Appeal number: UT/2019/0006

VAT – claim in respect of overpayment of output tax – whether provision of free education/vocational training to students where funding provided by government agencies was supply of services for consideration, as appellant argued, rather than funding with conditions – held supply of services for consideration – whether HMRC entitled to set-off input tax to extinguish repayment claim under s81(3A) VATA as interpreted in Birmingham Hippodrome – yes – appeal on consideration issue decision allowed - appeal against HMRC's set-off of input tax dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

COLCHESTER INSTITUTE CORPORATION
Appellant

- and -

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

TRIBUNAL: MRS JUSTICE WHIPPLE
JUDGE SWAMI RAGHAVAN

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4 1NL The Rolls Building, London on 28 and 29 January 2020 and at a remote hearing on 3 July 2020. Pursuant to direction, written submissions were received from HMRC on 13 November 2020 and from the Appellant on 19 November. HMRC and the appellant filed further submissions by way of response on 25 November 2020.

Melanie Hall QC and Elizabeth Kelsey, instructed by VATangles Consultancy, counsel for the Appellant

Peter Mantle, counsel, instructed by the General Counsel and Solicitor to Her Majesty's Revenue & Customs, for the Respondents

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DECISION

Introduction

1. Colchester Institute Corporation ("CIC") is a further education corporation providing further and higher and education and vocational training programmes to over 11,000 students. This is an appeal by CIC against a decision of the First-tier Tribunal ("FTT") issued on 15 August 2018 ("the FTT Decision") concerning VAT.

2. The appeal is a lead case, behind which a number of other colleges' appeals are stayed, under a Rule 18 Direction[1] made by the FTT which identified three common or related issues of fact or law. The appeal now before us in the Upper Tribunal ("UT") is primarily concerned with the first Rule 18 issue: whether the provision of education and /or vocational training by CIC provided free of charge to students and funded by grants from two government funding agencies is a "supply of services for consideration" for the purposes of Article 2(1)(c) Principal VAT Directive ("PVD") and if so whether it is an "economic activity" for the purposes of Article 9 PVD.

3. The FTT decided CIC's provision of education/training was not a "supply of services for consideration". Nor was it an "economic activity". CIC now appeals to the UT against the FTT Decision, with the permission of the FTT in relation to one of its eight grounds concerning the relevant Rule 18 issue, and with the permission of the UT in relation to the remaining seven grounds.

4. By the time of the hearing the scope of the appeal before us had narrowed to a single question, whether there was "a supply of services for consideration". HMRC accepted that, if we were to conclude the activities were "supplies of services for consideration" within Article 2, no issue would arise in relation to "economic activity" which was established on the facts. Conversely, if there was no "supply for consideration", as the FTT held, that would be an end of the matter because necessarily this would amount to non-business activity (see *Wakefield College*[2] at [52]).

Background

5. This appeal arises out of a claim submitted by CIC on 23 April 2014 (subsequently amended on 20 June 2016) for overdeclared output tax of £1,552,277, relating to VAT periods 04/10 to 01/14.

6. The background to the claim is set out by the FTT at [55]-[72]. We summarise the position. In 2008, CIC embarked on a major building project. At that time, it was the common understanding of CIC and HMRC that the provision of education and vocational training, when funded by a relevant funding body, was not a "business" activity within the scope of VAT. CIC applied for (and was eventually granted) permission to deduct the VAT incurred by it on the building project pursuant to the rule

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[1] Under Rule 18 (Lead Cases) of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009

[2] *Wakefield College v Revenue and Customs Commrs* [2018] EWCA Civ 952

in *Lennartz*[3]. In short terms, that permitted CIC to deduct the input tax it had incurred on the building project 'up front' and then account for deemed output tax on the provision of education and vocational services provided in due course, those services being thought to fall outside the scope of VAT and so amounting to non-business supplies, which attract a tax charge under paragraph 5(4) of Schedule 4 to the Value Added Tax Act 1994, read with Part 15A of the VAT Regulations 1995 [SI 1995/2518].

7. On 3 November 2009, CIC made its *Lennartz* claim and in December 2009, HMRC paid CIC £2,087,477, being input tax (including *Lennartz* input tax) less deemed output tax due for the periods 01/09 to 07/09. A further repayment of £138,329 was made by HMRC in November 2010 in respect of input tax (including *Lennartz* input tax) on construction costs, less deemed output tax due for the periods 01/10 to 07/10. Thus the total input tax repaid to CIC pursuant to *Lennartz* was £2,225,806. Thereafter, CIC continued to account for output tax on deemed supplies.

8. The basis of CIC's claim on 23 April 2014 was that the provision of education and vocational training to students was, after all, a business activity. That being so, there had never been any need to account for deemed output tax on non-business supplies. CIC therefore sought to reclaim those payments which were still in time (noting the four year cap imposed by s 80(4) of the 1994 Act). CIC netted off input tax credited in the periods which were subject to the claim. CIC did not net off the input tax credited as a result of the 2009 *Lennartz* claim which had been made and repaid more than 4 years earlier. On 20 June 2016, CIC reduced the amount of the claim by £23,778 from £1,552,277 to £1,528,499 on the basis of its view that, following the UT's decision in *Wakefield*[4], some of its supplies (where students paid reduced fees due to their personal circumstances) were indeed non-business. The types of supplies giving rise to this £23,778 reduction were referred to by the parties and later the FTT as "the Wakefield rump".

9. HMRC refused CIC's claim by a review decision dated 23 July 2014. That is HMRC's "preferred decision". CIC appealed against that decision.

10. On 5 February 2015, HMRC issued an "alternative decision" under s 81(3) and (3A) of the Act. The alternative decision only applied if CIC succeeded in its appeal against HMRC's preferred decision. CIC appealed against that alternative decision by means of a separate notice of appeal.

11. By directions dated 18 May 2015, CIC's appeals against the preferred and the alternative decisions were consolidated into a single appeal. That appeal was heard by the FTT on 24 to 26 July 2017.

12. The FTT dismissed CIC's appeal against the preferred decision and reached no conclusion on the alternative decision.

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[3] *Lennartz v Finanzamt München III* (Case 97/90) [1995] STC 514.

[4] [2016] UKUT 19 (TCC)

Facts

13. The principal facts as to the activities undertaken by CIC and the funding of those activities were not in dispute before the FTT. They are set out in the FTT's Decision (at [21] to [54][5]). The key facts, as found by the FTT in its decision, were helpfully summarised in CIC's skeleton argument and are as follows with some minor additions. We also include some further detail, where appropriate, from documents which were before the FTT and which we were shown at the hearing. These were: an example of a "Receipt" document given to students (at [17] below), and a witness statement exhibit on the funding arrangements (at [24(1)] and [29] below).

14. CIC is a body corporate incorporated as a further education corporation under the Further and Higher Education Act 1992. It operates the CIC Institute, categorised by the Department of Education as a general further education college. The college provides further and higher education and vocational training programmes to over 11,000 students, approximately 49% of whom are aged 16-18, offering 800 different courses each year. Students of all ages are educated or trained together, and there is no separation between them on grounds of age ([22] and [26]).

15. CIC Institute is an "eligible body" for the purposes of Item 1, Group 6 (Education) of Schedule 9, VAT Act ([22]).

16. The courses provided by the college that are the subject of this appeal are all "education" or "vocational training" within the meaning of Item 1 of Group 6, Schedule 9 VATA ([25]).

17. Students apply online, are invited for interview, and are made a written course offer which, if accepted, and assuming that any conditions are satisfied (e.g. academic achievement of grades) leads to enrolment. That process includes, inter alia, the completion by the college of an 'Individualised Learner Record Data' ("ILR") for the student, and the provision to the student of a document headed 'Receipt', which sets out the courses on which the student is enrolled. Where the course costs are met in full by a funding agency, the Receipt sets out a "fee" for the course and any associated examinations (the "fee" shown on the example Receipt shown to us was £4160). The Receipt also states that the student is entitled to a "waiver", and that the outstanding balance is nil. For students whose costs are not met in full by one of the funding agencies, the Receipt sets out the fees payable for the courses, the amount paid on enrolment by the student, and any outstanding amount: ([27]- [29]).

18. At the relevant times, CIC was funded primarily by three government agencies: the Skills Funding Agency ('SFA'), the Education Funding Agency ('EFA')[6] and the Higher Education Funding Council for England ('HEFCE'). The appeal relates to courses funded by the EFA and SFA, referred to the in the Decision collectively as 'the funding agencies'. The EFA funds the provision of education and vocational training for students aged 19 and under, certain categories of students aged over 19, and students

[5] Unless the context suggests otherwise paragraph numbers are those in the FTT Decision

[6] EFA and SFA have since been replaced by a single body, the Education and Skills Funding Agency "ESFA"

with learning difficulties aged between 19 and 25. The SFA funds all or part of the provision of education and vocational training for students aged 18 and over who have not achieved a specified level of academic qualification, or who are entitled to free education or training ([31]-[33]).

