[2016] UKFTT 56 (TC)

TC04855

Appeal number: TC/2010/05544

VALUE ADDED TAX – input tax repayment claim – whether the effect of VNLTO is that the Appellant cannot rely on the Lennartz mechanism – whether capital assets allocated on acquisition to business and whether there was private use within Article 6(2) (a) Sixth Directive

FIRST-TIER TRIBUNAL
TAX CHAMBER

THE WELLCOME TRUST LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE VICTORIA NICHOLL
HELEN MYERSCOUGH

Sitting in public at Royal Courts of Justice on 25 – 27 November 2015

Melanie Hall QC, instructed by KPMG, for the Appellant

Andrew Macnab, Counsel, instructed by the Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by The Wellcome Trust Limited ("Wellcome") against a decision of the Respondent ("HMRC") contained in a letter dated 25 January 2010 to refuse to allow Wellcome's claim for the repayment of input tax incurred on a building purchase and construction services using the "*Lennartz"* mechanism.

Background

2. Wellcome was incorporated on 24 April 1992 and was appointed to act as the sole corporate trustee of the Wellcome trust by an order of the High Court in 1992. The Wellcome trust was established under the terms of the Will of Sir Henry Wellcome, who died in 1936, and provided that the management of his shares in the Wellcome Foundation Ltd ("the Foundation") and a substantial part of his estate, should be held on the terms of a trust for the advancement of medical and scientific research for the improvement of the wellbeing of mankind ("the charitable purposes").

3. Wellcome is the representative member of its VAT group and it made a claim on 30 March 2009 for repayment of input tax incurred on the purchase of a building and substantial works of reconstruction of another property. The claim was made under regulation 29 of the VAT Regulations 1995 and sought to apply the mechanism authorised by the European Court of Justice (the "ECJ") in *Lennartz v Finanzamt Munchen III* (C-97/90) [1995] STC 514 ("*Lennartz"*).

4. In *Lennartz* the ECJ found that where a taxable person uses goods which are assets of his business partly also for private use or for purposes other than those of his business, he has in principle a right to treat them entirely as business assets and claim the input tax in full immediately and then account for output tax on private use of the goods over their economic life. This is referred to as the "*Lennartz* mechanism". It is permitted because the private use or use for purposes other than those of the business of goods forming part of the assets of a business is treated as a taxable supply of services (under Article 6(2) of the Sixth VAT Directive and implemented in paragraph 5(4) Schedule 4 VATA 1994) and so is liable to tax.

5. In the 2003 case of *Seeling v Finanzamt Starnberg (*C-269/00)[2003] STC 805 ("*Seeling")* the ECJ held that where a taxable person received supplies of construction services that resulted in the creation of a new business asset, the resulting asset can be brought within the *Lennartz* mechanism.

6. In 2003 HMRC sought, in their words, "to protect the revenue and prevent exploitation of the Lennartz mechanism, especially with regard to high value capital goods such as buildings purchased by charities or colleges and used mainly for non-business purposes", by introducing paragraph 5(4A) to Schedule 4 of VATA, which came into effect on 9 April 2003. Paragraph 5(4A) provided that where land, buildings or civil engineering works used in a business are put to non-business use, that was not a supply for a consideration and was therefore exempted from paragraph

5(4). This meant that there was no right to deduct input tax to the extent that it was attributable to non-business use. This legislation was found to be ultra vires in the ECJ case of *Charles and Charles-Tijmens v Staatssecretaris van Financien* (C-434/03)[2006] STC 1429 ("*Charles*").

7. In Business Brief 15/2005, HMRC announced that the *Lennartz* mechanism could be used on certain construction services and on purchasing land, buildings and civil engineering works following the decision in *Charles*. HMRC noted that back claims could be made for input tax incurred after 9 April 2003 but HMRC stated that "claims will not be accepted from periods prior to 9 April 2003, because businesses already had the option of using the Lennartz mechanism before that date and, having chosen not to use it, cannot change that choice now."

8. In 2003 Wellcome made a claim to apply the *Lennartz* mechanism to Babcock House. This building was purchased in 1998 and demolished in order to build a new construction that was attached to 183 Euston Road (The Wellcome Building). The Wellcome Building was linked via a tunnel to 210 Euston Road. This claim was refused on appeal in *The Wellcome Trust v The Commissioners for Her Majesty's Revenue & Customs* [2008] UKVAT V20731 (*"Wellcome Trust 2008"*).

9. Following the decisions *in Michael Fleming (t/a Bodycraft)* [2008] UKHL and *Conde Nast Publications Limited* [2008] UKHL 2, the three year time limit introduced into regulation 29 of the VAT Regulations 1995 ("regulation 29") for input tax claims had to be disapplied where the entitlement to deduct accrued before 1 May 1997. Accordingly, section 121 of the Finance Act 2008 provided a transitional period until 31 March 2009 to give taxpayers an opportunity to make a claim before the new time limits were introduced (a "*Fleming"* claim*)*.

10. Wellcome made the *Fleming* claim the subject of this appeal on the 30 March 2009 in respect of the input tax relating to, inter alia, (i) the purchase of the building at 210 Euston Road; (ii) extensive building works at The Wellcome Building (183 Euston Road) carried out between 1 October 1991 and 30 September 1994 and (iii) two other properties. The claim was originally in the sum of £13,700,000 but has since been reduced because the claim in respect of the two other properties has not been pursued and because the parties have agreed that it should be limited as explained in paragraph 49 below.

11. Wellcome's claim was split into two components:

(1) Payment of 3% of the VAT, representing the amount of input tax attributable to its taxable supplies ("***the First Claim***"); and

(2) Recovery of the remaining 97% of the VAT as under-recovered input tax which was now allowable under the *Lennartz* mechanism ("***the Second Claim***").

