TC06050

Tribunal refs: LON/2006/0603
TC/2015/04342

VALUE ADDED TAX — loyalty scheme — participating customers who have "earned" points by reference to the value of their purchases in retail shops periodically receiving vouchers reflecting nominal value of points so "earned" — appellants converting vouchers to tokens with a greater face value — supplies to customers by third parties in exchange for tokens — payment made to third parties by appellants — whether appellants entitled to recover input tax charged by third parties — yes — appeals allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) TESCO FREETIME LIMITED
(2) TESCO PLC **Appellants**

- and -

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

Tribunal: Judge Colin Bishopp

Sitting in public in London on 17 to 20 October 2016, with subsequent written submissions

Mr Jonathan Peacock QC and Miss Hui Ling McCarthy, counsel, instructed by Freshfields Bruckhaus Deringer LLP, for the appellants

Ms Alison Foster QC, Mr Andrew Macnab and Mr Ewan West, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the respondents

DECISION

Introduction

1. These appeals relate to the proper treatment, for VAT purposes, of one feature of the well-known loyalty scheme operated by the Tesco group of companies, the Tesco Clubcard programme. In its simplest and original form, a member of the programme ("a Clubcard Member") who buys goods in a Tesco retail shop and presents his or her membership card when paying is credited with a number of points, commensurate with the scale of his or her purchase. Goods so purchased, at their full retail price and paid for in cash or by credit or debit card, are sometimes referred to as "premium goods". At three-monthly intervals the points acquired in this way are translated into vouchers which can be used against the cost of a subsequent purchase from Tesco. Goods bought in exchange in whole or part for vouchers are sometimes known as "redemption goods". The scheme has expanded over the years and, in particular, points may be accumulated by a customer who makes purchases from Tesco online, and the vouchers may likewise be redeemed online. In addition, points may be collected on purchases from other retailers and service suppliers, known as Clubcard Partners; with one minor variant, to which I shall come, they are redeemed in the same way.

2. In 1999 the feature of the scheme with which I am concerned in this appeal was introduced. The option of using the vouchers to make a purchase from a Tesco store or online continued, but a Clubcard Member could instead have the vouchers converted to Reward Tokens which he or she could then use to make a purchase from a third party, known variously as a Redeemer, a Freetime Partner or (the term I shall use) a Deal Partner. Because the Reward Tokens have a greater face value than the vouchers for which they are exchanged this feature of the scheme is known as Partner Boost. The question in this appeal is whether the company which contracts with the Deal Partners and pays them the agreed charges for the provision of goods or services in exchange for Reward Tokens is entitled to recover, as input tax, the VAT included in those charges.

3. The overall Clubcard programme has always been operated by Tesco Stores Limited ("Stores"), the principal retail member of the Tesco plc group, but the Partner Boost arrangements have been administered by another company. Initially that company was at arm's length to the Tesco group, but in February 2002 the first appellant, Tesco Freetime Limited ("Freetime"), a group company, replaced the third party and it has been dealing with Partner Boost ever since. For part of the period with which I am concerned Freetime was separately registered for VAT, and for another part it was a member of the Tesco plc VAT group; it is for that reason alone that Tesco plc is the second appellant. The parties agree that the VAT grouping makes no difference to the analysis and for simplicity I shall assume in what follows that it is the eligibility of Freetime, throughout, rather than of Tesco plc to recover the input tax which is in issue.

4. The supplies with which I am concerned were made in the period from 1 September 2002 to 25 February 2017. Formally, the appeals are against five assessments by which the respondents, HMRC, seek to recover input tax for which the appellants have claimed credit, amounting in all to about £63 million, and six decisions by which HMRC have refused to allow the appellants' claims for further input tax credit of about £103 million. The detail of the assessments and the decisions is immaterial for present purposes.

5. Before me, Freetime was represented by Mr Jonathan Peacock QC, leading Miss Hui Ling McCarthy, and HMRC by Ms Alison Foster QC, leading Mr Andrew Macnab and Mr Ewan West. I was provided with an agreed statement of facts, supplemented by two statements and the brief oral evidence of Mr Rob Graham, a director of Freetime and a senior manager in the Tesco group, with responsibility at the relevant time for the Partner Boost programme. His evidence was primarily explanatory, but he gave oral evidence in order to deal with one matter which had been thought to be controversial, and to which I shall come. With that exception the facts which are relevant to the issue I must decide are uncomplicated and can be fairly briefly summarised. What follows in the next section of this decision represents my findings of fact.

The facts

6. Both Stores and Freetime are wholly-owned subsidiaries of Tesco Holdings Ltd, which is in turn a wholly-owned subsidiary of Tesco plc, the ultimate holding company of the group. Stores has been in existence for many years, but Freetime was incorporated only in 2001. Other group companies which played a part in the Clubcard scheme were Tesco Mobile Limited, a joint venture between Tesco and O_2 which, as its name implies, supplies mobile phones and airtime contracts; Nutri Centres Ltd, which supplies health food products, beauty products and other goods online and from "capsule spaces" in some Tesco stores; and Tesco Personal Finance plc, which trades as Tesco Bank ("Bank"). Tesco Mobile and Nutri Centres are treated in the same way as Clubcard Partners for the purposes of the scheme, but there are some differences, as I shall explain, in the manner in which Bank participates. I shall henceforth use "Tesco" to mean the group, or any member of the group when it is unnecessary to distinguish between them.

7. The Clubcard scheme was introduced in 1995 with the aim, like other similar schemes, of increasing customer loyalty and sales; Mr Graham's evidence was that it had been very successful in doing so, and that there were currently as many as 16 million Clubcard Members, all individuals as businesses are not eligible to join the scheme. It also provides the group with valuable information about its customers, information which is processed by Dunnhumby Limited, a group company engaged in market research. The processed information enables Tesco, among other things, to target its marketing more effectively. To take only one simple example offered during the hearing, the data captured from Clubcard Members enables Tesco to send advertising material about products for babies to young families, while simultaneously ensuring it is not sent to older customers.

8. Mr Graham's unchallenged evidence was that from Tesco's perspective the purpose of the Clubcard scheme was, and remains, that of increasing sales by the generation and maintenance of customer loyalty. The various rewards Clubcard Members can "earn" (to use what is intended to be a neutral term) are not attributable to benevolence on Tesco's part, but are the means by which Tesco achieves those objectives. He added that the scheme costs the group several hundred million pounds a year to run, and that "[i]t only makes business sense to keep investing that amount if the return from it makes the investment worthwhile." I should make it clear, in case there should be any doubt even though it seems to me to be an obvious conclusion, that I accept from Mr Graham's evidence that the scheme is run for the purpose of promoting Tesco's business and, whatever the appearance to an uninformed observer might be, that

there is no real element of bounty or benevolence; the cost to Stores of the scheme is one element taken into account when the prices of the goods it sells are determined.

9. The basic scheme is essentially the same now as it was in 1995: a Clubcard Member who produces the Clubcard issued to him (to avoid tedious repetition of "he or she" and variants I shall henceforth use only male pronouns) when paying for a purchase of premium goods from Stores or another Tesco group company is credited with points. Whether or not he produces his card, he invariably pays the same price as a customer who is not a member of the scheme. A purchase from a Tesco group company generally leads to a credit of one point for each whole pound spent, except for motor fuel (one point per £2) and some products such as tobacco and lottery tickets, in respect of which no points are awarded. From time to time extra points are offered either generally or on selected goods, and for a period higher-spending Clubcard Members were entitled to enrol in an enhanced scheme by which they earned more points than ordinary members in respect of the same goods. That feature, I understand, has been discontinued. Purchases from Clubcard Partners may lead to the award of points at more or less than one point per pound, depending upon the terms of the Clubcard Partner's agreement with Stores. With Stores' consent (and no doubt an adjustment of the amount paid by the Clubcard Partner to Stores) a Clubcard Partner may offer bonus points for promotional reasons.

10. Generally, the customer's card is swiped or scanned at the point of sale within a shop, or his membership number is recorded in the case of an online sale, and the number of points earned in the transaction is added by Stores to his points account. Points awarded by Clubcard Partners are communicated electronically to Stores and then credited to the member's account in the same way; once credited these points are treated in exactly the same way as points accumulated in purchases from Tesco group companies, other than Bank. A member may have only one account to which all of his points, whether acquired from Stores or from a Clubcard Partner, are credited. Although there are several Clubcard Partners, Mr Graham told me that about 80% of all the points issued to Clubcard Members result from purchases from Stores.

11. It is Stores which has negotiated the agreements with the Clubcard Partners. I understand that while the main features of each agreement with a Clubcard Partner are identical, or as near as may be identical when account is taken of the nature of the supplies made by the Clubcard Partner, there are differences of detail, for example in the amount the Clubcard Partner must pay to Stores in respect of points awarded, but those differences are immaterial for present purposes. It is a common feature of the agreements that, save for the grant of points, Clubcard Partners are required by Stores to treat Clubcard Members in the same way as other customers.

12. At quarterly intervals a Clubcard Member's accumulated points are converted by Stores to vouchers. The vouchers are issued to customers with at least 150 points; however they are earned, points have a nominal value of 1p each, and the vouchers have face values of multiples of 50p. Any points not converted in one quarter, because the member has fewer than 150 or because his points are not an exact multiple of 50, are carried over to the next. The vouchers are distributed in paper form by post. If a Clubcard Member uses such a voucher in part-payment for goods purchased from Stores, the face value of the voucher is treated as a discount from the ordinary price of the goods. Thus if a customer uses a £5 voucher as part-payment for goods costing £10,

Stores accounts for VAT (in accordance with its agreed bespoke retail scheme) on only the £5 cash element. If the voucher covers the entire price of the goods (although the rules of the scheme do not, strictly applied, permit the use of vouchers in full payment), they are treated as having been supplied for no consideration. It is not possible for a Clubcard Member to use a voucher to pay for goods with a price lower than the face value of the voucher, even if he foregoes the difference. From time to time Stores runs promotions by which vouchers are treated as having a multiple of their face value, usually double, if used for the purchase of specified goods. Again, Stores accounts for VAT only on the cash payment, if any, the customer makes. Vouchers which are not redeemed within two years expire; Mr Graham's evidence was that the proportion of issued vouchers which expire before redemption is small.

