TC04441

Appeal number: TC 2011/07066

VAT–input tax- whether part in respect of supply of corporate meeting services disallowable on basis of an apportionment to business entertainment - ss 24 to 26 VATA 1994 - Article 5 VAT (Input Tax) Order 1992

INCOME TAX-whether costs described as being for corporate meeting services disallowable as business entertaining - ss 34 and 45 ITTOIA 2005

FIRST-TIER TRIBUNAL
TAX CHAMBER

MERLIN SCIENTIFIC LLP **Appellant**

- and -

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

TRIBUNAL: JUDGE TIMOTHY HERRINGTON
MICHAEL BELL ACA CTA

Sitting in public at the Royal Courts of Justice, London WC2 on 29 and 30 April 2015

Kieron Beal QC and William Frain-Bell, Counsel, instructed by ARIG LLP, for the Appellant

Martin Priest, Presenting Officer, for the Respondents

DECISION

Introduction

1. The Appellant ("MSL") has two separate appeals against the following decisions of the Respondents ("HMRC") :

(1) A VAT assessment raised by HMRC on 22 March 2010 in the sum of £128,317 in respect of periods between 1 March 2006 and 30 September 2008 and HMRC's direction to MSL to amend its VAT return for the period 12/08. The basis for this decision was HMRC's finding that certain expenses in relation to corporate meeting costs were incurred in the provision by MSL of business entertainment and a proportion of the input tax referable to those costs was accordingly irrecoverable; and

(2) The decision taken on 28 June 2012 to close the enquiry into MSL's partnership self-assessment for the year 2006/2007 by making amendments to the return so as to disallow those same expenses as deductions in the computation of profits for income tax purposes.

2. Although HMRC's decisions are entirely separate, involving different taxes with slightly differently worded applicable legislation, HMRC in its income tax decision determined that its treatment of the deductibility of the corporate meeting costs in question should follow the VAT treatment determined by its indirect tax colleagues. Accordingly the parties agreed that the findings in the VAT appeal would also be determinative of the income tax appeal. Therefore this decision deals in substance solely with the VAT appeal, the decision on which also, as shown at the end of this decision, leads to the same decision on the income tax appeal.

3. The dispute which is the subject of these appeals can be summarised as follows:

(1) HMRC contends that sums payable by MSL to Glebe Corporate LLP ("Glebe Corporate") in respect of charges made by Glebe Corporate to MSL for the provision of meeting facilities at a property situated in the Cotswolds called Glebe House in fact predominantly related to the provision by MSL of business entertainment free of charge to MSL's clients and their contacts. Accordingly, the relevant proportion of the overall supply detailed in the relevant invoices should be excluded from credit for input tax pursuant to the provisions of Article 5 of the Value Added Tax (Input Tax) Order 1992.

(2) MSL contends that HMRC have fundamentally misunderstood the relevant contractual arrangements and the correct position is as follows:

(a) MSL, which provides consultancy services by making available the services of Sir Christopher Evans to its associated company Merlin Biosciences Limited ("MBL"), is requested by MBL to procure the provision of meeting facilities at Glebe House at which the consultancy services will be provided;

(b) MSL obtains those services from Glebe Corporate, which operates the facilities at Glebe House, and pays Glebe Corporate for those services, including the relevant VAT at the standard rate. It is the input tax on these invoices which is in dispute;

(c) MSL makes an onward supply of those services to MBL, as an ancillary supply to its consultancy services. In other words, MSL provides to MBL a composite supply of services consisting of a predominant supply of consultancy services and an ancillary supply of corporate meeting facilities, which may include a minimal amount of business entertaining;

(d) MSL pays the totality of MSL's invoices in respect of the services described at (c) above, including VAT at the standard rate. Therefore, in so far as such payment includes an amount for business entertaining it is clear that the services concerned are not provided free of charge;

(e) Consequently if there is a provision of business entertainment free of charge it is supplied by MBL, the services concerned being consumed by its clients and contacts who attend the meetings at Glebe House. Therefore, if there is to be any disallowance of input tax it should be pursued by HMRC at the MBL level.

Alternatively, MSL says, if, contrary to these contentions, there is a supply of business entertainment by MSL it is minimal and HMRC's decision that two thirds of the relevant input tax be disallowed cannot be sustained.

Evidence

4. The Tribunal was provided with the correspondence between the parties on the dispute and copies of the relevant invoices. We also saw the consultancy agreement entered into between MSL and MBL for the provision of consultancy services ("the Consultancy Agreement"). We were also provided with a short statement of agreed facts.

5. Sir Christopher Evans ("Sir Chris") provided a witness statement and gave oral evidence. We found Sir Chris to be a straightforward and reliable witness. Mr Priest did not in fact challenge Sir Chris's evidence in any material respect and we have no hesitation in accepting his evidence.

6. Michelle Hawes ("Officer Hawes"), who conducted the assurance audit into MSL which gave rise to HMRC's decision on the VAT dispute, provided a witness statement and gave oral evidence. We found Officer Hawes at times to be confused in her evidence, particularly as to the basis on which she had made the apportionment between business entertainment and other charges, and inflexible in her approach when challenged. She failed to demonstrate an open mind which led her to maintain her position in the face of what we have found to be clear evidence which undermines her decisions.

Findings of Fact

7. From the documents submitted and the oral evidence we make the following findings of fact.

8. At the relevant time MBL, which has now changed its name to Excalibur Fund Managers Limited, was an international fund management and corporate finance business specialising in the medical services sector. Through three venture capital funds MBL at the relevant time managed assets in excess of £500 million for the benefit of over 175 investors, in the process creating over £3 billion worth of medical bioscience companies in the UK and the rest of Europe.

9. In order to make a success of its business MBL needs to attract substantial investors to its funds and to have a good track record in identifying and choosing companies to invest in which are ultimately successful in providing value for the funds through the chosen exit strategy, such as an AIM or other stock market listing or a trade sale. Conversely, many of these potential investee companies will seek to market themselves, either directly or indirectly through their corporate finance advisers, to MBL in the hope that the funds will make an investment.