19. CIC receives tuition fees for other students who are not eligible for EFA, SFA or HEFCE funding ([35]).

20. CIC's annual income is approximately £40m. EFA funding amounts to approximately £19.7m; SFA funding, to approximately £4.7m; HEFCE funding, to approximately £7.5m. Fees charged to international students who are not entitled to EFA, SFA or HEFCE funding amounts to approximately £700,000. CIC also generates approximately £3.7m income per annum from activities other than the provision of education and vocational training (including rental of studio and other space) ([30] and [32]-[36]).

21. CIC enters into agreements with the EFA and the SFA each year in relation to the funding the agencies provide. The agreements are in standard form, are not negotiable, and incorporate by reference a series of other documents which collectively set out the basis on which funding is provided and the obligations placed on the college to deliver education and vocational training. The agreement with the EFA is entitled 'Conditions of Funding Agreement'; the SFA agreement, 'Financial Memorandum' ([37]-[38]).

22. Neither agreement set out the courses the college must provide, and the EFA agreement states expressly that "it is not for the Government or its agencies to determine which qualifications a student should take, or develop or generate new qualifications". The EFA and the SFA fund the course chosen by the student. The agencies only provide funding 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. Although CIC could in theory provide courses leading to non-approved qualifications, it does not do so as these would not be funded by EFA or SFA ([39]). As a condition of EFA and SFA funding, CIC is required to upload the ILR for each student on a monthly basis to a national Data Service Hub. There are in excess of 200 fields of data for each student ([53]).

EFA funding formula

23. The funding received by CIC from the EFA is determined by the national funding formula:

> [(student numbers) x (national funding rate per student) x (retention factor)[7] x (Programme cost weighting) + (Disadvantage funding) + (Large programme funding)] x area cost allowance

[7] The parties agreed the FTT had in error omitted reference to the retention factor in its description of the formula at [42]

24. How the formula was applied in 2016/17 was the subject of some debate before us, but was not in the end disputed. Thus, we record that the formula was applied as follows:

(1) Student numbers: 4105 - this figure represents "lagged student numbers" in other words the number of EFA funded students in the preceding year (2015/16). The December ILR return was monitored by the EFA and used to calculate the provisional funding allocation for the following year. (We were shown a summary of funding processes and procedure exhibited to the witness statement of Gary Horne dated 10 October 2016, which explained the methodology in more detail. The starting point was the number of students as at 1 November 2015 based on the December ILR return. This was multiplied by the ratio of the 1 November 2015 figure to all-year student numbers for 2014-15. EFA also compared this figure with the student numbers calculated from the year to date 1 February figure and the number recruited by 1 November.) Where there is a significant increase or decrease in student numbers EFA were entitled to revise the allocation accordingly.

(2) National funding rate - £4000 per student (on the basis of a full-time course with 540+ hours of tuition) which was then adjusted by reference to bands reflecting the planned hours per course and the lagged student numbers in each band.

(3) Retention factor: 0.952 – this is based on the number of students who do not drop out and attend their course to the anticipated end date. CIC clarified at the hearing that this figure referred to 2015/16.

(4) Programme cost weighting - 1.115. This weighting reflected the fact some courses were more expensive to deliver than others. CIC clarified at the hearing that this factor was calculated by reference to the courses undertaken in 2015/16.

(5) Disadvantage funding - £2,445,874. This relates to economic deprivation, students who are leaving care and students with learning difficulties and disabilities.

(6) Large programme funding - zero. This factor applies to those programmes which require more than 600 hours.

(7) Area cost allowance – not applied to CIC. This addresses the additional cost of providing education in London and the South-east of England.

25. For 2016/17, CIC's basic funding allocation was £18,772,634. It was supplemented by additional funding for high needs students, bursaries and other financial support awarded to individual students. The EFA figure is not a negotiated amount. The only scope for negotiation relates to student numbers. For example, if the college's student numbers were likely to be higher than in the preceding year (for example, because of the opening of a new campus), the EFA may increase the number of students used in the formula. The terms of the EFA's funding agreement prohibits CIC from charging fees to students for the courses that it funds ([40-45]).

SFA funding formula

26. The amount paid by the SFA is based upon a monetary funding allocation calculated before the start of the year, subject to a claw-back for under-delivery against that allocation. There is no additional payment for over-delivery ([46]).

27. The FTT was shown a breakdown of the £8,707,441 funded by SFA in 2013/14 broken down by reference to Adult skills, 16-18 apprenticeships and various other budgets. The SFA's Financial Memorandum provides that the College is free to spend its funding as it sees fit, providing it fulfils the conditions of funding imposed by the SFA. Where the SFA only partly funds a student, there is an expectation that the student will pay the balance of the cost, and in practice the college charges the student the balance of the fee ([46-48]).

28. At the end of the year, a final ILR return will determine the basis of reconciliation against the funding allocation of the SFA, and that is used to calculate any claw-back ([54]).

29. The funding summary exhibit to Gary Horne's witness statement elaborates on the funding process as follows. In January/February of each year the SFA uses current performance data to inform the calculation of allocation for the following year. Colleges are required by the SFA to submit a funding claim based on in year performance from the February return. Colleges are required to project forward based on their current enrolment and assumptions on likely retention rates using historical trends. Then in March the SFA sends its funding allocation statement for the following year. There is generally a caveat to state the allocations are subject to change ahead of the year commencing so for example on 28 July 2015 the allocation was reduced by 3% ahead of the 1 August start date. From August onwards SFA sends the final allocation. Variations through the year are also sent where in-year over- performance or under-performance can be reflected in increased or decreased allocations for apprenticeships subject to business case reviews.

30. Where students are fully funded by the EFA or the SFA, the fee set out on the Receipt is the baseline funding amount per student for that course. The actual amount paid for that student by the funding agencies will depend on their respective funding formulae. The actual funding received by CIC from the EFA to deliver its courses could be more or less than the aggregate of the amount stated on the Receipts issued for EFA funded courses. Similarly, the amount received by CIC from the SFA (together with any fees charged to the student) in any year would not exactly match the aggregate shown on the Receipts issued in respect of SFA funded courses ([50]-[51]).

The FTT Decision

31. Having set out the Rule 18 issues ([78]-[85]), the applicable legal provisions, the relevance of the Rule 18 issues to CIC, the background facts, and the parties' respective submissions in detail including the cases they relied on, the FTT went on to discuss the authorities on the meaning of "consideration". We will come to those cases below.

32. The FTT decided that the funding by EFA and SFA did not amount to consideration for any supplies by CIC. The FTT agreed with HMRC that the funding was not "negotiated consideration paid for services, but rather a block grant provided subject to conditions" (see [127]). Its reasons were set out in the same paragraph:

> "(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."

33. The FTT distinguished the various authorities on which CIC relied (at [129]).

34. The FTT found the terms of the funding agency agreement did not amount to third party consideration because there was not a sufficient direct link between the provision of education to the students and the funding provided. The requirements for consideration were also not met as there was no link between the amount paid by the funding agencies and the actual cost of the provision of any particular course to a particular student. The FTT also rejected CIC's argument that the amount of "fee" shown on the receipts represented consideration.

35. Having found the payments did not amount to consideration the FTT went on find that, given the scale of the activities of the College and the amount funded by the EFA and SFA, the funded activities were outside the scope of VAT and did not amount to economic activities ([133]).

36. The FTT summarised its conclusions at [183]-[190], dismissing the appeal against the preferred decision. The FTT then stated, at [191], that because it had dismissed CIC's appeal on the basis of the preferred decision, it did not need to consider HMRC's alternative decision.

I. Appeal against Preferred Decision

Grounds of Appeal and summary of parties' submissions

37. Necessarily, CIC's notice of appeal only addressed the preferred decision, because that was the only decision the FTT had considered. In its notice of appeal CIC raised, and was granted permission to appeal in relation to eight grounds of challenge to that decision. While the parties' written arguments addressed those eight grounds, the arguments at the hearing took a narrower focus.

38. The core submission of CIC represented by Mrs Hall QC and Miss Kelsey, neither of whom appeared below, was that the FTT erred in law in its approach to the question of whether the link between the grant funding on the one hand and the services CIC provided to students on the other, was sufficient to amount to a supply of services "for consideration". More specifically, they submitted that the FTT had misunderstood the nature of what was provided in relation to the lump sum grants; the provision was not to specific students in relation to specific courses but a sum paid, on an ongoing basis, according to a formula targeted at certain categories of students. They argued that the FTT had failed to appreciate the point illustrated by Case C-151/13 *Le Rayon d'Or SARL v Ministre de l'Économie et des Finances* [2014] STC 1165 to the effect that lump sum payments calculated by reference to a formula could be consideration for VAT purposes. The FTT was wrong to distinguish *Rayon D'Or* and other cases. Further, the FTT had made a fundamental legal error in concluding that the lack of link between the amount paid by the funding agencies and the actual *cost* of provision of any particular course to a student meant there was no consideration.

