business and work related experience: "You will acquire a wide range of knowledge, practical skill and industry experience both from your studies and work experience on a local farm…The course is especially designed to develop practical skills and produce students who are able to operate machinery and look after livestock and crops to a high standard."

(c) A level 3 course which involves the principles of health and safety, undertaking and reviewing work related experience in the land-based industries, land-based industry machinery operations, agricultural crop production, plant and soil science, estate skills, livestock husbandry,

business management in the land based sector, land based power units and forage crop production: "You will have the opportunity to work with local employers who will contribute to the knowledge and delivery of training….Students will also be given the opportunity to develop their practical skills on the College farm which will include occasional weekend and early morning duties."

(d) A level 3 extended diploma which involves the students undertaking the level 3 diploma in the first year and a specialism in either livestock, arable or farm mechanisation in the second year.

(e) An apprenticeship in agriculture which involves study but also "real work where you will learn teamwork in the food production industry". At the advanced level this course provides the knowledge and skills needed by the modern farm worker who may be aspiring to take supervisory responsibility.

(2) An apprenticeship in butchery.

(3) Level 1 and 2 courses in welding, fabrication and blacksmithing and level 3 courses in blacksmithing and metal work.

(4) Level 1, 2 and 3 courses in animal conservation and welfare. It was stated, as regards the level 1 course that: "This one year course will give you the opportunity to develop knowledge and practical skills by working with the wide range of animal species we have at the college."

(5) A variety of business courses: Apprenticeships in business and administration, accounting, customer service, retail, warehouse and storage, hospitality, teaching and learning, children and young people's workforce, team leading and management and a higher apprenticeship in management.

(6) Level 2 and 3 courses in countryside and wildlife management and gamekeeping and wildlife management. It was noted that these courses involve work experience within a local organisation or work experience on a local shoot.

(7) Apprenticeships in environmental conservation.

(8) As regards equine studies: Level 1 courses in an introduction to horse care, level 2 courses in equine care, level 3 courses in equine management and apprenticeships in equine as well as work experience.

(9) As regards foundation learning: courses in an introduction to skills for working life, skills for working life, practical skills development and certificate in employability and personal development.

(10) As regards horticulture: Level 1 courses in practical horticulture skills, level 2 and 3 courses in horticulture and intermediate apprenticeship in golf greenkeeping and apprenticeships in horticulture. There was reference to using "our fantastic campus facilities including newly developed glasshouses and involvement in college supported community and private projects".

(11) Level 2 and 3 courses in floristry. It was stated that these courses involve work experience in a retail florist and participating in regional and national competitions and large floristry projects for the college to learn techniques in event scale work.

(12) Level 2 and 3 courses in arboriculture and apprenticeships in arboriculture. It was stated that these courses involve work related experience and practical experience on the estate.

(13) As regards construction: level 1 in construction skills and level 2 in construction management operations and intermediate apprenticeships in property maintenance. It was stated that these courses include relevant work experience and practical work on the campus.

(14) Level 1, 2 and 3 courses in outdoor and adventure and level 3 professional outdoor instructor study programme and advanced apprenticeship in outdoor programmes.

(15) As regards public service, level 2 and 3 courses in uniformed public services and advanced apprenticeships in emergency services and intermediate and advanced apprenticeships in youth work.

(16) Level 2 courses in military preparation

(17) Level 2 and 3 courses in sport and fitness and intermediate apprenticeships in activity leadership and advanced apprenticeships in supporting teaching and learning in PE and school sport, apprenticeships in leisure operations and management and for the holiday park industry. Some of these refer to work experience in KMC's yard.

Commercial supplies

52. The activities undertaken by KMC which generate income comprise:

(1) sales of dairy milk, lambs, wool, beef, Maurward meats, wheat, barley, oil seed rape, straw,

(2) the provision of horse-riding lessons, horse stabling and livery, the hire of the riding area and the holding of equestrian shows and events,

(3) the hosting of conferences and weddings,

(4) sales of flowers,

(5) the hosting of special occasion parties and school proms,

(6) the provision of catering food and drink sales,

(7) sales of products in vending machines,

(8) the provision of residential accommodation to students and, outside terms time, others (such as those attending summer camps or special events),

(9) the sale of equipment and materials,

(10) the provision of dog grooming services,

(11) the admission to the park and gardens,

(12) the admission of caravan rallies, and

(13) the provision of outdoor adventure days and rent income.

Interaction between training services and commercial supplies

53. The documentary and oral evidence establishes that, as part of their course activities, students on KMC's agricultural and equine courses perform work which is necessary for KMC to make some of its taxable commercial supplies. The following description is taken from information provided by Mr Pedder for the 2016/17 year. He indicated that the nature and level of students' involvement in the relevant activities for 2016/17 was similar for the relevant period (although I note that he only joined KMC in 2014):

(1) KMC had over 80 students who studied agriculture related courses who spent at least a third of their time working on farm related activities which contribute to the income generated by KMC from those activities. The students' activities include:

(a) Supporting the farm herdsmen with the milking of 150 dairy cattle twice a day. In 2016/17 the herd produced 1.2 million litres of milk which generated income of around £350,000. Mr Pedder said that KMC would have to employ extra staff if the students did not perform this activity as part of their courses. He noted that KMC employ casual workers in the period between academic terms from the end of June until the end of August although students may have to work in the shorter holidays. There are two dairy herdsmen employed outside the key summer holiday when extra staff are taken on.

(b) Ploughing, seeding and harvesting the fields in respect of the arable part of the farm business used to grow wheat, barley and other crops. All students on agriculture courses are involved in aspects of this work including maintaining the tractors and machinery. Mr Pedder viewed this aspect of farming as a key skill for a student to learn to work as a farmer. For 2016/17 the college generated around £100,000 income from the sale of these crops.

(c) Tending to KMC's flock of sheep and assisting with the lambing season from January to March (for 8 to 10 weeks) which may involve students being in attendance through the night during that period. Students do not have much involvement with the sheep during the rest of the year when the sheep are out in the fields. Mr Pedder said that students need to understand how to safely deliver lambs if they are looking to have their own farms. The flock of 400 ewes on average produces at least 600 lambs. The new lambs generate around £30,000 of income for the college annually.

(2) KMC had in excess of seventy students who studied equine related courses who spent at least one third of their time on equine related activities which contribute to the income generated by KMC from its commercial supplies relating to those activities. These include:

(a) Supporting the stabling livery provision. There are approximately 40 horses stabled at the college. As part of the livery service the students muck out the stables on a daily basis and ensure feed and bedding is provided at the appropriate times. For 2016/17, the college generated around £40,000 of income from livery services.

(b) Supporting the provision of horse-riding lessons to the public seven days a week; the students are a key part of this service. For 2016/17, KMC generated around £85,000 of income from this.

(c) Supporting a number of equine related events which the college hosts at its indoor and outdoor arenas during the year such as a number of regional show-jumping competitions, gymkhanas and demonstrations. The students are involved in these activities from planning the events through to supporting the visiting horses and competitors. In 2016/17, KMC generated around £60,000 of income from this.

54. Mr Pedder's evidence establishes that students on the welding, fabrication and blacksmithing, animal conservation and welfare, countryside and wildlife and floristry courses, as part of their courses, provide labour which may be used in taxable supplies made by KMC but to a much more limited extent than students on the agriculture and equine courses. For example:

(1) Students on animal care courses assist with lambing on KMC's farm and with the animals in KMC's farm park which is open to the public.

(2) Students of blacksmithing perform work for the equine activities and engage in fence and iron work around the estate.

(3) Students on the countryside and wildlife courses, especially those on the level 2 courses, replace and repair fences and other equipment on the estate. Mr Pedder described this as a fair element of their courses but could not provide a precise split of their time; his best estimate was that students on these courses spend around 50% of their course time outside the classroom but he could not say how much time is spent specifically on fence work.

(4) Floristry students provide floristry services for weddings taking place on the estate (of which there are around 40 each year). At present there are around 12 students on these courses.

55. Mr Pedder said that students on horticultural, construction and blacksmith courses had assisted with KMC's projects at the Chelsea flower show in the current year but such activities are not a large part of their courses.

56. Mr Pedder suggested that students on the outdoor adventure courses and sport and fitness courses are also to some extent involved in KMC's commercial activities. However, the only significant example given was work outside term time assisting in a range of courses for young people during the holidays, during July and August, which was not undertaken as part of the students' courses and, if KMC was paid, KMC paid the student for his/her work. It appears that with very limited exceptions, students on apprenticeship courses are largely based in workplaces of third parties which are not located on KMC's estate and that staff from KMC travel to those work-places to provide training. A limited number of equine apprentices are based on KMC's estate and provide labour used in making taxable supplies.

57. Mr Pedder agreed that it is realistic to describe KMC as a provider of vocational training or that, at least, that is one of the things it does.

58. KMC did not provide any further details of the precise activities carried out by students on the courses referred to at [54] above which relate to its commercial activities during the relevant periods or of the numbers of students on those courses or on each of its other courses during the relevant period (other than the numbers provided for the agriculture and equine courses at [53] and [64(12)]). I note that it is unclear from this limited evidence whether and how works on fences impacted on and interacted with KMC's commercial activities. For example, it is not known where the relevant fences are located and whether and to what extent the fences form part of the infra structure used for commercial activities.

59. Mr Pedder said that the staff who are in charge of the commercial operations are often required to liaise and work closely with the academic staff such as the farm manager and the head of the agriculture teaching department. From around November 2015, having brought in management consultants to advise on driving forward KMC's commercial activities, Mr Pedder instituted quarterly meetings to bring together the staff from the commercial and academic sections to discuss the overall activities and the role of the students within that. He said that prior to November 2015 there were informal discussions of a similar kind. He thought that all the relevant heads of academic departments are mindful of KMC's relevant commercial activities.

60. The bundles contained a note of only one of the meetings which Mr Pedder referred to which took place on 18 January 2019, some time after the end of the relevant periods This was attended by Mr Pedder (as deputy principal), the principal, the farm manager, the head of the animal welfare and science department, Ms Hannam, as the head of agriculture, the personal assistant to the principal and a

representative of Velcourt Consultants, the management consultants Mr Pedder referred to. The matters recorded include that:

(1) A new fleets of tractors had been ordered and their use on the farm and in the agriculture academic department was discussed. The head of agriculture and the farm manager agreed that the tractors and machinery were a shared resource and it was recorded that: "The tele-handler is regularly used by students to unload deliveries for the farm as part of their training. [Animal welfare] students have not yet been able to attend sessions at the dairy [but] [the head of animal welfare and science] hopes that they may be able to soon".

(2) The head of agriculture highlighted his plans for students to provide more labour for the farm. The students had undertaken the livestock vaccine programme during the last year and the farm manager continued to provide projects for the students such as tractor driving, ploughing, hedge laying and working with animals. It was noted that: "The work that students undertake is incorporated into their timetable".

(3) The academic staff coordinate what work they need the students to undertake with the farm manager. The farm is used by animal welfare as well as foundation learning students and animal welfare and science department students. The agriculture students undertake more specialised activities such as tail docking and vaccinations and the animal welfare and foundation learning students undertake animal husbandry duties. The uniformed public services students also undertake work on the estate and utilise the grounds for their activities. It was stated that: "Without student resource the farm could not operate successfully."

(4) The head of agriculture and the head of equine had been discussing "rejuvenating the pony paddocks prior to the inspection and [equine] unit exams" to include "reseeding and weed treatments on top of the usual rolling and topping". The head of agriculture was "cascading his requirement to tutors so that the students can help with the work to ensure that it is completed in good time." The two heads had been discussing the possible re-organisation of machinery to improve farming activities. Level 1 students could repair an old cereal seeding kit as part of their courses and the level 2 and 3 students could use the old tele-handler to learn how to work with hydraulics and discussions were ongoing with the dealers to provide new machinery at an affordable price. The head of agriculture was to arrange for the students to do the fertilising soon depending on the weather.

(5) The farm manager and head of equine were to check if an area on the dairy may be suitable to use as an isolation box for horses (as there was a new requirement of the riding school licence to have such a facility away from the stable yard).

(6) It was agreed that if the animal welfare unit purchased the materials the level 3 estate skills students could erect the fencing and plant a new hedge needed in a particular part of KMC's site. The head of animal welfare and the farm manger were to discuss this in more detail.

(7) The farm manager had lambing in hand and was to prepare a rota for students needed from agriculture and animal welfare and science.

(8) The farm manager and the head of agriculture were to discuss in detail a project for DNA testing of calves.

(9) The sale of fresh milk was discussed and the marketing consultant present at the meeting was to obtain information from another business which had been successful in their projects.

61. Mr Pedder said the matters recorded in this note are typical of the type of discussions which take place at such meetings and that there were similar discussions on a more informal basis before these meetings were instituted from November 2015 onwards. Ms Hannam confirmed that she attended other meetings than the one referred to above said that, in her experience, similar issues to those recorded above were discussed at the other meetings.

62. Mr Pedder was taken to a note which was prepared by HMRC recording discussions at a meeting in 2006 between various officers of HMRC, the principal of KMC, the finance director at KMC and KMC's tax advisers. It seems, from the content of the note that the meeting was to discuss the VAT position and the use of an agreed PESM. It was recorded that:

> "The trader claimed that there is minimal student activity on the farm, and said many land based Colleges have not disposed of their farms as generally the curriculum no longer requires students to have practical experience on a farm, and where it does Kingston Maurward students are often placed in work experience at outside farms anyway. Nonetheless, Mr Baker readily accepted that input tax relating to the farm is residual (unlike the previous advisers who had been seeking to argue that the farm is a fully taxable area)….
>
> As the trader is not yet in a position to make final proposals for a method it was agreed that they may continue to use the existing method for now on a without prejudice basis, on the understanding this would not amount to a de facto approval of the current arrangements…"

63. Mr Pedder said that the comment in this note on the limited nature of student activity on KMC's farm is not reflective of how he found the interaction between the relevant activities when he joined KMC in 2014 and from that time onwards. In my view, this note is of little probative value as regards the scale of the involvement of students in KMC's commercial activities during the relevant periods given it relates to discussions which took place some four years before the start of those periods (as they run from 1 August 2010 to 30 April 2016).

Equine activities

64. Ms Hannam gave further details of the equine activities. At the time of the hearing Ms Hannan was the head of the equine teaching department and commercial equine activities. From September 2014 until May 2017 she was a course manager and she also worked at KMC between January 2001 and May 2003 as the yard manager, a role that encompassed both the management of the commercial riding school and show management. She made the following main points:

(1) All activities of the equine department take place at Manor Stables within KMC's site which have facilities of a high standard including a full show jumping and dressage arena.

(2) In her current role she is responsible for both the management and profitability of the commercial side of the department's equine activities as well as the success of the education and vocational training provision. This involves her making sure students are provided with all the resources they need to achieve the relevant qualification and planning all events at the equine centre.

(3) The courses that KMC offer are largely for students who are seeking a career in the equestrian world. KMC has links with other stables and facilities and arrange work placements for students with these bodies.

(4) In her view, the educational and training aspects of KMC's courses and the commercial riding school are intrinsically interlinked.

(5) As a part of their courses the students are required to work within the commercial riding school and on related events. This is an integral part of their course, and they would not pass their courses without it. KMC's commercial activities include running a range of shows on Sundays at Manor Stables, operating a "Pony Club" and a "Riding School" on Saturdays and Monday to Wednesday evenings, running "Clear Round" events on the first and third Thursday of the month (as well as the activities listed above). There are 250 lessons each week at the commercial riding school.