10. Negotiations between significant investors and potential investee companies can be long and protracted and need to be carried out in the right atmosphere to be successful.

11. The success of MBL is in no small degree due to the personal involvement of Sir Chris. In relation to MBL, Sir Chris was at the relevant time its non-executive chairman. He is a well-known and highly successful biotechnology entrepreneur, combining deep scientific expertise with highly developed business skills. His services are much in demand from those involved in the medical sciences sector.

12. As non-executive chairman of MBL Sir Chris carries out the usual ambassadorial role of a well-known and well connected chairman as well as leading MBL's Board. He does not get involved in MBL's day-to-day business or play any direct part in its investment decisions, but he may help where there are difficult issues with investors. He does not have any carried interest in MBL's investments in the way that its executives will.

13. Sir Chris has another quite distinct role in relation to MBL's business. His services are made available to MBL as its principal outside consultant, through the terms of the Consultancy Agreement. MSL, the other party to the Consultancy Agreement, is a limited liability partnership whose main business is the provision of consultancy services, specifically the services of Sir Chris. The two members of MSL are Sir Chris and Merlin Consulting Limited.

14. Sir Chris's services are vitally important to MBL. He has a complete knowledge and grasp of MBL's entire scientific company portfolio.

15. The Consultancy Agreement is dated 1 March 2007 and therefore post-dates the start of the period we are concerned with, but as the first recital of the agreement states that it operates to confirm the basis on which the services are provided we assume that the terms were not materially different for the period from 1 March 2006 to 1 March 2007. We saw copies of similar contracts between MSL and its other two clients to whom it provided services in the relevant period.

16. The services to be provided pursuant to the Consultancy Agreement include the following:

> "…advisory and complementary services to [MBL and its group companies] on an international basis"
>
> And
>
> "assistance to [MBL] with investors and prospective investors, analysts and key financial opinion leaders in relation to [MBL and its group companies] as a whole and to the extent requested from time to time, the Merlin Funds"

17. MSL has agreed pursuant to Clause 2.1 of the Consultancy Agreement to make Sir Chris available to perform these services, although it is clear from Clause 5.1 that MSL has its own separate obligation to provide all the services as well as to procure that Sir Chris provides them.

18. Clause 3.1 of the Consultancy Agreement deals with fees as follows:

> "In consideration of the Services hereunder the Company shall pay to the Consultancy a fee equivalent to £4,000 per diem for every day, or part thereof, during the period of the Consultancy. The Agreement is subject to a minimum payment to the Consultancy by the Company of £50,000 per month for an 18 month period commencing 1st March 2007. The Company shall reimburse the Consultancy, within seven days of the invoice, all reasonable travelling, accommodation and entertaining expenses incurred by it (including, for the avoidance of doubt, such expenses as the Consultancy reimburses to the Consultant) in or about the performance of the Services under this Agreement on production by the Consultancy of receipts or other evidence reasonably satisfactory to the Company of such expenses. The Company may at its sole discretion pay any additional performance related fee in respect of any project or service year or other period."

19. As can be seen from this provision, it was open to MSL to charge as disbursements certain expenses it incurred in providing the Services but, as we shall see, it did not in practice charge disbursements separately. All of the monthly invoices we have seen show MSL charging MBL the minimum monthly payment of £50,000 (plus VAT) and the description in the invoice of the services provided is simply as follows:

> "for consulting services provided during the [relevant month] under the agreement between [MBL] and [MSL]…"

20. Glebe House, situated in the Cotswolds, is the home of Sir Chris and his wife ("Lady Evans"). It is owned by Lady Evans. It is, however, much more than a family home. It is set within extensive grounds and has first class meeting facilities. It was conceived as a facility by Sir Chris and Lady Evans as a means of enabling Sir Chris to meet people in a private, secluded and calm environment where Sir Chris could transact business and, in particular, perform his role as a consultant pursuant to the Consultancy Agreement. Meeting facilities range from the traditional board room set up to an isolated summer house. All technological and presenting aids are available, including state of the art TV screens.

21. Sir Chris explained that Glebe House was designed as an exclusive conference and meetings complex. It clearly has extensive leisure facilities attached, as is often the case with a top quality spa hotel offering conference facilities and such facilities would be used when Sir Chris entertained his business contacts. He explained, and we accept, that this activity was entirely separate to his business activities and was treated as a personal rather than a business expense.

22. Many of the individuals that Sir Chris meets and transacts business with are very busy individuals in senior positions in their respective organisations. Sir Chris's business life is meticulously planned and extremely busy. We saw examples of his daily schedules and they are packed with commitments with limited time allotted to each meeting. Sir Chris divides his time spent on business between MBL's offices in London and Glebe House. He finds the facilities and surroundings at Glebe House highly conducive to complex discussions and well judged decisions. The environment enables meetings to be less rushed; attendees are less able to dash off to the next meeting leaving matters unfinished as they are in London.

23. Thus many of the discussions in which Sir Chris participates in his role as consultant to MBL involve senior figures representing potential investors or investee companies as well as MBL executives, as described in paragraph 9 above, and take place at Glebe House.

24. The facilities at Glebe House are operated by a separate entity, Glebe Corporate, a limited liability partnership which is controlled by Lady Evans.

25. Glebe's sole business is the provision of corporate meeting facilities at Glebe House and its sole client is MSL.

26. We have seen the invoices that were issued by Glebe Corporate to MSL in respect of the period between 1 April 2006 and 31 March 2007. The amount on each invoice is a round sum, the figures ranging from £23,500 to £42,000 per invoice, plus VAT at the standard rate. The narrative on each invoice as to the services provided is in identical terms as follows:

> "For meetings, teas, coffees, lunches, breakfasts, dinners, food and wine, overnight accommodation, use of facilities, vehicles, rifles and shotguns, cartridges, fishing rods, gear, mountain bikes, horses and tack, clothing, laundry, petrol, use of gym, snooker room and bar, meeting rooms, estate office for emails, faxing, copying typing, arranging appointments, general secretarial support, cleaning to support clients."