12. Wellcome also sought the payment of interest, calculated on a compound basis.

13. HMRC acknowledged the Claim on 6 April 2009. On 2 June 2009, HMRC wrote to Wellcome to accept the First Claim (it is understood that payment was made

on 8 June 2009) and to inform Wellcome that resolution of the Second Claim was to be deferred pending the decision in *VNLTO*.

14. By letter dated 25 January 2010, following the judgment in *VNLTO* and the issue of Revenue & Customs Brief 02/10, HMRC rejected the Second Claim.

15. Wellcome requested a review by letter dated 23 February 2010.

16. By letter dated 2 June 2010, HMRC's review upheld the decision to reject the Second Claim.

The facts

17. The facts are not in dispute and the content of the witness statements of John Hemming, Ian Macgregor, Philomena Gibbons and William Schupbach was not challenged.

18. The current constitution of the Wellcome trust was established by a scheme of the Charity Commissioners for England and Wales dated 20 February 2001. This sets out the objects of the trust at clause 4, and clause 5 provides that the trustee may exercise the powers and undertake its activities in furtherance of these objects. Wellcome, as trustee of the Wellcome trust, also carries on some economic activity, in the form of exempt supplies (related to its property portfolio) and some taxable supplies from the sale of duplicate books, the photo library and income from catering and vending machines. Wellcome is therefore partially exempt in relation to its economic activity. The split between (1) taxable supplies and (2) non-economic activity and exempt supplies is 3% taxable to 97% non-taxable.

19. The Wellcome trust's sole shareholding was in the Foundation until the mid-1980s when the decision was made to convert some of its interests into a managed investment fund. This enabled Wellcome to invest in a wider range of holdings, thereby maximising its assets so as to better enable it to achieve the charitable purposes. In 1984 it was considered prudent to diversify that holding and in 1985 the Charity Commission drew up a scheme authorising sales of parts of the shareholding in the Foundation.

20. The sale effected in 1985 made £200m available and this was used to make other investments, the proceeds from which were used for the charitable purposes. In 1986 the Foundation was floated on the stock market as a private limited company and renamed Wellcome plc. A High Court Order in July 1987 widened the trustee's investment powers considerably, including power to make investments in land. The Order required the trustee to have paramount regard to the trust's charitable status and to make all reasonable efforts to avoid engaging in trade when exercising investment powers. All investment activity was engaged in for the purposes of advancing the charitable purposes set out in Sir Henry Wellcome's Will.

21. In March 1992 a further tranche of sales was made ("the 1992 share sale"). These share sales reduced Wellcome's shareholding from 74% to 40% and involved a

long period of planning and considerable fees for the services of lawyers and financial consultants. The transactions raised £2.18bn.

22. In 1994 a dispute arose between Wellcome and HMRC concerning an input tax claim in respect of VAT paid in connection with the 1992 share sale to purchasers outside of the European Union ("EU"). The input tax claim corresponded to the percentage of shares sold to non EU residents. HMRC rejected Wellcome's case that the second share sale amounted to an economic activity and therefore refused to meet a claim for an input tax credit in respect of the services provided in connection with it.

23. A series of questions were referred to the European Court of Justice ("the ECJ") by the VAT Tribunal concerning the VAT status of the 1992 share sale and in particular whether it could be classified as an economic activity. The ECJ found in *Wellcome Trust Ltd v Customs and Excise* (Case C-155/94) [1996] STC 945 ("*Wellcome Trust CJEU*") that Wellcome must "be regarded as confining its activities to managing an investment portfolio in the same way as a private investor". It noted that neither the scale of the second share sale nor the employment of consultants could constitute criteria for distinguishing between the activities of a private investor, which fall outside the scope of the Directive and those of an investor whose transactions constitute an economic activity.

24. The Wellcome Building was originally built in the 1930s to house the Wellcome Foundation and Sir Henry Wellcome's various collections. Between 1989 and 1991 the building was substantially altered, adding 6,200 feet of usable space. The works were extremely extensive and cost in the region of £61,000,000. A new roof was built; and apart from the central core, the building above the 5th floor was removed and the 5th floor and above were reconstructed. When the works were completed, the finance and investment services division was moved to the Wellcome Building. It also provided replacement accommodation for the History Institute and the Science For Life Exhibition, together with accommodation for the Information Resources Centre, meeting rooms (some of which were hired to third parties), an auditorium with associated facilities and catering facilities operated by an external company.

25. Wellcome purchased 210 Euston Road in 1993 for £21,475,000. On completion of works the building was used as a photo library and housed certain support activities, such as the finance and investment services division. It opted to tax the building and 33% of the VAT charged on the acquisition and associated building works was reclaimed by Wellcome in its 03/95 VAT return by reference to the percentage of the building that was let. This did not preclude a *Lennartz* claim, and this claim and appeal as summarised in paragraphs 10-16 above relates to the *Lennartz* claim for balance of the input tax.

The Legislation

26. This case was presented largely by reference to the Sixth VAT Directive 1977 (77/388/EEC) ("Sixth Directive") as opposed to the relevant UK legislation as this is

cited in the case law referred to by the parties. At all material times the Sixth Directive states insofar as relevant:

27. Article 2 provides the following shall be subject to value added tax:

1. the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such ...

28. Article 4 provides:

"1. "Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity ..."

29. Article 5(6) provides:

"The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration. However, applications for the giving of samples or the making of gifts of small value for the purposes of the taxable person's business shall not be so treated.