(6) The students are involved in all of these commercial activities as part of their courses. Their involvement gives them the practical hand-on training they need to complete their courses successfully in a real-life commercial environment. Their activities include mucking out and grooming the horses, assisting with the commercial riding school by performing tasks such as tacking up and leading clients on horses, setting up the Sunday shows, designing and running events, building courses, taking money from the public and awarding rosettes and assisting with pony club. Some of these activities involve them in developing their marketing and managerial skills.

(7) Level 2 and 3 students perform early morning and evening yard duties for seven days at a time on a rota, around every four to five weeks, including during the shorter holidays although KMC does use some additional staff during the holidays. These students are required to stay on site during the time when they are performing these duties (and they are not charged for the accommodation). Three to six students perform these yard duties in any one week as the residential accommodation only takes six people. The precise numbers needed depends on what commercial activities are going on. Level 1 students do yard work during the academic day and can volunteer for additional duties. Some level 3 students also do such work in July and August as part of their study programme for which they do not receive pay but they are provided with riding lessons and training and there is no cost for their accommodation.

(8) Students are at all times supervised by trained, qualified staff comprising both academic and yard staff. Many of the students (typically those on level 2 and 3 courses) have to spend at least 150 hours in a commercial environment as part of their courses.

(9) On average students who are not on yard duty attend the KMC site from 9.15am to 4.45pm (although not necessarily every day as some courses are three or four day courses only) and spend about 5% of their time in the classroom and 50% on practical training. The students on yard duty attend the KMC site from 7.30 am and after a break for breakfast, attend a normal academic day before performing the evening yard duties. The students may be involved in shows midweek but the majority are at the weekend – only around 10% are midweek.

(10) The academic staff comprise one full time and three part time members plus Miss Hannam. Miss Hannam teaches students in the classroom and riding (but not in the commercial riding school) and runs the shows. The yard staff teach the students as regards their practical activities which play a role in the

commercial supplies. There are five full time yard staff and two apprentices and a bank of a further five persons who can be called on in the holidays.

(11) Miss Hannam agreed that her department provides vocational training and education and that the objective is to ensure that students obtain the relevant qualification ready for employment in the equine industry and develop their life skills as well. They do two weeks external experience.

(12) There are currently 25 students on level 2 and 3 courses and in 2014/15 there were probably on average 30 to 45 such students per year. The majority of the 30 apprentices obtain their commercial experience from external employers. At present KMC has two apprentices assigned to work at KMC. Occasionally students are employed at KMC on qualification,

(13) The following advert for a head of equine at KMC dated 30 March 2017 is an accurate description of Ms Hannam's role:

> "enthusiastic, self-motivated academic staff to lead the following dynamic College department: Equine:
>
> You will work with the Deputy Principal (Curriculum and Quality) and Heads of Department to maintain and develop a stimulating and supportive learning environment for students and staff. You will be a confident and successful manager, able to design an innovative and industry relevant curriculum and manage the development of teaching stages. Experience of managing a team is essential, as is the ability to work with and motivate staff. The development of sustainable and commercial activities will be crucial.
>
> Job purpose:
>
> To manage the departmental area efficiently and effectively within agreed parameters.
>
> To facilitate communication between teaching teams, middle and senior manager.
>
> To liaise effectively with other managers across the college to ensure a coherent and corporate approach to curriculum development, delivery and review within an ethos of continuing improvement and the college's strategic priorities.
>
> To work closely with other Heads of Departments and the Head of HE to ensure the effective and efficient delivery of FE and HE provision in your Department.
>
> To support the development and implementation of agreed curriculum and business initiatives through the annual curriculum business planning process in particular.
>
> To assist with the formulation of policy and procedures which facilitate the achievement of college objectives.
>
> To demonstrate high level interpersonal skills."

65. In support of the points made above, Ms Hannam produced a range of documentation illustrating the extent of these commercial activities within the current academic year noting that, in her experience, similar activities have been undertaken throughout her time at KMC. The documents comprised: (i) a diary of the equestrian events for the year, (ii) a list of the part-time courses provided for members of the public, (iii) a flyer promoting the availability of full or part livery, (iv) a flyer promoting the activities of the riding school, (v) A flyer promoting the pony club, and (vi) a flyer on respect of clear round.

Accounts

66. The bundles contained KMC's management accounts for the period of 12 months ending on 31 July 2016:

(1) These are broken down into the following "costs centres" relating to KMC's different activities: academic, agriculture and countryside, animal conservation and welfare, business skills and professional, catering, caretaking and cleaning, countryside foundation, conference, employer responsive, centre for equitation, essential skills, finance, farm, gardens, governors, green skills and garden industrial, human resources, IT support, Kingston Maurward park, management, management information systems, marketing, outdoor adventure and sports, premises, student administration, student services and wardening.

(2) The accounts show income and expenses for each costs centre which include items such as (a) as regards income, funding received for students, tuition fees, any income from commercial supplies, and (b) as regards expenses, salaries for the relevant staff and costs of telephone calls, stationery and related materials, printing, cleaning materials, hospitality, travel, staff accommodation, vehicles, protective clothing, examination fees and subscriptions, apprenticeship allowances, professional service, the purchase of teaching and non-teaching equipment/materials and a proportion of depreciation of certain assets and other specific items.

67. The bundles also contained a document, which appears to be part of the management accounts for the period ending on 31 July 2016, which shows KMC's overall actual income and expenditure for the 12 months to July 2016 as compared with its budgeted income and expenditure. This showed the following as regards the actual income and expenditure for this period of 12 months:

(1) Total actual income to date of £10,150,673 of which:

(a) The largest single item is £4,023,051 of funding received by KMC for students aged 16 to 18.

(b) Over £3.5 million is additional funding and tuition fees.

(c) The other main receipts are income of:

(i) £414,406 from the provision of catering,

(ii) £414,150 from conference facilities,

(iii) £507,007 from farm sales

(iv) £139,402 in respect of the Kingston Maurward gardens,

(v) £23,166 of examination fees,

(vi) £32,111 of rents from lettings,

(vii) £395,178 of miscellaneous income,

(viii) £170,872 of equestrian income, and

(ix) £447,251 from student travel.

(2) Total expenditure to date of £9,610,178 of which there is expenditure of:

(a) £5,783,597 on salaries and wages for staff. The single largest item is £2,778,939 for academic/teaching staff. The other items include:

(i) £659,373 for teaching support including the library staff.

(ii) £836,034 for central administration staff,

(iii) £111,428 for marketing staff,

(iv) £223,042 for coordinators/assessors,

(v) £450,515 for estates, caretaking and cleaning staff,

(vi) £204,180 for catering staff,

(vii) £166,853 for conference staff,

(viii) 151,593 for farm staff,

(ix) £39,664 for Kingston Maurward Gardens staff, and

(x) £22,286 for Indoor Riding Arena staff.

(b) £891,258 on teaching departments including on post, telephone and fax, materials, supplies and stationery, livestock purchases, licences, professional services, equipment supplies and repairs, study tours, hospitality, travelling, and vehicle running costs.

(c) £652,418 on teaching support services relating to library, learning centre computers, student travel and audio/visual aids.

(d) £100,553 on other support services relating to staff training and development, printing services and photocopying, staff recruitment and medical costs.

(e) £464,875 on central administration relating to post, phone and fax, materials, stationery, supplies, printing and photocopying, equipment supplies and repair, bank and financial services, insurance, travel and subsistence.

(f) £366,107 on general education expenditure relating to examination fees and expenses, subscriptions, the prospectus, publicity and course advertising and marketing.

(g) £659,181 on premises relating to vehicles, routine maintenance, long term maintenance, caretaking and cleaning.

(h) £96,378 on catering.

(i) £159,465 on conference expenses.

(j) £362,437 on farm expenses.

(k) £73,909 on Mauward park.

68. The management accounts also contained a breakdown of (a) overall income and (b) total expenses (including depreciation) for areas broken down as follows:

(1) Under a heading "Curriculum":

(a) Agriculture and countryside: (a) £1,476,386 and (b) £756,005.

(b) Animal conservation and welfare: (a) £1,748,233 and (b) £794,357.

(c) Centre for equitation: (a) £664,109 and (b) £549,420.

(d) Green skills and garden industrial: (a) £1,054,512 and (b) £542,310.

(e) Countryside foundation: (a) £387,254 and (b) £166,870.

(f) Outdoor adventure and sports: (a) £1,247,336 and (b) £700,526.

(g) Business skills and professional: (a) £289,554 and (b) £300,833.

(h) Essential skills: (a) £595,153 and (b) £585,599.

(i) Employer responsive: (a) £563 and (b) £138,794.

(2) Under a heading "Service Areas":

(a) Management: (a) £130,600 and (b) £416,628.

(b) Governors: (a) £37,014 and (b) £45,230.

(c) Marketing: (a) £9,245 and (b) £239,646.

(d) Human resources: (a) £2,608 and (b) £133,184.

(e) Academic: (a) £290,389 and (b) £298,073.

(f) Student services: (a) £15,051 and (b) £216,125.

(g) Student administration: (a) £447,251 and (b) £707,357.

(h) Catering: (a) £327,500 and (b) £308,388.

(i) Gardens: (a) £15,945 and (b) £177,627.

(j) Caretaking and cleaning: (a) £182,929 and (b) £213,650.

(k) Wardening: (a) £88,796 and (b) £40,663.

(l) IT support: (a) £1,962 and (b) £249,530.

(m) Finance: (a) £237,040 and (b) £328,527.

(n) Management information systems: (a) £1 and (b) £120,227

(3) Under a heading "KME and Farm Operations":

(a) "Conference": (a) £414,150 and (b) £349,866.

(b) "Kingston Maurward Park": (a) £139,402 and (b) £126,154.

(c) "KME Operations": (a) £553,552 and (b) £476,020.

(d) "Farm": (a) £507,007 and (b) £545,128

(4) The total figures for actual income and expenses are: for "Curriculum Operations", (a) £7,467,524 and (b) £4,534,714; for "Service Areas" (a) £1,628,351 and (b) £4,352,140; and for "KME Operations" and "Farm" the figures set out at (3) above.

69. The final accounts for the period ending 31 July 2016 include the following information and statements that the parties referred to:

(1) KMC "specialises in land-based and related subjects" and:

> "[a]s part of its educational role, the College runs a 750 acre mixed farm, equestrian centre and countryside visitor attractions including a formal garden and animal park. The Georgian House and grounds are also used for numerous educational conferences, functions, events and weddings.

(2) The mission of KMC is:

> "To provide inspiring and challenging training and development opportunities to equip people with the knowledge and skills to succeed in life and work."

(3) In delivering its mission KMC provides the following identifiable public benefits: high quality education and learning experience, high quality teaching, widening participation and tackling student exclusion, excellent employment record for students, progression to higher education, strong student support systems and links with employers, industry and commerce.

(4) The specific objectives include a focus on improved financial performance to mitigate the effects of reduction in funding and ensure financial sustainability through: operational efficiencies in use of resources and energy consumption; development of income streams and commercial activities that increase (i) student access to real work experience (ii) income generation for investment in buildings; implementation of shares services with partners.

(5) Under a heading "financial objectives" it was stated that as part of the strategic plan 2015 to 2018, KMC set a number of strength and efficiency objectives including to grow commercial income by 15% over three years.

(6) KMC has significant reliance on the education sector funding bodies for its principal funding source, largely from recurrent grants. In 2015/16 the funding bodies provided 59% of KMC's total income and in 2014/15, 57%.

(7) In 2015/16 KMC delivered activity that produced £4,813,000 in funding body main allocation funding and in 2014/15, £4,669,000.

(8) In 2015/16 KMC had 968 EFA and SFA funded students both full time and part time and in 2014/15, 1,166.

(9) In addition to "Further Education" students KMC has students in "Higher Education, Work Based Learning apprenticeships, Workplace Learning, 14-16 and fee paying students". KMC had in total approximately 2,790 students in 2015/16 and in 2014/15, 3,510.

(10) The accounts show for 2016 and 2015 respectively "recurrent grants" of £6,052,000 and £5,885,000. Of these totals, for 2016 £532,000 relates to SFA and £4,281,000 to EFA and for 2015 £689,000 relates to SFA and £3,980,000 relates to EFA. The majority of the remainder in each case relates to "Work Based Learning".

(11) For 2016 and 2015 respectively, there are (a) total tuition fees of £1,062 and 1,067,000, (b) total income for residences and catering of £414,000 and £529,000, (c) total income for farming activities of £507,000 and £577,000, (d) total income from other income generating activities of £231,000 and £277,000 and, (e) total other income of £875,000 and £807,000.

Part C - Did KMC make the supplies without charge for consideration in the course of a business/economic activity?

70. In summary, for the reasons summarised above and as further explained below, I have concluded that:

(1) On the basis of the UT's decision in *Colchester*, KMC makes its supplies without charge "for consideration" within the meaning of article 2 PVD.

(2) KMC carries on an independent economic activity within the meaning of article 9 PVD comprising its activities in respect of the supplies without charge.

(3) Accordingly, the supplies without charge are supplies made by a taxable person "acting as such" for the purposes of article 2 PVD.

(4) It follows that, for the purposes of the input tax provisions, KMC makes the supplies without charge in the course of furtherance of a business and inputs which are used are or to be used by it for the purposes of the supplies without charge are used for the purposes of a business (and, accordingly, s 24(5) VATA is not in point).

Meaning of business/economic activity

71. It is established that the expression "business" in s 4(1) and s 24 VATA has the same meaning as "economic activity" in article 9(1) PVD (see the decision of the Court of Appeal in *HMRC v Longridge on the Thames* [2016] STC 2362 ("*Longridge*") (in particular, at [13] and [104]) and *Wakefield* at [9]).