Each invoice then lists under the heading "Clients" the name of each attendee at the meetings in respect of which the facilities were made available during the relevant month. Some of the names are those of individuals and some are of corporations.

27. The impression therefore given by the list of items is that what is being provided by Glebe Corporate to MSL is predominantly a supply of leisure facilities and hospitality; obviously business related facilities such as meeting rooms and secretarial support appear to be ancillary if the invoice is taken at face value.

28. Taken together with MSL's own invoices to MBL, which make no separate reference to the provision of corporate meeting facilities and refer simply to the provision of consultancy services to MBL, it appears at first sight that the characterisation of the arrangements is that MSL makes the facilities available to the attendees in the course of providing its consultancy services to MBL and does not charge MBL or anyone else for them separately, the costs being absorbed by MSL as a cost component of its consultancy services. This would be analogous to a law firm advising its clients at its rented offices not making any separate charge for its meeting facilities, the rent and other property costs the firm incurs being a cost component of the legal advice it charges for. This is the characterisation that Mr Priest contends is the correct position in the current case.

29. The alternative characterisation is that MBL makes a composite supply to MBL which MBL pays for, namely a supply of consultancy services with an ancillary supply of corporate meeting facilities. On this analysis Sir Chris provides his consultancy services to MBL in surroundings that are conducive to the success of the meetings concerned, whether the outcome sought be to procure new investors or suitable new investments for MBL's funds. This is the analysis for which Mr Beal contends. Before dealing with these competing positions we turn to the correspondence between the parties on the issue.

30. HMRC decided to carry out a general assurance audit check on MSL following receipt of MSL's VAT return for the period 12/08. This visit was conducted by Officer Hawes at the offices of Calder & Co, MSL's accountants, in London on 24 February 2009.

31. As part of her checks Officer Hawes examined the invoices issued by Glebe corporate to MSL and took the view that the services featured on these invoices constituted business entertainment provided to persons who were not MSL's employees and as they appeared to have been provided for free they met the criteria for blocking of the input tax as business entertainment. Officer Hawes took the view that the services were not provided to MSL's own clients as it only had three clients at the time, including MSL, and the names disclosed included persons not connected with those three clients. Officer Hawes wrote to Calder & Co on 25 February 2009 with these conclusions, asking for further information so that she could carry out an apportionment of the sums on the invoices referable to business entertainment.

32. Calder & Co responded on 1 April 2009, explaining that the meetings referred to on the invoices were business meetings involving Sir Chris and MBL and its clients and contacts. Calder & Co did not explain the underlying contractual arrangements or emphasise that the services were paid for by MBL and consequently not provided by MSL free of charge. It also suggested an apportionment on the basis that 2.5% of the overall costs should be disallowed, on the basis that any entertainment provided was small in the overall context. This approach was inconsistent with the position that all the services were paid for by MBL as part of the consultancy and ancillary services provided by MSL to MBL, but we were told, and accept, that the offer was made in order to dispose of the matter swiftly.

33. It is easy to see why at this stage, faced with invoices which on their face appeared to relate predominantly to business entertainment provided to people other than MSL's clients, a less than comprehensive explanation by Calder & Co and an offer of apportionment which might suggest an acceptance of the fact that some free entertainment was provided, Officer Hawes continued to take the view that her initial view of the arrangements was correct. Accordingly, on 16 April 2009 Officer Hawes wrote to Calder & Co stating that 33% of the relevant input tax should be allowed, but she did not explain the basis of this apportionment.

34. In its reply of 14 May 2009, however, Calder & Co did set out clearly what it contended were two separate steps in the supply of the services provided by Glebe Corporate, namely a supply by Glebe Corporate to MSL with an onward supply to MBL. Therefore they contended that there should be no restriction whatsoever with regard to the input tax claimed. Calder & Co referred to the case of *Webster Communications International Limited v C & E Comrs (1997),* discussed in detail

below, in support of its analysis but nevertheless reiterated its offer to settle for an apportionment along the lines set out in its letter of 1 April 2009.

35. Officer Hawes, responding in a letter on 27 May 2009, did not engage with the point on the two stage process that Calder & Co made, reiterating that in her view entertainment was provided to persons who were not clients of MSL. She said she did not consider an apportionment based on time spent on the activities listed on the invoices to be reasonable as MSL was invoiced for the full range of activities, whether used or not, and on that basis she considered an apportionment of 33% to be reasonable and reflective of the services and activities invoiced.

36. Calder & Co spelt out their arguments in greater detail in a further letter on 11 June 2009, making the point that it would only be the companies to which MSL supplied the services that may have an apportionment to make in respect of the services supplied to them. Calder & Co also explained the presence of people at the meeting who were not clients of MSL and reiterated the fairness of its own suggestion as to how an apportionment may be made.

37. There was further inconclusive correspondence on the matter. In her letter of 12 August 2009 Officer Hawes closed her mind to the possibility of investigating the onward supply issue on the basis that she was only conducting an audit of MSL's supplies and reiterated her view that supplies of disallowable entertainment services were made to persons present at the meetings who were not clients of MSL. Again, Officer Hawes did not engage with Calder & Co's contention that Glebe Corporate's charges were passed on in a composite supply of services and paid for.

38. Officer Hawes was subsequently provided with a copy of the Consultancy Agreement. Her decision was made in her letter of 22 March 2010. She maintained her position that MSL was providing entertainment services to those present at the meetings and accordingly allowed one third of the VAT charged by Glebe Corporate as input tax with the remainder being assessed as entertainment. The relevant assessment was contained in a separate letter. Calder & Co asked for a review of the decision. Officer Hawes' decision was upheld on the review.