> (a) ""Supply of services" shall mean any transaction which does not constitute a supply of goods within the meaning of Article 5.
>
> (b) Such transactions may include inter alia: - assignments of intangible property whether or not it is the subject of a document establishing title,
>
> (c) - obligations to refrain from an act or to tolerate an act or situation,
>
> (d) - the performances of services in pursuance of an order made by or in the name of a public authority or in pursuance of the law."

30. Article 6(2) provides that "the following shall be treated as supplies of services for consideration:

> "(a) the use of goods forming part of the assets of a business for the private use of the taxable person or of his staff or more generally for purposes other than those of his business where the value added tax on such goods is wholly or partly deductible;

(b) supplies of services carried out free of charge by the taxable person for his own private use or that of his staff or more generally for purposes other than those of his business.

Member States may derogate from the provisions of this paragraph provided that such derogation does not lead to distortion of competition."

31. Article 11A.1(c) of the Sixth Directive provides that the taxable amount shall be:

"(c) in respect of supplies referred to in Article 6(2), the full cost to the taxable person of providing the services."

32. Article 26(1)(a) of the Principal VAT Directive 2006 (2006/112/EC) ("The Principal VAT Directive") states insofar as relevant:

"1. Each of the following transactions shall be treated as a supply of services for consideration:

(a) the use of goods forming part of the assets of a business for the private use of a taxable person or of his staff or, more generally, for purposes other than those of his business, where the VAT on such goods was wholly or partly deductible;"

33. Article 17 of the Sixth VAT Directive states that:

"(2) In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) value added tax due or paid within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person; …

…

(5) As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible, only such proportion of the value added tax shall be deductible as is attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person."

34. Article 168 of the Principal VAT Directive states that:

"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; …"

35. Section 83(c) of the Value Added Tax Act 1994 ("VATA") states insofar as relevant:

"[(1)] Subject to [sections 83G and 84], an appeal shall lie to [the tribunal] with respect to any of the following matters—

[…]

(c) the amount of any input tax which may be credited to a person;"

36. Section 24 VATA provides, insofar as relevant:

"Input tax and output tax

(1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—

(a) VAT on the supply to him of any goods or services;

(b) VAT on the acquisition by him from another member State of any goods; and

(c) VAT paid or payable by him on the importation of any goods from a place outside the member States, being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

[…]

(5) Where goods or services supplied to a taxable person, goods acquired by a taxable person from another member State or goods imported by a taxable person from a place outside the member States are used or to be used partly for the purposes of a business carried on or to be carried on by him and partly for other purposes, VAT on supplies, acquisitions and importations shall be apportioned so that only so much as is referable to his business purposes is counted as his input tax.

(6) Regulations may provide-

(a) for VAT on the supply of goods or service to a taxable person, VAT on the acquisition of goods by a taxable person from other member States and VAT paid or payable by a taxable person on the importation of goods from places outside the member States to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents or other information as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases."

37. Section 25(2) VATA provides:

"(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.

…

(6) A deduction under subsection (2) above and payment of a VAT credit shall not be made or paid except on a claim made in such manner and at such time as may be determined by or under regulations; and, in the case of a person who has made no taxable supplies in the period concerned or any previous period, payment of a VAT credit shall be made subject to such conditions (if any) as HMRC think fit to impose, including conditions as to repayment in specified circumstances."

38. Section 26 VATA provides, insofar as relevant:

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

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course of furtherance of his business-

(a) taxable supplies;

(b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom; and

(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection."

39. Paragraph 5(4) of Schedule 4 to VATA provides:

"(4) Where by or under the directions of a person carrying on a business goods held or used for the purposes of the business are put to any private use or are used, or made available to any person for use, for any purpose other than a purpose of the business, whether or not for a consideration, that is a supply of services."

40. At the time of the claim regulation 29 of the Value Added Tax Regulations 1995 provided inter alia:

"29-(1) Subject to paragraph (1A) and (2) below, and save as HMRC may otherwise allow or direct either generally or specially, a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable.

(1A) HMRC shall not allow or direct a person to make any claim for deduction of input tax in terms such that the deduction would fall to be claimed more than 3 years after the date by which the return for the prescribed accounting period in which the VAT became chargeable is required to be made."

41. Section 121 of the Finance Act 2008 provides insofar as relevant:

"(2) The requirement in section 25(6) of VATA 1994 that a claim for deduction of input tax be made at such time as may be determined by or under regulations does not apply to a claim for deduction of input tax that became chargeable, and in respect of which the claimant held the required evidence, in a prescribed accounting period ending before 1 May 1997 if the claim is made before 1 April 2009.

(3) In this section—

"input tax" and "prescribed accounting period" have the same meaning as in VATA 1994 (see section 96 of that Act), and

"the required evidence" means the evidence of the charge to value added tax specified in or under regulation 29(2) of the Value Added Tax Regulations 1995 (SI 1995/2518).

(4) This section is treated as having come into force on 19 March 2008."

Submissions

42. Ms Hall put forward her submissions under three main headings:

(1) The narrow scope of the judgment in VNLTO does not affect Wellcome's claim

Ms Hall submits that *VNLTO* is narrow in scope. The ECJ was at pains to point out that its reasoning was based upon the particular fact pattern before it. *VNLTO* concerned the use of certain goods and services other than for taxable transactions and so the conditions for the application of Article 17(2) were not satisfied, whereas *Lennartz* concerned the 100% allocation of a capital asset to the taxable business. The ECJ's consideration of *VNLTO's* claim did not relate to its capital assets and it was concerned that there was no means of collecting the output tax over the life of an enduring asset as envisaged by *Lennartz*. Article 11A.1(c) was not even mentioned in *VLNTO*. *VLNTO* shared one characteristic with this appeal in that it did not (relevantly) make any third party supplies. The fundamental distinction between *VNLTO* and this case is that this was the only reason *VLNTO*'s activities fell outside the scope of the VAT system. By contrast, Wellcome's investment activities fall outside the scope of VAT for that reason and because those activities represent no more than Wellcome enjoying the benefits of owning assets, which is why the ECJ assimilated them to those of a private individual enjoying the benefits of owning assets.