39. Mr Mantle, for HMRC, who did appear below, submitted that none of the appellant's grounds disclosed any legal error particularly when the decision is read properly in its whole context and taking account of the particular submissions that were made to it and which have since shifted (for example in relation to the significance or otherwise of the student "receipts"). He argued the FTT was correct to consider the issue from the perspective of whether CIC had made a supply in relation to an individual student (it was accepted that the identity of the particular student did not need to be known) in respect of a particular course. The FTT was correct to conclude, having examined the circumstances including the detail of the formula in the agreements that there was no direct link between the amount of funding provided in one year to the provision made to students in the subsequent year. Nor was there any link between the funding in one year to the courses provided in the following year. The issue of whether there were supplies for consideration was fact sensitive but in any case the FTT was correct to distinguish *Rayon D'Or* for a number of reasons including the fact that case was concerned with supplies characterised by the permanent availability of the service provider to supply healthcare services to the relevant beneficiaries (residents of care home) at the appropriate time. More generally the FTT was correct in its evaluation of the weight to be accorded to the various factors it identified and the UT should accord the FTT some lee-way in matters of evaluative judgment.

The Law

40. Section 4(1) of the Value Added Tax Act 1994 ("VATA") defines the scope of VAT as follows, and introduces the concept of a supply:

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

41. The issue in this case is whether the provision of education and training by CIC amounts to a supply for VAT purposes; that is determined by reference to section 5 VATA which provides, so far as material,

> "(a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration;
>
> (b) anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right) is a supply of services."

42. These provisions implement the relevant articles of the Directive. Article 2 of EC Council Directive 2006/112 (the "Principal VAT Directive" or "PVD") (formerly Article 2 of the predecessor directive 77/388, the "Sixth Directive") provides:

> "The following transactions shall be subject to VAT:
>
> (a) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such;
>
> …

> (c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such;"

43. Article 9(1) (formerly Article 4(1) of the Sixth Directive) provides:

> "'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity."

44. Consideration for VAT purposes is a broad concept, which is clear from Article 73 (formerly Article 11A(1)(a) of the Sixth Directive) which provides:

> "In respect of the supply of goods or services … the taxable amount 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."

45. The meaning of consideration has been examined in a number of cases, including Case C-16/93 *R J Tolsma v Inspecteur der Omzetbelasting Leeuwarden* [1994] STC 509 where the Court said this:

> "13. In its judgments in Case 154/80 *Cöoeperatieve Aardappelenbewaarplaats* [1981] ECR 445, paragraph 12, and Case 230/87 *Naturally Yours Cosmetics* [1988] ECR 6365, paragraph 11, the Court stated on this point that the basis of assessment for a provision of services is everything which makes up the consideration for the service and that a provision of services is therefore taxable only if there is a direct link between the service provided and the consideration received (see also the judgment in Case 102/86 *Apple and Pear Development Council v Commissioners of Customs and Excise* [1988] ECR 1443, paragraphs 11 and 12).

46. Consideration can be third party consideration, ie paid by a person who is not the recipient of the supply. This is clear from cases such as Case C-353/00 *Keeping Newcastle Warm v CEC* [2002] STC 943 at [26], and was addressed by the Supreme Court in *Revenue and Customs Commissioners v Airtours Holidays Transport Ltd* [2016] UKSC 21, per Lord Neuberger who cited *Tolsma* at [55] and said:

> "56. This formulation demonstrates the need for a direct link between the service provided and the consideration received which the court had previously articulated in *Staatssecretaris van Financiën v Association Coöperatieve Aardappelenbewaarplaats* GA (Case C-154/80) EU:C:1981:38; [1981] ECR 445; [1981] 3 CMLR 337 , para 12, *Apple and Pear Development Council v Customs and Excise Comrs* (Case C-102/86) EC:C:1988:120; [1988] ECR I-1443; [1988] 2 All ER 922 , paras 11-12, and *Staatssecretaris van Financiën v Hong Kong Trade Development Council* (Case C-89/81) EU:C:1982:121; [1982] ECR 1277 , para 10. The Court of Justice's later statements of the test have followed *Tolsma* in not requiring the recipient of the services under the arrangement itself to be the provider of the consideration or to have legal responsibility for its provision-see *Primback Ltd*, para 25 and *Newey*, para 40, and see also

> *Dixons Retail plc v Revenue and Customs Comrs* (Case C-494/12) EU:C:2013:758; [2014] Ch 326, paras 31-32; [2014 2 WLR 893 .
>
> 57. When the Court of Justice speaks of "reciprocal performance" it is looking at the matter from perspective of the supplier of the services and it requires that under the legal arrangement the supplier receives remuneration for the service which it has performed. It is not necessary that the recipient of the service is legally responsible to the supplier for payment of the remuneration; it suffices that the arrangement is for a third party to provide the consideration. Were it otherwise, taxpayers could structure their transactions so as to escape liability to pay VAT, so long as they could meet the economic reality test."

47. Moreover, third party consideration can be in the form of subsidy paid from public funds, so long as the subsidy bears a direct link with the goods or services at issue: see Case C-184/00 *Office des Produits Wallons ASBL v Belgium* [2003] STC 1100 at [14] and illustrated by *Groundwork Cheshire v HMRC* [2012] UKFTT 750 (TC) where payments through the Enworks Programme, funded by the North West Regional Development Agency and the European Regional Development Fund, were held to constitute consideration for environmental consultancy services provided by the taxpayer to third parties.

48. The fact that payments are from public funds or that the services are provided pursuant to statutory obligations is not determinative: see Case C-263/15 *Lajvér Meliorációs Nonprofit Kft v Southern Transdanubia Regional Tax Directorate, Hungary* at [38]-[43].

Case Law

49. CIC's case rests heavily on an analogy with the facts in *Rayon d'Or*. The taxpayer in that case ran a residential care home for the elderly ("RCHE") in France. It was paid a "healthcare lump sum" by the French sickness insurance fund which it argued fell outside the scope of VAT because the payments did not amount to consideration for VAT purposes. The French authorities argued that the payments were consideration for the healthcare services provided to the elderly care home residents. The French court referred a question to the CJEU. The CJEU held that the healthcare lump sum was consideration for the care provided by the RCHE to its residents.

50. The healthcare lump sum was calculated by reference to a statutory tariff which was intended to cover the medical and paramedical services needed to treat the elderly residents. Further, the Court recorded that:

> "[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 arts R 314-170 and R 314-171 of the Code de l'action sociale et des familles, and of historical coefficients which are determined at a national level and updated each year on the basis of the average expenses of all RCHEs".

51. The taxpayer argued that there was no direct link between the healthcare lump sum, calculated in this way, and the services provided to its residents, which were "neither defined in advance nor personalised and the residents are not made aware of the price of those services" [22].

52. The Court rejected that argument in conclusions at [29]-[38]. Specifically, it held that:

> "[32] It is clear that the 'healthcare lump sum' at issue in the main proceedings 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.
>
> …
>
> [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 & Country Club v Staatssecretaris van Financiën* (Case C-174/00) [2002] STC 502, [2002] ECR I-3293, para 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."

53. In response to HMRC's submission that *Rayon d'Or* is a case limited to its particular facts, which fit a similar pattern to the facts in *Kennemer* which was cited by the CJEU at [36] (see the extract above), CIC argues that the approach in *Rayon d'Or* is not so limited, and in support of that cites Case C-174/14 *Saudaçor – Sociedade Gestora de Recursos e Equipamentos da Saúde dos Açores SA v Fazenda Pública* [2016] STC 681, the facts of which fall outside the *Kennemer* model but where the CJEU nonetheless applied *Rayon d'Or*. In *Saudaçor*, the taxpayer was a company which provided consultancy and management services related to the regional health service of the Azores. By an agreement between the company and the Government of the Azores, the Government was obliged to pay a "financial contribution" to the company. The issue arose as to whether the company was engaged in economic activity for VAT purposes, which led the Court to examine whether the financial contribution by the Government was consideration for the company's services. The Court reminded itself of the "direct link" test [32], before answering the question referred:

> "36. In the light of the permanent and continuous nature of the planning and management services provided by Saudaçor, the fact that that compensation is determined not on the basis of individualised services but on a flat-rate and annual basis to cover the operating costs

> of that company is not in itself 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 (see, to that effect, judgment in Le Rayon d'Or, C-151/13, EU:C:2014:185, paragraphs 36 and 37).
>
> 37. The existence of that direct link also does not appear to be called into question by the fact that the programme agreements concluded between Saudaçor and the RAA contain clauses which stipulate that the amount of compensation payable to Saudaçor may be adjusted where, because of a change of circumstances, that amount is manifestly insufficient to allow for the performance of those agreements."