39. Following MSL having appealed to the Tribunal, Calder & Co made further representations on the matter which were rejected by Officer Hawes. In the further correspondence that followed Officer Hawes explained the basis of her assessment as follows:

> "My assessment was raised based upon allowing the recovery of 33.34% of the total input tax previously claimed on the Glebe Corp LLP purchase invoices. This allowance factored in the attendance at the meetings by Sir Christopher Evans and his three clients and any probable recharging on of the services received to these clients. The clients as evidenced by sales invoices raised were Merlin Biosciences Limited, Celsis Intl Ltd and Decon Sciences Ltd, and as well as DERMS Development and Lab 21 which were prior to the three years assessed."

40. It is unclear to us how this approach led Officer Hawes to conclude that a recovery of one third of the input tax concerned was appropriate. She was cross-examined as to the basis of her decision to make an apportionment of this amount but was unable definitively to explain it to us; she suggested that it may have been on the basis that MSL had three clients at the relevant time, but there were on average

representatives of ten firms disclosed as having been present at the meetings covered by each invoice.

41. In her final letter on the matter that we have seen, written on 22 February 2012, Officer Hawes addressed the argument that MSL was not providing business entertainment as the costs were recharged to its clients. On the basis that the invoices issued by MSL to its clients (primarily to MSL) were only for consultancy services and there was no reference on these invoices to the making of an onward supply of the facilities of Glebe House, Officer Hawes concluded that the facilities were freely provided by MSL to the attendees. Her view was that MSL chose to carry out its contract to provide consultancy services by providing facilities at Glebe House which were then used in part for a recoverable business purpose and in part to provide hospitality to the attendees.

42. The essential question of fact for us to decide is therefore whether the evidence takes us to the conclusion reached by Officer Hawes, as described in paragraph 41 above, or the alternative characterisation described in paragraph 29 above. We find that the alternative characterisation is the correct analysis for the following reasons.

43. Sir Chris was clearly wearing his consultancy hat when the meetings which are the subject of the invoices took place at Glebe House. We have described earlier how he keeps his two roles separate and we are satisfied that the meetings to which Glebe Corporate's invoices relate were connected solely with the business of MBL and its other consultancy clients and, in relation to MBL, its business of securing new investments for its funds and new investments by investors in those funds.

44. Taking MBL, the client to whom the invoices predominantly relate, as described by Sir Chris in his evidence, the initiative to use his consultancy services will come from MBL. MBL will determine that Sir Chris's services are required in a particular situation and it will then be agreed between MBL and Sir Chris whether it would be appropriate for those services to be provided at Glebe House rather than MBL's offices in London, for the reasons outlined above. The primary responsibility for concluding the business in question lies with MBL. The services of Sir Chris assist in that task but the meeting is essentially MBL's meeting; it is conducting its business at the meeting and MSL makes the facilities at Glebe House available for that purpose. This approach enables Sir Chris to provide his advice efficiently, bearing in mind his tight schedule, as previously described.

45. As we have described, the Consultancy Agreement enables MSL to provide, in addition to consultancy services, other services which are complementary to those services. In our view the facilities made available at Glebe House fall into that category and we find that they were in fact provided on that basis. We therefore reject Mr Priest's submission that there was no contractual basis for MSL to provide the facilities to MBL.

46. As far as the services themselves are concerned, the meetings concerned can last for a relatively short period, an hour or two, or for much longer periods with occasional overnight stays. Naturally, refreshments will be provided during meetings, tea, coffee and light refreshments during shorter meetings with lunch and dinner available for longer meetings. Sir Chris and MBL may judge that it would be more conducive to meet in less formal surroundings, such as in the summer house or around the pool. It is clear to us, as Sir Chris stated in his evidence, that the focus is on business activity so that any use of the leisure facilities will be purely incidental. For

example, there may be a break in proceedings for a short time which means that an attendee finds time to use the spa or gym. As we have previously indicated, if the emphasis of a particular visit is on leisure rather than business that will be because the guest is invited predominantly for pleasure rather than to transact business, rather than the reverse.

47. The question therefore arises why none of this is apparent from the invoices, and in particular why the narrative on the Glebe Corporate invoices focuses on leisure activities.

48. Sir Chris's unchallenged evidence on this point was that PWC, who advised on the arrangements between MSL and Glebe Corporate when they were first established, advised that MSL should be invoiced for all services that were provided and it should also be made clear on the invoices which clients of MBL and MSL were present when the services were provided. It therefore appears that when invoices were first created, whoever did so decided to include every conceivable facility that was available at Glebe House and the narrative was the same on each invoice, whether or not the facilities listed were actually used. As we have previously found, in practice the use of the leisure facilities and consumption of food and drink by those who attended for business meetings was not significant.

49. It is also the case that the practice of including the name of every attendee on the invoice under the generic heading "clients" also created a misleading impression. During the relevant period MSL only had three clients to whom the meeting facilities procured through Glebe Corporate were provided, namely MBL and two other companies, Lab 21 and Decon Sciences. The other persons named on the invoices were individuals associated with MBL or its business contacts, such as the potential investors in MBL funds or potential investee companies.

50. Sir Chris also explained that MSL was not billed purely on the basis of a direct recharge of costs and a profit element. Whilst each amount invoiced by Glebe Corporate would, for instance, take into account the number of meetings held and the cost of all food, drink and other materials used, the total invoiced amount would reflect the amount that MSL could comfortably afford to pay, bearing in mind the overall amount that it was charging to its own client, primarily MBL. It was agreed therefore that the fees payable to Glebe would be in the region of £10,000 to £60,000 per month, the actual amount in any particular month being fixed on a value basis, that is the amount paid was based upon how successful the outcome of the relevant meetings had been. In other words a view was taken of the value of the contribution that the Glebe facilities had made to the outcome of the relevant business negotiations. It can therefore be clearly seen how the success of MSL's contribution through Sir Chris's consultancy services was closely linked to the facilities at Glebe House and how the two services were complementary in achieving the business objective, as envisaged by the terms of the Consultancy Agreement.