72. In *Wakefield*, the issue was whether the provision by a college of further education courses to students paying a fixed but publicly-subsidised fee amounted to carrying out an economic activity within the meaning of article 9 PVD. Lord Justice Richards explained in *Wakefield* that whether there is a supply of goods or services for consideration for the purposes of article 2 PVD and whether that supply constitutes economic activity within the meaning of article 9 PVD are separate questions. He said, at [52], that, therefore, a "supply for consideration is a necessary

but not sufficient condition for an economic activity" and, at [52] to [58], he explained the operation and interaction of these two separate tests as follows:

> "52…..It [the question of whether there is a supply of goods or services for consideration] is, therefore, logically the first question to address. It requires a legal relationship between the supplier and the recipient, pursuant to which there is reciprocal performance whereby the goods or services are supplied in return for the consideration provided by the recipient: see, for example, the judgment in *Borsele* at [24]. That is what is meant by "a direct link" between the supply of the goods or services and the consideration provided by the recipient: see *Borsele* at [26] and contrast *Apple and Pear Development Council v Customs and Excise Comrs*. There is no need for the consideration to be equal in value to the goods or services. It is simply the price at which the goods or services are supplied. This requirement was satisfied in both *Finland* and *Borsele*.
>
> 53. Satisfaction of the test for a supply for consideration under article 2 does not give rise to a presumption or general rule that the supply constitutes an economic activity. However, as Mr Puzey for HMRC pointed out, the Advocate General remarked in her Opinion in *Borsele* at [49], "the same outcomes may often be expected".
>
> 54. Having concluded that the supply is made for consideration within the meaning of article 2, the court must address whether the supply constitutes an economic activity for the purposes of the definition of "taxable person" in article 9. The issue is whether the supply is made for the purposes of obtaining income therefrom on a continuing basis. For convenience, the CJEU has used the shorthand of asking whether the supply is made "for remuneration". The important point is that "remuneration" here is not the same as "consideration" in the article 2 sense, and in my view it is helpful to keep the two terms separate, using "consideration" in the context of article 2 and "remuneration" in the context of article 9.
>
> 55. Whether article 9 is satisfied requires a wide-ranging, not a narrow, enquiry. All the objective circumstances in which the goods or services are supplied must be examined: see the judgment in *Borsele* at [29]. Nonetheless, it is clear from the CJEU authorities that this does not include subjective factors such as whether the supplier is aiming to make a profit. Although a supply "for the purpose of obtaining income" might in other contexts, by the use of the word "purpose", suggest a subjective test, that is clearly not the case in the context of article 9. It is an entirely objective enquiry.
>
> 56. In describing the relationship between the supply and the charges made to the recipients in the context of article 9, the CJEU has used the word "link". In *Finland* at [51], the court concluded that "it does not appear that the link between the legal aid services provided by public offices and the payment to be made by the recipients is sufficiently direct…for those services to be regarded as economic activities". Likewise, in *Borsele* at [34], the court adopted precisely those words in concluding that the provision of the school transport was not an economic activity.
>
> 57. Mr Prosser QC for the College submitted that whether there was "a sufficiently direct link" between the services and the charge made was an important circumstance, while Mr Puzey submitted that "direct link" does not feature in the analysis.
>
> 58. I regard this as a largely semantic point. The word "link", whether "sufficient" or "direct", is used as no more than shorthand to encompass the broad enquiry as to whether the supply is made for the purpose of obtaining income. It is not a separate test, or one of the factors to be considered when

addressing the central question. For my part, I think it is apt to cause some confusion to use the same word for both article 2 and article 9 and I have not myself found it particularly helpful or illuminating in considering whether there exists an economic activity."

73. For the purposes of the proceedings in *Wakefield*, as set out at [67] and [68] of the decision, HMRC conceded that the provision of education to students at the college who received full funding or to those who were not eligible for any government funding did not amount to carrying on a business.

74. Lord Justice Richards held, at [78], that overall the evidence established that the supply of courses to students paying subsidised fees is an economic activity carried on by the college for the reasons he set out at [79] to [85]:

> "79. First, the sole activity of the College, in the most general terms, is the provision of educational courses. It is not comparable to the municipality in *Borsele* for whom the provision of school transport was very much ancillary to its principal activities.
>
> 80. Second, the provision of courses to students paying subsidised fees is a significant, albeit minority, part of the College's total undertaking.
>
> 81. Third, the fees paid by such students are significant in amount…..
>
> 82. Fourth, the subsidised fees made a significant contribution to the cost of providing courses to the students paying those fees, to the extent of some 25-30%.
>
> 83. Fifth, the level of fees was fixed by reference to the cost of the courses…...
>
> 84. Sixth, the fees were not fixed by reference to the means of the students or employers or others paying the fees. The fee was a fixed fee for each course, published each year in the College's prospectus…...
>
> 85. Seventh, it is undeniable that there is a market in the provision of further and higher education, whose viability is underpinned by a combination of grant aid and fees. There is no reason to suppose that the College is other than a typical participant in that market or that it provides courses to students paying subsidised fees on anything other than a typical basis, allowing no doubt for some variations between different institutions….."

Were the without charge supplies made for consideration?

75. The first question, therefore, is whether the supplies without charge were made for consideration. As noted, in effect, the answer to that question has been provided by the decision of the UT in *Colchester*. Prior to setting out details of the decision in *Colchester*, I have set out the other relevant caselaw, in particular, the caselaw which was considered in *Colchester* and the parties' arguments on the caselaw which are substantially the same as the arguments made in *Colchester*.

76. As recognised in *Wakefield*, it is well established in the caselaw that a supply of services is effected "for consideration", within the meaning of article 2(1) PVD, only if there is a legal relationship between the supplier and the recipient, pursuant to which there is "reciprocal performance" whereby the goods or services are supplied in return for the consideration provided by the recipient.

Caselaw – early cases

77. One of the earlier cases in which this principle was set out, as referred to in *Wakefield*, is C-102/86 *Apple and Pear Development Council v Customs and Excise Commissioners* [1988] STC 221 ("*Apple and Pear*"). In that case, the Council was a body established by statutory instrument whose functions related to advertising, promotion and the improvement of the quality of apples and pears grown in England

and Wales. The CJEU held that the mandatory annual charge which the Council imposed on growers, which was calculated per hectare of land used for growing apples and pears alternatively according to the number of fruit trees planted, was not consideration for supplies of services by the Council to growers.

78. At [11], the court noted that it was held in Case 154/80 *Staatssecretaris Van Financien V Cooeperatieve Aardappelenbewaalplaats* (1981) ECR 445 ("*Aardappel*") that for the provision of services to be taxable within the meaning of the relevant directive there "must be a direct link between the service provided and the consideration received". The court held, at [16], that mandatory charges of the kind imposed on the growers did not constitute consideration with a direct link with the benefits accruing to individual growers from the exercise of the Council's functions. The court said, at [14], that so far as the Council was a provider of services, the benefits deriving from those services accrued to the whole industry, any benefits derived by individual growers derived indirectly from those accruing generally to the industry as a whole, and it could not be ruled out that, in certain circumstances, only apple growers or else only pear growers could derive benefit from the exercise of specific activities by the Council.

79. The CJEU continued, at [15], to note that:

> "… no relationship exists between the level of benefits which individual growers obtain from the services provided by the Council and the amount of the mandatory charges which they are obliged to pay under the 1980 Order. The charges, which are imposed by virtue not of a contractual but a statutory obligation, are always recoverable from each individual grower as a debt due to the Council, whether or not a given service of the Council confers a benefit on him."

80. In his opinion, the Advocate General said, at p 235a-c, that the payment to the Council was only indirectly for the benefit, if any, received by particular growers. The obligation was to pay towards the Council's expenses of improving the industry; it was not to pay for what was individually received. On that basis, the necessary reciprocity or direct link could not be established.

81. At p 235c-d, the Advocate General also drew attention to the distinction, recognised by the Court of Justice in *Gaston Schul Douane Expediteur BV v Inspecteur der Invoerrechten en Accijnzen, Roosendaal* (Case 15/81) [1982] ECR 1409, at [14], between a "transaction" necessary for an internal supply under which there is a supply of goods for valuable consideration and the mere importation of goods, which is a chargeable event whether there is a transaction or not, and whether or not the transaction is carried out for valuable consideration. The Advocate General took the view, at p235e-f, that the obligatory payment of the levy and the obligatory discharge of statutory functions unrelated to individual growers could not constitute the necessary transaction, let alone any form of bargain.

82. In expressing that opinion, the Advocate General drew a distinction between the general levy and "the Kingdom Scheme". That was a voluntary scheme for the promotion of the sale of top-quality apples which was the precursor to the compulsory scheme under consideration in *Apple and Pear*. Apart from an initial government grant, the Kingdom Scheme was self-financing and growers voluntarily paid for services directed to their specific products. The Court of Appeal upheld the High Court's conclusion that the services provided by the Council in return for the additional levy from the growers who chose to join the scheme were supplies for consideration (see the judgment reported at [1985] STC 383, at p 390). Before the House of Lords, it does not appear that HMRC challenged the distinction between the Kingdom Scheme and the general activities of the Council (see the judgment reported

at [1986] STC 192). The Advocate General also accepted that the position in relation to the payments under the Kingdom Scheme was very different to that under consideration as regards the compulsory scheme (see p 235 of his Opinion).

83. The need for "reciprocity" for there to be a direct link between the service and payment received was emphasised in *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509 ("*Tolsma*"). In that case, Mr Tolsma played a barrel organ on the public highway in the Netherlands. He solicited voluntary donations from passers-by and by knocking at the doors of houses and shops to ask for payment. The court held, at [14], that a supply of services is effected "for consideration" only if there is:

> "a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient".

84. In *Tolsma* there was no agreement between the parties, and no necessary link between the musical service and the payments to which it gave rise. It was irrelevant that Mr Tolsma played his music with a view to receiving payment and that he received payment or that Mr Tolsma solicited money and expected to receive it. The payments were entirely voluntary and the amount was practically impossible to determine.

85. In his opinion in *Tolsma*, Advocate General Lenz set out, at [14], a helpful summary of the criteria set out in the case law to define this principle:

> "….there must be a direct link between the service supplied (which in this case would be the music provided) and the consideration received (in this case the payments by passers-by) (see the judgments in [*Aardappel*].... para1012, [*Apple and Pear*]……..para 11 and *Naturally Yours Cosmetics Ltd v Customs and Excise Comrs* (Case 230/87) [1988] STC 879 at 894, [1988] ECR 6365 at 6389, para 11). The link must be such that a relationship can be established between the level of the benefits which the recipients obtain from the services provided and the amount of the consideration (see [*Apple and Pear*…para 15). The consideration must be capable of being expressed in money (see the [*Aardappel*] judgment (at 454, para 13), and the [*Naturally Yours Cosmetics* judgment…para 16]). It must be a subjective value (see para 23 below), since the taxable amount is the consideration actually received and not a value estimated according to objective criteria. A service for which no subjective consideration is received is consequently not a service 'for consideration' (see the [*Aardappel*] judgment (at 454, paras 10, 11), the [*Naturally Yours Cosmetics*] judgment…para 16)."

Keep Newcastle Warm and Rayon D'Or

86. KMC relied, in particular, to the decisions of the CJEU in *Rayon D'Or* and Case C-353/00 *Keep Newcastle Warm*.

87. In *Keep Newcastle Warm*, as set out at [4] to [11]:

(1) At the relevant time, regulations in place in the UK provided for the award of grants to improve energy efficiency in dwellings occupied by certain persons including for advice relating to "thermal insulation or to the economic and efficient use of domestic appliances or of facilities for lighting, or for space or water heating".

(2) Under the regulations:

(a) when a householder made an application for a grant to the relevant network installer, in that case Keep Newcastle Warm, the installer had to

consider whether the applicant was eligible for the grant and, if it was satisfied that was the case, it had to:

(i) send the application to the administering agency for the area for determination and certify to the agency that it had carried out verification as to the applicant's eligibility for a grant as laid down from time to time by the agency,

(ii) decide whether, pending the determination of the application, it was prepared to carry out the work on the basis that, in the event that the agency did not approve the grant, the installer would bear the cost of the work (except to the extent specified below), and

(iii) notify the applicant in writing that it was prepared to carry out the work on the basis that, unless the application was not approved or the claim not paid by the agency on grounds of material misrepresentation, the applicant would be liable to pay for the work only the amount agreed in writing between the applicant and the installer before the application was made as representing the amount by which the full cost of the work would exceed the grant.

(b) The maximum amount of a grant for each piece of energy advice was £10.

(c) Where the conditions for payment of a grant were satisfied, and the work was carried out by a network installer, the administering agency was required to pay the grant to the network installer.

(3) The administering agency required (amongst other things) that a standard-form agreement was entered into by the applicant and the network installer which reflected the above provisions.

(4) KNW sought to reclaim from HMRC the VAT which it had for several years declared and paid on the grants paid to it by the administering agency on the basis that the grants did not form part of the taxable amount for its supplies of services to applicants within the meaning of article 11A(1)(a) of the Sixth Directive.

88. The CJEU concluded as follows at [23] to [28]:

"23. Article 11A(1)(a) of the Sixth Directive deals, *inter alia*, with situations where three parties are involved: the authority which grants the subsidy, the body which benefits from it and the purchaser of the goods or services delivered or supplied by the subsidised body (see, to that effect, judgment of 22 November 2001 Case C-184/00 *Office des produits wallons* [2001] ECR I-9115, paragraph 10).

24. In that context, the sum paid by a public authority such as the EAGA to an economic operator such as KNW in connection with the service of energy advice supplied by KNW to certain categories of householders may constitute a subsidy within the meaning of Article 11A(1)(a) of the Sixth Directive.

25. In any event it must be noted that the taxable amount in respect of a supply of services is everything which makes up the consideration for the service (see, *inter alia*, *Tolsma*, cited above, paragraph 13).

26. It is clear that the sum paid by the EAGA to KNW is received by the latter in consideration for the service supplied by it to certain categories of recipient.

27. As consideration in respect of a supply, that sum forms part of the taxable amount within the meaning of Article 11A(1)(a) of the Sixth Directive.

28. Accordingly the answer to be given to the questions referred to the Court must be that Article 11A(1)(a) of the Sixth Directive is to be interpreted as meaning that a sum such as that paid in the case in the main proceedings constitutes part of the consideration for the supply of services and forms part of the taxable amount in respect of that supply for the purposes of VAT."

89. In *Rayon D'Or* the CJEU held that "healthcare lump sums" which a French residential care home for the elderly ("**RCHE**") received from the French sickness insurance fund sum was consideration for the care provided by RCHE to its residents. The CJEU set out the material facts at [14] to [18] as follows:

"14 [The relevant French law] states:

'Expenses relating to medical care given to insured persons and recipients of social assistance in the homes and facilities listed in…. shall be borne by health insurance schemes or covered by social assistance, in the manner laid down by regulation, using lump-sum formulae where appropriate.'

15 In accordance with [the relevant article in the French law], RCHEs which have signed a multi-annual agreement with the President of the General Council and the competent State authority are to receive a global lump-sum payment in respect of the care which they provide.

16 [The relevant article in the French law] reads as follows:

'The care provided by the establishments or sections thereof referred to in Article L. 313-12 … involve:

1. A daily rate for accommodation,
2. A daily rate for dependency,
3. A daily rate for care.'

17 [The relevant article in the French law] provides:

'The tariff relating to healthcare shall cover the medical and paramedical services needed to treat the somatic and psychological ailments of persons residing in the home and the paramedical services corresponding to healthcare that are connected with the dependency level of the residents.'

18 …… the detailed rules for calculating the 'healthcare lump sum' take account of the number of residents hosted by each home and their dependency level, which are assessed in accordance with the conditions set out in [certain articles of the applicable French law], and of historical coefficients which are determined at national level and updated each year on the basis of the average expenses of all RCHEs."

90. The court said, at [28], that in essence, the question was:

"whether Article 11A(a) of the Sixth Directive and Article 73 of the VAT Directive are to be interpreted as meaning that a lump-sum payment such as the 'healthcare lump sum'……constitutes the consideration for the healthcare provided for consideration by an RCHE to its residents and, on that basis, falls within the scope of VAT."

91. The CJEU concluded, at [32] to [38], that the answer to the question set out at [28] is as follows:

"32. It is clear that the 'healthcare lump sum'…..paid by the national sickness insurance fund to the RCHEs is received by the latter as consideration for the care which they provide, in different forms, to their residents.