The ECJ in *VNLTO* reaffirmed its previous jurisprudence to the effect that the *Lennartz* mechanism is available with regard to the private use of assets. The question whether of *VNLTO* privately used its assets was not in play in the ECJ and so the facts of the case were distinguished from those of previous cases that concerned private use. The ECJ's focus was on *VNLTO*'s inability to make a clear distinction between its main corporate purpose and any non-business non-taxable activity which would entitle it to use the *Lennartz* mechanism. *VNLTO*'s non-taxable activity was an extension of and indistinguishable from the activity which was its main corporate purpose – promoting the interests of its members. By contrast, managing investments is not Wellcome's main purpose, which is to achieve the charitable purposes. Managing investments is simply one of the means by which it does so and these investment activities are carried on in the relevant buildings, together with taxable activities, such as catering, sub-letting space, hiring out rooms, and the sale of slides and prints to the public. It is important not to conflate activities with purpose.

HMRC are wrong to combine the reasoning in paragraphs 38 and 39 of the ECJ decision in *VNLTO* to create a new category of activity for the purposes of the *Lennartz* mechanism, comprising "the main corporate purpose" of an entity. Had the ECJ's intention been as radical as HMRC maintain, the ECJ would have made an explicit statement of the new principle, which does not even appear in the dispositif.

The explanation for the ECJ's conclusion in paragraph 38 that Article 6(2)(a) "is not intended to establish that transactions outside the scope of the VAT system may be considered to be carried out for "purposes other than" those of the business" is that Article 6(2)(a) is a derogation from the VAT system for the private use of goods to be taxed exceptionally. The provision must therefore be interpreted strictly as, to characterise Article 6(2)(a) as a general rule, would contradict Article 2(1) of the Sixth Directive and render it meaningless. This is quite distinct from the point made in by the ECJ in paragraph 39 which is that, unlike *Charles*, *VNLTO* could not identify any use (let alone a private use) which was completely different from its "main corporate purpose".

(2) The European Court of Justice has already determined that Wellcome's investment activities are activities engaged in as a private individual.

Wellcome Trust CJEU is the conclusion of a line of cases concerning investment activities and is exclusive jurisprudence for Wellcome that it carries out its investment management activities in the same way as a private investor. Paragraph 36 of the judgment in *Wellcome Trust CJEU* concludes as follows:

"… irrespective whether the activities in question are similar to those of an investment trust or a pension fund, the conclusion must be that a trust which is in a position such as that described by the referring tribunal must, in the light of art 4 of the Sixth Directive, be regarded as confining its

activities to managing an investment portfolio in the same way as a private investor.."

This finding reflects the fact that Wellcome is forbidden from entering a trade or taking a majority holding in other companies. The absence of any supplies being made to third parties was a key part of the ECJ's reasoning. This enabled the ECJ to identify private investors as relevant comparators for the purpose of the principle of fiscal neutrality and it avoided giving Wellcome unequal treatment vis-a-vis the taxation of other private investors. Nothing in VNLTO has modified this reasoning and the investment management activities continued to be carried on in qualitatively the same way in the same buildings.

(3) The timing of the election to apply the Lennartz mechanism and the timing of the claim are not points that can be relied upon by HMRC to refuse a claim in this case.

Wellcome always intended to use the buildings for business and private purposes. *Wellcome Trust 2008* confirms that the obligation in *Lennartz* is for there to be an intended business use at the time of acquisition, but that the claim for recovery does not have to be made at that time, subject to a consideration of whether there had been too long a time lapse. Intention is sufficient to establish the allocation of the buildings for the purposes of a *Lennartz* claim.

Wellcome did not have the option to use the *Lennartz* mechanism at the time the input tax was incurred because, at that time, HMRC did not accept that the *Lennartz* mechanism applied to the purchase of buildings or building works where those costs related to a building used for non- business purposes.

It is not clear at what point HMRC consider that an election to use *Lennartz* should have been made or on what basis they can refuse a retrospective claim. HMRC accepted retrospective claims after the decision in *Charles* and there is no fundamental principle or case law to prevent a retrospective claim. HMRC's published policy is not sufficient to take away a right under the directive.

Wellcome considers that the comments made by Judge Gort in *Wellcome Trust 2008* confirm that it could have made a retrospective *Lennartz* claim.

Ms Hall also reserved Wellcome's position to raise a new argument on appeal relating to the ongoing proceedings in Wolfgang and Dr Wilfried Rey Grundstucksgemeinshaft GbR v Finanzamt Krefeld (Case C-332/14)

During the course of the hearing Ms Hall reserved Wellcome's right to introduce a further argument on appeal, if necessary, based on the outcome of Case C-332/14.

43. Mr Macnab put forward the following submissions:

44. *(1)* The decision of the ECJ in *Securenta Gottinger Immobilienanlagen and Vermogensmanagement AG (as the legal successor of Gottinger Vermogensanlagen AG) v Finanzamt Gottingen* [2008] ECR1-1597("*Securenta*") is the starting point for

dealing with this claim. (1) The direct effect of the Sixth Directive and the Principal VAT Directive does not produce, and has never produced, a basis in EC law for a taxable person to recover VAT incurred in the purchase of capital assets that are to be used partly for economic and partly for non-economic business activities. This is confirmed by the ECJ in *VNLTO* and *Gemeente's-Hertogenbosch v Staatssecretaris van Financien* C-92/13[2014] ("*Hertogenbosch")*. Wellcome is instead entitled only to deduct input tax in accordance with section 24(5) VATA using the agreed ratio between (1) its taxable supplies and (2) its exempt supplies and non-economic activities, in accordance with the principles in Securenta. That agreed ratio is 3% (taxable) / 97% (non-taxable) and that entitlement has already been accommodated by HMRC.