51. Sir Chris fully accepted that none of this was adequately reflected in the narrative on either MSL's invoices to MBL or Glebe Corporate's invoices to MSL. He accepted that with hindsight it would have been better to have made matters more explicit, so as to include a breakdown of the services actually used rather than, as was done, providing an identical list on each occasion of those facilities that were available. Sir Chris's evidence, which we accept, was that MBL were present at all the meetings involving their contacts. Consequently, MBL were fully aware of the

true position in terms of the value basis of the invoicing so that they did not require detail of the actual facilities used from those on the list.

52. Our assessment of Officer Hawes's evidence was that she failed to understand the business context in which the facilities were made available and the key point that they were provided by MSL to MBL or one of MSL's other clients alone. Her analysis assumed that the services were provided by MSL to the attendees directly. She failed to recognise that the attendees were there at the instigation of MBL, which was the entity to whom MSL was providing its services, including the use of the facilities at Glebe House.

53. Officer Hawes continued to maintain her position at the hearing despite the clear unchallenged evidence given by Sir Chris as to how the arrangements operated, and in particular his evidence that the entertainment element of the services was very small. Her whole approach was coloured by the narrow enquiry that she chose to undertake which meant that she did not address the representations made by Calder & Co regarding the two stage supply. She maintained that MSL had been given ample opportunity to provide documentary evidence to show that the basis of her apportionment was wrong but this entirely misses the point. The whole thrust of Calder & Co's representations was that all the input tax in dispute should be allowable because the services were provided to a single entity alongside the consultancy services and were paid for.

54. Officer Hawes was, and continues to be, overly influenced by the documentation in the form of the invoices and what was written on them and did not engage with the explanations that were provided either during her correspondence with Calder & Co or at the hearing when cross- examined by Mr Beal.

55. We can therefore summarise our principal findings of fact as follows:

(1) MBL receives consultancy services from MSL, primarily through Sir Chris;

(2) Where MBL has clients, potential clients or potential investors or investee companies with whom they wish to explore business opportunities, they consider whether obtaining consultancy services from Sir Chris will assist in conducting successful negotiations with the party concerned;

(3) A discussion will take place between MBL and Sir Chris as to whether the business concerned will be better facilitated if the negotiations are carried out and Sir Chris's advice provided making use of the facilities at Glebe House;

(4) If a decision is made to use the facilities at Glebe House Sir Chris arranges for those services to be provided by Glebe Corporate to MSL;

(5) Glebe Corporate invoices MSL for its services on a value basis; that is the amount it charges is based upon how successful the outcome of the relevant meetings had been rather than a direct charging of costs. Although the invoices referred to a large number of services that could properly be regarded as business entertainment or hospitality in practice such services were not consumed to any material extent; and

(6) Although MSL's invoices for the services it supplies to MSL refer only to it supplying consultancy services to MBL, in fact the invoice covers a composite supply to MBL of consultancy services and an onward supply of the

corporate meeting facilities supplied to MSL by Glebe Corporate, consistent with the terms of the Consultancy Agreement which makes provision for the supply of advisory and complementary services by MSL to MBL.

The Law

Relevant legislation

56. There was no dispute between the parties as to the relevant legal principles to be applied in this case. Mr Beal helpfully summarised the relevant domestic law provisions implementing the relevant EU law governing input tax recovery as follows.

57. Section 25(1) of the Value Added Tax Act 1994 ("VATA") sets out the obligation imposed on taxable persons to account for and pay VAT in respect of supplies made by him for each prescribed accounting period. Section 25 also states:

> "(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.
> (3) If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then, subject to subsections (4) and (5) below, the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the Commissioners; and an amount which is due under this subsection is referred to in this Act as a 'VAT credit'.
> . . .
> (6) A deduction under subsection (2) above and payment of a VAT credit shall not be made or paid except on a claim made in such manner and at such time as may be determined by or under regulations . . .
> (7) The Treasury may by order provide, in relation to such supplies, acquisitions and importations as the order may specify, that VAT charged on them is to be excluded from any credit under this section; and—
> (a) any such provision may be framed by reference to the description of goods or services supplied or goods acquired or imported, the person by whom they are supplied, acquired or imported or to whom they are supplied, the purposes for which they are supplied, acquired or imported, or any circumstances whatsoever; and
> (b) such an order may contain provision for consequential relief from output tax."

The relevant parts of section 26 VATA read as follows:

> "(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.
> (2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business –
> (a) taxable supplies;
> . . ."

58. Article 176 of the Principal VAT Directive provides that in no circumstances shall VAT be deductible in respect of expenditure which is not strictly business expenditure "such as that on luxuries, amusements or entertainment."

59. This restriction has been implemented in UK domestic law through Article 5 of the Value Added Tax (Input Tax) Order 1992 ('the 1992 Order') which now provides as follows:

> "(1) Tax charged on any goods or services supplied to a taxable person, or on any goods acquired by a taxable person, or on any goods imported by a taxable person, is to be excluded from any credit under section 25 of the Act, where the goods or services in question are used or to be used by the taxable person for the purposes of business entertainment unless the entertainment is provided for an overseas customer of the taxable person and is of a kind and on a scale which is reasonable, having regard to all the circumstances.
>
> (2) Where, by reason of the operation of paragraph (1) above, a taxable person has claimed no input tax on . . . a supply of any services, tax shall be charged . . . on a supply by him of the services in question, as if that supply were for a consideration equal to the excess of—
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> (a) the consideration for which the services are supplied by him, over
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> (b) the consideration for which the services were supplied to him,
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> and accordingly shall not be charged unless there is such an excess.
>
> (3) For the purposes of this article, "business entertainment" means entertainment including hospitality of any kind provided by a taxable person in connection with a business carried on by him, but does not include the provision of any such entertainment for either or both—
>
> (a) employees of the taxable person;
>
> (b) if the taxable person is a body corporate, its directors or persons otherwise engaged in its management,
>
> unless the provision of entertainment for persons such as are mentioned in sub-paragraph (a) and (b) above is incidental to its provision for others."