> 33. Firstly, as Rayon d'Or accepted at the hearing, the RCHEs are actually obliged to provide services to their residents in consideration of the payment of that lump sum.
>
> 34. Next, it is not a requirement of the directive that, for a supply of goods or services to be effected 'for consideration', within the meaning of that directive, the consideration for that supply must be obtained directly from the person to whom those goods or services are supplied, since it may be obtained from a third party (see, to that effect, Joined Cases C-53/09 and C-55/09 *Loyalty Management UK and Baxi Group* EU:C:2010:590, paragraph 56).
>
> 35 The fact that, in the main proceedings, the direct beneficiary of the services in question is not the national sickness insurance fund which pays the lump sum but the insured person is not, contrary to the submissions of Rayon d'Or, such as to break the direct link between the supply of services made and the consideration received.
>
> 36 Finally, it is clear from the Court's case-law that where, as in the main proceedings, the supply of services in question is characterised, inter alia, by the permanent availability of the service provider to supply, at the appropriate time, the healthcare services required by the residents, it is not necessary, in order to recognise that there is a direct link between that service and the consideration received, to establish that a payment relates to a personalised supply of healthcare at a specific time carried out at the request of a resident (see, to that effect, *Kennemer Golf* EU:C:2002:200, paragraph 40).
>
> 37 Accordingly, the fact, in the main proceedings, that the healthcare provided to residents is neither defined in advance nor personalised and that the payment is made in the form of a lump sum is also not such as to affect the direct link between the supply of services made and the consideration received, the amount of which is determined in advance on the basis of well-established criteria.
>
> 38 Having regard to the foregoing considerations, the answer to the question referred for a preliminary ruling is that Article 11A(1)(a) of the Sixth Directive and Article 73 of the VAT Directive must be interpreted as meaning that a lump-sum payment such as the 'healthcare lump sum' at issue in the main proceedings constitutes the consideration for the healthcare provided for consideration by an RCHE to its residents and, on that basis, falls within the scope of VAT."

92. In *Kennemer*, to which the CJEU referred at [36] of *Rayon D'Or* the CJEU held that the annual subscription fees paid by members of a golf club in Holland, who also paid admission fees for the use of the course, were consideration for services. The court held that there was the required "direct link" (within the meaning of (amongst other judgements) the judgment in *Apple and Pear*) on the basis that the service provided in exchange for the subscription fee was the opportunity to make use of the facilities, as set out at [40]:

> "As the Commission argues, the fact that…..the annual subscription fee is a fixed sum which cannot be related to each personal use of the golf course does not alter the fact that there is reciprocal performance between the members of a sports association….and the association itself. *The services provided by the association are constituted by the making available to its members, on a permanent basis, of sports facilities and the associated advantages and not by particular services provided at the members' request*. There is therefore a direct link between the annual subscription fees paid by members of a sports association…. and the services which it provides." (Emphasis added.)

93. The parties made similar submissions on these cases as those that the parties made respectively in *Colchester* as recorded in the decision of the UT in that case. Essentially, KMC's stance is that the facts of the current case are analogous to those in *Rayon D'Or* and *Keep Newcastle Warm* and that the tribunal was wrong to form the opposite view in its conclusion in *Colchester*. In its view, there is the requisite direct link between the lump sums received from EFA and SFA and the supplies without charge such that those supplies are made for consideration in the form of the lump sums. KMC said that, similarly, to the situation in those cases, that direct link exists notwithstanding that (a) the payments made by EFA and SFA to KMC are not individualised to any particular student or course, are calculated by reference to a formula containing various components and are paid in advance, and (b) KMC carries out its activities in the context of a statutory framework which imposes responsibilities on it to provide education and training courses.

94. HMRC submitted that, on the contrary, as the tribunal held in *Colchester*, the facts of this case are materially different from those in *Keep Newcastle Warm* or *Rayon d'Or*. In their argument before the UT in the Colchester case, HMRC relied in particular, on the assertion that the decision in *Rayon d'Or* was made on the basis that the relevant supplies made by RCHEs comprised "making available" healthcare services to elderly residents in the care home in the same way as in *Kennemer* the services provided by the golf club were "constituted by the making available to its members, on a permanent basis, of sports facilities and the associated advantages and not by particular services provided at the members' request". In their view, on the other hand, in this case (and in *Colchester*), there is no supply of the type identified in *Kennemer*. The better analogy is with cases like *Apple and Pear* and *South African Tourist Board v Customs Commissioners* [2014] UKUT 280 (TCC) [2014] STC 265 ("*SATB*").

SATB

95. In *SATB*, the UT considered whether the South African Tourist Board ("**the Board**"), a statutory body with the objective of promoting tourism in South Africa made supplies of services for consideration comprising the funding it received from the South African government. Each year, the Board entered into a performance agreement with the South African government to achieve its targets on increasing tourism and funding was subject to the Board achieving those targets.

96. The UT said the following as regards determining the nature of a supply, at [51]:

> "…regard must be had to the economic realities and to all the circumstances in which the transaction takes place (see *Revenue and Customs Commissioners v Loyalty Management UK Ltd* (Case C-53/09 and C-55/09) [2010] STC 2651 at para 39, and *Revenue and Customs Commissioners v Loyalty Management UK Ltd* [2013] STC 784 per Lord Reed at para 38). It is necessary to have regard to the level of generality which corresponds to the social and economic reality (*Dr Beynon and Partners v Customs and Excise Commissioners* [2005] STC 55, per Lord Hoffman at [31]). As explained by Arden LJ in the Court of Appeal in *Esporta Ltd v Revenue and Customs Commissioners* [2014] EWCA Civ 155, the contractual terms are the starting point, and the court has to consider whether those terms reflect the economic and commercial reality of the transaction."

97. At [55] the UT drew what they regarded as an important distinction which was "at the heart of the *Apple and Pear* decision" and "at the heart of this case" between:

(1) the supply of services "for consideration"; and

(2) "a situation where Government funding is provided to a body in order for it to perform its function but where the services are not provided to the funder in return for that consideration…"

98. In their view, the Board's case fell within the second type of situation they had identified at [55]. They said, at [56]:

> "In our judgment, on its own the Performance Agreement falls far short of demonstrating the degree and nature of reciprocity required to constitute the payments made by the Department to SATB as consideration for supplies by SATB. There is a link between the funding and the performance by SATB of its functions in accordance with the agreed business plan and objectives, but that is consistent with an arrangement of negotiated funding. There is nothing in the agreement to deflect away from that analysis towards a transaction of supply. The linkage is not one of mutual exchange of supply and consideration for that supply."

99. The UT said, at [57] to [60], that the following factors supported their conclusion:

> "57. The economic and commercial context supports that analysis. It starts with the Tourism Act, and its high-level provision for the objectives and purpose of SATB. It provides for the means of funding of SATB, including the appropriation of monies by the South African Parliament. There is a statutory obligation of SATB to expend those monies in performance of its objectives.
>
> 58. The Tourism Act itself provides a framework for a funding arrangement as between the Government and SATB. SATB is under a duty, subject to being adequately funded, to perform according to its objectives. The fact that the funding is then determined by an iterative process involving negotiation to achieve a consensus on the detail of the business plan does not result in there being the necessary reciprocity or mutuality to convert a funding arrangement as contemplated under the Tourism Act into a transaction of the supply of services for a consideration.
>
> 59. We accept Ms Hall's submission that the relationship between SATB and the South African Government is not exclusively defined by the Tourism Act. But the whole tenor of the Tourism Act, the PFMA, the Governance Protocol and the Performance Agreement is one of the funding of SATB's activities. We regard that as a different legal relationship from the one contemplated by the reference to supply of services for a consideration in the VAT legislation. The Performance Agreement operates not to record the supply of services by SATB for a consideration, but to crystallise the funding at the level to support the detailed programme of activities. Ms Hall argued that reciprocity in terms of subjective agreement as to the value of the services was the material factor. We agree that is a relevant factor, but there is a difference between agreeing the value of something for the purpose of providing the appropriate level of funding to enable that thing to be carried out, and agreeing the value of a service for the purpose of paying for that service. The mere act of agreeing a value is not therefore decisive of the required mutuality. In this case the negotiation and agreement as to value was a function of the oversight of the arrangements by a funder, and not to provide a monetary exchange for a service provided.
>
> 60. The fact that the South African Government received a benefit from the activities of SATB is relevant, but again not decisive. Although the Government received something of value to it, that value was received as an incidental outcome of the ability of SATB to perform its statutory duties by virtue of the funding it had received. There was no relevant reciprocity and

> accordingly no direct link between the payment and the value received by the Government."

100. The UT formed a different conclusion in respect of the different funding arrangements made under a memorandum of understanding between SATB and a separate entity, TBCSA, an organised body of business in tourism and related businesses. This body collected voluntary levies on the sale of hotel accommodation and rental cars to tourists (see [23]). The memorandum provided for specific benefits to be made available to those collecting levies such as: notice of marketing agreements, preferential profiling for the levy collectors, availability of office space and assistance in setting up appointments for the levy collectors, preferential participation in exhibitions, and other preferential promotional treatment (see [99]). The UT held that this demonstrated reciprocity, and even though a particular level of service could not be identified under the memorandum, it still contained a "quid pro quo" for the payments, which were consideration for VAT purposes (see [100]).

101. As set out in *Colchester*, HMRC consider that similarly, EFA and SFA provide funding on conditions to bodies such as Colchester and KMC; the arrangements between the funders and KMC lack the required reciprocity or direct link for the funding to be consideration for the supplies without charge. In *Colchester*, the appellant argued that the facts of *SATB* (save for as regards the TBSCA) and of *Apple and Pear* are very different to those in this case and other cases where payments have been held to lack a direct link are far distant from the facts of this case. For example, *Institute of Chartered Accountants of England and Wales v CEC* [1999] WLR 701 involved a public body performing regulatory functions, and Case C-284/04 *T-Mobile Austria GmbH v Austria* [2008] STC 184 involved the auction of mobile phone telephony licences, a public function undertaken by the competent authorities as part of their regulatory function.

Decision in Colchester

102. In *Colchester* the UT rejected HMRC's arguments for the reasons set out below and held that the tribunal had erred in its conclusion.

103. As set out at [32] of the UT's decision, the tribunal decided that the funding provided by EFA and SFA to CIC did not amount to consideration for any supplies by CIC. It agreed with HMRC that the funding was not "negotiated consideration paid for services, but rather a block grant provided subject to conditions" (see [127]). The UT then cited the reasons given by the tribunal at [127] as follows:

> "(1) The statutory background for the provision by the Secretary of State for funding for education and vocational training. This is not a strong factor against the payments amounting to consideration, but it is a factor.
>
> (2) The absence of any direct link between the education and training provided to any particular student, and the funding provided by the funding agencies. This is a strong factor against the funding constituting consideration. We note in particular the fact that the funding is provided by reference to formulae which are set out by the agencies on a "take it or leave it" basis –and are not negotiated. There is no direct link in the formulae between the costs actually incurred by CIC in providing a particular course to a particular student, and the funding it receives. The College has great freedom in the courses it chooses to provide. There is no control by the funding agencies over the number of students offered places, or (as regards EFA funding) the courses they will fund (providing they meet certain basic criteria).
>
> (3) The existence of agreements between the funding agencies and CIC is a neutral factor, as it is consistent both with the funding arrangements

amounting to third party consideration, and with the funding arrangements amounting to a block grant made out of public funds but subject to conditions.

(4) The rights of the funding agencies to "claw back" amounts in the event that a student does not attend the course to the end, or other conditions of funding are not met. This is a point in favour of the funding amounting to third-party consideration. But as the amount clawed-back bears no direct relationship to the actual amount of resources expended by the college on that student's education or vocational training (or, indeed the "fee" that was "waived") it is a weak point.

(5) The amount shown on the "Receipts" issued to students whose fees are "waived" does not reflect a fee that is charged to the relevant funding agency for the provision of the course. It will not be the case (except by happenstance) that the aggregate amount shown on such receipts will equal the amount funded by the funding agencies, because of the components of, and adjustments made under, the funding formulae. This is a strong factor in demonstrating that there is not a fixed monetary amount which represents consideration paid in respect of each student.

(6) The College would not be able to provide education and vocational training "but for" the funding it receives from the funding agencies. This is a factor in favour of the payments being consideration, but is a weak factor.

(7) The College educating paying and non-paying students together. We consider this to be a neutral point, as it is consistent both with the funding provided to non-paying students being a block grant made out of public funds but subject to conditions, and the fees paid by fee-paying students amounting to consideration."

104. I note that in this case there were no receipts of the type referred to by the tribunal in *Colchester* at 127([5)] as set out above.

105. Essentially, the UT held, at [69] to [74], that, contrary to HMRC's view, the decision in *Rayon d'Or* is not limited to "*Kennemer* supplies" and that, on the facts, *Colchester* fell squarely within its ambit; *Rayon d'Or* is analogous on its facts with *Colchester* and their analysis must follow that of the CJEU in that case:

(1) They noted, at [69], that it was common ground that there was no "*Kennemer* supply" in *Colchester*:

"If the grant funding is consideration for anything, it is for supplies of education and vocational training made by CIC to students - albeit not students who can be identified at the start of the year when the payment is made, but students who fall within a category which that funding is intended to benefit."

(2) They explained, at [70] and [71], that in *Rayon d'Or*, the Court made repeated reference to the fact that the healthcare lump sum was paid in respect of the care provided to the residents of the care home and did not approach the relevant supplies as "some sort of right of access to healthcare, which might be called a *Kennemer* supply". Rather on the facts, "the services in question were healthcare services supplied to the individual residents in due course, and the issue was whether the healthcare lump sum was directly linked with those services".

(3) They continued, at [71], that, therefore, they did not understand the reference at [36] of *Rayon d'Or* to services which are "permanently available", to be a characterisation of the RCHEs' supplies as *Kennemer* supplies, as distinct from any other type of supply for VAT purposes. Rather they understood the words "permanently available" to describe the relevant services

as "services provided year on year by the RCHEs to their residents, whoever they may be from time to time, on a rolling basis" and they noted that:

> "The Court's conclusion was that the healthcare lump sum, which was not personalised to any specific supply of healthcare to any particular resident, was still consideration for VAT purposes. *Kennemer* supported that conclusion, because *Kennemer* shows that reciprocity can still exist even though the payment in question "cannot be related to each personal use ..." (to quote from *Kennemer* [40], cited at [30] of *Rayon d'Or*)."

(4) They considered that, accordingly, at [72] the better analysis is that:

> "the rules for identifying what is, or is not, consideration for a VAT supply are generic, developed in the case law of the European Court, which rules fall to be applied in an infinite variety of different circumstances. *Kennemer* was just one case on one set of facts, it is an illustration of the rules being applied.
>
> *Rayon d'Or*, properly understood, is not a case involving a *Kennemer* supply at all. Mrs Hall sought to make that point by referring us to *Saudeçor*; we agree that *Saudeçor* helps because *Saudeçor* plainly did not involve a *Kennemer* supply. But it is not necessary in our judgment to look outside the judgment in *Rayon d'Or* itself to understand the basis of the CJEU's reasoning in that case."

106. At [75] to [81] the UT went on to consider the particular factors which the tribunal had pointed to in its conclusions (as summarised at [127] of its decisions and set out above) to the contrary to those made by the UT:

(1) At [75] they said that the statutory background is relevant in that it "opens the door to the "funding with conditions" analysis, because such funding is typically found in the context of bodies carrying out public functions on behalf of government (as was the case in *SATB*). But they considered that *Rayon d'Or* demonstrates that a supply analysis remains possible even where the payments are made pursuant to statute. Therefore, they concluded that the statutory background was a neutral factor, consistent with both parties' cases.

(2) At [76] the UT disagreed with the tribunal's finding that the existence of agreements between the funding agencies and CIC was a neutral factor; their existence was consistent with either side's case. In the UT's view "the content of those agreements is far from neutral, because the agreements are the starting point in the analysis" (referring to *SATB* at [55]). The UT did not consider them to be evidentially neutral but to be key to the analysis. They then set out four important features which they consider provide the answer to the question.