13. Although it is a Tesco group member, Bank is treated in a different manner. It pays Stores for the right to issue vouchers rather than points. The points accumulated by a Clubcard Member from his transactions with Bank are recorded separately and result in the issue of vouchers specifically identified as Tesco Bank vouchers, both on their face and in the Member's periodic points account statements. Although, from the perspective of a Clubcard Member, Bank vouchers are for all practical purposes identical to ordinary vouchers, the VAT treatment is different: these vouchers are retailer vouchers within the meaning of para 4 of Sch 10A to the Value Added Tax Act 1994 ("VATA"), with the consequence that the consideration paid by Bank to Stores is disregarded save to the extent it exceeds the face value of the voucher (the excess is treated as the consideration for a taxable supply), and Stores must account for the full price of goods sold in exchange for Bank vouchers. This difference is immaterial for the purposes of this appeal.

14. I have described the means by which Clubcard Members acquire points and vouchers and may use the vouchers as the equivalent of cash by way of background and for completeness only, since those features of the Clubcard scheme are of only incidental relevance for present purposes. The use of vouchers, whether ordinary Clubcard vouchers or Bank vouchers, in acquiring goods or services in this manner is dealt with by Stores alone, and Freetime has no involvement in the process. I shall have more to say about the redemption of vouchers by way of in-store purchases later, but it is unnecessary to describe the process in any more detail.

15. What matters is the sequence of events when a Clubcard Member elects to convert his vouchers into Reward Tokens. That process has always been managed by Freetime or, before it became involved, the arm's-length company. A Clubcard Member wishing to exchange his vouchers for Reward Tokens must approach Freetime (and not Stores) by post, telephone or online in order to exchange vouchers for tokens. The Reward Tokens, as I have said, have a greater face value than the vouchers for which they are exchanged, in some cases by a multiple of four. The Reward Tokens are specific to a Deal Partner and a Clubcard Member exchanging vouchers for Reward Tokens must specify the Deal Partner with which he wishes to use his tokens at the time of exchange.

16. Freetime has entered into agreements with more than 500 Deal Partners, of various kinds: examples are restaurant chains, cinema operators, theme parks or similar attractions, and travel companies. Some Deal Partners allow Clubcard Members to use Reward Tokens in order to gain benefits under their own loyalty programmes, for example by exchanging them for airmiles. In the Clubcard Member's hands a Reward

Token (unless it is to be exchanged for airmiles or similar benefits) is effectively cash, even if it can be spent only with the Deal Partner to which the token relates. Reward Tokens may be used in full or part payment for the relevant goods or, more commonly, services offered by the Deal Partner. Deal Partners are required by their agreements with Freetime to accept the Reward Tokens for their face value, and to treat customers using them in exactly the same way as other customers.

17. Deal Partners are also required by their agreements with Freetime to ensure that they accept only valid Reward Tokens, which they must submit to Freetime at agreed intervals, accompanied by an invoice for the appropriate amount. Some Deal Partners account electronically for the vouchers they have redeemed, but the process is essentially the same. The formula by which the amount invoiced is calculated differs from one Deal Partner to another, but is usually a percentage of the face value of the Reward Tokens which have been used in the period to which the invoice relates. Whatever the formula in an individual case, the common feature is that the amount invoiced is always less than the face value of the Reward Tokens, and correspondingly the normal retail price of the goods or services received by the Clubcard Member in exchange for them (or the notional value when there is no normal retail price, for example when Reward Tokens are exchanged for airmiles). The result is that the economic cost of providing the reward to the Clubcard Member is shared between the Deal Partner and Freetime and, through Freetime, the Tesco group. The benefit to the Deal Partner is that it has made a sale which it might not otherwise have made, and in some cases it has in addition gained the opportunity of selling additional goods and services, such as drinks in the case of a restaurant, to the Clubcard Member.

18. Freetime meets the cost to it of running the scheme, including the payments it makes to Deal Partners, by invoicing Stores, monthly, for an agreed fee reflecting the cost of providing its service plus a charge determined by reference to the amount it has paid during the preceding month to Deal Partners. That amount is, of course, determined by the extent to which Clubcard Members have converted the vouchers they have received in respect of accumulated points to Reward Tokens, and have then used those tokens. The total amount invoiced exceeds the costs which Freetime incurs, and it therefore makes a profit. It follows that there is an arithmetical link between the amounts received by Stores from its own customers, the Clubcard Partners and Bank on the one hand, and the combination of the amounts it is obliged to forego when customers redeem vouchers against the price of goods and services and the amounts it pays to Freetime, on the other. I should also formally record, since it was a matter on which HMRC relied, that the amount Freetime pays to each Deal Partner is directly linked to the extent to which Clubcard Members have used Reward Tokens to acquire goods and services from that Deal Partner, and that the amount Freetime receives from Stores is directly linked to the aggregate use by Clubcard Members of Reward Tokens during the month.

19. The point of possible factual controversy to which I have referred is that HMRC did not accept, before the hearing, that the arrangements I have described above have been unchanged throughout the relevant period. Rather, they put the appellants to proof that they were materially the same. However, although the point was raised, it was not pursued when Mr Graham gave his evidence and I detected no reason to think that there was any change in the operation of the scheme during the relevant period which has any bearing on the matters I must decide. I should add, though only for completeness and

because it was the sole topic of his cross-examination, that Mr Graham was asked by Ms Foster about Freetime's directors and employees. It had its own board of directors who were not remunerated by Freetime, I deduce because they held other paid offices within the Tesco group, but no employees of its own. Its staff were employed by Stores, but seconded to Freetime which paid a charge for their services to Stores. It does not seem to me that these features of the case are of any relevance and, although she questioned Mr Graham on the matter, Ms Foster said no more about it.

20. I should nevertheless record, again if only for completeness, that although the relationship between Stores and Freetime is clearly not at arm's length, since they are members of the same trading group, I accept Mr Graham's evidence that Freetime was managed, as nearly as may be in those circumstances, as an independent operation. Thus although the overall scheme was under the control of Stores I accept that Freetime established its own relations with the Deal Partners and ran the Partner Boost feature of the scheme with a substantial degree of autonomy. In particular, it alone was responsible for identifying and "recruiting" Deal Partners, and for agreeing the precise terms on which it contracted with each of them, and it alone was responsible for maintaining a working relationship with them. The agreements, with variations to cater for the nature of the business of each Deal Partner, dealt not only with the basis on which Freetime was to make payments to the Deal Partner but also with such matters as staff training, service standards, the use of Tesco logos and other devices and marks by the Deal Partner and vice versa, and similar topics.

21. Mr Graham's evidence was that the Partner Boost feature of the scheme was not simply an arrangement by which Tesco offered Clubcard Members a different way of using the points they had accumulated, but was regarded as an integral part of the Clubcard scheme, designed to increase customer loyalty by demonstrating that Tesco offered something its competitors did not, and he gave a number of examples of what he said were the superior benefits of the Clubcard scheme and, in particular, the Partner Boost feature. Although the Clubcard Member received the reward from the Deal Partner, the aim was to ensure that he remained conscious of the connection with Tesco, and took the view that it was Tesco which was providing the benefit to him. By way of example he described in his witness statement the manner in which complaints by a Clubcard Member about the service he had received from a Deal Partner were handled:

> "… strictly speaking the problem lies with the Deal Partner. However, in order to keep customers as loyal as possible, Freetime is generally involved so as to ensure that Members are provided with the best possible customer service. So, for example, if a Member complained to Freetime about the fact that they used their Reward Tokens to book a room at a hotel and the level of cleanliness was poor, Freetime personnel would have a conversation with the hotel and try to persuade them to offer something to the Member by way of compensation. But if that did not happen, Freetime would usually deal with the issue, either by sending the Member alternative Reward Tokens, or by instructing Clubcard to restore points to their account. Freetime would own the relationship with the relevant Member throughout this process, and the contact with the relevant Deal Partner would be made by the appropriate account manager at Freetime."

22. Stores makes appropriate entries in its accounts for the cost to it of the scheme, including a provision at each year end relating to the value of points in circulation but as yet unredeemed, adjusted to take account of the assumed rate of redemption (because

some vouchers are not redeemed before they expire) and the cost to it of redemption, which differs depending on the use the Clubcard Member makes of the vouchers but can be statistically determined. Freetime accounts conventionally for the amounts it pays to Deal Partners and the amounts it receives from Stores. It is common ground that the accounting treatment does not impact on the matters I must decide.

The relevant legislative provisions

23. There is no dispute between the parties about the relevant legislation. One needs to look no further than the European directives, for part of the period the Sixth VAT Directive (77/388/EEC) ("the Sixth Directive"), for the remainder the Principal VAT Directive (2006/112/EC) ("the PVD"). Their terms are materially the same, and it is common ground that the domestic legislation, found primarily at s 26 of VATA, implements it correctly. Although the parties focused on the provisions of the Sixth Directive, it seems to me that, 10 years after it came into effect, it is more appropriate to refer to the PVD. Both parties emphasised the principle established by art 1(2):

> "The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.
>
> On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.
>
> The common system of VAT shall be applied up to and including the retail trade stage."

24. Article 2(1) defines the scope of VAT:

> "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;
>
> (b) [immaterial]
>
> (c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such …."

25. The meanings of "supply of goods" and "supply of services" are to be found in arts 14(1) and 24(1) respectively:

> "'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner."
>
> "'Supply of services' shall mean any transaction which does not constitute a supply of goods."

26. Article 73 defines the "taxable amount":

> "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 …."

27. The critical provision, on the application of which to the facts of this case Freetime's case stands or falls, is art 168:

> "In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:
>
> (a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person …."