60. We observe, as submitted by Mr Beal, that the restriction operates against the person who supplies the business entertainment in question.

61. In relation to the direct tax issue, MSL, as a limited liability partnership, is excluded from the definition of a "company" and is therefore not subject to corporation tax; see section 852 of the Income Tax (Trading and other Income) Act 2005 ("ITTOIA") and section 1237 of the Corporation Tax Act 2009. By virtue of Part 2 of ITTOIA a limited liability partnership is subject to income tax on its trading profits.

62. Section 34 ITTOIA provides as follows:

> "(1) In calculating the profits of a trade, no deduction is allowed for—
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade, or
>
> (b) losses not connected with or arising out of the trade.
>
> (2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade."

63. Section 45 ITTOIA provides as follows:

> "(1) The general rule is that no deduction is allowed in calculating the profits of a trade for expenses incurred in providing entertainment or gifts in connection with the trade.
>
> (2) A deduction for expenses which are incurred—
>
> (a) in paying sums to or on behalf of an employee of the person carrying on the trade ("the trader"), or

(b) in putting sums at the disposal of an employee of the trader,
is prohibited by the general rule if (and only if) the sums are paid, or put at the employee's disposal, exclusively for meeting expenses incurred or to be incurred by the employee in providing the entertainment or gift.

(3) The general rule is subject to exceptions—
for entertainment (see section 46), and
for gifts (see section 47).

(4) For the purposes of this section and those two sections—

(a) "employee", in relation to a company, includes a director of the company and a person engaged in the management of the company,

(b) "entertainment" includes hospitality of any kind, and

(c) the expenses incurred in providing entertainment or a gift include expenses incurred in providing anything incidental to the provision of entertainment or a gift."

64. Section 46 ITTOIA provides as follows:

"(1) The prohibition in section 45 on deducting expenses incurred in providing entertainment does not apply in either of cases A and B.

(2) Case A is where—

(a) the entertainment is of a kind which it is the trader's trade to provide, and

(b) the entertainment is provided in the ordinary course of the trade either for payment or free of charge in order to advertise to the public generally.

(3) Case B is where the entertainment is provided for employees of the trader unless—

(a) the entertainment is also provided for others, and

(b) the provision of the entertainment for the employees is incidental to its provision for the others."

The Authorities

65. The well-known case of *Card Protection Plan v C & E Comrs* [1999] ECR I - 973 deals with the test to be applied in deciding whether a transaction consists for VAT purposes of a single composite supply or of two or more independent supplies. Paragraphs 29 to 31 of the judgment so far as relevant provide:

> "29. In this respect, taking into account, first, that it follows from Article 2 (1) of the Sixth Directive that every supply of service must normally be regarded as distinct and independent and, second, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of the transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service.
>
> 30. There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied…
>
> 31. In those circumstances the fact that a single price is charged is not decisive. Admittedly, if the service provided to customers consists of several elements for a single price, the single price may suggest there is a single service…."

66. We observe from this judgment, as submitted by Mr Beal, that if there is a single supply of a principal service and an ancillary service there is no need to state that to be the case or separate out the ancillary service.

67. The authorities demonstrate that for a service to constitute "entertainment" for the purposes of what is now Article 5 of the 1992 Order it must be provided free of charge to the recipient: see *Celtic Football and Athletic Co Ltd v C & E Comrs* [1983] STC 470, a decision of the Inner House of the Court of Session. This case concerned a situation where the home club was obliged to pay for its visiting opponent's board and lodgings as well as the travelling and accommodation expenses of the match officials. It was held that since Celtic's visiting opponents had reciprocal obligations under UEFA's rules to meet Celtic's accommodation expenses when they played "away" matches the entertainment was not free to them.

68. This case was followed in *BMW (GB) Ltd v HMRC* [1997] STC 824 where Keene J at page 830 f to g explained the mischief with which Article 5 of the 1992 Order was intended to deal as follows:

> "Where a person receives food, drink or similar benefits without making any payment for them, he by definition pays no VAT for that supply to him. If the person providing those facilities is entitled to credit for the input tax he has paid on them, the end result is that he does not pay VAT on them either. I accept the commissioners' argument that art 5 of the 1992 order is intended to prevent that situation arising, which it does by classifying the provision that is free to the recipient as "business entertainment".
>
> I conclude therefore that the crucial characteristic of "entertainment" within the phrase "business entertainment" is that it is provided free of charge. On that basis alone the tribunal below was entitled to arrive at the conclusion which it reached."

69. HMRC's own guidance in VAT Notice 700/65 confirms that one of the conditions to be met for entertainment to be considered "business entertainment" is that it is provided free.

70. It is not necessary to itemise separately the services being provided; it is sufficient that there is a composite supply of services which are paid for: see *Webster Communications International Ltd v HMRC* [1997] V & DR 173. Mr Beal submits that the circumstances of the supplies in question in that case were analogous to the situation in this case. Webster organised conferences which took place at hotels and paid for the hotel facilities. Sponsors of a conference pay a fee to Webster in return for which they may address the conference and nominate persons to attend the conferences free of charge. The conference programmes include the provision of meals and refreshments to those attending. The question for determination was whether VAT charged on the invoices delivered by the hotels to Webster was excluded from credit for input tax on the ground that the supplies made by the hotels were used by Webster for the purpose of business entertainment.

71. The Tribunal observed at paragraph 22 of its decision that Articles 5(1) and (3) of the 1992 Order had the effect of excluding from input tax credit "tax charged on any goods or services supplied to a taxable person…where the goods or services in question are used or to be used by the taxable person for the purpose of "business entertainment" which means "entertainment including hospitality of any kind provided by a taxable person in connection with a business carried on by him".