(a) First, at [77]:

> "although the agreements did not state in terms which courses CIC was to provide, they did restrict the funding to courses within a list on the Government's website. The essence was that the funding was for those courses; CIC was not at liberty to do anything else with the money."

(b) Secondly, at [78], the amount paid was by way of formula and not negotiated. Whilst the "use of a formula is not itself a basis for concluding that the payments are not consideration, as *Rayon d'Or* shows", in this case "the components of the formula give clues as to what the grant payment were for":

> "The starting point was a "per student" amount (of £4,000); the number of students was based on the last year's intake, used as a

> proxy for the expected number of students in the current year; there were a number of adjustments to be made which related to the courses themselves –mostly reflecting the higher costs of providing courses (or certain types of courses) to students within the catchment of CIC. The formula was therefore highly specific to CIC's outputs - to the number of students, the type of students, the number of courses and the type of courses."

(c) Thirdly, at [79], one way or another, CIC would have to pay back any part of the grant funding which was not used for supplying the courses as anticipated at the beginning of the year:

> "So far as SFA was concerned, if CIC did not provide courses of a sufficient number to meet the assumptions in the funding formula, the funding was clawed back pro-rata at year end. The arrangements with EFA were different, with a retention applied the following year to reflect any shortfall in provision by CIC for the current year, as part of the formula for that agency's funding. Both mechanisms were aimed at ensuring that CIC delivered the number of courses paid for in any given year. The fact that the EFA retention applied in the following year and did not affect current year payments is not significant. In the context of a corporation making supplies year on year pursuant to statutory obligations funded by Government, a system of delayed adjustment at year end with effect on the following year's payment is understandable. It is simply the means to an end, an accounting mechanism chosen to ensure that there was no overpayment. The FTT did not distinguish between the two methods of adjustment, clawback and retention; we agree that there is no meaningful distinction to be drawn between them."

(d) Fourth, at [80]:

> "in order to give the funding agencies full sight of its activities, and to permit accurate application of the relevant funding formulae, CIC submitted an ILR for each student on a monthly basis, comprising over 200 fields of data for each student. The ILRs were required under the agreements. By them, the funding agencies were given detailed information about how the funds are being spent by CIC. With that information, the funding agencies were able to adjust their payments to match that data and according to the standard formula. With that information, the funding agencies were able to see how their grant funding had been spent."

(3) The UT concluded on the above points, at [81], as follows:

> "Taken together, we conclude that these features, all contained within the agreements, seen in context, indicate the existence of a direct link between the grants coming into CIC and the courses provided to CIC's students for free. We accept, of course, that the link could have been more direct than it was: the funding was not specific to any particular course or courses, it did not reflect the specific costs of any particular course, nor did it identify the particular students who would take those courses. But the law does not require such a degree of specificity; the concept of "direct link" encompasses a range of possibilities."

107. At [82] and [83], the UT said that their conclusions also made sense viewed against "the wider canvass":

(1) At [82], they noted that some students did not benefit from grant funding but were required to pay, in whole or in part and the experience for these students was identical to that for the students who attended "free" courses fully funded by the grants:

> "To conclude that all students were in receipt of supplies by CIC, the consideration for those supplies coming from different sources, meets with common sense. If the law drove us to conclude that CIC made supplies only to the extent that a student actually paid for the services, but that otherwise the courses were not supplied for VAT purposes at all –as Mr Mantle suggested was the case –we would of course have to live with that, and with the consequence that within the same classroom CIC could be making business and non-business supplies. But that would be a strained analysis of these straightforward facts. Our conclusion has the advantage of simplicity."

(2) At [83], they said that CIC's activities in this case "have echoes of the supplies under the Kingdom Scheme" in *Apple and Pear* and TBSCA supplies in *SATB*, which were for consideration. In both of those examples, there was little precision at the point of payment about what would be provided in exchange; rather, there was an understanding about the sort of services which would be provided year on year in exchange for the money paid. They said that these cases are "at one" with *Rayon d'Or*, *Saudeçor* and *Nagyszénás* and are "a better fit than the cases relied on by HMRC which are very distant on their facts from this case".

108. At [85] to [88], the UT summarised the tribunal's errors of law in *Colchester* as follows:

> "85. The error is clearest in the FTT's treatment of *Rayon d'Or*, which the FTT appears to have distinguished on the basis that the taxpayer in that case made its services of healthcare "permanently available" to the elderly residents and the funding in that case was a "mandatory tariff fixed by legislation" (see [130]). For reasons set out above, we do not agree that *Rayon d'Or* can be distinguished in that way.
>
> 86. More fundamentally, the FTT was in error in looking for a link which was so direct that the payments could be matched to individual supplies or the costs of individual supplies, or to individual students taking courses. There is nothing in the case law to suggest that a link of that degree of specificity or directness must be present for a payment to constitute consideration. The concept of direct link is more flexible than that…….
>
> 87. To the extent that the FTT concentrated on the cost of the supplies (see again [127(2)] and [131]), it made a separate error because the cost of supplies is irrelevant to the question of whether a transaction is to be regarded as for consideration: see Case C-520/14 *Gemeente Borsele v Staatssecretaris van Financiën* [2016] STC at [26].
>
> 88. Finally, to the extent that the FTT placed emphasis on the figure CIC quoted on the "receipt" given to students who did not pay fees, it was in further error. The description by CIC to the students about the cost or funding of the courses is of little relevance to the analysis of the transaction between the funding agencies and CIC for VAT purposes."

Conclusion

109. I can see no material distinction between the circumstances of this case (as set out in Part B) and those in the *Colchester* case (as set out at [21] to [54] of the tribunal's decision in Colchester and summarised by the UT at [13] to [30] of its decision) which lead the UT to conclude that the relevant supplies of education and

training made by CIC in that case were made for consideration within the meaning of article 2(1) PVD. Accordingly, applying the reasoning of the UT to the circumstances of this case, the supplies without charge were made for consideration within the meaning of article 2(1) PVD.

Was KMC carrying out an economic activity?

110. The next question is whether, under article 2 PVD, the supplies without charge are made by KMC as a "taxable person acting as such" namely, under article 9 PVD, as a person who independently carries out in any place any economic activity, whatever the purpose or results of that activity". I take the words "acting as such" to mean that the relevant supplies must be made by the relevant person who carries out such an economic activity in the course of or for the purposes of that activity. As Richards LJ set out in *Wakefield*, determining if supplies constitute an economic activity involves assessing whether the relevant supplies are made for the purposes of obtaining income therefrom on a continuing basis or, as it has been put by the CJEU by way of shorthand, "for remuneration".

111. HMRC do not dispute that this test is satisfied if, contrary to their view, the supplies without charge are made in return for consideration. On that basis, given the tribunal's conclusion on the consideration point, it is not necessary to consider this issue further in order to determine this appeal. However, given the point was argued at the hearing and that it is also relevant to the issues considered in Part D, I have considered KMC's argument that even if the supplies without charge are not made for consideration, they constitute an economic activity for the purposes of article 9 PVD on the basis that KMC's supplies of training services are inextricably linked to and are an intrinsic part of its commercial activities, such that together they form an integrated composite whole.

Discussion and conclusion

112. As set out in *Wakefield*, whether article 9 is satisfied requires a wide-ranging, not a narrow, enquiry. All the objective circumstances in which the goods or services are supplied must be examined: this does not include subjective factors such as whether, in subjective terms, the supplier is aiming to make a profit. As HMRC noted, it must be borne in mind in assessing all the objective circumstances that "consideration of economic realities is a fundamental criterion for the application of the common system of VAT" (see *HMRC v Loyalty Management UK Ltd; Baxi Group Ltd v HMRC* (Joined cases C-53/09 and C55/09) [2010] STC 2651, at [39]).

113. I note that, as HMRC emphasised, the caselaw relating to articles 1(2), 168 and 173 PVD indicates that it is entirely possible for a taxable person to carry on both economic and non-economic activity. For example:

(1) In *Securenta Göttinger Immobilienanlagen und Vermogenmanagement AG* v *Finanzamt Göttingen* (Case C-437/06) 2008] STC 3473, the CJEU's comments at [26] to [31], included the following acknowledgement:

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

(2) In *University of Southampton v HMRC* [2006] STC 1389, it was recognised that the University was undertaking a variety of activities and transactions which had to be separately analysed and that publicly funded

research had to be regarded separately for VAT purposes from other research and other activities (even though it used the same infrastructure and equipment and all of the activities were "vital" to the university) (see in particular [82]).

114. Essentially, KMC's stance is that KMC has a single economic activity, as a rural studies college, due to what it asserts is a high degree of interaction between its training function and its commercial supplies. KMC did not dispute the proposition set out in the cases referred to at [113] but said that, on the facts, there simply is no distinction to be drawn between KMC's activities in this case. KMC pointed to decisions in the tribunal, in support of its case, in particular, *NWT* and *BDA*.

115. As HMRC emphasised, as is evident from the articles of the PVD in point here, the common VAT system is based around the key concept of "supply". Leaving aside imports and acquisitions, the regime operates in relation to supplies and the precise VAT consequences for a taxable person who makes and/or receives supplies differ according to the categorisation of the particular supply in question. With that in mind, it seems to me that, assessing the nature and scope of an economic activity, which it is argued is formed of or includes particular supplies, requires a more granular analysis, at least as a starting point, by reference to the nature of the particular supplies which KMC makes, than the more generalised approach adopted by KMC.

116. It is readily apparent that KMC's supplies fall into two groups, namely, supplies of training services made to students and commercial supplies of a wide range of goods and services made to a much broader range of persons. Viewing all the relevant circumstances objectively, given their different nature, these two sets of supplies are, in economic and commercial terms, distinct and different from each other.

117. It seems that KMC's argument is, in effect, that, notwithstanding the clear distinction in economic and commercial terms between the two sets of supplies, the supplies without charge are somehow subsumed within a single economic activity on the basis that all of its supplies (or the vast majority of them) are inextricably linked due to the scale of students involvement in its commercial activities, such that they are to be regarded as made for the purpose of generating remuneration on a continuing basis from this single overall activity of acting as a rural studies college. As HMRC set out, activities which are merely preparatory to the making of supplies for consideration or which, in all the relevant circumstances, viewed objectively in an economically realistic way, have no real independent existence may be part of a single economic activity of the supplier. However, that is plainly not the case here and, indeed, KMC did not seem to argue its case on that basis.

118. KMC asserted in its skeleton argument that: "Students *on most courses* at KMC engage in its Agricultural activities as part of their course of study, and the Agricultural activities are operated with the input of KMC's students, alongside employees" (emphasis added). However, this assertion, which appears to be the lynchpin of KMC's stance that it operates a single integrated business as a rural studies college, is not supported by the available evidence. In my view, overall KMC has not provided sufficient evidence to establish that its case is made out on its own terms.

119. I note the following:

(1) During the hearing, it transpired from the evidence given by Mr Pedder that many of the courses operated by KMC do not involve students, as part of the courses, working on matters relating to KMC's commercial activities (see [50], [51], and [53] to [58]).

(2) KMC has provided evidence that students on the agriculture and equine courses, as part of those courses, are involved in a range of activities relating to

its commercial activities, that there is some liaison between the relevant teaching and commercial staff and utilisation of the same premises and some equipment for teaching and commercial activities (see [53] to [65]). However, even if it is accepted that the relevant students' work can be described as substantial and/or significant in the sense, for example, that KMC would have had to engage additional staff had the relevant students not performed the relevant tasks, the difficulty is that:

(a) The tribunal is without the means to assess in any meaningful more precise way the scale or significance of such students' involvement in commercial activities viewed in the context of KMC's overall activities, given, in particular, that KMC has not provided evidence of the numbers of students on each of its courses during the relevant periods. The evidence sets out details only of the overall number of students and some numbers for part of the period for students on the equine and agriculture courses (see [53], [64(12)] and [69(9)]. The tribunal cannot determine, therefore, how many students overall were involved at any given time during the relevant periods, as part of their courses at KMC, in work relating to KMC's commercial activities.

(b) Such evidence as there is indicates that (i) the numbers of students on the agriculture and equine course form a relatively low proportion of the overall number of students (see [53], 64(12)] and [69(9)]), and (ii) whilst the income from the commercial farm and commercial equine activities is a relatively substantial part of KMC's overall income from commercial activities, it does not appear to form the majority of that income, and (iii) the commercial farm and commercial equine activities are a relatively small part of KMC's overall operation having regard to the income which the various stands of its commercial and training activities generate (see [67] to [69] as regards (ii) and (iii)).

(c) Given that neither Mr Pedder nor Ms Hannam were employed at KMC throughout the relevant periods (they both joined in 2014) and that the documentary evidence does not relate to the full relevant periods, it is unclear whether the levels of interaction referenced above were the same throughout the relevant periods.

(3) Whilst Mr Pedder's evidence establishes that students on a limited number of other courses, as part of those courses, have some limited involvement in its commercial activities, KMC has not provided evidence sufficient to enable the tribunal to assess how many students were involved in such work, the extent of the relevant activities and whether and to what extent the relevant students' work contributes to KMC's ability to generate income from its commercial supplies (see [54] to [56]). The same comment as made in (2)(c) also applies here.

(4) Such evidence as there is indicates that the scale of KMC's educational activities vastly exceeds that of the commercial activities at least in terms of income generated by them. For example, it is clear from the management accounts and the accounts for the period ending on 31 July 2016 that the income arising to KMC in the form of fees paid by or on behalf of students for the provision of the training services and grants provided by the agencies in relation to the training services is very much larger than the income generated by the commercial supplies (see [67] to [69]).

(5) Given the involvement, as part of their courses, of students on the equine and agricultural courses (and on some other courses) in practical hands-on training on KMC's own commercial farm and commercial riding school, it is unsurprising that (a) Ms Hannam, as the head of equine, had a role in relation to both training and commercial activities as did the "yard" staff working at the equine centre, (b) there was at least some discussion between the relevant academic staff and the manager of the commercial farm operation on how the students on the relevant courses were and could be involved in the commercial farm activities and how KMC's resources could be used for both training and commercial activities purposes, and (c) some premises and equipment were used for the purposes of both sets of activities. However, (i) these factors do not of themselves cast any light on the overall scale of KMC's students' involvement, as part of their courses, in work relating to its commercial activities, and (ii) this does not suffice in combination with the other evidence to demonstrate that all of KMC's activities form some kind of single integrated whole.

(6) The fact that in the limited set of management accounts and accounts produced in the bundles (see [66] to [69]) KMC's income and expenses are not divided strictly into separate categories as regards KMC's training activities and its commercial activities does not add material support to KMC's stance. I cannot see that it can simply be assumed that the manner in which, for accounting purposes, an entity presents and organises its income and expenses, generated by various strands of its overall activities, necessarily reflects the manner in which the entity actually operates and the degree of interaction between those strands. In any event, even if these accounts may be taken as providing some support for KMC's stance, having regard to the other issues set out above, this is not sufficient to demonstrate that the central theme of KMC's case namely, that the majority of its students are involved in commercial activities, is made out.

120. I cannot see that there is support for KMC's stance on the basis of *NWT* and/or *BDA*.

121. In *BDA* the tribunal held that the provision by the association of free membership to dental students was economic activity. The facts were summarised, at [2] and [3], as follows:

> "2. The Appellant is a mutual association targeted at, and providing various services to, dentists, retired dentists and dental students. It is not compulsory for anyone, even dentists, to join. Its services for VAT purposes include standard-rated services (including the provision of conferences and seminars) as well as services provided in exchange for membership subscriptions that are exempt.
>
> 3. The Appellant admitted dental students at universities to membership without charging them subscriptions. The reasons for this were all commercial. It was easy to attract dental students to membership when they were all congregated at universities, provided at least that membership was then free. By attracting them to membership, there were then two benefits. Firstly, they would be likely to remain paying members when they qualified. Secondly the Appellant would have their contact details. It would, by contrast, be far more difficult to locate qualified dentists, practising all over the country, and attract them as members if the Appellant only sought to do this once they had left universities and qualified."