45. *(2)* The *Lennartz* mechanism is only available in respect of works or acquisitions which are put partly to the use of the business and partly to uses which are private or otherwise outside the scope of the business. Prior to 2009 it was thought that *Lennartz* could be applied in relation to any activity viewed as 'non-business'. *VNLTO* clarified that *Lennartz* accounting does not apply to activities that, although "non-economic"/ "non-business", are pursued in a businesslike way. This extended the concept of "business" in the context of Article 6(2) beyond economic activities giving rise to supplies within the scope of VAT: it also includes activities that form part of the wider purpose of the taxable person's undertaking or enterprise, even those that are not economic activities and so are not normally regarded as "business" for UK VAT purposes. This means that the use of goods and services other than for business purposes does not apply to use in non-business or charitable activity unless that use is completely different from its main corporate purpose. This followed the ECJ's decision in *Danfoss A/S and another v Skatterministeriet* [2009] STC 701 ("*Danfoss*") that the words "other than those of its business" should be considered in the light of whether the needs of the company required it to provide the free meals.

On that basis, *Lennartz* accounting is now confined to situations where an input of the taxable person's business is put to strictly non-business use (private or as per the language of Revenue & Customs Brief 02/10 "other uses which are wholly outside the purposes of the taxpayer's enterprise or undertaking") giving rise to a deemed supply for VAT purposes.

The conclusion of the Court of Justice (and that of the AGO) in V*NLTO* applies squarely to the facts of Wellcome's case. It is clear that the scope of its business includes not just Wellcome's economic activities (i.e. taxable and exempt supplies) but also non-economic "business" activities falling within the corporate purpose of the entity. Wellcome's charitable activities (the charitable funding of scientific and medical research) and investment activities to fund those charitable activities are neither private nor outwith the corporate purpose of the entity. They are within its charitable purpose and "non-economic business activities" as were the activities considered in *VLNTO*.

46. *(3)* HMRC do not agree that the use of 'in the same way as a private investor' in *Wellcome Trust 2008* automatically equates to that activity being "private". Mr Macnab submits that paragraph 40 of the judgment in *Wellcome Trust 2008* indicates that actively investing its portfolio was the Wellcome's primary activity and that it

puts Wellcome on all fours with *VNLTO*, whose primary activity was a non-economic one but who still used their costs for a 'business' purpose. The term 'private investor' used in *Wellcome Trust 2008* is used to differentiate non-economic investors who may actively manage their portfolio but nonetheless simply enjoy the fruits of ownership of their assets (e.g. dividends) from commercial investors who either run an economic activity of dealing in shares or acquire shares in order to supply management services to the companies acquired. This does not prevent the management of Wellcome's investment portfolio from being part of the corporate purpose of the undertaking and so part of the "business". Therefore, although Wellcome's activities might be similar to those of a private investor, they cannot be classed as a private activity given that they constitute a primary purpose for the organisation and its activities.

The consideration of Wellcome's activities in *Wellcome Trust CJEU* did not address the context of private use in Article 6(2). In that context the term 'private' refers to costs used as an individual and not in pursuance of a business activity, whether economic or otherwise. Therefore, while it is not impossible for a legal person to have access to the *Lennartz* mechanism, it is more difficult than a claim by a natural person.

47. *(4)* The application of the *Lennartz* mechanism is conditional upon the taxable person electing to allocate the goods and services (if within *Lennartz*) wholly to the assets of its business at the time of their acquisition (or receipt). This means that a taxable person must decide whether goods are to be treated under the Lennartz mechanism in sufficient time for the tax to be deducted in the VAT return period when that tax was charged. Wellcome did not make or purport to make any such election at that time. Any claim now to seek to apply the *Lennartz* mechanism, some 15 years retrospectively, must be rejected.

HMRC submit that this obligation is reflected in the penultimate paragraph of Revenue & Customs Brief 02/10 which states that *Fleming Lennartz* claims will be rejected if "the taxpayer had not taken up the option to use *Lennartz* accounting at the time the input tax was incurred (where this was available) and/or where the *VNLTO* decision means that the claimants were not entitled to use *Lennartz* accounting as there was no EU law right to do so."

HMRC submits that *Wellcome Trust 2008* supports its view that the taxpayer is required to make an 'immediate choice' as to whether to adopt *Lennartz* accounting as the Tribunal found that Wellcome could have made an earlier claim yet chose not to do so. It is not sufficient to allocate the assets, as a claim must also be made under regulation 29 to use *Lennartz* accounting.

It is accepted that, after acquisition, the immediate use of the goods for taxable or exempt supplies is not a condition for the application of Lennartz, but output tax must be accounted for on the deemed supplies arising from private use from the outset of that use.

48. **The parties have agreed that the following are common ground:**

(1) Wellcome does not engage in trade.

(2) At all material times both taxable supplies and investment activities took place at 210 Euston Road and at the Wellcome Building.

(3) If Wellcome is entitled to make a retrospective election to use the *Lennartz* mechanism, it must, as a condition of being permitted to do so, account and give credit for the output tax in respect of the purchase and works on the deemed supplies in respect of private use from which any input tax is to be deducted.