54. From these two cases, principally, CIC argues that the payments received by way of lump sum from EFA and SFA are consideration for supplies of education and vocational training provided by CIC to its students; there is, CIC argues, the requisite direct link between the lump sum payments and the services provided to the students. That direct link exists notwithstanding the fact that the payments are not individualised to any particular student or course, they are calculated by reference to a formula containing various components, and they are paid in advance. Further, that direct link exists even though CIC carries out its activities in the context of a statutory framework which imposes responsibilities on it to provide education and training courses. All these features, argues CIC, are present to some extent in *Rayon d'Or* and *Saudeçor*. This analysis is supported in CIC's submission by Case C-182/17 *Nagyszénás Településszolgáltatási Nonprofit Kft v Appeals division of the National Tax and Customs Authority, Hungary* where flat rate payments not individualised to services were nonetheless held to be consideration (see [36] and [37] of the Judgment in that case).

55. HMRC disputes the applicability of these cases and argues that none contains a compelling analogy with the facts of this case. Specifically, HMRC suggests that *Rayon d'Or* is to be distinguished because the RCHEs there were making a different type of supply, namely "making available" healthcare services to elderly residents in the care home, in contrast with the supplies of education and vocational training to students in this case, which are individualised supplies and not merely the "making available" of such services. That characterisation, says HMRC, explains the Court's reference at [36] of *Rayon d'Or*, to *Kennemer*, a case where the Court had characterised the supply (of membership of a golf club for an annual subscription) in this way:

> [40] …"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."

56. So, argues HMRC, *Rayon d'Or* is a different case on different facts, it is a case where the taxpayer was making a *Kennemer* supply and that explains the conclusion that the payment was consideration. That reasoning does not transpose to CIC's case where there is no *Kennemer* supply. HMRC argues that the better analogy is with cases like C-102/86 *Apple and Pear Development Council v Customs and Excise*

Commissioners [1988] STC 221 and *South African Tourist Board v Customs Commissioners* [2014] UKUT 280 (TCC) [2014] STC 2650.

57. *Apple and Pear* concerned a body established by statutory instrument. Its functions related to advertising and promotion and improvement of the quality of apples and pears grown in England and Wales. It imposed a mandatory annual charge on growers which was calculated per hectare of land used for growing apples and pears alternatively according to the number of fruit trees planted. The House of Lords referred a question to the European Court, which concluded that the annual charge imposed was not consideration for supplies by the Council. The benefits deriving from the Council's activity accrued to the whole industry (see [14]) and further,

> "[15] … 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.".

58. The Advocate General (Sir Gordon Slynn) distinguished between the mandatory annual charge and the earlier Kingdom Scheme which was funded in part from a government grant and in part by way of voluntary charges to growers for services directed to their specific products; these were supplies for consideration, because the necessary reciprocity existed (p 235f, and see the analysis in *South African Tourist Board* at [44]).

59. In *South African Tourist Board,* the Upper Tribunal considered the position of the Board, a statutory body with the objective of promoting tourism in South Africa. It was funded by the South African government and used its funds to promote South Africa as a tourist destination. Each year, it 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.

60. The UT held that it was necessary to analyse the entire circumstances of the case, weighing the competing factors ([48]), and that regard must be had to the economic realities and to all the circumstances in which the transaction takes place, using the contractual terms as a starting point ([51]).

61. The UT held that the performance agreement fell far short of demonstrating the degree and nature of reciprocity required to constitute the payments to the Board as consideration; there was a link but it was not one of mutual exchange of supply and consideration for that supply ([56]). The economic and commercial context supported the analysis that there was no supply, because this was a funding arrangement under the statute which lacked the required mutuality ([58]-[59]). There was no supply in so far as activities were funded in this way [64].

62. Different funding arrangements under a memorandum of understanding between the South African Tourist Board and a separate entity called TBCSA, an organised body

of business in tourism and related businesses, which collected voluntary levies on the sale of hotel accommodation and rental cars to tourists (see [23]), met with a different analysis. The MoU provided for specific benefits to be made available to the collectors of these levies, which benefits were described at [99]: 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. The UT held that the MoU demonstrated reciprocity, and even though a particular level of service could not be identified under the MoU, the MoU still contained a "quid pro quo" for the payments, which were consideration for VAT purposes (see [100]).

63. HMRC rely, principally, on *South African Tourist Board* to support their case that EFA and SFA provided funding on conditions to CIC; that, by analogy with the facts of that case, the arrangements between the funders and CIC lacked the required reciprocity or direct link, and in consequence the lump sum payments by those agencies were not consideration for supplies; the payments were outside the scope of VAT altogether.

64. CIC's response to HMRC's arguments is that *South African Tourist Board* is on different facts, which are far distant from the facts of this case, save for the TBSCA payments which are analogous. Likewise, *Apple and Pear Development Council* concerned a very different sort of arrangement between those who paid the levy and the Council; this is more like the Kingdom Scheme. There are other cases where payments have been held to lack a direct link, but those cases are all far distant from the facts of this case. So, as examples, *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

65. We note that the CJEU gave judgment in *Rayon d'Or* in March 2014. *South African Tourist Board* was decided later that year, but there is no reference in South African Tourist Board to *Rayon d'Or*.

66. So, we are faced with two diametrically opposed analyses, each drawing on previous cases which are said to provide a compelling analogy. So far as the authorities are concerned, that exposes the question which lies at the heart of this appeal: on which side of the line does this case fall? Is this a *South African Tourist Board* case where the payments are a form of funding on conditions? Or is this a *Rayon d'Or* case where the payments are made pursuant to a reciprocal arrangement for services, and constitute consideration for supplies?

67. Before embarking on our own analysis of the essential features of the transaction at issue in this appeal, we set out our conclusions on the scope of the judgment in *Rayon d'Or*. To do that, we first consider the facts and judgment in *Kennemer*, upon which so much of the argument in this case turns. The taxpayer was a golf club in Holland, and an issue arose about whether the annual subscription fees paid by members, who

also paid admission fees for the use of the course, were consideration for services. The relevant question referred by the Dutch appeal court was this (from [18] of A-G Jacobs' opinion):

> "Is there a direct link, within the meaning of inter alia the judgment of the Court of Justice in Case C-102/86 *Apple and Pear Development Council v Customs and Excise Commissioners* in the case of subscription fees charged by the association which, pursuant to the object laid down in its articles of association, provides its members with sports facilities in the context of an association and, if not, is the association to be regarded as a taxable person with in the meaning of art 4(1) of the Sixth Directive only in so far as it also provides benefits for which it receives direct consideration?

68. The Court answered that question in the affirmative, there was a direct link between the subscription fees and services provided. That was because the services provided in exchange for the subscription fee were not the use made of the golf course, but the opportunity to make use of the facilities, see the Court at [40]:

> "As the Commission argues, the fact that in the case before the national court 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 such as that concerned in the main proceedings 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 such as that concerned in the main proceedings and the services which it provides."

69. This sort of supply, where a fee is paid for the right of access to further services, is sometimes called a *Kennemer* supply. The question for us is whether the Court's analysis in *Rayon d'Or* is limited to *Kennemer* supplies, or whether it extends more broadly. It was common ground that the facts in this case cannot be analysed as giving rise to a *Kennemer* supply. 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.

70. We turn back to the facts in *Rayon d'Or*. The Court made repeated reference in its judgment to the fact that the healthcare lump sum was paid in respect of the care provided to the residents of the care home: see, as examples, at [15] where the Court refers to the payment "in respect of the care which they provide", at [16] where the Court cites from the legislation which establishes a tariff to cover the services needed to treat the ailments of persons residing in the home, and the fact recorded at [18] that the healthcare lump sum is calculated by reference to a formula based on the number of residents adjusted for their level of dependency as well as other factors. In answering the question referred, the Court asked itself whether the healthcare lump sum constituted "consideration for the healthcare provided … by an RCHE to its residents"

(see [28]) and answered that at [32] in a passage cited above in the affirmative, referring to the healthcare lump sum being received by the RCHE as consideration "for the care which they provide, in different forms, to their residents". There is further reference at [33] to the "services to the residents" which the RCHEs are obliged to provide. At [34] the Court reminds itself of the possibility that this is third party consideration and then at [35] the Court recognises that the direct beneficiary of the services is the resident. Thus, it is clear that the Court was not approaching the RCHEs' supplies as some sort of right of access to healthcare, which might be called a *Kennemer* supply. On the facts of *Rayon d'Or*, 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.

71. Thus, we do 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, we understand those words to describe the services at issue in *Rayon d'Or*, namely services provided year on year by the RCHEs to their residents, whoever they may be from time to time, on a rolling basis. 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*).

72. This is all conventional VAT wisdom. It would be surprising to us if the Court had held that a different rule should apply just because a transaction happens to fit the *Kennemer* model, as HMRC suggests. The better analysis is surely 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.

73. *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.

74. It follows that we do not consider that *Rayon d'Or* can be distinguished; it is analogous on its facts with this case and our analysis must follow that of the CJEU. That is sufficient to dispose of the question before us on this appeal in relation to HMRC's preferred decision. But the arguments before us ranged more widely, with each side identifying particular factors which were said to support each side's case, and the FTT took a "balance sheet" approach in its judgment at [127] in order to deal with those arguments. So, we address those arguments, although not necessarily in the same order as they were taken by the FTT or advanced by the parties.