122. It was held, at [5], that:

"We have absolutely no hesitation in saying that the provision of free membership to dental students is a provision within the compass of the Appellant's one business. We also conclude that there is no VAT principle, either in the Directives or in UK law, that requires a provision of free services, inherently made in the course of the undertaking of the one business, and given on very sensible commercial grounds, as requiring any disallowance of input tax."

123. At [15] to [19] the tribunal explained its finding that the BDA conducted only one business as follows:

14. In the present case, the services provided to the student members were the same as the services supplied to the fee-paying members and it is impossible to conclude that the Appellant was conducting two separate activities, one being a business and one being a distinct activity.

15. The facts of *The Imperial War Museum* case [*The Imperial War Museum v Commissioners of C&E* (1992) VATTR 346] are relevant in this context. In that case, the Trustees of the Museum amassed a display of British war memorabilia, to which the public were admitted. The public were charged for admission, but school parties were admitted free, and anyone was admitted free on Fridays. There were fairly marginal business ends still achieved by admitting people free, in that it was likely that they would buy refreshments, and possibly goods from the museum shop, and their admission would also increase the publicity achieved by the Museum's sponsors. Nevertheless, the Commissioners contended that the provision of free admission was not in the course of the business, albeit that they accepted that the overall activity, and all admissions for payment, constituted a business.

16. The Tribunal concluded that the Trustees conducted only one business, and they also concluded that the provision of the free admission was an act performed in the course of the conduct of that one business.

17. The *Imperial War Museum* case appears to be identical to the present case in this respect, and we conclude that it is impossible, in a general sense of the phrase, to conclude that the present Appellant was doing anything other than conduct one single business.

18. We also adopt the conclusion and the reasoning of the Tribunal in *The War Museum* case for the proposition that the grant of free membership to dental students was an integral, and highly sensible, act in the course of the conduct of that one business. The only difference between the two cases is that the present case is much stronger. The only commercial benefit of granting free admissions on Fridays in the earlier case, was that the Trustees might make some profits from providing refreshments, and selling a few goods in the shop. In the present case, we accept the argument that it was absolutely vital to maintaining high levels of membership that free membership should be provided to dental students.

19. We agree with counsel for the Appellant that this case is no different from that where banks give free banking services to students, or where many suppliers of services might give free introductory offers to new customers. All of those provisions of service are made in the course of the conduct of the one business. The Respondents might have found it easier to accept the point if matters had been expressed along the lines that new members would have three years of free membership, and would thereafter pay if they remained members. That nevertheless is the reality, and so our findings of fact, or mixed fact and law, are that:

- the Appellant conducted only one business;
- it did not, in the normal usage of the phrase, conduct any distinct activity that might be a non-business activity; and

- the provision of free membership was a commercially sensible introductory offer made entirely for business purposes, and made to foster the Appellant's one and only business, and thus made in the course of that business."

124. In *NWT*, the facts, as set out at [4] to [15] included that:

(1) NWT was a registered charity whose principal purpose was the conservation of natural resources within Nottinghamshire. It managed 65 nature reserves, promoted conservation and provided education about it, conducted wildlife surveys, and provided various consultation and information services relating to wildlife.

(2) As set out at [7], the 65 sites differed in character:

> "Many consist of open land, and of those sites some are suitable for grazing livestock; other sites are of woodland, including coppices; some are a mixture of the two; other sites still are wetlands. All have some form of wildlife. Most of the sites are freely open to the public, a few (or parts of them) only on prior request. Public footpaths cross many of the sites and, like any other landowner, NWT is obliged to keep the land alongside those footpaths, some paths it has itself created, and other areas to which the public have access, in a safe condition. That obligation entails the maintenance of trees by, for example, lopping dangerous branches. In order to protect the wildlife visitors are asked to keep to the marked paths and to keep dogs on leads."

(3) It was explained, at [8], that NWT had several sources of income:

(a) Income such as membership subscriptions, fees earned from the grant of grazing rights and the proceeds of the sale of publications, souvenirs and similar items were agreed to represent the consideration for taxable supplies, and there was no dispute about the recoverability of the input tax attributable to them.

(b) The sources in issue included "income derived from sales of merchandise such as meat, wool, animal feeds and bedding, timber and timber products, the provision of consultancy services, sales of data and hire of equipment". The tribunal noted that they heard no detailed evidence about the scale of those activities but it was apparent that it was modest.

(c) In addition, NWT's activities were supported by grants, subsidies, donations, legacies, investment income and occasional fund-raising events but again there was no detailed evidence about the magnitude of such income.

125. It was held that NWT carried on non-economic conservation activities but also the businesses of sheep farming and forestry, at [24] to [27], as follows:

(1) At [24], the tribunal said that it is immaterial that NWT's principal non-business activity is the conservation of the land entrusted to it, and the provision of access to that land, free of charge, to members of the public and that, without the land NWT could not carry on its activities of keeping a flock and selling wood and timber, and that the profit it derives from those activities are applied to its charitable purposes:

> "Whether or not the ultimate objective of the activity is the advancement of NWT's charitable purposes is immaterial: see *BLP*…the question is whether the activities are pursued with the

> intention, or for the purpose, of making taxable supplies; but, contrary to his contentions, I am satisfied they are. The notion that they are partly pursued for that purpose and partly for another, because of NWT's ultimate aims, seems to me to be misconceived."

(2) At [25] and [26], the tribunal continued to state that whilst no doubt the relevant activities were conducted in a manner which is consistent with, even designed to advance, NWT's conservation obligations, (a) the management of a flock is a single indivisible activity and where, as was the case in *NWT*, it is pursued in a business-like manner (as distinct from a hobby) with a view to earning profit, it is a business activity, and (b) "the fact of consistency does not mean that the forestry is itself no more than conservation. In my view it is a business activity which happens to be pursued by an organisation whose objects are charitable, but it is no less a business activity for that".

(3) At [27], the tribunal accepted that many of the visitors to NWT's sites may come in order to see the sheep, and to walk within managed, rather than wild, woodlands but held that the motives of NWT's visitors and the fact that NWT encourages them (whereas other landowners might accept them only on sufferance) are "quite irrelevant considerations".

126. I note that I am not bound to follow the decisions in *BDA* and *NWT* and that they were, of course, made without the benefit of the Court of Appeal's comments in *Wakefield*. In any event, my view is that the decision in these cases do not provide support for KMC's stance:

(1) The decision in *BDA* hinged on the fact that BDA provided precisely the same services to its non-fee-paying student members as to its fee-paying members and that taking on non-fee-paying students members was "absolutely vital to maintaining high levels of membership". On that basis the tribunal considered that BDA did not conduct any distinct activity and rather the provision of free membership was "a commercially sensible introductory offer" made "entirely for business purposes….to foster [BDA's] one and only business". The tribunal considered that the situation in *BDA* was the same as that where a business gives free introductory offers to new customers or a bank offers free banking services to students in order to retain or obtain them as fee paying customers in the future. In this case, by contrast, (a) KMC makes two distinct sets of supplies in the form of the training services provided to students and the range of commercial supplies of goods and services it provides to businesses or the public at large, and (b) KMC did not suggest that it regarded taking on students *without charge* as vital to it obtaining fee paying students or to its ability to make commercial supplies.

(2) KMC considered that the decision in *NWT* was based on a similar approach to that taken in *BDA*. That case also demonstrates, so KMC asserts, that the fact that a business makes some supplies without receiving consideration for them does not necessarily prevent those supplies from forming part of a single overall economic activity. However, it was held in *NWT* that it is the purpose for which the relevant supplies are made which demonstrates their character as an economic activity or otherwise. Hence, NWT's sheep farming and forestry activities were held to constitute an economic activity because they were pursued for the purpose of making taxable supplies, as a business-like activity, with a view to making profit. The tribunal viewed it as irrelevant that NWT's ultimate aim may have been to act consistently with or even to advance its charitable, non-business, conservation obligations; that did not detract from the business-like nature of the farming and forestry activities.

In this case, it seems to me that (a) KMC's clear purpose in making the supplies without charge is to provide education and training to students, and (b) similarly to *NWT*, it does not detract from that purpose that KMC may also have had the aim of providing some of the students with the required practical element of their training and education in a way which contributes to KMC's ability to generate income through making other commercial supplies.

127. KMC did not seem to rely on the caselaw on when a transaction constitutes a single supply or a set of separate individual supplies but for completeness, for the reasons set out below, that caselaw does not support KMC's stance.

128. In *Card Protection Plan Ltd v CCE* (Case C-349/96) [1990] STC 270 the CJEU considered, in the context of insurance services, the appropriate criteria for deciding for VAT purposes "whether a transaction which comprises several elements is to be regarded as a single supply or as two or more distinct supplies to be assessed separately". Having noted, at [27], that having regard to the diversity of commercial operations, it is not possible to give exhaustive guidance on how to approach the problem correctly in all cases, the CJEU went on to give the following guidance:

(1) At [28], the CJEU said that where the transaction in question comprises a bundle of features and acts, regard must be had to all the circumstances in which the transaction takes place.

(2) At [29], they held that whilst each supply must normally be regarded as distinct a supply which comprises a single service should not be artificially split:

> "In this respect, taking into account, first that it follows from art 2(1) of the Sixth Directive that every supply of a service must normally be regarded as distinct and independent and, second, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of the transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service".

(3) At [30], the CJEU continued that there is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast as ancillary services which share the same tax treatment as the principal service:

> "A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied".

(4) At [31], the fact that a single price is charged is not decisive. If the service provided to customers consists of several elements for a single price, the single price may suggest there is a single service. However, if circumstances indicated that the customers intended to purchase two distinct services (in that case being an insurance supply and a card registration service) it would be necessary to identify the part of the single price which related to the insurance supply.

129. In *Levob Verzekeringen BV and another v Staatssecretaris van Financiën* (Case C-41/04) [2006] STC 766L, having endorsed the principles in *Card Protection Plan*, the CJEU added the following at [22]:

> "The same is true [that there is one supply] where two or more elements or acts supplied by the taxable person to the customer, being a typical consumer,

are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split.

130. In this case, it is plain from the evidence set out above that:

(1) The training services provided by KMC are not ancillary to its taxable commercial supplies such that the test out in *Card Protection Plan* for there to be a single supply is not met.

(2) Nor do the supplies of training services and the commercial supplies comprise "two or more elements or acts supplied" by a taxable person to the customer (a typical consumer) which are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split" under the test set out in *Levob Verzekeringen BV and another*.

Part D – Attribution of input tax

131. It follows from the conclusion set out in Part C above that I accept that, so far as the claimed tax was incurred by KMC to inputs used for the purpose of making supplies without charge, it is not excluded from qualifying as "input tax" (as defined in s 24 VATA) on the basis that it relates to non-business activity. However, on KMC's own case, KMC is entitled to "credit" for the claimed tax only if and to the extent that it constitutes "residual input tax". On that basis, it is for KMC to demonstrate that:

(1) The relevant inputs on which the claimed tax was charged were used or were to be used in making or, as it is put in the caselaw set out below, have "a direct and immediate link" with, both taxable and exempt supplies, or are "cost components" of KMC's business as a whole and were not used or to be used exclusively in making exempt supplies of training services.

(2) To the extent that the claimed tax does constitute "residual input tax", it is properly attributable to taxable supplies under the terms of the 1998 letter

132. For the reasons set out below in this Part D, in my view, KMC has failed to establish that that the claimed tax constitutes "residual input tax" such that its appeal must fail. I have considered the point in [131(2)] in Part E.

Caselaw on input tax recovery

133. As explained in the caselaw, the "input tax" recovery system is meant to relieve a taxable business entirely of the burden of the VAT payable or paid in the course of all its economic activities so that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way (see, for example, Case 268/83 *Rompelman v Minister van Financiën* [1985] ECR 655, at [19]) ("*Rompelman*"). Accordingly, as it is put in *Rompelman* at [16] (a) 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" and (b) "only taxable persons may deduct the VAT already charged on the goods and services from the VAT for which they are liable".

134. This has been further explained in extensive case law on the topic as meaning that for a taxable person to be entitled to "credit" for VAT charged to it there must be a "direct and immediate link" between the inputs on which tax was charged and the taxable person's onward taxable supplies. Hence, in Case C-4/94 *BLP Group V Customs and Excise Commissioners* [1995] STC 424 ("*BLP*") the CJEU held that BLP was not entitled to credit for tax which it had incurred on professional services received in connection with the sale of shares in a German subsidiary. The CJEU rejected BLP's claim it was entitled to "credit" on the basis that, whilst the share sale was an exempt transaction, the purpose of the sale was to raise money to pay off debts

that had arisen as a result of various taxable transactions. The CJEU said, at [19], that the inputs 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". They continued, at [25] and [26], that:

> "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 taxable transactions and that if BLP had decided to take out a bank loan for the purpose of meeting the same requirements, it would have been entitled to deduct the VAT on the accountant's services required for that purpose. 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.
>
> 26. In that respect it should be noted that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. The principle of the neutrality of VAT, as defined in the case law of the court, does not have the scope attributed to it by BLP. That the common system of VAT ensures that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way, presupposes that those activities are themselves subject to VAT (see in particular [*Rompelman*] para 19)."

135. The decision in *BLP*, therefore, shows the need for an objective assessment of the link between the relevant inputs and the supply or supplies to which they relate. BLP's claim to deduct the relevant input tax failed because the only direct and immediate link which the inputs had was to the exempt sale of the shares.

136. It has also been recognised by the CJEU in cases such as C-98/98 *Midland Bank plc v Customs and Excise Commissioners* [2000] STC 501 that the absence of a direct and immediate link with specific output transactions is not fatal to the deductibility of VAT if the expenses in question are nonetheless cost components of the supplier's business as a whole. In that case a company (S) in the Midland Bank group, acted as merchant bank for a client in a takeover bid. The client made an agreement with a rival bidder for the takeover of the target company and the sale of its broking arm to the client. The agreement was not adhered to and led to litigation which included a claim against S. S incurred solicitors' fees in connection with the agreement and the subsequent litigation which it claimed were directly and solely attributable to the taxable services it supplied to its client. The Commissioners contended that the legal services were not used solely for the purpose of carrying out those taxable services but were also attributable to S's business generally which included the making of both taxable and exempt supplies.

137. The CJEU noted, at [29], that VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components and said, at [30], that it follows from that principle as well as from the rule enshrined in *BLP* 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 [2000] STC 501 at 519 generally have arisen before the taxable person carried out the taxable transactions to which they relate."

138. The court concluded, at [31], that it follows that:

> "….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 transaction, the fact remains that it is not generally part of the cost components 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 transaction. 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."

139. This principle was endorsed in Case C-408/98 *Abbey National plc v Customs and Excise Commissioners* [2001] STC 297 and Case 29/08 *Skatteverket v AB SKF* (Case C-29/08) [2010] STC 419 where the court said the following at [58] and [60]:

> "58. 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); *Abbey National* (para 35); *Kretztechnik* (para 36); and *Investrand* (para 24))….
>
> 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 is based on the premise that the cost of the input services is incorporated either in the cost of particular output transactions or in the cost of goods or services supplied by the taxable person as part of his economic activities….
>
> 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 which SKF intends to sell or whether they are only among the cost components of SKF's products."