(4) In 2009 HMRC repaid the input tax reclaimed by Wellcome on the basis of the agreed 3% taxable: 97% not attributable to taxable supplies apportionment. Simple interest was paid on the sums due.

49. **The parties have agreed that the Tribunal should not be asked to consider the following points on the basis that they will address quantum after this case has been decided:**

(1) Whether the scale and nature of the relevant works at The Wellcome Building was sufficient for Wellcome to create a new capital asset is not agreed between the parties. They have agreed that this should be considered in relation to quantum after this hearing has determined whether the claim is successful. We have been asked to assume that this was the case only for the purpose of applying the facts relating to the allocation and use of the building in order to determine whether the conditions for the application of the *Lennartz* mechanism have been met.

(2) The extent of the output tax, if any, accounted for by Wellcome in respect of private use has not been quantified and the Tribunal is not invited to consider any issues with regard to quantum. It is though relevant to note that the parties are not agreed whether the claim should be assessed on the basis that Wellcome was required to account for output tax over a period of 10 years or 20 years but, given the passage of time, Wellcome has no subsisting claim in respect of any principal sum by way of input tax credit, whichever adjustment period were to apply. Wellcome must be regarded as having accounted for all of the relevant output tax in the context of quantum.

(3) Following on from the points made in paragraph (2) above, this case only concerns whether a claim is payable in respect of the cash flow cost to Wellcome of the refusal to allow the *Lennartz* claim. The 3% input tax recoverable has been repaid with simple interest. The Tribunal is not asked to consider the quantum of the claim nor whether compound interest is due on any amounts payable.

Discussion

50. The *Lennartz* mechanism is available to a taxpayer who acquires an asset that will be used for both business and (i) private or (ii) other non-business purposes if it chooses to allocate the capital asset wholly to the assets of its business. This is set out in paragraphs 23 to 25 of *Charles* and adopted in the findings of the ECJ in paragraph

32 of *VNLTO*. This is an exception to the general position and is only available if the use will fall to be taxed under Article 6(2), and Article 11A.1(c) determines the amount of the charge.

51. As Advocate General Sharpston concludes in paragraph 52 of her opinion in *Hertogenbosch*, the issue addressed by the ECJ in *VNLTO* was whether Article 6(2)(a) could be applied to the use, for the purposes of transactions falling outside the scope of VAT, of goods and services acquired by *VNLTO* and allocated to its business. The ECJ held that the transactions in question were not capable of being considered to be non-business transactions given that they constituted the main corporate purpose of *VNLTO*. This was contrasted with *Charles* which concerned immovable property allocated to the assets of the business before being attributed, in part, to private use, 'by definition completely different from the business of the taxable person'.

52. In order therefore for the *Lennartz* mechanism to be capable of applying to the acquisition of the capital assets, they must be (a) acquired for business and either private or other non-business purposes within Article 6(2) as interpreted by the ECJ; and (b) allocated wholly to the assets of its business. This raises the two key points of dispute.

53. First, were the capital assets acquired by Wellcome for both business and private or other non-business use within Article 6(2)(a)? Is the effect of *VNLTO* that Wellcome cannot rely on the *Lennartz* mechanism? Second, if Wellcome satisfies the conditions for the potential application of the *Lennartz* mechanism, did it take the necessary action at the relevant times to make its claim? In particular, did it allocate the capital assets wholly to the business or were they integrated only to the extent to which they were actually used for business purposes?

1. Were the capital assets acquired for both business and private/other non-business use within Article 6(2) (a)? How is this affected by VNLTO?

Article 6(2)(a)

54. The deductions scheme of the Sixth Directive allows recovery of input tax only where there is a related taxable output. Where input tax recovery is claimed under the *Lennartz*, Article 6(2)(a) is the mechanism that creates the related taxable output without which the recovery claim cannot be made.

55. Mr Macnab has sought to rely on *Securenta* to support his argument that *Lennartz* cannot give rise to a right to deduct in Wellcome's case as there is mixed use of the buildings. The references to *Securenta* in paragraphs 37 and 38 of the *VNLTO* decision set out the general position that where a taxable person carries on both economic and non-economic activity outside the scope of VAT "deduction of the input VAT relating to expenditure is allowed only to the extent to which that expenditure may be attributed as an output to the economic activity of the taxable person". It goes on to explain that Article 6(2) cannot therefore be a general rule that extends to non-economic activity outside the scope of VAT. It is a derogating

provision that must be interpreted strictly as Article 2(1) would otherwise be rendered meaningless. But in those exceptional cases where Article 6(2) does apply to create a taxable output, it appears to us from ECJ case law such as *Charles* that, notwithstanding mixed use, Article 6(2) can operate and the *Lennartz* mechanism can be applied. Advocate General Jacobs explains it as follows at paragraph 60 of his opinion:

56. "if there is to be any overlap between the [types of use to which supplies are put] the first step must be to apply Articles 5(6) and 6(2), so that private use becomes a taxed output; then all the taxed outputs, including private use, must be aggregated and distinguished, for the application of Article 17(5), from exempt outputs".

57. The parties agree that there is no minimum percentage of taxable supplies required for the application of the *Lennartz* mechanism. Accordingly the 3% recovery by Wellcome is sufficient to satisfy the requirement of Article 6(2)(a) that the value added tax is partly deductible.

VNLTO

58. In *VNLTO* the ECJ distinguished the facts from those of *Charles* by explaining at paragraph 39 that "the main proceedings in the present case relates to transactions other than *VNLTO*'s taxable transactions, consisting in safeguarding the general interests of its members, and not capable of being considered, in this case, to be non-business transactions, given that they constitute the main corporate purpose of that association." This terminology makes clear that the activity in question, promoting he interests of its members, is outside the scope of VAT because it is not carried out as part of a taxable business, but it is part of its business purpose, being the main purpose of the organisation. It is therefore "non-economic business activity".