The agreements between the participants

28. The agreement between Stores and a Clubcard Member, which in reality is not a contract in the conventional sense but consists of the terms and conditions to which a Clubcard Member subjects himself on subscribing to the scheme, was considered by the Court of Appeal in *Tesco plc v Customs and Excise Commissioners* [2003] EWCA Civ 1367, [2003] STC 1561 ("*Tesco plc*"). In that case the Partner Boost feature was not relevant; the primary issue before the court was whether, as Tesco contended, the vouchers sent periodically to a Clubcard Member who had accumulated sufficient points were issued for consideration. Had that been so, Tesco would have been able to deduct the cost of the vouchers from the selling price of premium goods, thus reducing its output tax liability at that stage, though it would have to treat the face value of the vouchers, when redeemed, as consideration or part consideration for redemption goods, and then account for the tax included in the selling price of those goods. Its overall VAT liability would be reduced because, at that time, only about 93% of vouchers were redeemed, and it would in addition achieve a cashflow advantage by deferring the time at which it must account for the output tax.

29. The VAT and Duties Tribunal concluded that a Clubcard Member buying premium goods from Stores or a Clubcard Partner would take the view that part of the price paid represented the cost of the goods and part the cost of the right to obtain the vouchers, that his perception represented the economic reality of the contract, and that he was therefore paying for the vouchers. Both Tesco and the Commissioners appealed, and Ferris J in the High Court ([2002] EWHC 2131 Ch, [2002] STC 1332) held, in brief, that the points were awarded, whether the purchase was from Stores or a Clubcard Partner, for no consideration, that there was no distinction to be drawn between points and vouchers, and that therefore the vouchers too were granted for no consideration.

30. The Court of Appeal took the view that the subjective perceptions of the parties were irrelevant, and that it was necessary, rather, to determine objectively whether the Clubcard Member gave consideration, in the Community law sense, for the vouchers. Jonathan Parker LJ (with whom Schiemann and Latham LJJ agreed) plainly thought it significant, first, that a member who made few purchases of low value would have to wait for some time to become entitled to any vouchers, and, second, that a member who made no purchases for, as the rules of the scheme then provided, eight weeks was removed from the scheme with the consequence that any points he had earned were forfeit. He recorded, at [112], the finding of Ferris J in the High Court that the Clubcard Member complying with the terms and conditions of the scheme had an enforceable right to the award of points and to their subsequent conversion into vouchers, but did not expressly agree or disagree with it. He put his conclusions in this way:

> "[164] Under the basic scheme it seems to me impossible to say that there is monetary consideration for the issue of a voucher in the form of a monetary

> payment made by the member when he purchases premium goods (assuming for present purposes that such a payment is made). As explained in Part 2 of this judgment, the voucher is not a direct product of the particular 'points' which are awarded to, or earned by, a member of the scheme when purchasing premium goods. Given (a) the stipulated minimum of (currently) 150 points in any one quarter, and (b) the fact that a member who has not earned any points in a continuous eight-week period is liable to be removed as a member of the scheme, notwithstanding that he may have points to his name carried forward from an earlier period, it cannot be said with any degree of certainty when (if at all) points earned in a purchase of premium goods (where those points, when aggregated with any points already standing to the purchaser's name, amount to less than 150 points) will be reflected in, or will contribute to, the issue of a voucher. Nor, as Mr Vajda [for HMRC] points out, is it possible to identify the particular points which trigger the issue of a voucher, and hence the specific 'consideration' for that voucher.
>
> [165] It follows that [Ferris J] was in my judgment in error in saying … that 'the only significance of a point is that, when aggregated with other points, it will *automatically be converted* into a voucher' (my emphasis); and that '[e]very point credited to a customer will, in time, be converted in this way'.
>
> [166] In my judgment, adopting the approach to the analysis of the scheme which I have set out above, the true position is that even if (as I assume for present purposes) a member of the scheme when purchasing premium goods pays for something else in addition to the premium goods, that something else can only be the points which he 'earns' on his purchase of those premium goods. I do not see how, on any objective analysis, he can be taken to be paying for a voucher or vouchers: the issue of vouchers is a subsequent, and distinct, stage in the operation of the scheme."

31. It seems to me to follow, and indeed to be apparent from the terms and conditions of the scheme, whose draftsman has taken care to avoid spelling out an enforceable obligation on Stores to issue points or to ascribe any particular value to them, that it is at best doubtful whether the Clubcard Member acquires, on joining the scheme, any contractual right to points or indeed to anything. The nearest one comes to a contractual obligation is the statement that if a customer complies with the applicable terms and conditions and makes a purchase costing at least £1 "then one point will be awarded for every £1 that is spent". That statement is, however, immediately qualified by the next sentence: "This can be altered at the discretion of Tesco". Mr Graham explained that Stores had taken advantage of that provision when, some years ago and in the face of customer protest, it had reduced the award rate from two points per pound to one point per pound. The terms on which points are converted to vouchers are similarly qualified. Clause 14 of the May 2009 terms and conditions (other versions are materially identical) is as follows:

> "The current redemption value of points is one point equals one penny. Tesco reserves the right to vary the rate at any time."

32. On the other hand, it seems to me clear from Mr Graham's evidence, from the manner in which the promotional material produced to me is worded, and by virtue of Tesco's conduct over a prolonged period that a Clubcard Member has, and quite reasonably so, an expectation that *some* points will be awarded, and that they will

periodically be converted to vouchers, as long as he meets the conditions of membership.

33. The terms on which a Clubcard Member is able to convert vouchers to Reward Tokens are set out in the standard Clubcard scheme terms and conditions and, since Ms Foster laid some emphasis on them, I set the relevant provisions out:

> "**Partner Rewards**
>
> 1 Tesco Freetime Limited operates this Scheme under the current terms and conditions of the Tesco Stores Limited (Tesco) Clubcard Scheme, which can be found at: www.tesco.com/clubcard.
>
> 2 In-store rewards are provided by Tesco. Out of store awards are provided by Tesco Freetime Ltd.
>
> 3 When ordering Clubcard rewards online please refer to the online Clubcard accounts awards terms and conditions that can be found above.
>
> **Clubcard Vouchers**
>
> 4 Valid Clubcard vouchers (which are those printed with your name in your quarterly Clubcard Statement mailing entitled 'Voucher' and which are in-date, are not sold, damaged, defaced, copied, altered or redeemed) can be exchanged for a reward, token or Airmiles at the rates shown in this brochure. Bookings and orders can only be made by the Clubcard Member.
>
> 5 Exchanges can only be made in Clubcard vouchers. Part payment in cash is not permitted unless otherwise stated.…
>
> 6 Airmiles can only be applied to your own Airmiles account.
>
> 7 Tesco Freetime does not accept any responsibility for Clubcard vouchers that are not received.…
>
> 8 Rewards tokens cannot be used in conjunction with any other discount, offer, scheme or promotion and cannot be exchanged in whole or in part for cash.…
>
> **Supplier**
>
> 19 Tesco Freetime does not accept any responsibility for the loss of rewards tokens between customer and supplier.…
>
> 21 Do not make any dependent arrangements until your booking is confirmed by the Supplier.
>
> 22 Tesco and Tesco Freetime shall not be liable for any goods or services provided by the Supplier or any act or omission of the Supplier, save as required by law."

34. In my judgment these provisions show that the position of the Clubcard Member who has received vouchers has changed. He no longer has merely an expectation that his purchases will lead to the award of points, but has received Tesco vouchers with a face value marked on them. I do not need to decide the point for the purposes of this appeal, but it would in my view be remarkable if Stores could, with impunity, refuse to honour the vouchers if presented by a Clubcard Member buying goods. Similarly, it would be remarkable if Freetime were able to refuse to convert vouchers to Reward Tokens in accordance with the published conversion rates and conditions prevailing at the time. It seems to me that the Clubcard Member who has vouchers is in at least as good a position as the successful "Spot the Ball" competitor in Case C-498/99 *Town and County Factors Ltd v Customs and Excise Commissioners* [2002] STC 1263, in

which the European Court of Justice ("the ECJ") concluded that as long as there was reciprocity of obligation the fact that the obligations were not legally enforceable was not critical.

35. I did not understand Ms Foster to argue that the agreements between Stores and the Clubcard Partners, between Stores and Freetime, and between Freetime and the Deal Partners did not give rise to legally enforceable obligations; rather, the question is what those obligations are. I have already dealt with the agreements between Stores and the Clubcard Partners, and need say no more about them. The agreement between Stores and Freetime, called a "Clubcard Marketing and Services Agreement", requires Freetime, in return for consideration paid to it by Stores, to issue Reward Tokens in exchange for vouchers and to ensure that the Deal Partners honour the tokens on presentation. There is no dispute that Freetime makes a taxable supply to Stores, and nothing of significance turns on this agreement.

36. The most important, and the real focus of the dispute, are the agreements between Freetime and the Deal Partners. One example on which the parties addressed me in some detail was between Freetime and a museum which allowed Clubcard Members to use Reward Tokens in full or part payment of its admission charges; as I have said, the agreements are in materially the same form and this example can be taken as typical. The agreement describes what the museum is to provide as "fulfilment services" and states that the museum:

> "shall supply to Tesco Freetime the services (to include provision of Rewards to Clubcard Members) as required by Tesco Freetime to enable Tesco Freetime to perform and discharge its obligations to provide or procure the provision of Rewards to Clubcard Members in accordance always with the Terms and Conditions printed overleaf (Fulfilment Services)."

37. The terms and conditions are not relevant for present purposes, save for the provision to which I have already referred, by which the Deal Partner is required to treat a customer using Reward Tokens to pay for the provision of goods or services in exactly the same manner as any other customer. The museum is required by the agreement to accept Reward Tokens in full or part payment, and on surrender to it of the tokens so accepted Freetime is required to pay the museum a percentage of their face value. The manner in which that payment has been treated for VAT purposes in some cases has changed during the period with which I am concerned, for unconnected reasons (for example, because of changes in the incidence of tax on entry fees for cultural attractions), but it is not suggested that the manner in which the Deal Partners invoice Freetime and account for the VAT added to their charges is either incorrect or a factor material to this decision.