140. HMRC referred to the summary of the principles involved in determining if a person is entitled to "credit" for input tax in the Court of Appeal's decision in *HMRC v Mayflower Theatre Trust Ltd* [2006] EWCA Civ 116 where Carnwath LJ said the following:

> " 9……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.
>
> 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…….
>
> 11. To that list I would add two further points, relied on by Miss Hall, 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…..(Emphasis added.)

141. HMRC emphasised the comment highlighted above, that the "direct and immediate" link test is not a "but for" test of causation, satisfied if the inputs were "necessary" or "essential" for the relevant output supply to be made. It is simply not enough to show "but for" causation to establish the necessary sufficient link, and generally not very useful to think in such causal terms. HMRC also referred to the *JDI International Leasing Ltd v HMRC* [2018] STC 1570 at [38] as endorsing this view.

KMC's submissions

142. As set out above, KMC initially argued that none of the inputs received in the relevant period on which it incurred VAT were used or were to be used by it exclusively in making exempt supplies of training services. In other words, as put in the terms used in the cases, in its view, (a) none of the relevant inputs have a "direct and immediate link" only with such exempt supplies, and (b) rather they have a "direct and immediate" link both with exempt and taxable supplies, or are cost components of, and are attributable to, the overall business activities carried on by KMC.

143. KMC did not approach this by seeking to demonstrate what inputs the claimed tax relates to and how those inputs were used by KMC. KMC simply said that (a), in practice, it had not been able to identify "input tax" which is attributable exclusively to its exempt supplies, and (b) this is unsurprising given that all the taxable and exempt activities of KMC are very closely integrated such that it carries on a single "interlinked" and "integrated" business as a rural studies college. KMC's stance is very similar, therefore, to that taken in relation to the issues set out in Part C, namely, that due to the students' involvement, as part of the courses provided by KMC, in work needed for or, which assists KMC to make its taxable commercial supplies, all its activities form an integrated whole. KMC seemed to suggest that it must follow

from the closely integrated nature of its outputs that all of its "input tax" (other than that wholly attributable to taxable supplies) must relate to both its exempt supplies of training services and its taxable commercial supplies.

144. During the hearing, KMC's counsel accepted that given that it transpired from the evidence that many students were not involved, as part of the courses provided by KMC, in work relating to KMC's taxable commercial supplies, at least some of the input tax which KMC incurred in the relevant periods must relate exclusively to KMC's exempt supplies of training services. However, in submissions provided after the hearing, KMC maintained its stance that all or virtually all of its input tax is "residual" and suggested that there is a de minimis amount of tax attributable to exempt supplies exclusively. For example, KMC said that:

> "The contention of KMC has always been that, since the provision of education and/or vocational training was a single activity, indivisible by student age, payment or any other profile, input tax should be considered in the same way. *As such, the clear and accepted interaction of such education and/or training with the commercial activities would make all input tax incurred in respect of it residual.* The conditions for input tax apportionment set down in the PESM would, therefore, make it impossible for any input tax to be wholly and directly attributable to either exempt or, had HMRC been correct, *'non-business'* activities. As such, all input tax would be reclaimable, almost by default.
>
> However, the Appellant took on board the comments in the hearing of Counsel for the Respondents with regards to certain individual courses in the pragmatic and conciliatory manner that it appeared that they were being made. The Appellant was, and remains, keen to find a solution to this somewhat strange issue…." (Emphasis added.)

145. For the reasons already set out in Part C above, I do not accept the premise underpinning KMC's arguments on this issue. Moreover, I can see no basis for the tribunal simply to assume, as is the effect of KMC's argument, that all (or the majority of) the claimed tax relates to inputs which have a "direct and immediate link" to both its exempt and taxable supplies (and/or that the tax is a cost component of its overall activities) and that the relevant inputs do not have such a link only with its exempt supplies of training services.

146. It is an inherent feature of the test set out in the case law for determining whether a taxpayer is entitled to "credit" for "input tax", that an examination is required of both sides of the VAT equation. The test requires an assessment of precisely what inputs the relevant VAT relates to and whether and how those particular inputs were used by the taxpayer in making onward taxable supplies/taxed transactions (or other outputs). Moreover, it is for KMC to establish (to the required standard (on the balance of probabilities)), that it is entitled to "credit" for the claimed tax on the basis that it constitutes "residual input tax" and, accordingly, that HMRC are wrong to deny its claim. However, KMC has not done so:

(1) As set out in Part E (see, in particular, [165] to [167]), when KMC originally submitted its VAT returns for the relevant periods, it accounted for VAT on the basis that in those periods (a) it had incurred VAT which was attributable exclusively to its exempt supplies of training services taken as a whole, and (b) a portion of that VAT constituted "input" tax which was attributable exclusively to such of those exempt supplies as were assumed at the time to constitute a business activity, namely, the supplies for fees.

(2) KMC did not seek explain at the hearing or in any of the correspondence with HMRC in the bundles (see [165] to [167]) why it considered that allocation was

appropriate originally but now considers that all of the relevant inputs are not to be taken as used in making both exempt supplies of training services and taxable commercial supplies other than by reference to its argument that all its activities constitute a single "integrated" business. It appears that at no time has KMC re-considered the basis on which the relevant inputs were actually used by it.

(3) KMC has chosen to argue its case, therefore, by reference only to the output side of the equation, namely, on the basis, that all the inputs must relate to all its supplies due to the integrated and interlinked nature of its output activities. It has not made any reference to the nature of the relevant inputs and to how those are used for the purposes of all or any of those output activities. However, KMC cannot sidestep the required analysis to establish that it is entitled to "credit" for the claimed tax simply on the basis that there are various strands to its business which, to some extent, are interrelated.

(4) Without any example of what kinds of input the claimed tax relates to and what the inputs were used for it is guesswork whether the inputs to which the claimed tax relates have a "direct and immediate" link with both taxable and exempt supplies (or whether the relevant VAT is a cost component of an overall business activity) rather than only with its exempt supplies, as accords with the basis on which KMC originally submitted its VAT returns for the relevant periods.

(5) Finally, as noted in Part C, KMC did not appear to argue that the relevant individual supplies to which it says the claimed tax is attributable are to be treated as elements in some over-arching single supply but, in any event, for the reasons set out in Part C, I do not consider that to be a viable argument.

Part E – Partial exemption special method

1998 Letter

147. In this Part E, I have set out how the 1998 PESM would apply if, contrary to my view, it is found to be correct that, on the basis of KMC's arguments, all or part of the claimed tax is properly to be categorised as "residual input tax" which falls to be apportioned under it.

148. Paras 5 and 6 of the 1998 letter contain the method agreed between the parties, as permitted under regulation 102 of the Regulations, for determining for each accounting period the portion of KMC's "residual input tax" which is to be attributed to its taxable supplies for the purposes of ss 24 to 26 VATA and the related Regulations. So far as material, these provide as follows:

> "5. In each prescribed accounting period you should:
>
> i. First calculate the elements of your input VAT which relates to the business and non-business supplies using the methods set out in Annex 1 to this letter. The input VAT relating to non-business supplies is not recoverable and must also be excluded from the partial exemption calculations.
>
> The input VAT relating to your business supplies should be treated as follows:
>
> 6. In each prescribed accounting period you should:
>
> i. Identify all supplies, acquisitions and imports you receive which are used, or to be used, in whole by you exclusively in making taxable supplies. The input tax thereon is recoverable (Category [A] in Annex 1).
>
> ii. Identify all supplies, acquisitions and imports you receive which are used, or to be used, in whole by you exclusively in making exempt

supplies. The input tax thereon is not recoverable (Category [J] in Annex 1).

iii. Determine the recoverable percentage of the remaining non-attributable input VAT (Category [H] in Annex 1) using the following formula:

$$\frac{\text{Input tax relating to taxable supplies [A]}}{\text{Input tax relating to business supplies [A] + [J]}} \times 100$$

The resulting percentage should be calculated to two decimal places."

149. The introduction to annex 1 to the 1998 letter sets out the following:

(1) the provision of education services in return for fees constitute supplies made in the course or furtherance of a business which is exempt under item 1 of group 6 of schedule 9 VATA;

(2) as the Education Acts prohibit colleges from charging fees to students aged 19 or under, the supply of education services to such students is a non-business activity; and

(3) the VAT on expenditure relating to non-business activities is not input tax and is non-deductible and should be calculated each quarter using the method set out in annex 1.

150. Annex 1 then set out the following method for attributing VAT between KMC's business and non-business activities:

"1. Identify the input tax which relates directly to taxable supplies which you have made or intend to make [A].

2. Identify the VAT which does not relate directly to any particular supply eg general overheads, accountancy fees etc. This is your non-attributable VAT [B].

3. Identify the input tax which relates to either exempt or non-business supplies (currently known as Non-Reclaimable VAT) [C].

4. Identify the guided learning hours which relate to students under the age of 19 [D].

5. Identify the total guided learning hours [E].

The non-business element of your input VAT should then be calculated using this formula:

[**1**] $\frac{[D]}{[E]} \times [B]$ = Element of non-attributable VAT relating to non-business supplies [F]. This is not recoverable.

[**2**] $\frac{[D]}{[G]} \times [C]$ = Element of NRV VAT relating to non-business supplies [G]. This [E] is not recoverable.

[**3**] [B] – [F] = Element of non-attributable VAT relating to taxable and exempt supplies [H]. This is partly recoverable using the Special Method for Partial Exemption.

[**4**] [C] – [G] = Element of NRV VAT relating to exempt supplies [J]. This is not recoverable but the figure is needed to operate the Special Method for Partial Exemption."

151. I have added the numbers in bold in para 5 of annex 1 for ease of reference. I refer to:

(1) the calculations in para 5 of annex 1 which I have numbered [1] and [3] as "**the residual tax calculation**" and those which I have numbered [2] and [4] as "**the exempt tax calculation**"; and

(2) the fraction of the number of guided learning hours relating to students under the age of 19 divided by the total number of guided learning hours as "**the learning hours fraction**".

Approach to the interpretation of the 1998 letter

152. In my view, the 1998 letter, as an agreement between the parties of a special method for the attribution of "input tax" to taxable supplies (as permitted under regulation 102 of the Regulations), must be interpreted according to the usual principles of contractual interpretation as set out most recently by the Supreme Court in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24.

153. Prior to the decision in that case, there has some debate about the respective importance of what Lord Hodge (who gave the leading judgment in *Wood v Capita*) referred to as "textualism" and "contextualism" in interpretation. Lord Hodge said that both approaches have a role and it is not a case of one approach or the other. He set out, at [10], that the court's task is to ascertain "the objective meaning of the language which the parties have chosen to express their agreement" and noted that it has:

> "long been accepted that this is not a literalist exercise focused solely on a parsing of the wording of the particular clause but that the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning…"

154. He continued that it is affirmed in the cases that "the factual background known to the parties at or before the date of the contract, excluding evidence of the prior negotiations" is of relevance. He noted, however, that when in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 Lord Hoffmann (at pages 912-913) reformulated the principles of contractual interpretation, "some saw his second principle, which allowed consideration of the whole relevant factual background available to the parties at the time of the contract, as signalling a break with the past". But Lord Bingham in an extra-judicial writing (*A new thing under the sun? The interpretation of contracts and the ICS decision* Edin LR Vol 12, 374-390) "persuasively demonstrated that the idea of the court putting itself in the shoes of the contracting parties had a long pedigree".

155. In the passage in the *Investors* case to which Lord Hodge referred, Lord Hofmann gave the following guidance on the relevance of background information:

> "(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.
>
> (2) …Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, [the background] includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
>
> (3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification…."

156. Lord Hodge said, at [13], that "textualism" and "contextualism" are not "conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation". Rather when interpreting any contract, they can be used "as tools to ascertain the objective meaning of the language which the parties have chosen to

express their agreement". He noted that the extent to which each "tool" will assist the court will vary according to the particular circumstances:

> "Some agreements may be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals. The correct interpretation of other contracts may be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance....."

Interpretation of the 1998 letter

157. The language used in the 1998 letter is rather "loose". For example, the term "input tax" appears to be used sometimes as that term is defined for VAT purposes and sometimes in a broad sense of any tax charged to KMC on inputs. However, in my view, on the objective exercise required, the scope of the parties' agreement is nevertheless apparent from the various formulas set out in the 1998 letter and the accompanying explanatory text, as viewed in the statutory context of the input tax provisions which the parties must have had in mind when agreeing the terms of this letter.

158. It is plain, in particular, from the introductory wording of both the body of the 1998 letter and of annex 1 that in entering into the 1998 letter that, as set out at [17] and [18] above, the parties were acting on a number of assumptions. In particular, the parties assumed that:

(1) supplies without charge do not constitute a business activity (although it appears they thought that, broadly, only supplies made to students aged under 19 constitute supplies without charge, which is not correct as a factual matter) but the remainder of its supplies do constitute a business activity, and

(2) accordingly, for each accounting period, it is necessary to apportion VAT incurred by KMC on relevant inputs between those used for business purposes and those used for other purposes (as required by s 24(5) VATA) as a prior step to applying the 1998 PESM.

159. With that background in mind, reading annex 1 in conjunction with the body of the 1998 letter, for each accounting period:

(1) KMC is required to identify, under para 1 of annex 1, the "input tax" ([A]) which "relates directly" to taxable supplies which KMC has made or intends to make, it seems, from para 6(ii) of the PESM, in the sense that it is charged on inputs KMC receives "which are used, or to be used, in whole by [KMC] exclusively in making taxable supplies…".

(2) KMC is required to identify under para 3 of annex 1, the input tax ([C]) which "relates to *either* exempt *or* non-business supplies", meaning, as further explained in (4) below, the VAT incurred by KMC on inputs which are used or to be used by KMC exclusively in making:

(a) exempt supplies which constitute a business activity (broadly, as assumed to comprise supplies for fees), *and/or*

(b) non-business supplies (broadly, as assumed to comprise supplies without charge).

(3) Reading para 3 of annex 1 in the context of the rest of the 1998 letter and the statutory background of which the parties would have been aware when they agreed the terms of the1998 letter, it appears that:

(a) The reference to input tax in para 3 is to VAT incurred by KMC on inputs it received in the relevant accounting period and not to that term as defined in VATA.

(b) The reference to input tax (in this broad sense) relating to "*either* exempt *or* non-business supplies", is intended to capture VAT incurred by KMC on inputs used or which are to be used by KMC in making all and any supplies of training services, whether, on the assumptions on which the parties acted at the time, they are made for business or other purposes. This appears to be on the basis that, although such VAT can be identified as relating *exclusively* to supplies of training services (as opposed to also relating to taxable supplies) it cannot readily be divided between these two categories.

(c) If that is not the case, there would be no need to apportion the total VAT in this category ([C]), under the exempt tax calculation, between supplies of training services made for business purposes and supplies of training services made for other purposes. This calculation would be redundant if input tax in relation to both sets of supplies is not captured under para 3 in the first place. In my view, therefore, this is the only sensible interpretation to put upon para 3.