75. The FTT placed some weight on the statutory background, characterising that as a factor weighing against the payments being consideration. We agree with the FTT that the statutory background is relevant. 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 *South African Tourist Board*). But *Rayon d'Or* demonstrates that a supply analysis remains possible even where the payments are made pursuant to statute. Thus, we conclude that in this case the statutory background is a neutral factor, consistent with both parties' cases.

76. The FTT found that the existence of agreements between the funding agencies and CIC was a neutral factor; their existence was consistent with either side's case. The fact that there were agreements might be said to be consistent with either party's case, but the content of those agreements is far from neutral, because the agreements are the starting point in the analysis (see *South African Tourist Board* and paragraph [55] above). We do not consider them to be evidentially neutral, rather we consider them to be key to the analysis. There are four important features of the agreements, in our judgement, which provide the answer to the question.

77. First, 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.

78. Secondly, the amount paid was by way of formula and not negotiated. (There was some room for negotiation if larger student numbers were anticipated for some reason, but that did not arise in the periods considered by the FTT and that anyway was an exception to the general rule.) The use of a formula is not itself a basis for concluding that the payments are not consideration, as *Rayon d'Or* shows. But 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.

79. Thirdly, 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. The FTT referred to these as "clawback arrangements". 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.

80. Fourth, 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.

81. 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.

82. We stand back and test our conclusions against the wider canvass. We note that some students did not benefit from grant funding but were required to pay, in whole (for example international students) or in part (as could be the case on SFA funded courses). 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.

83. Further, CIC's activities in this case have echoes of the supplies under the Kingdom Scheme in *Apple and Pear Development Council* and TBSCA supplies in *South African Tourist Board*, 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. These cases are at one with *Rayon d'Or*, *Saudeçor* and *Nagyszénás*. They are a better fit than the cases relied on by HMRC which are very distant on their facts from this case.

84. We return to the FTT's decision. In the light of what we have said above regarding the relevant legal principles and their application to the facts of this case, we find the FTT to have erred in law in its analysis.

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. Therefore, the FTT's repeated references to the absence of any direct link between the funding and "any particular student", or between the funding and "the costs actually incurred by CIC in providing a particular course to a particular student" (see [127(2)] and [131] as examples) are misconceived; the absence of those features was not determinative of the question before the FTT.

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

89. The consequence of our decision is that CIC was making supplies of education services, which were at all material times exempt from VAT. In light of HMRC's acceptance of the "economic activity" point, that deals with CIC's appeal from HMRC's preferred decision. CIC's appeal in relation to the preferred decision succeeds. But that does not resolve this appeal, because that brings the alternative decision into focus. We now turn to that decision.

II. The Alternative Decision

Procedural Matters

90. We were told that the FTT heard argument on the merits of the alternative decision, CIC having filed a Notice of Appeal against that alternative decision, as we have noted, and the two appeals (against preferred and alternative decisions) having been consolidated into one. There is some dispute as to whether the FTT heard "full argument", CIC maintaining that there was only "limited argument" on the alternative

decision because the matter was "not capable" of being fully argued before the FTT. We do not follow this submission, which was not developed in argument before us (see below). The extent of argument on that decision was a matter for the parties and for the FTT. On any view, the alternative decision was before the FTT.

91. The FTT did not reach any decision on it, opting instead to determine only the preferred decision and so to leave the appeal against the alternative decision undetermined. This is regrettable. The FTT should have dealt with all matters which were before it.

92. At the appeal hearing in relation to the preferred decision, the parties invited us to remit the appeal against the alternative decision to the FTT in the event that the appeal against the preferred decision succeeded (as it has done). We indicated our concerns about that proposal in a draft decision on the consideration point which we sent to the parties on 24 February 2020, in the following terms (extracted from [93] of that draft decision which is now superseded):

> "We are reluctant to accede to that invitation. It would mean that this was, in effect, an interlocutory appeal and the substantive issue of whether CIC was entitled to its repayment would remain unresolved. Resolution of that issue would depend on further time and costs being expended in the FTT, with the prospect of a further appeal to the UT on the alternative decision in due course. Further, it would mean that any onward appeal against this decision to the Court of Appeal … would have to wait for the FTT and the UT to catch up, or would have to proceed in a somewhat lop-sided way by including only part of the case as this appeal has done, to date. These options are highly undesirable all the more so given our understanding that the facts which underpin the alternative decision are not in dispute and that the issue in the appeal against the alternative decision is one of statutory interpretation."

93. We directed further submissions on the procedural point. CIC and HMRC filed written representations on 26 March 2020 and HMRC filed a further response on 4 May 2020. In those submissions, the parties agreed that the alternative decision was properly before us: the decision under appeal pursuant to s11 TCEA was the FTT's decision, which encompasses the whole of the appeal as it stood before the FTT, which included CIC's appeal against the alternative decision. Section 12 TCEA enabled us, once we set aside the FTT's decision (as we had done on the preferred decision), to make any decision the FTT could have made. But the parties remained at odds about how this tribunal should proceed. While HMRC were content for us to determine the alternative decision, CIC was not and maintained its position that the appeal against the alternative decision should be remitted to the FTT. A hearing took place on 3 July 2020 to determine whether this tribunal should remit the appeal to the FTT and if not, to determine CIC's appeal against the alternative decision. At that hearing, CIC did not press its case that the appeal should be remitted to the FTT and that hearing moved on swiftly to arguments on the merits of the alternative decision. Those arguments of course proceeded without the benefit of any analysis by the FTT and were, in effect, heard by this tribunal at "first instance".

Further Background

94. We have set out the background facts above (at [5]-[12]). The consequence of allowing CIC's appeal against the preferred decision is that the supplies of education by CIC are revealed to have been exempt supplies of education and not supplies which fell outside the scope of VAT as had been thought. The consequence of that is that no deemed output tax was ever properly due on those supplies. That is the basis on which CIC has submitted its claim for repayment of overpaid VAT. The amount reclaimed is £1,552,277 (see [5] above). It is worth noting, because it is a matter we come on to discuss, that CIC later confirmed it sought the lesser amount of £1,528,499 because it considered, following the issue of the UT's decision in *Wakefield*[8], that supplies in respect of certain students were non-business and that deemed output tax had been properly accounted for on those supplies (which we will refer to as the "*Wakefield* rump"). To answer that repayment claim, by its alternative decision, HMRC rely on s81(3A) of the 1994 Act, which disapplies the statutory limitation periods in certain circumstances. HMRC argues that s 81(3A) permits them to bring into account against CIC's claim for overpaid output tax, all the *Lennartz* input tax which had previously been credited to CIC (ie £2,225,806, see [7] above) with the effect that CIC's claim would be extinguished entirely. That input tax was credited to CIC in 2009 and 2010, and is therefore long out of time for any form of assessment or recovery by HMRC; but if s 81(3A) applies, HMRC will be able to offset it against CIC's claim. Thus, the issue in this part of the appeal is a short one: does s 81(3A) apply?

Law

95. CIC's claim for overpaid output tax proceeds under s 80 of the 1994 Act, as follows:

> 80.— Credit for, or repayment of, overstated or overpaid VAT
>
> (1) Where a person—
>
> (a) has accounted to the Commissioners for VAT for a prescribed accounting period (whenever ended), and
>
> (b) in doing so, has brought into account as output tax an amount that was not output tax due,
>
> the Commissioners shall be liable to credit the person with that amount.
>
> …
>
> (2A) Where—
>
> (a) as a result of a claim under this section by virtue of subsection (1) or (1A) above an amount falls to be credited to a person, and
>
> (b) after setting any sums against it under or by virtue of this Act, some or all of that amount remains to his credit,
>
> the Commissioners shall be liable to pay (or repay) to him so much of that amount as so remains.

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[8] *HMRC v Wakefield College* [2016] UKUT 19 (TCC)

96. Section 80(4) imposes a limitation period of 4 years on any claim by a taxpayer. CIC's claim was submitted in April 2014 and revisited periods 04/10 to 01/14 (which were "in time"). HMRC can raise an assessment for input tax wrongly credited to a taxpayer HMRC under s73(2) VATA, subject to the four-year time limit in s77(1)(a) VATA. HMRC's first input tax credit of £2,087,477 was paid to CIC in December 2009; the second input tax credit of £138,329 was paid in November 2010. The limitation period for recovering those sums expired on 31 January 2014 and 31 January 2015 respectively.

97. Section 81(3A) of the 1994 Act provides as follows:

> …
>
> (3A) Where—
>
> (a) the Commissioners are liable to pay or repay any amount to any person under this Act,
>
> (b) that amount falls to be paid or repaid in consequence of a mistake previously made about whether or to what extent amounts were payable under this Act to or by that person, and
>
> (c) by reason of that mistake a liability of that person to pay a sum by way of VAT, penalty, interest or surcharge was not assessed, was not enforced or was not satisfied,
>
> any limitation on the time within which the Commissioners are entitled to take steps for recovering that sum shall be disregarded in determining whether that sum is required by subsection (3) above to be set against the amount mentioned in paragraph (a) above.