Loyalty Management UK Ltd

38. Much of the argument before me related to the similarities and differences between the Clubcard arrangements and those of the Nectar scheme which, Mr Graham told me, is its closest rival. That scheme was the subject of litigation successively in the VAT and Duties Tribunal, the High Court and the Court of Appeal, and was then the subject of a reference by the House of Lords to the ECJ; that court's judgment, which related also to another, rather different, loyalty scheme, is reported as *Revenue and Customs Commissioners v Loyalty Management UK Ltd, Baxi Group Ltd v Revenue and Customs Commissioners* (Joined cases C-53/09 and C-55/09) [2010] STC 2651, [2010]

ECR I-9187 ("*LMUK-ECJ*"). The Nectar case (though not the litigation relating to the other loyalty scheme) then came before the Supreme Court, which had by that time replaced the Appellate Committee of the House of Lords. The Supreme Court's judgments are reported as *Revenue and Customs Commissioners v Loyalty Management UK Ltd* [2013] UKSC 15, [2013] STC 784 ("*LMUK-SC*"). The relevant elements of the Nectar scheme were described by Lord Reed as follows:

> "[1] This appeal concerns the well-known Nectar scheme. Its essential elements as at the relevant time can be summarised as follows. A member of the scheme has an account with Aimia Coalition Loyalty UK Ltd, formerly called Loyalty Management UK Ltd ('LMUK'), the promoter of the scheme, and is issued with a Nectar card. When a member purchases goods or services from a retailer which has agreed with LMUK to participate in the scheme in relation to the issue of 'points', the retailer swipes the Nectar card and the member's account with LMUK is electronically credited with a number of points. The member is then entitled to use the points to receive goods or services, either at no cost or at a reduced cost, from a retailer which has agreed with LMUK to participate in the scheme in relation to the 'redemption' of points. When the member receives goods or services from that retailer, the retailer swipes the Nectar card and the member's account with LMUK is electronically debited with the number of points which have been redeemed.
>
> [2] The scheme involves four parties: (1) the promoter of the scheme, LMUK; (2) the members of the scheme ('collectors'); (3) retailers of goods and services ('sponsors'), who pay for their customers, if they produce a Nectar card, to have points credited to their accounts with LMUK when they have purchased goods or services and their cards are swiped; and (4) other retailers of goods and services ('redeemers'), from whom collectors receive goods and services, at no cost or at a reduced cost, when their cards are swiped and points are debited to their accounts."

39. The similarities lie in the collection by subscribers of points, and the redemption of the points by their use in place of cash to purchase goods. The differences lie in the fact that in the Clubcard scheme the points are converted to vouchers before the Clubcard Member can use them, that the element of the Clubcard scheme I am required to consider, the Partner Boost, was absent from the Nectar scheme as it was considered in *LMUK-ECJ* and *LMUK-SC*, and that the role taken in the Nectar scheme by LMUK is divided between Stores and Freetime in the Clubcard scheme. In addition, LMUK was only the promoter; it did not sell goods or services to the collectors. Freetime's argument, in a nutshell, is that the differences are immaterial, and that the outcome of *LMUK-SC* is of equal application to this case. That outcome was that the redeemers made supplies of redemption services to LMUK in exchange for payments to which VAT was added, and that LMUK could treat that VAT as input tax. Freetime's argument is that, in this respect, it is in an identical position to that of LMUK. HMRC argue that the differences between the two schemes are material, so much so that *LMUK-SC* cannot be translated to this case, and that I should follow, in preference to *LMUK-SC*, what was said by the ECJ in *LMUK-ECJ*. For that argument to be understood it is necessary to set out the reasons why the majority did, and the minority did not, think it open to them to depart from *LMUK-ECJ*.

40. Lord Reed, with whom Lords Hope and Walker agreed, was highly critical (with appropriate judicial courtesy) of the terms of the reference which, he said, were such as to mislead the ECJ, and to result in its addressing the wrong questions. As he put it at [48]:

> "As I have explained … the terms of the reference resulted in the court's approaching the facts on a different basis from that which the referring court was bound to adopt. It left out of account a number of matters found by the tribunal and relied upon by LMUK before the national courts, including (1) the fact that sponsors pay LMUK for the grant to collectors of the right to receive goods and services, (2) the fact that LMUK meets the cost of the provision of goods and services to collectors out of those payments, (3) the fact that LMUK has, in return for those payments, granted collectors the right to receive goods and services without further payment or at a reduced cost, (4) the fact that collectors obtaining goods and services from redeemers are therefore exercising a right which has already been paid for, (5) the fact that the provision of goods and services by the redeemers is the means by which LMUK discharges its obligations to sponsors and collectors, and (6) the fact that the payments made by LMUK to redeemers are therefore an essential cost of its business. More generally, as I have explained, the court does not appear to have assessed the transactions in question in the context of the arrangements considered as a whole, or determined on that basis what they amounted to in terms of economic reality. Nor is it apparent that the court took into account, in reaching its conclusion, the fact that (1) LMUK had agreed to make a taxable supply when it granted to collectors the right to receive goods and services at no cost or at a reduced cost, and (2) collectors receiving goods and services on that basis were therefore exercising a right for which LMUK had already been paid, and the consideration for which had already been subject to VAT."

41. Lords Wilson and Carnwath, who took the view that the court was bound by *LMUK-ECJ* despite any shortcomings in the terms of the reference, formed the minority. Lord Carnwath (with whom Lord Wilson agreed—he did not deliver a judgment of his own) explained his reasons for respecting *LMUK-ECJ* at [123], as follows:

> "I do not see how we can, properly or responsibly, go behind either the decision of the House to make the reference, or the questions which were then approved with LMUK's consent. Nor, still less (with respect to Lord Reed), do I believe that it is appropriate or fair for us now to decide that there were other relevant facts, necessary for the determination, but which, through oversight of ourselves and the parties, were not drawn to the attention of the court; and, further, that the true issues were not questions of law at all, so that we are free to redetermine them for ourselves as questions of fact, without regard to the CJEU's conclusions on them. Those are to me entirely novel and controversial propositions …."

42. If I understood her argument correctly, Ms Foster went further by saying that, should there be a conflict between *LMUK-ECJ* and *LMUK-SC*, I should prefer the former: not only was there a material difference between the two schemes, but Lord Carnwath was right to say that the pronouncements of the ECJ cannot be departed from, still less disregarded. I will deal with that argument later.

43. I should mention before going further that I was taken by the parties to many authorities besides *LMUK-ECJ* and *LMUK-SC*. However, as they were, with three exceptions, the subject of a detailed analysis by, in particular, Lord Reed in *LMUK-SC* I do not think it either necessary or appropriate to undertake my own analysis of them—indeed, it would be presumptuous to do so. Rather, I shall adopt the analysis of the earlier authorities of the Supreme Court, an analysis which is reflected in the reasoning and conclusions of the majority.

44. The three exceptions I have mentioned are all judgments of the Supreme Court decided after *LMUK-SC*, and therefore not covered by Lord Reed's analysis. They are, in chronological order, *WHA Ltd v Revenue and Customs Commissioners* [2013] UKSC 24, [2013] STC 943 ("*WHA*"), *Secret Hotels2 Ltd v Revenue and Customs Commissioners* [2014] UKSC 16, [2014] STC 937 ("*Secret Hotels*") and *Revenue and Customs Commissioners v Airtours Holiday Transport Ltd* [2016] UKSC 21, [2016] STC 1509 ("*Airtours*"). In *Airtours* the judgment of the majority was delivered by Lord Neuberger, who drew on *WHA* and *Secret Hotels*, and, again, I do not think it necessary or appropriate to undertake an analysis of my own. I shall, however, need to quote some of the observations in those cases when dealing with the parties' submissions.

The appellants' case

45. The core of the appellants' argument is that the various agreements, when properly analysed, show that the Deal Partners are making supplies to Freetime, leading to an input tax credit in its hands. The most important agreement, in the context of this case, is that between Freetime and each of the Deal Partners: it imposes on the Deal Partner an obligation, owed to Freetime, to make a supply of fulfilment services for consideration paid by Freetime. It is immaterial to that analysis that the reward itself is consumed by the Clubcard Member; the supply to Freetime of fulfilment services enables it, in turn, to fulfil its own obligations to Stores to operate the Partner Boost programme and to discharge its obligation to make good to the Clubcard Member the reward to which he has become entitled by virtue of his surrender of vouchers. Those vouchers have value in his and, after surrender, Freetime's hands. Without the supplies made to it by the Deal Partners Freetime would be unable to discharge its own contractual obligations.

46. That the most useful starting point is the contractual position has been made clear by the Supreme Court on several occasions. A clear statement to that effect was made by Lord Reed (with whom the other Justices, including Lord Carnwath, agreed) in *WHA* at [27]. The reasons were given by Lord Neuberger in *Secret Hotels*:

> "[31] Where parties have entered into a written agreement which appears on its face to be intended to govern the relationship between them, then, in order to determine the legal and commercial nature of that relationship, it is necessary to interpret the agreement in order to identify the parties' respective rights and obligations, unless it is established that it constitutes a sham.
>
> [32] When interpreting an agreement, the court must have regard to the words used, to the provisions of the agreement as whole, to the surrounding circumstances in so far as they were known to both parties, and to commercial common sense."

47. It is plain from the agreements in this case, Mr Peacock argued, that if a Deal Partner failed to perform its obligations, for example by failing to honour a Reward Token at all or by treating a Clubcard Member tendering a Reward Token less favourably than other customers, Freetime would have a cause of action against it. Similarly, the terms of the Clubcard scheme, which I have set out at para 33 above, show that even if the Clubcard Member does not have an enforceable contractual right he has an expectation that the Reward Tokens for which he exchanges his vouchers will be honoured. Stores, too, is dependent on the supply made to it by Freetime of redemption services since without them it would be unable to meet its own contractual obligations to Clubcard Partners, including the obligation to make the Partner Boost

feature available to the Clubcard Partner's own customers, or to meet the expectations of Clubcard Members making purchases from Stores itself.

48. There are, Mr Peacock continued, clear and direct parallels between the Clubcard and Nectar schemes. The services supplied by redeemers to LMUK, even if they differ in their mechanics, are indistinguishable in economic effect from the services provided by Deal Partners to Freetime, just as the services Freetime supplies to Stores, and through it the Clubcard Partners, are indistinguishable economically from the supplies made by LMUK to the sponsors. There, as here, the success of the scheme depended on a network of contracts between LMUK and the collectors, sponsors and redeemers. Again, there may have been differences of detail but the essential elements of the two schemes are directly comparable.