59. In the *Wellcome Trust CJEU* the ECJ found that the investment management activity concerned was outside the scope of VAT as it was not commercial share-dealing or trade. The fact that it was within the purpose or concern of the organisation could not bring it back within the scope of VAT. Similarly the fact that it is outside the scope of VAT does not necessarily make it for purposes 'other than those of [the] business'. The question is whether it is a non-business transaction for the purposes of Article 6(2)(a) or a "non-economic business activity" within *VNLTO.*

60. This conclusion is reflected in the opinion of Advocate General Sharpston in *Hertogenbosch* as she notes that she does "not consider that the reason for which activities or transactions fall outside the scope of VAT can be relevant to determining whether they constitute 'purposes other than those of [the] business'; what matters, according to *VNLTO* is whether they fall within the 'main corporate purpose' of the entity concerned."

61. *VNLTO* did not create a new category of activity for the purpose of applying the *Lennartz* mechanism, but it has clarified that Article 6(2)(a) should be interpreted strictly and so only provides for the taxation of the use of goods 'for purposes other than those of [the] business' if such use is outside the 'main corporate purpose'. The

decision is not limited to goods and services as considered in *VNLTO*, but applies to capital assets as noted by Advocate General Sharpston at paragraph 56 of her opinion in *Hertogenbosch.*

62. However, we agree with Ms Hall that *VNLTO* does not address 'private use' and that reference to 'private use' is only by way of contrast with use 'for purposes other than those of [the] business'. VNLTO has clarified the interpretation of 'for purposes other than those of [the] business' but this does not affect the interpretation of the first half of Article 6(2)(a) concerning 'private use'. This is confirmed by the ECJ in the later cases of *Danfoss* and *Hertogenbosch* which make a clear distinction between 'private use' and use for purposes other than those of the business. Indeed HMRC's Brief 02/10 following *VNLTO* refers to *Lennartz* accounting only being available where the goods are used for taxable supplies and "in part for the private purposes of the trader or his staff, or, exceptionally, for other uses which are wholly outside the purposes of the taxpayer's enterprise or undertaking."

63. On this basis we consider that the question of whether Wellcome's use of the buildings for investment management allows it to use the *Lennartz* mechanism should be considered under the two separate and alternative heads of (i) private use; or (ii) purposes 'other than those of [the] business' as clarified by *VNLTO*.

Purposes other than those of [the] business

64. Addressing the second head of 'purposes other than those of the business', Wellcome has submitted that its main corporate purpose is to secure the charitable purposes of the Wellcome Trust, not to engage in investment activity, which it describes as simply one of the means by which it does so. The question of whether use of the buildings for investment management is within this main corporate purpose has not been addressed here as Ms Hall made clear at the hearing that Wellcome wishes to rely on the argument that its use of the buildings for investment management is 'private use' within the first part of Article 6(2)(a). We have therefore gone on to consider the first head of whether the investment management is 'private use', noting only that, unlike the claim made in *Wellcome Trust 2008,* Wellcome has not claimed that any of its other non-business activities that are outside the scope of VAT fall within either head of Article 6(2)(a).

Private Use

65. Wellcome relies on the ECJ's decision in *Wellcome Trust CJEU* to support the argument that there is private use in relation to those parts of the buildings as were used for investment management activities. In *Wellcome Trust CJEU* the ECJ concluded at paragraph 37 that the buying and selling of shares by the trustee managing the assets of the charitable trust was outside the scope of the Sixth Directive. It found that the trustee was managing its portfolio in the same way as a private investor and that this was not economic activity for the purposes of Article 4(2) of the Sixth Directive.

66. Mr Macnab has drawn our attention to the fact that the ECJ was considering whether the activities were economic activities within Article 4 in the *Wellcome Trust CJEU* and that the ECJ did not consider Wellcome's investment activity in the context of Article 6(2)(a).

67. We have noted this point and that the context of Article 6(2)(a) is the imposition of a tax charge where goods are used "for the private use of the taxable person". As Advocate General Mengozzi noted at paragraphs 37 and 49 of the opinion in *VNLTO*, the ECJ's case law, such as *Finanzamt Munchen III v Mohsche* Case C-193-91 [1997] STC 195, make clear that Article 6(2)(a) is designed to prevent the non-taxation of business goods used for private purposes and should be interpreted strictly to tax the private use of goods only exceptionally.

68. We were also referred to *Danfoss* and *St John's College, Oxford v Her Majesty's Revenue and Customs* [2010] UKFTT 113 (TC) ("*St John's*") in relation to the nature of 'private use'. Both cases concerned the provision of free meals to staff rather than the use of capital goods, but *St John's* was heard after *VNLTO*. In *Danfoss* the ECJ held that the provision of meals free of charge to staff could come within Article 6(2) unless "the needs of the company, such as the need to ensure that work meetings are run smoothly and without interruptions, require the employer to ensure that meals are provided." In *St John's* Judge Hellier referred to *Danfoss* and *VNLTO* and noted that the phrase "for the purposes other than those of his business" at the end of Article 6(2)(b) "permeates and infects" the phrase 'private use'. While we note that this comment relates to Article 6(2)(b) rather than Article 6(2)(a), it reflects both the context and the strict interpretation the ECJ requires of Article 6(2). It is also consistent with the comment at paragraph 39 of the ECJ's decision in *VNLTO* which contrasts the use of the goods and services in *VNLTO* with the 'private use' in *Charles* as follows:

> "the situation in *Charles and Charles-Tijmens*, [which] concerned 'immovable property allocated to the assets of the business before being attributed, in part, to private use, *by definition completely different from the business of the taxable person*' (our emphasis added in italics).