98. Section s 81(3A) was considered in *Birmingham Hippodrome Theatre Trust Ltd v Commissioners for HM Revenue and Customs* [2014] EWCA Civ 684 ("*Birmingham Hippodrome CA")* and [2013] UKUT 057 (TCC) ("*Birmingham Hippodrome UT"*). That appeal concerned a registered charity which operated a theatre and accounted for output tax on its principal supplies of theatre tickets for periods from 1990 to 2004. It received repayments of input tax on a capital project between 2000 and 2001. It subsequently emerged that the theatre tickets should have been treated as exempt from tax all along which meant that the input tax had never been properly eligible for credit. In 2006, the theatre claimed for repayment of overpaid output tax in respect of periods (1990-1996) where it was not time-barred (making a *Fleming* claim for those periods, relying on *Fleming t/a Bodycraft v HMRC* and *Conde Nast v HMRC* [2008] STC 324). By then, HMRC were out of time to recover the input tax from 2000 and 2001, the amount of which exceeded the theatre's output tax repayment claim.

99. The FTT decided that s 81(3A) entitled HMRC to offset the input tax erroneously repaid for 2000 to 2001 against the claim in respect of 1990 to 1996 so as extinguish the taxpayer's claim. That decision was upheld on appeal to the UT and Court of Appeal.

100. The *ratio decidendi* can be extracted from two paragraphs of the judgment in *Birmingham Hippodrome CA* (per Lewison LJ with whom Sharp LJ (as she was) and Vos LJ (as he was) agreed)*:*

> [59] The purpose of section 81 (3A) is, in my judgment, clear. It is that where a taxpayer makes a claim for repayment of VAT which has been paid owing to a mistake, all the consequences of the mistake are to be taken into account in assessing the quantum of his claim. That purpose is consistent with the overarching scheme of VAT under the Sixth Directive which treats the payment of output tax and the deduction of input tax as an "inseparable whole". This is borne out by section 81 (3A) (b) which deals with amounts payable "to or by" the taxpayer. It is clear from this that section 81 (3A) was intended to allow HMRC to take into account both credits and debits. It is not, therefore, simply concerned with past claims by the taxpayer for credit of input tax. In evaluating those claims HMRC are also to look at amounts payable "by" the taxpayer: in other words output tax. Section 81 (3A) (b) is not limited to particular accounting periods. The main limiting factor is that the payment "to or by" the taxpayer must derive from the same mistake as that which gave rise to the claim. Section 81 (3A) is not part of the general scheme of VAT accounting, which requires a direct and immediate link between an input and an output. Rather it is a special provision, which seeks to undo the consequences (and all the consequences) of the same mistake.
>
> …
>
> [62] Unless HMRC has the opportunity to set off repayments (or credits) that it has made but should not have, the end result will be that the taxpayer will end up paying less by way of VAT than the Directive said that he should. That result would fail to give effect to the principles of EU law about the effect of direct applicability of directives. As in *Olimpiclub* the principle of legal certainty has to give way to the principle that a directive must be applied in full and to the principle that the right to deduct is part of an "inseparable whole…."

101. Because it is material to the arguments advanced by CIC in this case, we record parts of the judgment in *Birmingham Hippodrome UT* which relate to the meaning of "mistake". Those arguments were not the subject of any appeal or discussion in the Court of Appeal. At [90] the UT had noted the words of s 81(3A) "hinged on a particular mistake". The Theatre argued there were two distinct mistakes, in summary i) a failure by Government to implement the cultural exemption in Article 13A(1)(n) of the (EC Council Directive 1977/388) (the Sixth Directive) at all until 1996, followed by ii) an administrative failure by HMRC in mis-interpreting or mis-applying the domestic legislation which from 1996 did implement the cultural exemption contained in the Directive. The consequence of both mistakes, so the Theatre argued, was that the Theatre's supplies were wrongly treated as taxable when they should have been exempt, but the two mistakes were legally and conceptually separate. And, so the Theatre argued, its repayment claim was attributable to the first mistake (in the period 1990-1996) whereas HMRC's mistaken input tax credit in 2000 and 2001 was attributable to the second mistake (post-1996). HMRC countered that there was one mistake: treating the supplies as taxable when they should have been exempt. The UT addressed these arguments in a section headed "One mistake or two" at [35]-[39] and came to its conclusion on those arguments at [111]-[125].

102. The UT rejected HMRC's argument that, because the results of the failure to implement the Directive and the administrative failure were the same, there was therefore one mistake explaining that "in ordinary usage two different mistakes may have the same result" ([121]). It also rejected the Theatre's argument that if too wide a meaning was given to "mistake" – for instance that the mistake was "a mistake about the operation of VAT" - the limitation in s81(3A) would become meaningless. It held:

> 122. …This argument shows that it remains a question of the use of language: when does a description become so general as not to fit the purpose of the statutory language?
>
> 123. In this appeal the treatment of the Theatre's supplies as standard rated derived from the omissions and actions of two different bodies: Parliament omitted to legislate, and HMRC acted to interpret legislation wrongly. The errors were corrected in different ways: Parliament by legislating, HMRC by changing their practice. It is not possible to describe each separate omission or action as the same mistake - they were plainly different mistakes; but is it possible to describe the circumstances of both as the failure of the member state (its legislature and executive) to treat the Theatre's ticket sales as exempt - for all that s. 81 (3A) requires is a description of events which may be called a mistake by reason of which rights to repayment and failure to assess arose?
>
> 124. It seems to us that it is possible to do so. If one had asked the Theatre why it was declaring output VAT or reclaiming input VAT, it would have said "because our ticket sales are standard rated". That is a fair description of the mistake made even though further enquiry might reveal different reasons for different aspects of it.

Lennartz

103. Article 26 PVD (previously Article 6 of the Sixth Directive) deems certain transactions to be treated as a supply of services for consideration, in particular the use of goods forming part of the assets of a business "…for the private use of a taxable person…or, more generally for purposes other than those of his business, where the VAT on such goods was wholly or partly deductible."

104. The rule in *Lennartz* derives from Case C-97/90, *Lennartz v Finanzamt Munchen III*. Mr Lennartz had a car which he used for his own private purposes. He set up a business and contributed the car to the assets of that business, seeking a credit of VAT in relation to VAT paid on the car. The Court held that he was entitled to that deduction, so long as he then accounted for deemed output tax on the extent of his private (non-business) use of that car (see [26]).

105. The scope of *Lennartz* was clarified in *Vereniging Noordelijke Land- en Tuinbouw Organisatie v Staatssecretaris van Financiën* (Case C-515/07) [2009] STC 935 ("*VNLTO*") . This concerned a body which engaged in two main business streams: promotion of the general interests of its members which was not economic activity, and providing services to its members for a specific fee. These were both business activities, but only one of them, the provision of services to members, was within the scope of

VAT; the other, promoting members' interests generally, was non-economic activity. The Court held that VNLTO was not entitled to deduct input tax on goods and services used for both its business streams, and that in so far as its non-economic activity was business activity, there was no right to deduct. *VNLTO* thus clarified that "non-business activity" for the purposes of *Lennartz* did not extend to business activity which fell outside the scope of VAT.

106. In light of *VNLTO*, it became apparent that the UK had allowed *Lennartz* to apply in certain situations where it was not applicable. That meant there were taxpayers who deducted input tax in reliance on *Lennartz* when they ought not to have and who had then also wrongly accounted for output tax on deemed supplies under the rule when that was not required.

107. For taxpayers who were already operating *Lennartz* accounting, HMRC did not insist on reversing these over-deductions of input tax and overpayments of deemed output tax even if they were not justified on the *VNLTO* approach. Instead, HMRC published a Revenue and Customs Brief (RCB 2/10) which was followed by legislation (in the form of in the form of Finance (No. 3) Act 2010, Schedule 8, Paragraph 4). Taxpayers were given the option of retaining the overpaid input tax provided they continued to account for output tax on deemed supplies on the understanding of the law that existed before.

108. CIC had adopted *Lennartz* accounting in 2009. That was by means of a Partial Exemption Special Method ("PESM") formally approved by HMRC on 23 December 2009 (see the FTT at [61]). Given the timing of CIC's adoption of *Lennartz* treatment, CIC was entitled to preserve that treatment and was not affected by *VNLTO* and the narrowed approach to the *Lennartz* rule.

Summary of Parties' submissions

109. CIC submits that *Birmingham Hippodrome* is distinguishable, at least so far as outcome is concerned, because in that case the particular mistake was a failure to give effect to the Directive, and that feature drove much of the UT's and Court of Appeal's reasoning, focussing on securing the objects of the Directive in conformity with the principle in *Marleasing*. That is not the case here; there is no question of any failure to implement the Directive, the mistakes here were of a different nature altogether.