49. In the *LMUK* litigation, as in this case, LMUK claimed that it was entitled to deduct as input tax the VAT element of the payments which it had made to the redeemers on the basis that the payments were the consideration for the redeemers' supply to LMUK of the services for which it had contracted with them; and that supply was made to LMUK for the purposes of its business. HMRC argued that the supply was made to the collector, not LMUK, and that the payment by LMUK to the redeemer represented third party consideration for the supply made by the redeemer to the collector, and that any VAT charged on such a supply was therefore not deductible by LMUK as input tax. That is HMRC's position here, and it is untenable because of what Lord Reed said in *LMUK-SC*. He was not unmindful of the need to respect ECJ jurisprudence; indeed he expressly referred to it at [56]:

> "… this court's responsibility for the decision of the present case on the basis of all the relevant factual circumstances, and all the arguments presented, requires it to take into account all the facts found by the tribunal, including those elements left out of account by the Court of Justice, and to consider all those arguments, including those which were not reflected in the questions referred. That responsibility under domestic law is also recognised in EU law, as the Court of Justice explained in the *AC-ATEL* judgment (see [1994] ECR I-2305, paras 17 and 18 of the judgment). In the exceptional circumstances of this case, this court cannot therefore treat the ruling of the Court of Justice as dispositive of its decision, in so far as it was based upon an incomplete evaluation of the facts found by the tribunal or addressed questions which failed fully to reflect those arguments. This court must nevertheless reach its decision in the light of such guidance as to the law as can be derived from the judgment of the Court of Justice. In that regard, important aspects of the judgment include the statement that consideration of economic realities is a fundamental criterion for the application of the common system of VAT (see [2010] STC 2651, [2010] ECR I-9187, para 39), and the statement that, where a transaction comprises a bundle of features and acts, regard must be had to all the circumstances in which the transaction in question takes place (see para 60 of the judgment)."

50. After setting out, at [73] to [75], the principles that the deduction system "is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities" and that "the right to deduct VAT, as an integral part of the VAT scheme, has been described by the court as a fundamental principle underlying the common system of VAT, which in principle may not be limited", he went on to say this:

> "[76] In the present case, the Court of Justice focused upon the relationship between redeemers and collectors. Since collectors are usually final consumers of

the goods and services provided by redeemers, the principle described in para 75 would suggest, at first sight, that final taxation should take place at the stage of that supply. Since no monetary consideration is paid by the collector in so far as the goods or services are exchanged for points, but a payment is subsequently made by LMUK which is based on the value of the points as agreed with the redeemer, it would be possible, if these aspects of the present case were considered in isolation, to conclude that that payment should be regarded as third party consideration for that supply, and taxed accordingly.

[77] As I have explained, however, there is another dimension to the case, which the Court of Justice was not requested to consider, and which it therefore left out of account. The appeal before this court is concerned with the claim of LMUK, a taxable person, to deduct input tax. LMUK's business is of an unusual character. Through the Nectar scheme, it provides collectors with a contractual right to obtain goods and services from redeemers in exchange for points. It is common ground before this court that that is a taxable supply, and that the taxable amount is the whole of the consideration which is received by LMUK. The counterpart of the right supplied to collectors is an obligation on the part of LMUK to procure that redeemers provide goods and services in exchange for points. The payments made to redeemers constitute the cost of fulfilling that obligation, and are therefore a cost of LMUK's business.

[78] Applying the principles summarised at [73] and [74], above, VAT should be chargeable on LMUK's taxable supplies only after deduction of the VAT borne by LMUK's necessary costs. The most obvious of those costs, as I have explained, is the cost of securing that goods and services are provided to collectors in exchange for their points: that is to say, the payments made by LMUK to the redeemers. The principles summarised at [73] and [74] therefore indicate that LMUK should be authorised to deduct from the VAT for which it is accountable the VAT charged by the redeemers, so that it accounts for VAT only on the added value for which it is responsible. Only in that way will VAT be completely neutral as regards LMUK.

[79] It is implicit in that approach that the transaction between a redeemer and LMUK involves a taxable supply by the former to the latter. That analysis appears to me to be consistent with economic reality. LMUK carries on a genuine business for its own benefit. It issues the points in its own name and on its own behalf: it is not a mere cipher for the sponsors. As a matter of economic reality, the payments which it makes to redeemers are an essential cost of its business. Its business model is to sell the right to receive goods and services, pay redeemers to provide the goods and services, and derive a profit from the difference between its income from the sponsors and its expenditure on the redeemers.

[80] There is a legal relationship between the redeemer and LMUK pursuant to which there is reciprocal performance. In accepting points, which have no inherent value, in exchange for goods or services, the redeemer is acting in a manner which is only explicable because of its agreement with LMUK, under which LMUK will pay it for doing so. LMUK pays it for doing so because its business is dependent on redeemers accepting points in exchange for the provision of goods and services. The only economically realistic explanation of LMUK's behaviour is the value to LMUK itself of the redeemers' acceptance of points in exchange for the provision of goods and services. The only economically realistic explanation of LMUK's behaviour is the value to LMUK itself of the redeemers' acceptance of points in exchange for the provision of goods and services.

> [82] The approach described in the foregoing paragraphs is consistent with the fundamental principle, as the Court of Justice has described it, that a taxable person is entitled to deduct the VAT payable in the course of his economic activities. The alternative approach described at [76] is not."

51. HMRC's assertions in their statement of case that the exchange of vouchers for Reward Tokens is just "mechanics" and that input tax recovery should be refused because the Clubcard Programme is "essentially a gratuitous scheme" are impossible to reconcile with that analysis, Mr Peacock added. The issue of points by LMUK to a Nectar member led to obligations on LMUK's part, just as the exchange of Clubcard vouchers for Reward Tokens creates obligations on Freetime's part. The Clubcard Programme is no more gratuitous than the Nectar programme, but even if the schemes are gratuitous the Supreme Court did not consider this feature to be a bar to LMUK's input tax recovery. There was no reason, said Mr Peacock, that it should be a bar in this case either.

52. Nothing said in the later Supreme Court cases undermined what was said by Lord Reed in *LMUK-SC*. On the contrary, said Mr Peacock, it was consistent with what was said in *Airtours*, namely that the contractual position cannot be ignored in favour of some perception of economic substance, but must be respected. In that case the question was whether the VAT included in payments made by Airtours to consultants, PwC, who produced a report about Airtours' proposed restructuring, was deductible input tax in Airtours' hands. Although Airtours paid for it, the report was commissioned by about 80 financial institutions from which Airtours wished to borrow in order to support its restructuring. Lord Neuberger (with whom Lords Mance and Hodge agreed—Lords Clarke and Carnwath dissented) described the essential issues at [21]:

> "The first question is whether, under the terms of the Contract, PwC agreed with Airtours that it would supply services, and in particular to provide the Report. If the answer to that question is Yes, then the Commissioners accept that there has been a supply of services to Airtours, and that this appeal must be allowed, subject to a question of apportionment. On the other hand, if the answer to that first question is No, then the Commissioners contend that this appeal must be dismissed, but Airtours contends that its appeal should still succeed, subject, again to a question of apportionment. In effect, on this second point, Airtours argues that, in order to show that it received a supply of services from PwC for the purposes of VAT, it does not have to show that it had a contractual right to require the Services to be provided to the Institutions by PwC."

53. At [22] Lord Neuberger explained that, as to the first question, "it is enough for Airtours' purposes if it can establish that PwC were under a contractual duty to supply services, such as providing the Report, to the Institutions. Airtours does not have to show that PwC were under a contractual duty to supply any services directly to Airtours." In *Airtours* the first question was answered in the negative: PwC had no contractual obligation to Airtours to supply the Services to it or to the Institutions (see [41]). The position here, however, was quite different: Freetime *did* have the right to demand that the Deal Partners provide goods or services to Clubcard Members using Reward Tokens.

54. Lord Neuberger then addressed the second question. At [44] and [45] he discussed the proposition of Lord Millett in *Customs and Excise Commissioners v Redrow Group plc* [1999] STC 161 at 172, that "[o]nce the taxpayer has identified the payment the

question to be asked is: did he obtain anything—anything at all—used or to be used for the purposes of his business in return for that payment?", and Lord Reed's comments on it in *LMUK-SC*, to the effect that economic reality is a "fundamental criterion for the application of VAT" and that Lord Millett's proposition "should be understood as being concerned with a realistic appreciation of the transactions in question". He then said this:

> "[46] Lord Hope made the same point in para [110] in remarks which are perhaps particularly germane for present purposes:
>
> > '… I think that Lord Millett went too far ([1999] STC 161 at 171, [1999] 1 WLR 408 at 418) when he said that the question to be asked is whether the taxpayer obtained "anything—anything at all" used or to be used for the purposes of his business in return for that payment. Payment for the mere discharge of an obligation owed to a third party will not, as he may be taken to have suggested, give rise to the right to claim a deduction. A case where the taxpayer pays for a service which consists of the supply of goods or services to a third party requires a more careful and sensitive analysis, having regard to the economic realities of the transaction when looked at as a whole.'
>
> [47] This approach appears to me to reflect the approach of the Supreme Court in the subsequent case of *WHA Ltd v Revenue and Customs Commissioners* [2013] UKSC 24, [2013] STC 943, [2013] 2 All ER 907 where at [27], Lord Reed said that '[t]he contractual position is not conclusive of the taxable supplies being made as between the various participants in these arrangements, but it is the most useful starting point'. He then went on in paras [30]–[38] to analyse the series of transactions, and in para [39], he explained that the tribunal had concluded that 'the reality is quite different' from that which the contractual documentation suggested. Effectively, Lord Reed agreed with this, and assessed the VAT consequences by reference to the reality. In other words, as I said in *Secret Hotels2 Ltd (formerly Med Hotels Ltd) v Revenue and Customs Commissioners* [2014] UKSC 16, [2014] STC 937, [2014] 2 All ER 685 (at [35]), when assessing the VAT consequences of a particular contractual arrangement, the court should, at least normally, characterise the relationships by reference to the contracts and then consider whether that characterisation is vitiated by [any relevant] facts."