(4) KMC is required to identify, under para 2 of annex 1, VAT ([B]) which does not "relate directly to any particular supply eg general overheads, accountancy fees etc", which it appears from para 6(iii) of the PESM, is intended to cover the VAT "remaining" after correctly identifying the VAT falling within paras 1 and 3 of annex 1. It seems, therefore, that this is intended to cover all "residual" VAT incurred by KMC on inputs used in making both taxable supplies and supplies of training services or which forms a cost component of an overall business activity. Hence, the need to apportion the total VAT in this category, under the residual tax calculation, as described below.

160. It appears that the intention is that, having allocated the VAT incurred by it on inputs relating to the relevant accounting period as described at [159], for that period:

(1) KMC is to apply the residual tax calculation, using the learning hours formula, to determine the portion of the total sum, [B], which it had identified as "residual" VAT within para 2 of annex 1, which is to be taken as relating to inputs used or which are to be used for business purposes; namely, on the assumptions on which the parties acted in agreeing the terms of the 1998 letter, the portion of the total residual VAT in this category which is attributable to both taxable supplies and supplies for fees ([H]).

(2) KMC is to apply the exempt tax calculation, again by reference to the learning hours formula, to determine the portion of the total sum, [C], which it had identified as falling under para 3 of annex 1 (comprising VAT charged on inputs used or to be used exclusively in making supplies of training services) which relates to inputs used or which are to be used for business purposes; namely, on the assumptions on which the parties acted when agreeing the terms of the 1998 letter, the portion of the total VAT in this category which is attributable to supplies for fees ([J]).

161. It is plain that the parties considered that the residual tax and exempt tax calculations are required on the basis that, as accords with s 24 VATA, (a) only the sum resulting from the residual tax calculation, [H], counts as "residual input tax" to which the 1998 PESM is to be applied, and (b) only the sum resulting from the

exempt tax calculation, [J], counts as "input tax" attributable exclusively to exempt supplies which should play a part in the 1998 PESM in determining the portion of KMC's "residual input tax" for which KMC can claim "credit."

162. As is apparent from para 6(iii), which sets out the 1998 PESM, the parties intended that, for each accounting period, KMC is able to claim "credit" for the percentage of its total "residual input tax", [H], which corresponds to the percentage which the sum in (a) below forms of the sum in (b) below, namely:

(1) KMC's "input tax" for the relevant period which is attributable exclusively to taxable supplies, [A]; and

(2) the aggregate of (i) [A] and (ii) KMC's "input tax" for the relevant period which is attributable exclusively to exempt supplies, [J].

163. On the face of it this gives the odd result that if, as I have held, all of KMC's activities constitute business activities and, as KMC initially argued, no "input tax" is attributable exclusively to exempt supplies, under the terms of the 1998 letter, KMC is able to claim "credit" for all of its "residual input tax". However, when the terms of the 1998 letter were agreed, plainly the parties were acting on the assumption that generally KMC would incur "input tax" which is attributable exclusively to its exempt supplies of training services. Otherwise, it is inexplicable why the formula in the 1998 PESM operates by reference to such "input tax" ([J]). As explained below, originally KMC did in fact operate the 1998 PESM using positive sums for [J] and I note that KMC conceded at the hearing that there must be some "input tax" in this category (albeit that, in its view, that is a minimal sum).

164. I note that the rationale behind some of the methodology set out in the 1998 letter is not clear. In particular, KMC's total residual tax falling within para 2 of annex 1 necessarily relates to both taxable and exempt supplies and/or an overall business activity. However, annex 1 provides for it to be apportioned between business and non-business activities/supplies based only on factors which relate to KMC's exempt supplies (namely, guided learning hours for students under the learning hours formula).

Application of the 1998 letter prior to the claim

165. From the correspondence in the bundles, it appears that, when it submitted its VAT returns for the relevant periods, in calculating the "input tax" for which it claimed "credit", KMC applied the terms of the 1998 letter broadly as I have described them as operating above. This is illustrated in a letter to HMRC dated 9 October 2014 (in which KMC's adviser notified HMRC of KMC's revised claim for "credit" for the relevant periods), where the advisers set out a summary of how KMC had originally computed its recoverable "input tax". In the letter:

(1) KMC's advisers asserted that all courses which KMC run are involved in one way or another with the income from its agricultural and rural activities so that it cannot be the case that the supplies without charge constitute non-business activity. They said that HMRC "have previously made it clear that where a supply is made partly for the purposes of business and partly not, the complete supply will be deemed to be made in the course of business. You cannot be half in business and half not!" They added that the 1998 PESM is not only inappropriate for an agricultural college but it is also not properly calculable in that "the education of no student is wholly and directly attributable to the provision of grant income - further education or higher education. Certainly, it cannot provide a result that is "*fair and reasonable*"."

(2) The advisers then set out details of how KMC had originally accounted for VAT in respect of the periods from October 2010 to April 2014 (followed by their revised calculations given their comments in (1)). Under a heading "Input tax Recovery Calculation per College", for each relevant quarterly period, the advisers set out figures which it appears are taken from KMC's original VAT returns under headings which correspond to the terms and lettering used in the 1998 letter. I have set out below the figures for the period from January to March 2014 in the order in which the headings appear in the letter. For ease of reference, I have included in italics a summary of what each of the headings appears to relate to according to the corresponding letters used in and the terms of the 1998 letter:

A – Attributable Input tax: £20,264.25.

VAT incurred on inputs attributable exclusively to taxable supplies.

C – Non-Reclaimable Input tax: £54,149.07.

VAT incurred on inputs attributable exclusively to exempt supplies and/or non-business supplies.

B - Non-Attributable Input Tax: £18,880.81.

All other residual VAT incurred on inputs which does not fall within [A] or [C], namely, VAT incurred on inputs used for both making taxable and exempt supplies or comprising a cost of an overall activity

Total Input Tax: £93,294.15.

The total of the figures in [A], [B] and [C].

D - Non-Business Learning Hours: 542,553.

Learning hours for students aged under 19.

Therefore Business Learning Hours: 149,838.

Total learning hours less Non-Business Learning Hours.

E - Total Learning Hours: 692,391.

F - Non-Business Non-Attributable Input Tax: 14,794.88.

The proportion of the figure [B] (the total residual tax) which is attributable to non-business activities applying the learning hours formula.

G - Non-Business Non-Reclaimable Input Tax: £42,430.85.

The proportion of the figure [C] (the total VAT which is attributable exclusively to exempt and/or non-business supplies) which is attributable to non-business supplies applying the learning hours formula.

H - Business Non-Attributable Input Tax: £4,085.93.

The proportion of the figure [B] (the total residual tax) which is attributable to business activities applying the residual tax calculation ([B] less [F]).

J - Business Non-Reclaimable Input Tax: £11,718.22.

The proportion of the figure [C] (the total VAT which is attributable exclusively to exempt business supplies and/or non-business supplies) which is attributable to exempt business supplies applying the exempt tax calculation ([C] less [G]).

K - Partial Exemption % per Method: 63.36%.

The figure produced under the PESM formula of [A] of £20,264.25 divided by [A] of £20,264.25 plus [J] of £11,718.22.

Reclaimable Business Residual Input Tax: £2,588.87

63.36% of [H] (residual input tax) of £4,085.93.

Capital Goods Scheme Adjustment: £0.00

Annual Adjustment: £0.00

Reclaimed Non-Attributable Input Tax: £2,588.87

Attributable Input Tax: £20,264.27

Reclaimed Input Tax: £22,853.1

(3) I note that the figures in the letter for each quarterly period show a positive sum for [C], the total VAT charged to KMC for the relevant period which is attributable exclusively to exempt and/or non-business supplies and for [J], the input tax for the relevant period which is attributable exclusively to exempt business supplies. The figures match workings later provided to HMRC (as included in the bundles).

166. In later correspondence in the bundles between KMC's advisers and HMRC, KMC's advisers assert that for all the relevant periods there is no VAT which is attributable exclusively to exempt supplies and that it must follow that [J] in the 1998 letter is zero so that the 1998 PESM allows KMC to recover all of its "residual input tax". In a letter dated 19 March 2015, the advisers set out an example using figures they stated are taken from KMC's original computations for the period from January to March 2014.

(1) Some of the figures correspond to those set out in the earlier letter dated 9 October 2014 (as described at [165]) but the figure for "input tax" attributable exclusively to exempt supplies constituting business activity is shown as zero whereas in the earlier letter the figure, shown as [J], is £11,718.22.

(2) The advisers asserted that the correct calculations for this period are as follows:

(a) Due to there being no non-business activity, the "residual input tax" is £73,029.88 (£54,149.07 which KMC had originally attributed to its non-business activities (shown as [C] in the earlier letter) plus £18,880.81 which it had originally allocated as "residual input tax" (shown as [B] in the earlier letter).

(b) The total reclaimable "input tax" is £93,294.15, comprising (i) the figure for "input tax" wholly attributable to taxable activities of £20,264.07 (shown as [A] in the earlier letter), and (ii) the increased figure for "residual input tax" of £73,029.88.

(c) The 1998 PESM operates as follows to allow KMC to obtain "credit" for all of the revised amount of "residual input tax": £73,029.88 (of "residual input tax") x £20.264.07 (of "input tax" attributable exclusively to taxable supplies/£20,264.07 plus £0.00 (of "input tax" attributable exclusively to exempt supplies) = 100%.

(3) The advisers said the total "input tax" underclaimed by KMC for the periods 10/10 to 01/15 is £1,627.246 which they said was based upon the VAT returns rendered by the KMC and that:

> "Clearly the PESM is entirely unsuitable for [KMC], and gives a result that cannot possibly be "*fair and reasonable*". In the light of the position set out recently by the CJEU unless it leads to an "*inaccuracy*"

> a taxpayer should use an income based method of apportionment for partial exemption.
>
> Please therefore treat this letter as an application for [KMC] to revert to the standard method of apportionment for partial exemption with effect from the start of its next tax period – 1 May 2015."

167. In a letter of 16 October 2015, the advisers said that KMC's historic VAT returns do not and indeed cannot comply with the 1998 PESM and the reasons for this included that:

> "Since the training undertaken by [KMC] consists of practical instruction whilst working on the working farms and other units where taxable supplies are made, there can be no input tax that is directly attributable to education and training as a whole."

Submissions and decision

Position if the supplies without charge constitute a business activity

168. KMC argued at the hearing that, on the basis that the supplies without charge (whether made to students under or over the age of 19) constitute a business activity, it should not have applied the 1998 PESM as set out above but on the basis that, for each relevant period:

(1) The figure for "residual input tax", [H], is the full amount of VAT incurred by KMC for that period on inputs used in making both taxable and exempt supplies (and/or which constitutes a cost component of KMC's overall activities). Annex 1 plainly cannot apply to reduce that sum by reference to the learning hours formula where in fact the supplies without charge constitute a business activity so that all of KMC's supplies are made for business purposes.

(2) On the basis of its argument set out in Part D, the figure for [J], the "input tax" attributable exclusively to exempt supplies which constitute business activity, is a minimal amount. On that basis, the formula in the 1998 PESM gives a high percentage to be used to determine the amount of the "residual input tax", [H], for which KMC is entitled to "credit".

I note that for all the reasons set out in Part D, I do not accept that KMC has established that the proposition in (2) is correct and nothing in the discussion below is to be taken as detracting from that conclusion.

169. HMRC submitted that in this scenario, annex 1 nevertheless applies to require KMC to compute the figure for "residual input tax" for use in the 1998 PESM by reference to the learning hours formula. In their view, the fact that neither paras 4 or 5 of annex 1 make any reference to non-business activity demonstrates that the residual tax calculation is not intended to be restricted to cases where KMC carries on at least some non-business activity. Moreover, the 1998 PESM simply cannot operate without a figure for [H] as determined under annex 1 by reference to the sums falling within para 2 of annex 1. (HMRC did not pursue their other argument on the basis that KMC accepted that in fact there must be a positive figure for [J] (see [23(4)]).

170. My view is that KMC's interpretation of how *in principle* the terms of the 1998 letter are intended to be applied in this scenario as set out in [168(1)] is correct. In my view, in these circumstances, it would be out of kilter with the applicable law and with the parties' agreement set out in the 1998 letter, for KMC to be required, as HMRC argue it is, to apply the residual tax calculation:

(1) Evidently, in such circumstances, s 24(5) VATA, which requires an apportionment of VAT incurred on inputs used for business and non-business purposes, is not in point.

(2) Contrary to HMRC's view, a reasonable person, mindful that the parties would have been aware of the relevant statutory background when they agreed the 1998 letter, would not understand the 1998 letter to mean that, in these circumstances, KMC is not intended to apply the learning hours formula to the "residual" tax identified as falling within para 2 of annex 1:

(a) As explained in full above, the introductory words to both the body of the 1998 letter and annex 1 make plain the intended scope and operation of annex 1; as accords with s 24(5), it is intended to exclude VAT incurred on inputs which is attributable to KMC's non-business activities from being taken into account in the figures used in the1998 PESM.

(b) Moreover, in annex 1:

(i) Immediately after paras 1 to 3, which requires KMC to allocate the VAT it incurs for each period into the specified different categories, it is stated that: "The non-business element of your input VAT should then be calculated using this formula".

(ii) In the first calculation which then follows (which I have labelled [1]), it is stated that the application of the learning hours formula to the figure for "residual" tax, as identified under para 2, produces the "element of non-attributable VAT relating to non-business supplies [F]".

(c) In my view, this wording, as viewed in the wider context of the overall terms of the 1998 letter and the statutory background of which the parties would have been aware when they agreed the terms of the letter, plainly indicates that the parties did not intend the learning hours formula in calculation [1] in annex 1 to be applied where there can be no element of "non-attributable VAT relating to non-business supplies" simply because there are no such non-business supplies.

(d) On that basis, for each relevant accounting period, (i) for the purpose of the further calculation in annex 1, which I have labelled [3], there can be no positive sum [F] to be deducted from the total "residual" tax for the period as identified under para 2 of annex 1, and (ii) the figure for [H], which is to be used in the 1998 PESM, is to be taken as the full amount of tax identified as falling under para 2 of annex 1.

Position if the supplies without charge do not constitute a business activity

171. KMC argued that it is entitled to "credit" for all VAT identified as "residual input tax" even if the supplies without charge do not constitute or form part of a business activity. In its view, in that case, the figure for [J] for inclusion in the formula in the 1998 PESM cannot be a positive sum:

(1) KMC emphasised that the reference in para 3 of annex 1 is to input tax which relates to *either* exempt *or* non-business supplies. KMC seemed to suggest, therefore, that para 3 captures only VAT incurred on inputs which is either attributable exclusively to exempt supplies which constitute a business activity or attributable exclusively to non-business supplies and not VAT which is attributable exclusively to both sets of supplies.

(2) In its view, it is not possible to identify separately (a) VAT incurred on inputs used in making supplies for fees (which constitute a business activity), and (b) VAT incurred on inputs used in making supplies without charge (which, on this analysis, do not constitute a business activity). No distinction can be

made between VAT on inputs used in making supplies to the different sets of students given they were all taught together in precisely the same way.

(3) KMC concluded that, on that basis there can be no positive figure [C] which can be included in the exempt tax calculation and no positive figure [J] for inclusion in the formula in the 1998 PESM.

172. For the reasons set out already (see, in particular, [159]), I do not accept this interpretation of the terms of the 1998 letter. I note that HMRC's submissions on the correct interpretation of the 1998 letter in this respect are in line with the interpretation I have set out above.

Conclusion

173. For all the reasons set out above, this appeal is dismissed.

174. 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.

HARRIET MORGAN
TRIBUNAL JUDGE

RELEASE DATE: 27 APRIL 2021