72. The Tribunal also observed that the exclusion from credit does not apply to "supplies" of business entertainment but only applies to the person "providing" the business entertainment: see paragraph 23 of the decision. It therefore decided the issue as follows in paragraphs 24 and 25 of the decision:

> "24. It is therefore necessary to ask who, in the present appeal, "provided" the meals and refreshments consumed during the conferences? Who paid for them and whose guests consumed them free of charge? On the evidence before us we find that the meals and refreshments were "provided" by the sponsors. The sponsors paid sums to the Appellant which covered the total cost of the conferences together with a profit for the Appellant. It was the guests of the sponsors who consumed the meals and refreshments free of charge. The hotels supplied the meals and the refreshments and other facilities to the Appellants who made an onward supply of those services, together with their own services to the sponsors. We accept that each invoice sent by the Appellant to the sponsors showed one fee only and did not show separately the charge for the meals and refreshments supplied to the delegates at the conference. However, there was no obligation on the Appellant to show anything other than the total fee. None of the other cost components of the Appellant's fee was shown separately. Also, the Appellant's fee to each sponsor was agreed in advance of the conference, before the delegates were invited, and it would probably not have been possible for the Appellant to have identified at that stage a separate cost for the meals and refreshments supplied to the guests of each sponsor.
>
> 25. We conclude that the only supply made by the Appellant was a supply to the sponsors of conference arrangements, which included meals and refreshments among other things. As, therefore, the meals and refreshments were not "provided" by the Appellant the input tax on their supply is not excluded by the Orders."

73. It is also important to bear in mind that in accordance with the principle of fiscal neutrality, a supplier of services is entitled to deduct input tax incurred in the course of its taxable services in full. This is illustrated by the ECJ's judgment in *Ampafrance SA v Directeur des Services Fiscaux de Maine-et- Loire* [2000] ECR I-7013, where the taxpayer challenged the decision of the taxing authority to disallow the right to deduct input tax referable to expenditure on accommodation, food, hospitality and entertainment provided by the taxpayer in the course of its commercial activities.

74. The court set out the relevant principle at paragraph 34 of its judgment as follows:

> "It should be pointed out that, according to the fundamental principle which underlies the VAT system, and which follows from Article 2 of the first and sixth Directives, VAT applies to each transaction by way of production or distribution after deduction has been made of VAT which has been levied directly on transactions relating to inputs…It is settled case- law that the right of deduction provided in Article 17 et seq. is an integral part of the VAT scheme and in principle may not be limited. That right must be exercised immediately in respect of all the taxes charged on transactions relating to inputs…Any limitation on the right of deduction affects the level of the tax burden and must be applied in a similar manner in all the Member States. Consequently, derogations are permitted only in the cases provided for in the directive…

75. Consequently, the ECJ held at paragraph 57 of its judgment that the right to deduct the VAT charged on the expenditure in question could not be denied in the following terms:

> "It follows that the application of the system of exclusion of the right of deduction…may have the effect that undertakings are unable to deduct the VAT charged on business expenditure which they have incurred and that VAT is thus charged on certain forms of intermediate consumption, contrary to the principle of the right to deduct VAT, which ensures the neutrality of that tax."

76. This does not prevent the taxing authority imposing "sticking tax" on the end consumer where he is the recipient of services provided free of charge through a restriction on the recovery of input tax or the raising of an assessment for output tax. This is illustrated by the ECJ's judgment in *Enkler v Finanzamt Homburg* [1996] ECR I-4517 where it held at paragraph 33:

> "Second, in order to prevent a taxable person who has been able to deduct VAT on the purchase of goods used for his business from escaping payment of VAT when he takes those goods away from his business for private purposes and from thereby enjoying undue advantages over the ordinary consumer who buys the goods and pays VAT on them, Article 6(2) of the Sixth Directive provides that "the use of the goods forming part of the assets of a business for the private use of the taxable person or his staff or more generally for purposes other than those of his business where the value added tax on such goods is wholly or partly deductible" is to be treated as a supply of services for consideration…"

77. It is clear that if any part of a supply must be excluded from input tax credit on the grounds that it relates to business entertainment that there can be an apportionment between those services qualifying for a credit and those that do not. This follows from the Court of Appeal's judgment in *Thorn EMI plc v HMRC* [1995] STC 674 where Millett LJ held at page 679 d and g:

> " If an indivisible supply is made of goods or services which are used or to be used partly for business and partly for non-business purposes, the input tax is apportionable and credit given for that part which reflects the business use. It is impossible to believe that Parliament intended to treat the supply of goods or services used or to be used for business entertainment less favourably than the supply of goods or services used or to be used for non-business purposes. I find that consideration compelling.
>
> …
>
> The exclusion of all credit for input tax in the present case would deny the company the basic right of deduction guaranteed by Art 17(2) and (3) of the sixth directive and would go beyond anything permitted in the second sentence of Art 17(6)…"

Issues to be determined

78. We take from the analysis of the authorities set out above that the issues we need to determine on this appeal are as follows:

(1) Was there a supply of business entertainment?

(2) If so, who provided it?

(3) Did the supplier of the business entertainment provide it free of charge?

(4) If the answers to the first three questions above lead to the conclusion that MSL provided business entertainment free of charge what proportion of the input tax shown on the invoices from Glebe corporate to MSL should be disallowed?

Mr Priest accepts that these are the findings that the Tribunal needs to make on this appeal.

Discussion

79. Mr Priest submitted that the evidence shows that the only services that MSL provided to MBL were consultancy services. He relies on the terms of the Consultancy Agreement, which anticipated that ancillary matters such as accommodation and meals would be charged as disbursements rather than as a supply of services, and the invoices issued by MSL which narrated that the only services provided by MSL were consultancy services. Mr Priest distinguishes *Webster* on the facts; he submits that the taxpayer in that case was in the business of staging conferences, unlike MSL whose sole business was the provision of consultancy services.

80. Mr Priest's analysis was that in reality MSL used the facilities of Glebe House in the course of its business activity of providing consultancy services and therefore these facilities were a cost component of its supply of consultancy services, rather than an onward supply of the facilities made available by Glebe Corporate to MSL.