110. Alternatively, CIC says that the mistake giving rise to the output tax error is not the same as that giving rise to the input tax error, relying on *Birmingham Hippodrome UT*. CIC characterises our conclusion on the preferred decision on the output tax side as one which relates only to the consideration issue, ie whether CIC was making supplies *for consideration.* This is a mistake about the operation of Article 2 PVD. By contrast, CIC argues that the mistake on the input tax side, which led to CIC receiving an input tax credit to which it was not entitled, was different. CIC suggests that input tax mistake could be described in any one of four different ways:

> (1) HMRC wrongly conflated the concept of a "supply of services for consideration" for the purposes of Article 2 with the concept of "economic activity" for the purposes of Article 9 PVD. HMRC wrongly thought that

CIC was engaged in non-business activity until that point was conceded only very recently (shortly in advance of this appeal). The basis of HMRC's thinking was that CIC was not participating in a market – see cases like *Institute of Chartered Accountants* and *T-Mobile* referred to at [64] above. This was an Article 9 mistake, distinct from the Article 2 mistake identified by this tribunal.

(2) HMRC made a mistake, following *VNLTO,* permitting taxpayers the option to choose whether to continue to use *Lennartz* accounting or to follow *VLNTO.* It was not open to give taxpayers that option and CIC should not have been able to continue to use *Lennartz* accounting, even if the main purposes of its activities were non-economic.

(3) HMRC mistakenly applied a policy that provision of education by further education colleges could not be a supply because such colleges were under the control of local authorities who were under a statutory obligation to provide such education. That policy was out of date because CIC stopped being under local authority control from 1993.

(4) HMRC did not seek repayment of input tax because they relied on their own policy in manual VATR8200 on the application of s81(3A) to offset in different accounting periods which (wrongly) limited that provision to cases where there was *Halifax*[9] abuse.

111. Mrs Hall suggested that it was not possible to find one compendious description for the mistake which led to CIC's reclaim of output tax <u>and</u> which could also explain HMRC's failure to assess the overpaid input tax within time.

112. HMRC, on the other hand, submitted that there was, for the purposes of s 81(3A), one mistake. They described that mistake as "failing to treat the relevant supplies of grant-funded education/vocational training as exempt supplies of services, part of CIC's economic activity, treating them instead as non-economic activity".

Evidence

113. Mrs Hall spent some time going through the extensive correspondence between CIC (and its advisors) and HMRC. CIC and its advisors raised a very large number of points. HMRC responded to many of those points. The exchanges travelled far beyond the limited questions which arise in this appeal. It is important not to take HMRC's letters or parts of them out of their proper context.

114. We understood Mrs Hall's purpose in going through the correspondence in this way was to make good her submission that there were two different mistakes at play, and the output tax mistake (the subject of the first part of this decision) was different from the input tax mistake (in whichever of its four guises she proposed).

115. Mr Mantle sought to answer the various points made by taking us to other parts of the correspondence. He submitted that whatever the details under discussion, the

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[9] *Halifax & others v HMCE Case C-255/02 [2006] STC 919*

general tenor of HMRC's letters was to focus on the distinction between education funded by grants on the one hand and education funded by fees paid by or for students as consideration on the other.

116. It is plain from a fair reading of all the correspondence, taken together, that HMRC clearly thought *Lennartz* accounting applied, and that position was predicated on HMRC's view that CIC's outputs of grant-funded education services were outside the scope of VAT. Indeed, no one seemed to suggest otherwise; it was a shared view at all times up to 23 April 2014 (the date of CIC's reclaim) that *Lennartz* accounting was available and appropriate to the extent that CIC was providing education in return for grant funding. After that date, the arguments moved on to the character of CIC's outputs, but HMRC did not accept CIC's arguments on that issue and stood by the analysis that the grant funded education was out of scope.

Decision

117. We reject CIC's first submission that *Birmingham Hippodrome* is distinguishable because it concerned a failure to implement the Directive. The facts at issue in that case were different, of course. But the reasoning in the case is directly relevant and applicable. It is the leading authority on the interpretation and application of s 81(3A) and we are bound by it.

118. We turn then to consider the application of s 81(3A), as construed in the light of the principles explained in *Birmingham Hippodrome,* to the facts of this case.

119. As described above at [6], CIC had accounted for deemed output tax on non-business supplies of educational and vocational services to students. Its obligation to account in that way was the consequence of CIC having opted into *Lennartz* at the outset, enabling it to reclaim input tax in 2009 and 2010. We have now decided that CIC's supplies were not non-business, they were exempt supplies *within* the scope of VAT. That being so, there never was any obligation to account for deemed VAT on those supplies pursuant to *Lennartz*. So, the mistake which gave rise to an overpayment by CIC in the first place was a mistake about the applicability of the *Lennartz* mechanism.

120. We turn then to consider the mistake which led HMRC not to assess the input tax credited to CIC in time. The answer is that HMRC thought, throughout the limitation period for any assessment and indeed to date, that CIC had correctly been credited with that input tax under *Lennartz*. That is the very essence of HMRC's preferred decision, which is predicated on CIC's services of grant-funded education and vocational training being non-business and so – it follows – amenable to a deemed output tax charge under *Lennartz*. Now that it is established that CIC's services were within the scope of VAT as supplies for consideration which were in fact exempt from VAT, those supplies did not import any entitlement to *Lennartz* treatment at all.

121. In the course of our deliberations after the hearing we found it necessary to clarify the parties' views on the applicability of *Lennartz* in relation to the *Wakefield* rump, which were negligible in value, leading to a reduction in the s 80 claim of just £23,778.

It did not seem to us, from a review of the Statement of Agreed Facts before the FTT, that anything turned on the *Wakefield* rump but in light of some of Mrs Hall's submissions at the oral hearing on 3 July 2020 we wished to check our footing. Paragraphs 20 and 21 of the Statement of Agreed Facts recorded as follows:

> "20. On 23 April 2014 VATangles, on behalf of the Appellant, submitted a net claim for output tax over-declared … The basis of the claim was that the provision of education to students, however it was funded, was a business activity of the Appellant and that, as such, no part of the buildings in question were 'put to any private use, or used, or made available for use, for 'non-business' purposes. Consequently, there was no requirement to account for deemed output tax under paragraph 5(4), Schedule 4 and the Regulations. Accordingly, such output tax was over-declared and, to the extent that it fell within the four year capping period the wrongly declared output tax was reclaimable.
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> 21.It followed that, the input tax incurred in respect of the 'Lennartz' scheme was also wrongly reclaimed and, to the extent that it related to periods within the four-year cap, the repayment sought by the Appellant from the Commissioners was netted off to reflect this overclaim. However, as the vast majority of the input tax had been claimed in the preceding period (01/10) the input tax netted off amounted to just [left blank in original]."

122. These paragraphs seemed to confirm that the input tax claimed under *Lennartz* was, in light of CIC's arguments on the preferred decision, wrongly claimed and was to be brought into account as an offset against the claim to the extent that it was still in time to assess; but that no adjustment was to be made where the four-year cap applied, because HMRC was out of time to assess. We posed three questions to HMRC, giving CIC a right of reply. Those questions in summary were: 1) Was it common ground that CIC was not entitled to a *Lennartz* deduction in the first place (citing paragraph 21 of the Statement of Agreed Facts before the FTT)? 2) If so, why not? Was it because CIC was not conducting or intending to conduct non-business activity? And 3) If so, how was that to be reconciled with the appellant's position that the *Wakefield* rump was non-business?

123. The submissions revealed the following positions in summary: CIC did not regard it as common ground that it was not entitled to a *Lennartz* deduction in the first place. By submissions dated 19 November 2020 and 27 November 2020, CIC submitted that the *Wakefield* rump was indeed non-business activity, so the FTT had found, and that conclusion had never been challenged by HMRC in the *Wakefield* litigation or indeed in this appeal. CIC invited us to have regard to paragraph 24 of the Statement of Agreed Facts which was a concession relating to the *Wakefield* rump and which recorded:

> "24. Following the Upper Tribunal's decision in Wakefield College [2016] UKUT 19 (TCC) ('the Wakefield case') the Appellant accepted that it had made some "non-business" supplies. Accordingly, by a letter dated 20 June 2016 the Appellant amended the net claim made on 23rd April 2014, reducing it by £23,778 being deemed output tax in respect of that activity which was found to be 'non-business' in the Wakefield case."

124. CIC accepted that the *Wakefield* rump constituted only a tiny fraction of CIC's outputs (somewhere between 0.44% and 1.46% by value). But, so it was argued, HMRC had never challenged the existence of this rump of supplies which were non-business, and the existence of those supplies was sufficient, in and of itself, to engage the *Lennartz* mechanism.