55. Here, the contractual position was clear: the Deal Partners were obliged to, and did, provide services to Freetime, which in turn was obliged to, and did, provide services to Stores, and Stores was obliged to, and did, provide services to the Clubcard Partners and Bank. There was a direct contractual relationship between the Deal Partners and Freetime, by which the Deal Partners satisfied Freetime's obligation to the Clubcard Member to provide the rewards. The amounts paid by Freetime to the Deal Partners were an ordinary cost component of its business, and the VAT it incurred in making those payments should be deductible in accordance with ordinary principles. It would be a remarkable outcome, Mr Peacock said, if the tax treatment of the Clubcard and the materially identical Nectar schemes were to differ.

HMRC's case

56. The essence of HMRC's case is two-fold: that the Clubcard scheme is gratuitous, in that the Clubcard Member pays nothing for the points, the vouchers or the benefits, whether of reduced-price redemption goods or of rewards, he eventually receives; and

that the amounts paid by Freetime to the Deal Partners are third-party consideration for the supplies of rewards made by the Deal Partners to the Clubcard Members.

57. Ms Foster's starting point was the proposition that in the context of a network of contractual arrangements it is necessary to look at the matter as a whole in order to determine its economic reality; it is not permissible to look at each contract in isolation without regard to the part it plays in the overall scheme. That is all the more necessary when, as here, the contracts themselves are equivocal about who is supplying what to whom. That proposition was made clear by Lord Reed in *WHA* at [26]:

> "As this court has recently observed ([*LMUK-SC*] at [68]), decisions about the application of the VAT system are highly dependent upon the factual situations involved. A small modification of the facts can render the legal solution in one case inapplicable to another. It is therefore necessary to begin by considering carefully the facts of the present case. As was also noted in [*LMUK-SC*] at [38], the case law of the Court of Justice indicates that, when determining the relevant supply in which a taxable person engages, regard must be had to all the circumstances in which the transaction in question takes place. Furthermore, as Lord Walker explained in [*LMUK-SC*] at [114]–[115], in cases where a scheme operates through a construct of contractual relationships, as in the present case, it is necessary to look at the matter as a whole in order to determine its economic reality."

58. From that passage it is clear that it is necessary to undertake a careful comparison of the various agreements relating to the Nectar and Clubcard schemes; it is not possible to contend, as the appellants do, that because the two schemes have a similar purpose their tax treatment must be the same. Moreover, as Lord Reed said in *WHA* at [27], although the contractual position is "the most useful starting point", it is "not conclusive". It follows that what the majority said in *LMUK-SC* cannot be applied uncritically to this case; rather, the more general analysis of the ECJ of the VAT treatment of what Lord Reed, in *LMUK-SC*, described as "typical" loyalty schemes should be applied, the more so because it was the other, Baxi, scheme, considered in *LMUK-ECJ* which more closely resembled the Clubcard scheme.

59. After setting out the relevant features of the references the court said this of the competing arguments:

> " [34] … LMUK argues that the payments which it made to the redeemers constitute the consideration for services supplied to it by the redeemers. Those services, it submits, consist of various contractually agreed services, including the redeemers' undertaking to supply goods or services to customers without charge or at a reduced price.…
>
> [36] According to the United Kingdom government, the Greek government and the European Commission, the payments made … by LMUK to the redeemers must be regarded as the consideration, obtained from a third party, namely LMUK, for a supply of goods made by the redeemers to customers and/or, according to the nature of the loyalty reward, for a supply of services made by those redeemers for the benefit of those customers."

60. The Court's approach to the correct analysis of the VAT treatment was as follows:

> "[39] It must also be recalled that consideration of economic realities is a fundamental criterion for the application of the common system of VAT (see, first, as regards the meaning of place of business for the purposes of VAT, *Customs and Excise Comrs v DFDS A/S* (Case C-260/95) [1997] STC 384, [1997] ECR I-1005,

para 23, and *Planzer Luxembourg Sarl v Bundeszentralamt für Steuern* (Case C-73/06) [2008] STC 1113, [2007] ECR I-5655, para 43, and, secondly, as regards the identification of the person to whom goods are supplied, by analogy, *Auto Lease Holland BV v Bundesamt für Finanzen* (Case C-185/01) [2005] STC 598, [2003] ECR I-1317, paras 35 and 36).

[40] In the light of the foregoing, it is necessary, in order to provide an answer to the questions referred, to determine, in the first place, the nature of the transactions carried out within the context of the loyalty rewards schemes at issue in the cases in the main proceedings.

[41] It is evident from the orders for reference that the loyalty rewards schemes at issue were designed to encourage customers to make their purchases from particular traders. To that end, LMUK … provide[s] a number of services linked to the operation of those schemes.

[42] Nevertheless, the economic reality is that, under those schemes, loyalty rewards, which may consist of both goods and … services, are supplied by the redeemers to the customers."

61. At [47] the Court added:

"It is evident from the order for reference … that LMUK enters into contracts with the redeemers under which, when the redeemers supply loyalty rewards to customers in return for points, LMUK pays to those redeemers an agreed value for those points. Thus, under the contract entered into by LMUK with each redeemer, the possibility of the redeemers receiving any payment from LMUK is in fact conditional on the supply by the redeemers of loyalty rewards to the customers, rewards which can take the form not only of tangible goods but also of services. Only in this way can the redeemers obtain points which then give rise to the making of payment by LMUK."

62. A supply of goods or services "for consideration", within the meaning of the Directives, presupposes the existence of a direct link between the goods or services provided and the consideration received. Here, however, the price the Clubcard Members paid to Stores or to Clubcard Partners for premium goods and services was the same as that charged to other customers. It was well established that a retailer offering points in such a manner could not contend that the price paid contained an element representing the value of the points, vouchers, Rewards Tokens or Rewards. As the court put it in *LMUK-ECJ* at [53]:

"In that context, it should be borne in mind that, in relation to a loyalty rewards scheme whereby an oil company handed over goods to purchasers of fuel in exchange for points which those purchasers had obtained, the number dependent on the quantity of fuel purchased, by paying the retail price at the pump, the court held that the oil company could not reasonably maintain that the price paid by the purchasers of fuel in fact contained an element representing the value of the points or the goods supplied in exchange for those points because the fuel purchaser, whether he took the points or not, had to pay the same retail price (see, to that effect, *Kuwait Petroleum (GB) Ltd v Customs and Excise Comrs* (Case C-48/97) [1999] STC 488, [1999] ECR I-2323, para 31)."

63. The court went on, at [55], to observe that:

> "…the sale of goods and the supplies of services giving rise to the award of points to customers, on the one hand, and the supply of loyalty rewards in exchange for those points, on the other hand, are two separate transactions."

64. At [56] it added (though this too is well-established) that it is not necessary that the consideration for the latter supply is obtained directly from the person to whom those goods or services are supplied. Here, it was quite clear, Ms Foster said, that the consideration for the reward supplied to the Clubcard Member was obtained from Freetime. It was the handing over by the Clubcard Member to a Deal Partner of a Reward Token which triggered a payment by Freetime to the Deal Partner. The court put it this way, at [57]:

> "… it is evident from the order for reference in [LMUK] that the exchange of points by the customers with the redeemers gives rise to the making of a payment by LMUK to those redeemers. The amount of that payment is the sum total of the charges, which are of a fixed amount for each point redeemed against all or part of the price of the loyalty reward. In that context, it must be considered that, as maintained by the United Kingdom government, that payment corresponds to the consideration for the supply of the loyalty rewards."

65. What is clear in this case, on any analysis, is that the Deal Partner supplies the reward to the Clubcard Member; no-one else is in a position to enjoy that reward. The appellants themselves appear to accept that that is so. Put another way, the agreements between Freetime and the Deal Partners were simply arrangements under which the Deal Partner made a supply to the customer, with the consideration for the supply being paid by Freetime.

66. It is equally clear, says Ms Foster, that Freetime pays the Deal Partners to make those supplies, and it is for those supplies, and only those supplies, that its payments represent the consideration. The payments are, therefore, third party consideration for supplies by the Deal Partners to the Clubcard Members. It is possible, as the ECJ indicated at [63] and [64], that the sums paid by LMUK to the redeemers might be the consideration for two supplies, of rewards to participants and of redemption services to LMUK or, here, Freetime; but it recorded that LMUK did not advance that case. If it had done, the court said, it would be a matter for the national court to determine. Here, too, Freetime had expressly stated in its reply to HMRC's statement of case that it was not arguing for apportionment between two putative supplies; its case was that the entirety of the payments it made to the Deal Partners were the consideration for redemption, or fulfilment, services.

67. Ms Foster did not accept that the Supreme Court was right, in *LMUK-SC*, to reach a different conclusion; on the contrary, she said, the minority was correct to say that it was not a course open to it. Even if the Supreme Court was right, however, Ms Foster said, there were differences between the Nectar and Clubcard schemes which must lead to the conclusion that the outcome in that case cannot be applied to the facts of this scheme. The differences on which Ms Foster relied were those features of the Nectar scheme which Lord Reed identified as the justification for the Supreme Court to depart from *LMUK-ECJ*. They were that Nectar points represented the collectors' "contractual rights to receive goods and services at no cost or at a reduced cost"; that sponsors paid LMUK for granting the collectors those contractual rights to obtain goods and services in exchange for their points; and that the points were supplied by LMUK to collectors pursuant to a taxable supply by LMUK.

68. By contrast, at least in respect of points awarded by Stores itself, the Clubcard programme is essentially an "in-house" scheme and is indistinguishable from the Baxi scheme considered by the ECJ in *LMUK-ECJ*, but only indirectly, and as a comparator, by the Supreme Court in *LMUK-SC*; Clubcard points do not confer or represent any kind of contractual right in the Clubcard Member to receive goods or services at no cost or at a reduced cost; and Clubcard points do not represent anything more than a record that the Clubcard Member has spent a certain amount of money in purchasing goods or services from Stores or a Clubcard Partner.