81. Therefore, Mr Priest submits, MSL makes the facilities of Glebe House directly available to the attendees of the meetings held there. Those people have the use and enjoyment of those facilities free of charge, so that the provision of those facilities above and beyond the use of the venue for business meetings is the provision of business entertainment by MSL.

82. Consequently, he submits, HMRC were entitled to disallow a proportion of the input tax on the Glebe Corporate invoices and it had exercised best judgment in allowing MSL to reclaim one third of the VAT on the Glebe Corporate invoices as its input tax.

83. We have no doubt that the evidence as a whole, and in particular Sir Chris's evidence which was not challenged to any material respect, does not support Mr Priest's analysis.

84. We have found as a matter of fact that the services supplied by MSL to MBL, consistent with the terms of the Consultancy Agreement and Sir Chris's evidence as to how the arrangements operated, was a composite supply of services. In our view, following the reasoning in *Card Protection Plan* this single, composite supply consisted of a principal supply of consultancy services and an ancillary supply of corporate meeting services, which facilitate the supply of the consultancy services. We accept Mr Beal's submission that no separate charge for the ancillary services needs to be specified on MSL's invoices as there is a composite supply for a single price, MSL having chosen to treat the onward supply of corporate meeting services as ancillary to the principal supply of consultancy services. It was open to MSL to provide its services in this way and it was not obliged to treat the ancillary services as a disbursement. In any event, the language in the consultancy agreement regarding disbursements, as quoted in paragraph 18 above, is more apposite to cover the situation where the consultant, Sir Chris in this case, travels to provide his services. This provision would, for instance, cover his expenses where he travelled to London to provide his services at MBL's offices, which, as we have found, did happen from time to time.

85. Those findings lead to the inevitable conclusion that in so far as any of the supplies constituted the supply of business entertainment they were not provided free of charge. They were provided by MSL to MBL and MBL paid for them by settling MSL's invoices. We therefore accept Mr Beal's submission that the situation is analogous to that in *Webster*. As found in *Webste*r, the key issue is who is the provider of the services in question and in this case the services were provided by Glebe Corporate to MSL who made an onward supply of those services to MBL along with the provision of its consultancy services. This is on all fours with the position in *Webster* as analysed in paragraphs 24 and 25 of the decision, as set out in paragraph 72 above. As was also found in *Webster*, there was no obligation for MSL to show anything on its invoices except the single charge for the composite supply of services made. And, as we have found, invoicing was carried out on a value basis so it was not possible to identify a separate cost for the facilities that were provided. On the basis of this analysis, in accordance with the principle of fiscal neutrality, MSL must be entitled to deduct the input tax incurred in the course of its taxable transactions involving the provision of a composite service, taxable at the standard rate, in full.

86. It is clear that those attending the meetings at Glebe House, in particular the clients and other contacts of MBL, do receive the use of the facilities free of charge and those facilities detailed on the invoices which constitute the provision of food and drink and leisure facilities, such as shooting and fishing facilities and the use of the gym and snooker room, are to be regarded as business entertainment covered by Article 5 of the 1992 Order. However, the consequence of our finding that the services are provided by MSL to MBL means that any supply of business entertainment free of charge would be by MBL to its clients and contacts. Therefore, MBL may be subject to a restriction as to the input tax it may obtain credit in respect of its own supplies. There can be no restriction on the input tax claimed by MSL as it is not the final consumer of the services in question. As Mr Beal submitted, consistent with the reasoning in *Enkler*, referred to in paragraph 76 above, the principle of fiscal neutrality can be preserved by HMRC imposing "sticking tax" on MBL in this way.

87. If Mr Priest were correct in his submissions, on his analysis the position would be that the provision of the facilities at Glebe House would be a cost component of the consultancy services that MSL provides and MSL would therefore be entitled to deduct all of the input tax as an overhead of its business, save for any blocking for business entertainment required pursuant to Article 5 of the 1992 Order.

88. As we have found, despite the impression that might have been given by the narrative on Glebe Corporate's invoices, the use of the leisure facilities and provision of meals etc was minimal in the context of the overall supply of services. That supply was primarily the provision of the meeting facilities for business purposes, the costs of which were fully deductible. On that basis, we cannot see how an allowable proportion of one third can be justified and in our view Officer Hawes put forward no rational basis to justify it. Neither did Mr Priest seek to defend the reasoning for it. On this point, Officer Hawes did not engage with Calder & Co's representations. She was misguided in her view that she required further documentary evidence to enable her to reconsider her view. On the basis of the evidence before us, had it been necessary to undertake an apportionment, it is clear to us that all but a small proportion of the input tax should have been credited. We hesitate to suggest a particular figure as this is not an issue which, because of our earlier findings, we need to determine but in our view the disallowable proportion should not have exceeded 5%.

Conclusion

89. It follows from our findings in paragraphs 83 to 87 above that we answer the first three questions posed in paragraph 78 above as follows:

(1) There was a supply of business entertainment, but of a minimal amount;

(2) MSL provided that business entertainment to MBL as part of the onward supply of the facilities made available to MSL by Glebe Corporate; and

(3) MBL paid for that business entertainment by settling MSL's invoices which included sums in respect of the onward supply of the meeting facilities and accordingly it was not provided by MSL free of charge.

These answers are equally applicable to the services provided by MSL to its other two clients during the relevant period.

90. Accordingly, for the reasons we have given, MSL should be given full credit for the input tax on the Glebe Corporate invoices and the VAT assessments which are the subject of MSL's appeal on this issue must be discharged.

91. Consequently, as it has been agreed that the direct tax treatment of the corporate meeting expenses will follow the VAT treatment, these expenses are allowable in full as they have been wholly and exclusively incurred for the purposes of MSL's trade for the year 2006/7.

Disposition

92. Both the appeals are allowed.

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

TIMOTHY HERRINGTON
TRIBUNAL JUDGE

RELEASE DATE: 4 June 2015