125. HMRC disputed this analysis. By submissions dated 13 November 2020 and 25 November 2020, HMRC argued that in light of this tribunal's conclusion on the preferred decision, it followed that the *Wakefield* rump did constitute business supplies, being supplies for consideration, just like other types of grant-funded supplies of education such that the FTT's decision in *Wakefield* was now impliedly overruled. Further, HMRC reminded us that CIC had reclaimed input tax incurred on its capital projects in 2009 and 2010 pursuant to its PESM, which was the subject of agreement between CIC and HMRC, and which permitted a percentage recovery of input tax in line with anticipated non-business activity – which was then thought to extend across all of CIC's grant-funded services. Even if it now turned out that the *Wakefield* rump was non-business (for the sake of argument) but everything else done by CIC was business, the amount of any permitted deduction via a PESM, and on the facts of this case, would have been tiny, such that the wrongly deducted input tax would still greatly exceed the reclaimed output tax, so that s 81(3A) would still stand as a bar to this claim.

126. The *Wakefield* rump derives from the FTT decision in *Wakefield College v HMRC* [2013] UKFTT 731 (TC) (this was the second FTT decision, following a remittal of the FTT's earlier decision[10] by the UT). The FTT considered the question of part-payment of fees and whether the education provided in that context was non-business; the FTT looked at five categories of students. Four categories of students who paid nothing, very little and/or were entitled to remissions depending on their individual circumstances fell under paragraphs 19, 20, 21 and 22. The *Wakefield* rump, as it has been referred to in this case, reflects supplies to students in those categories. (CIC and HMRC go by different paragraphs when defining their understanding of the *Wakefield* rump but for present purposes nothing turns on those differences.) The fifth category comprised students who were not otherwise entitled to remission and paid fees albeit reduced compared with those which overseas students paid; they were addressed at paragraph 23 of the FTT's decision. The FTT decided that there was no "consideration" for supplies to students falling in any one of the five categories. There was no discussion about grant-funding, and whether that was consideration and no findings were made by the FTT in the context of that issue. There was no discussion of the issues which have informed our own conclusion on the preferred decision.

127. HMRC appealed successfully to the Upper Tribunal[11] in relation to paragraph 23 students. There was no appeal in relation to the other paragraphs. The UT was subsequently affirmed by the Court of Appeal on different grounds which are not material for present purposes[12]. The fees paid by paragraph 23 students were found to

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[10] *Wakefield College v HMRC* [2011] UKFTT 70 (TC)

[11] *HMRC v Wakefield College* [2016] UKUT 19 (TCC)

[12] *Wakefield College v HMRC* [2018] EWCA Civ 952

be consideration and it was held that the College was in business when making supplies of education to that category of student.

128. In apparent acceptance of the FTT's decision in relation to the "rump", CIC reduced its claim by £23,778 to reflect the activities which were thought to be non-business in the *Wakefield* case (see paragraph 24 of the Statement of Agreed Facts, above).

129. We turn then to consider whether, and if so how, the *Wakefield* litigation affects this appeal. The *Wakefield* rump categories were not considered by the UT or the Court of Appeal in *Wakefield.* CIC's case that the *Wakefield* rump comprises non-business supplies therefore depends on a FTT decision which is not binding on this tribunal. That decision does not have a strong pedigree, it was accepted by all parties in the Court of Appeal to be "not altogether satisfactory", see [60]. Further, the issues considered by this tribunal in relation to the proper VAT analysis of grant-funded education were simply not considered by the FTT in *Wakefield.* Anyway, in light of our conclusion on the preferred decision, the FTT's decision in *Wakefield,* in relation to the rump categories, cannot be considered to be good law. Our analysis is that the *Wakefield* rump – being supplies in whole or in part for grant funding of one sort or another – comprises exempt supplies.

130. If we are wrong about that and the *Wakefield* rump is non-business, we accept Mr Mantle's alternative point that it is obvious, as a matter of basic VAT law and practice, that CIC would not have been entitled to deduct input tax in excess of £2 million under *Lennartz* based on non-business activity of something less than £25,000; the PESM would not have permitted that, any deduction would have been very modest indeed, and HMRC's arguments on the alternative decision in this case would be untouched: the amount of input tax wrongly credited would still easily exceed the amount of the reclaim, such as to extinguish it.

131. We are therefore satisfied that the *Wakefield* rump has no relevance to this appeal.

132. We return to the central issue raised by the alternative decision: what was the reason for HMRC not assessing CIC within time for the input tax over-deducted in 2009 and 2010? The answer is that HMRC mistakenly thought CIC was entitled to that input tax under the *Lennartz* mechanism, and that in turn was based on HMRC's mistaken view that CIC's grant-funded supplies were not within the scope of VAT. Once established that CIC's grant-funded supplies were within the scope as exempt supplies, it becomes clear that the rule in *Lennartz* was not applicable in the first place (or, if applicable at all, only to a small extent under the PESM to reflect the tiny percentage of activity which was the *Wakefield* rump). So, the mistake which led to HMRC's failure to assess to recoup the input tax in time was a mistake about the applicability of the *Lennartz* mechanism. This is a real world, common sense, accurate and specific description of the mistake.

133. In our judgment, the mistake which gave rise to an overpayment by CIC in the first place is the same as the mistake which led to HMRC's failure to assess to recoup input tax in time. It was a mistake about the application of *Lennartz.*

134. That mistake affected both sides of the equation, namely inputs and deemed outputs. To identify this as a mistake about the applicability of *Lennartz* is a convenient, and not overly general "compendious" description (to adopt Mrs Hall's phrase). It is a fair description (see [124] of *Birmingham Hippodrome UT*).

135. We were not in the end attracted by Mr Mantle's description of the mistake (see [112]) although we acknowledge that is in substance close to ours. It too, explains why HMRC thought the input tax was properly deductible under *Lennartz* and therefore did not assess in time. However, his description risks undue focus on the exempt nature of the supply. The exempt nature of the supply only comes into play once the logically prior question of whether there was a supply for consideration is answered. The mistake lay in thinking that the input tax deduction and deemed output tax charge under *Lennartz* were available in relation to CIC's provision of grant-funded education. That was the nub of the mistake. We think our description does greater justice to the reality of past events and better explains why HMRC did not assess in time, which is of course the essential question posed by s 81(3A).

136. We reject each of Mrs Hall's four other candidates as free-standing or separate mistakes which explain HMRC's failure to assess in time (see [110] above) either because they are irrelevant or because they are on close analysis just another way of saying this was a *Lennartz* mistake. Following the order set out above:

> (1) Mrs Hall may be correct to assert that HMRC's attention was more closely on Article 9, economic activity, than on the Article 2, consideration/direct link. But it is well established that Articles 2 and 9 are themselves conceptually linked: as the Court of Appeal observed in *Wakefield* at [52], "A supply for consideration is a necessary but not sufficient condition for an economic activity". To alight on Article 2 as opposed to Article 9, in the context of this long debate, as Mrs Hall seeks to, is artificial and distracts from the real points of difference between the parties. Both Articles are relevant to the key question, which was whether *Lennartz* treatment applied.
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> (2) We are not persuaded that HMRC's policy to extend *Lennartz* treatment after *VNLTO* has any relevance to explain why HMRC did not assess within time. It matters not whether the domestic scope of *Lennartz* was overly broad, the point was that HMRC thought *Lennartz* applied.
>
> (3) We are not satisfied on the evidence we have been shown that HMRC did make a mistake in maintaining a policy that provision of education by further education colleges could not be a supply because such colleges were under the control of local authorities (not true of CIC from 1993). But in any event, this "mistake", if it existed, would be another way of saying that HMRC were wrong to conclude that CIC's supplies were non-business and so within *Lennartz.* This is not a different mistake but an outworking of the same one.
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> (4) We fail to see that HMRC's stated policy in VAT manual VATR8200 has any relevance to this case. It has been plain since *Birmingham Hippodrome* was decided that HMRC can apply s 81(3A) in any case which

meets the statutory criteria, whether *Halifax* abuse is established on the facts or not.

137. CIC was wrong, as it turns out, to claim and apply *Lennartz* treatment in the first place. As our conclusion on the preferred decision reveals, contrary to HMRC's view, CIC's provision of grant-funded education was an exempt supply of services. That meant no deemed output tax was due and no *Lennartz* input tax deduction could arise. Each of CIC's candidate mistakes could be restated as reasons relevant to the "applicability of the *Lennartz* treatment mistake" which had resulted in HMRC failing to assess CIC to *Lennartz* input tax wrongly repaid to CIC.

138. For these reasons, we conclude that s 81(3A) does apply in the present case, and we dismiss CIC's appeal against the alternative decision.

Conclusion

139. CIC's appeal in relation to the preferred decision under Issue 1, i.e. whether there was a supply for consideration, is allowed.

140. However, in remaking the FTT Decision, we have decided that CIC's appeal in relation to the alternative decision should be dismissed.

141. It follows that CIC's appeal against HMRC's refusal of CIC's claim for repayment of overpaid output tax is accordingly dismissed.

Signed on original.

Mrs Justice Whipple Judge Swami Raghavan
Upper Tribunal Judges

Release date:
22 December 2020