69. I will return to the first of those points in my conclusions. As to the other points, Ms Foster's argument was that an individual point, in itself, had no value; it could not be exchanged or redeemed for anything, it could not be used to obtain any supply of goods or services and it could not be linked to any identifiable supply of goods or services. It was only if a Clubcard Member accumulated sufficient points and then had those points converted into vouchers that he acquired the ability to obtain benefits, whether of redemption goods or in accordance with the Partner Boost feature of the scheme. As Jonathan Parker LJ explained in *Tesco plc*, conversion of points into vouchers at the end of each quarter was neither automatic nor (unless the Clubcard Member happened to have an exact multiple of 50 points) complete, and was a subsequent, and distinct, stage in the operation of the scheme. Awards of points therefore represented an expectation of future benefit, but only if the scheme remained in existence and unchanged.

70. In reality, the Clubcard Member who elected to convert his vouchers to Reward Tokens received no supply of anything of substance until the Deal Partner actually provided the Reward to him in exchange for a valid Reward Token. It was only at that point that Freetime came under any obligation to the Clubcard Member, and that obligation was to provide the (third party) consideration for the reward.

71. Lord Reed concluded his judgment in *LMUK-SC* with these remarks:

> "[84] If one asks, what about taxation of the supply to the final consumer, the answer is that the Commissioners have decided to treat the issue of the points to the collectors—that is to say, the award of the right to obtain goods and services from redeemers—as a taxable supply. The taxable amount is agreed to be the whole of the consideration received by LMUK for the grant of those rights: an amount which exceeds the value received by the redeemers from LMUK when the rights are exercised. No question arises in this appeal as to whether that tax treatment is correct. Because of the principle of tax neutrality, however, that tax treatment has implications for the question in issue.
>
> [85] As the Court of Appeal pointed out, if the provision of goods or services by redeemers were treated as a taxable supply to the collector (other than to the extent to which any monetary consideration might be paid by the collector), the tax authorities would receive not only VAT on the amount received by LMUK for supplying the right to receive those goods and services, but also VAT on the amount which LMUK must pay to satisfy that right. If, on the other hand, the consideration paid by LMUK to the redeemers is regarded as the consideration for the supply of a service to LMUK (a service which encompasses the provision of goods and services to collectors), the tax authorities will still receive VAT from LMUK on the difference between the value of the supplies which it makes in the course of its business (ie its receipts from the supply of the right to receive such goods and services) and the value of the supplies which it receives for the purposes

> of that business (ie the cost to LMUK of satisfying that right). The tax authorities will thus recover VAT on the value added by the taxable transactions entered into by LMUK, taking the issue and redemption of points as a whole. That conclusion is in accordance with the basic principle of VAT."

72. Those comments are explicable, said Ms Foster, only if LMUK's supplies are considered to have been made to the collectors in the form of contractual rights to receive goods or services. If that were not so, the final consumption of the rewards would be untaxed. On the facts of this case the appellants cannot suggest that there is simply a single chain of supply, in which the tax "sticks" to the final consumer, the Clubcard Member, by reason of the prior taxable supply of premium goods or services by Stores or a Clubcard Partner to him, and that the reward he eventually receives is paid for by reason of that prior supply—in other words, that the price paid by the Clubcard Member for the premium goods included an element of consideration for the reward. Such a suggestion would be contrary not only to the analysis in *LMUK-ECJ*, but also that of Lord Reed in *LMUK-SC*.

73. Their analyses both assumed two chains of transactions, one ending in the supply of premium goods or services to the collector, the other ending in the provision of the reward. On Lord Reed's analysis, it was not the supplies of premium goods or services that achieved "sticking" taxation on final consumption of the rewards; the taxed consideration paid for those supplies was the same whether or not they were made to a collector and led to the issue of points. That was an inevitable conclusion in the light of what the ECJ said in *Kuwait Petroleum* and in *LMUK-ECJ* at [53] (see para 62 above). In other words, VAT could only "stick" to the final consumer (*ie* the collector) if it could be established that there was a taxable supply (that is, a supply made for consideration) to the collector, the price for which included some element representing the value of the points awarded, or of the rewards eventually supplied in exchange for them. but here, as in the LMUK litigation, that was not the case: the price of premium goods was the same whether or not points were taken. Lord Reed was able to find "sticking" tax in that case in the supply by LMUK to the collectors of contractual rights to rewards, a feature absent from this case.

Discussion and conclusions

74. I have laboured, I regret for too long, to reconcile the competing requirements that I must pay heed to the contractual position, to the economic reality of the facts as I find them to be, and to prior authority; and I have been puzzled by the extent of that authority. The arguments in this appeal occupied four days of tribunal time, and resulted in several rounds of submissions and responses after the hearing had concluded. Those factors have caused me to wonder, both during the hearing and thereafter, whether there is some complication to loyalty schemes such as the Clubcard scheme which has escaped my notice since, try as I might to find that complication, I have failed. Rather, it seems to me that the VAT analysis is in truth both simple and straightforward once one puts aside some misconceptions and understands how the scheme works.

75. I think it appropriate to begin with the argument about the status of *LMUK-SC*. I do not accept that I can do as Ms Foster suggested, that is effectively ignore what the majority of the Supreme Court said, and instead apply what was said by the ECJ, without more, to the facts of this case. One can understand Lord Carnwath's objection to the course the majority adopted; but it is plain from what Lord Reed said that the

majority was alive to the objection, yet felt able to put it aside. It is clearly not open to me to do otherwise.

76. It seems to me that two conclusions follow from Lord Reed's observations as I have set them out at para 50 above. The first is that what the ECJ said must be treated with some caution, and is to be read in the light of the facts as the court understood them to be, rather than as they were. The second is that where there is, or perhaps more accurately appears to be, a conflict which is material in this case between *LMUK-SC* and *LMUK-ECJ*, I must follow the former because judges at the highest level in the United Kingdom, whose decision is of course binding on me, have already considered and resolved the conflict. In other words, if there is a finding of the Supreme Court in *LMUK-SC* decisive of any issue before me I must follow it and disregard any apparently corresponding finding of the ECJ in *LMUK-ECJ* because, as the Supreme Court has explained, that finding was based on a false understanding of the relevant facts.

77. Both parties urged me to have proper regard to economic reality, as indeed the authorities require, but in my view the flaw in HMRC's argument is that it does not, itself, reflect the economic reality. The underlying theme of their argument is that the Clubcard Member is getting "something for nothing", a supply from the Deal Partner "essentially for free", as their skeleton argument puts it, and there is correspondingly untaxed consumption. In my judgment both of those premises—"something for nothing" and untaxed consumption—are demonstrably false.

78. The foundation of their argument from which, as it seems to me, all else follows is at para 62.11 of their skeleton argument:

> "Following Case C-48/97 *Kuwait Petroleum (GB) Ltd v CCE* [1999] STC 488, neither Tesco nor Freetime can contend that the price paid for the purchase of premium goods or services from Tesco contained an element representing the value of the points, Vouchers, Rewards Tokens or Rewards, because the customer had to pay the same retail price for the premium goods/services whether or not he or she took the Tesco Clubcard points: cf. *LMUK ECJ*, §53. Indeed, the Appellants do not contend otherwise: see Reply, §3(a), (b)."

79. I should make the point at once that that is an overstatement of the appellants' position. The relevant passage in para 3 of the Reply is as follows:

> "a. the initial issue of Clubcard points by Tesco to Clubcard Members is not a supply (the member pays no consideration for the points);
>
> b. the subsequent conversion of points to Clubcard vouchers is not a supply (again, the member pays no consideration)."

80. The paragraph does not go on to accept that there is no element of the price paid for premium goods which reflects the cost of the scheme. On the contrary, at para 57 of the Reply, the appellants say in clear terms that it *is* part of their case that the purchase price of premium goods includes an element representing the cost of the scheme. As I have already indicated I accept Mr Graham's evidence that this is the case.

81. The proposition that the price of the goods does not reflect the cost of the scheme stems, as para 62.11 of HMRC's skeleton argument indicates, from what the ECJ said in *Kuwait Petroleum*. The paragraph of the judgment in point, paragraph [31], is as follows:

> "… it is not contested that the retail price of Q8 fuel, whether or not the purchaser accepted the vouchers, was the same, and this was the only price referred to on the invoice relating to the fuel purchase which, pursuant to art 22(3) of the Sixth Directive, Kuwait Petroleum or the independent retailers had to issue to the customers who were themselves taxable persons. That being so, Kuwait Petroleum cannot reasonably maintain that, contrary to the statements on the invoices which it issued, the price paid by the purchasers of fuel in fact contained a component representing the value of the Q8 vouchers or of the redemption goods."

82. I confess that I have encountered great difficulty with that paragraph, not only in this case but in others too. The difficulty arises because, if the second sentence is intended to be a statement of general principle, it is a *non sequitur* and, if I may respectfully say so, as a statement of general principle would be manifestly wrong. Rather, I think, it was a statement made in the factual context of the case before the court, which related to a loyalty scheme differing in several ways from the Clubcard scheme. I propose therefore to adopt the same course as Lord Reed in *LMUK-SC*, by not treating as dispositive in one factual context a statement of the ECJ made in a different factual context.

83. I shall explain shortly why I think para 62.11 contains a proposition for which there is no warrant. At para 63 the skeleton argument draws the threads, as HMRC perceive them, together:

> "The Court's conclusion in *LMUK ECJ* is unsurprising, and follows the logic of the VAT system. Under that system, final consumption is to be subject to the tax. Final consumption has taken place: the Clubcard Member (i.e. the end consumer, at the end of the value chain) has consumed the reward services supplied by the immediate taxable person (i.e. the Deal Partner) and has done so in return for consideration. That is a taxable supply and tax has to be paid in respect of it (or in respect of the value chain that ends at the Member), by someone. Neither *LMUK SC* nor the Appellants offer any answer as to who pays that tax."

84. Those two paragraphs of the skeleton argument, in my view, reveal the underlying error of HMRC's approach, namely that there is consumption which is untaxed. With respect to its author, it seems to me that when one examines the economic reality of the arrangements the answer to the implicit question posed by para 63 is obvious: it is the customer who pays the tax. I recognise, as does para 3 of the appellants' Reply, that the provision of points to a Clubcard Member does not amount to a taxable supply since no identifiable consideration is paid for them: the Clubcard Member pays the same price for premium goods as any other customer. Similarly, the conversion of points into vouchers does not amount to a taxable supply. It is quite right, too, that the Clubcard Member does not pay, in a direct sense, for the points, or the vouchers. Thus the concessions, if that is the right term, at paras 3.a and b of the Reply are correct; moreover they were inevitable in the light of *Kuwait Petroleum* and *Tesco plc*.

85. But the question, in my view, is not whether there is a VAT-recognised supply of points, or whether the customer pays identifiable consideration for the points; the question is whether the customer bears the economic burden of the scheme. There is only one possible answer to that question: Yes. I do not see that as heresy; without deciding the point, because it was unnecessary for the decision in that case, Jonathan Parker LJ clearly recognised, at [166] of his judgment in *Tesco plc* (see para 30 above),

the possibility, to put it no higher, that some of what the customers were paying was attributable to the points.

86. Among the submissions with which I was provided, some during and more still following the hearing, were arguments and counter-arguments, illustrated by charts with multiple arrows, about the flows of consideration within the scheme. It seems to me, however, that the point can become over-complicated and is more productively illustrated by a simple analogy, which in turn leads to an equally simple description of the scheme which shows that, contrary to Ms Foster's argument, art 1(2) of the PVD is not offended: the tax charged, if Freetime is right, is exactly proportional to the price of the goods and services supplied.

87. The analogy is this. Until they were compelled by law to charge for them, retailers commonly handed over plastic carrier bags to their customers in order that they could conveniently carry their purchases home. The bags were "free" to the customer in the same sense as the points in this case are "free": the price of the goods was the same whether or not the customer took a bag. But it is an untenable proposition that the customer did not pay for the bag; the price charged for the goods included an element, small though it might have been, reflecting the cost to the retailer of providing it. It is an equally untenable proposition, and moreover contrary to the evidence of Mr Graham which I have accepted, that Stores did not factor the cost of the scheme into the prices it charged to its customers, whether or not they were Clubcard Members. In other words, a small part of what is paid for premium goods in Stores' shop contributes to funding the meal a Clubcard Member using his Reward Tokens eventually eats in the Deal Partner's restaurant.

88. That proposition can be developed in this way, using hypothetical figures. A retailer might sell standard-rated goods for, say, 100 plus VAT. Of that 100, 75 is the price of the goods paid to the manufacturer, producer or wholesaler, 5 is the cost of transport and warehousing, 5 is the cost of the retail premises, 5 is attributable to staff costs, 3 represents general overheads such as head office costs and advertising, 2 the cost of a loyalty scheme and the remaining 5 is profit. No-one would say that the customer is receiving a supply of, or paying a price for, warehousing or advertising services, but he is nevertheless bearing their economic cost. If the retailer is to make a profit, he will not do so by charging only the aggregate of the manufacturer's price and his desired profit, in the example 80; he must factor all of the incidental costs into the selling price of 100. The customer is buying goods, not warehousing or advertising services or points, but he nevertheless pays the entire 100. That amount is taxable with the consequence that the customer pays (at the current standard rate) 120. Importantly, the 2, representing the cost of the loyalty scheme, has borne tax. I recognise that Stores sells many goods which are zero-rated, and some taxed at the reduced rate, but that does not seem to me to affect the principle; the goods have borne tax at the rate set by Parliament, even if that rate is 0%. For simplicity I assume in what follows that the goods and services referred to are all standard-rated.

89. Suppose that a customer has bought premium goods for £1000 and has in consequence received vouchers with a face value of £10 (leaving out of account differing award rates). He then uses the vouchers to pay for redemption goods with a shelf price of £10 (assuming for simplicity that full payment by voucher is permitted). Overall he will have paid, and Stores will have received, a VAT-inclusive amount of

£1000, and Stores will account for the VAT element in accordance with its retail scheme. HMRC accept, as I have said, that its doing so is correct—there is nothing beyond the customer's £1000 which represents taxable consideration. The same is the case if, by way of a short-term promotion, Stores accepts vouchers, in payment or part-payment for certain goods, at double their face value. If, in that case, the customer buys redemption goods with a shelf price of £20 using a voucher with a face value of £10, treated for the promotion as having a value of £20, he has still paid £1000, and Stores accounts for tax on that amount. Doubling the face value of the voucher does not add to the total consideration *actually* paid; no additional money is introduced. The same holds good if the Clubcard Member uses his voucher in part payment, and makes up the shortfall, say £10, in cash. Here, as HMRC accept, the taxable amount is still the total sum the Clubcard Member has paid, £1010.

90. Suppose instead that the customer converts his £10 voucher to Reward Tokens, with a face value of, say, £40, which he then uses in part payment for a meal which would ordinarily cost £50. He is required to pay the difference of £10 and, again, his total payment is £1010. Stores has already accounted for the tax included in the £1000, and borne by the Clubcard Member, which has led to the provision of the points subsequently converted to vouchers and then to Reward Tokens, and the restaurant will account for the VAT included in the supplementary payment of £10. Thus, just as in the first example, everything paid by the customer has borne tax; there is no additional consideration which has somehow been magically introduced into the supply chain. I agree with Mr Peacock that it is impossible to understand why HMRC accept that in the first example, whether or not the face value of the voucher is multiplied, the tax-inclusive consideration is £1000, or £1010 if the voucher is used in part-payment, but in the second example they consider it should be something else. Although in the examples the Clubcard Member has converted his vouchers into different things there really is no economic difference between them. All that can be said is that in one case the Clubcard Member has used his points to obtain the apples of redemption goods, in the other to obtain the pears of a restaurant meal. In either case he has borne the economic cost of what he receives.

91. If HMRC's case is right, and art 1(2) of the PVD to the effect that the tax is "exactly proportional to the price of the goods and services" is to be respected, one has to identify what is the additional price, beyond (in the example I am using) the £1000 or £1010 already paid by the Clubcard Member, which attracts further tax. HMRC's position, in so far as I understand it, is that the amount paid by Freetime to the restaurant is that additional price: the restaurant has received some additional consideration (say £30 rather than the token's face value of £40, again using hypothetical figures, on the basis that the restaurant bears part of the burden of providing the reward). The restaurant will, of course, account for the VAT included in the £30. HMRC appear to take the view that if Freetime is allowed input tax credit for the same VAT element that proportion of the supply to the Clubcard Member will effectively go untaxed.

92. That line of argument depends for its validity on the premise that the £30 is new money injected by Freetime. But that premise, if I may say so self-evidently, is false. It is plain that the £30 is derived from (using the hypothesis set out above) the 2 representing the cost of the scheme, an amount which has been paid by the customer and which has borne tax. Translating that hypothesis to a customer who has bought

goods for £1000 to earn vouchers with a face value of £10 shows he will have borne a cost of £20 (£16.66 plus VAT of £3.34 assuming the premium goods were standard-rated) to acquire the vouchers. Those figures are, of course, illustrative, and do not necessarily represent the actual amounts.

93. One can test what I have said by considering what would be the position if, instead, the customer were to be offered a choice: pay 98 for premium goods with no points, or pay 100 and be awarded points. In such a case there could be no doubt that a customer who elects to pay 100 is paying a taxable amount of 2 for the supply to him of the points, and that what follows—whether a purchase of redemption goods, a restaurant meal or entry to a museum—is the making good of what he has already paid for. In economic terms it makes absolutely no difference whether the 2 referable to the points is an overt price, or simply an element, unstated, contributing to the 100.

94. It seems to me plain beyond argument, from those examples, that the whole scheme is funded by the customer's taxed payment: the 2 is taken by Stores to meet the cost of supplying redemption goods for no additional, or reduced, consideration, and to meet the cost of the rewards supplied by Freetime and the Deal Partners. If Freetime is not allowed an input tax credit the 2, or at least part of it, will attract tax twice.

95. Ms Foster argued that double taxation is sometimes an inevitable consequence in a case of third party consideration, a proposition which finds some support in the judgment of Lord Carnwath in *LMUK-SC* (see [141]). That leads me to the question whether, notwithstanding what I have already said, the payments made by Freetime to the Deal Partners amounted to third party consideration.

96. It seems to me, however, that there is little I need to say on the subject since Lord Reed has already answered the point, in the extract of his judgment set out at para 50 above. Once one accepts, as I do, that no meaningful distinction can be drawn between the arrangements between LMUK and the redeemers on the one hand and Freetime and the Deal Partners on the other the answer given by Lord Reed, in particular at [80], is determinative in this case as it was there. It is immaterial, whether or not Lord Millett "went too far" in *Redrow*, that the Clubcard Member receives the goods or services provided by the Deal Partner; the Deal Partner is making a supply to Freetime of redemption services which are necessary to Freetime if it is to discharge its own obligations to the Clubcard Members, of making good the rewards to which they have become entitled, and to Stores of providing the Partner Boost element of the Clubcard scheme. In my judgment it necessarily follows that the VAT it incurs when paying for the redemption services is recoverable input tax in its hands.

97. I do not accept Ms Foster's argument that there is a closer similarity between this scheme and the Baxi scheme considered, with the Nectar scheme, in *LMUK-ECJ*. There, the arrangement was that the intermediary managing the scheme, and positioned between Baxi (the sponsor) and the collectors, would itself make direct supplies of rewards to the collectors. That, as it seems to me, is an arrangement which gives rise to different issues; moreover the question in that appeal was what Baxi, rather than the intermediary, could treat as its input tax.

98. I also see little substance to the argument that Lord Reed's analysis assumes two supply chains; not only am I unpersuaded that he did proceed on that basis, but if my own analysis of the arrangements in this case is right it makes no difference to the outcome. I am similarly unpersuaded that it is a matter of significance that the amounts

received by Freetime from Stores, and the amounts paid by Freetime to Deal Partners, were driven by and dependent upon the rate at which Clubcard Members chose to convert their vouchers to Reward Tokens and then use them. That was simply how the scheme worked.

99. For those reasons the appeals are allowed.

Appeal rights

100. 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.

Colin Bishopp

Tribunal Judge

Release date: 4 August 2017