69. With this case law in mind we have noted that the ECJ stated in *Wellcome Trust CJEU* that Wellcome's investment management was outside the scope of VAT because it was acting "in the same way as a private investor in reaping the rewards of ownership *to increase the value of its holdings"* (our emphasis added in italics). This reading is reflected in the statement at paragraph 40 of *Wellcome Trust CJEU* that notes that "whether or not the sale of shares and other securities is the predominant concern of the activity in the course of which the sales in question took place cannot affect the classification of that activity". Both statements suggest to us that although it does not bring the investment management within the scope of VAT, the investment activity is for the charitable purposes of the Wellcome Trust. This is confirmed by Mr Hemmings who concludes at paragraph 44 of his witness statement, "[the trustee has] always been required to manage the Trust assets so as to maximise the funds available to the Trust for the promotion of medical and scientific research."

70. Wellcome is acting as the trustee of the charitable trust in carrying out this activity in the offices, not as a corporate person or individual investment managers making private use of the offices. Wellcome *qua* trustee uses the offices in the same way whether it uses the offices for taxable or exempt property management, investment management or medical grant administration.

71. There is nothing 'different' (in the sense referred to by the ECJ as set out in paragraph 68 above) about Wellcome's use of the offices for investment management as compared to, say, use for the trust's property management or medical grant administration. The witness statements and minutes of the meetings about the acquisition and refurbishment of the buildings to include office space do not show any change in the capacity of the user, nor any different terms of use or accounting for investment management, as opposed to use by any other group of Wellcome employees. *Wellcome Trust CJEU* can be distinguished as it concerns the way in which the investment management activity is conducted, not how or what purpose the managers used the offices for.

72. For these reasons we find that, based on the facts, Wellcome's use of offices for investment management does not constitute 'private use' of the buildings to which the *Lennartz* mechanism can be applied.

2. Were the capital assets wholly allocated to the business or were they integrated only to the extent to which they were actually used for business purposes? Was the Lennartz claim made in time?

73. In case we are wrong in finding that there is no 'private use' of the buildings within Article 6(2)(a), we have set out our findings in relation to Wellcome's allocation of the two buildings to its business and the making of the claim.

74. Wellcome did not make any distinction between its internal office use for one trust purpose or another when acquiring and planning the use of the buildings. Mr Hemmings witness statement refers at paragraph 22 to the fact that "[the Trust's] approach to accounting for sums expended on premises is demonstrated in note 10 to the accounts for the year ending September 1991, in which it is stated that '*Expenditure on premises used by the Trust and its Institutes is written off at the time of expenditure as is the cost of subsequent alterations and improvements.*'".

75. The witness statement of Ian Macgregor, Deputy Director (Finance and Administration at the time of the relevant activities) confirms that it was always intended that the team involved in investment management should move into the Wellcome building upon completion of the works and this is what happened. They then moved into 210 Euston Road shortly after that building was purchased. Mr Macgregor cannot recall at what stage it was decided that the investment management team should make this move but his understanding is that 210 Euston Road was purchased with the specific intention of relocating Wellcome employees into the building while also letting out a proportion of the floor space.

76. We find that Wellcome intended to allocate the two buildings on acquisition and completion wholly to its business, being in part to provide accommodation for the trust's charitable activities and in part to lease space to third parties.

77. For completeness, we note that both parties have made further submissions in writing since the hearing in relation to regulation 29. This was raised in HMRC's oral submissions in the context of determining the point at which a *Lennartz* claim can or should be made. HMRC submit that a taxable person must decide whether goods are to be treated under the *Lennartz* mechanism in sufficient time for the tax to be deducted in the VAT return period when that tax is charged. This reflects HMRC's published policy. At the hearing Mr Macnab referred to regulation 29 as authority for this policy, but this oral submission was challenged by Ms Hall as a new point raised in rejoinder. It was agreed that in the circumstances Wellcome would make a written submission on this point after the hearing.

78. The written submission was made in a letter from KPMG dated 4 December 2015. This submits that Parliament cannot have intended that regulation 29 should debar a retrospective application. It also submits that, "such was the brevity of [HMRC's] submission, in relation to a Regulation which has changed many times over the years, that the Wellcome Trust should not be burdened with addressing it in any detail at this late stage". HMRC's response by letter dated 16 December 2015 submits that it was not seeking to introduce a new point but to address Wellcome's submission that there is no domestic legislation that requires a *Lennartz* election to be made in the tax period in which the input tax could first be deducted not satisfy the conditions.

79. Given our finding that the investment management does not constitute private use of the offices we are not required to go on and consider regulation 29 as Wellcome has not proved that there was 'private use' of the buildings. We note however that the parties agree that regulation 29 is the mechanism for making a *Lennartz* claim and that the dispute relates to when and how a claim may be made.

80. We also record our findings with regard to Wellcome's intention to make a *Lennartz* claim in respect of the buildings. In order for a *Lennartz* claim to be made there is a critical and "corresponding obligation" to account for the output tax on the private use (as referred to by the ECJ in *Seeling* at paragraph 43 and paragraph 30 of *Charles*). We have not been provided with the evidence about the basis on which Wellcome accounted for output tax under Article 6(2)(a) as the parties have reserved this issue to be considered in relation to quantum as noted in paragraph 49 above. It is common ground that Wellcome would have to account and give credit for this output tax as part of its claim. If however, as Mr Macnab has suggested, no output tax was accounted for it suggests that Wellcome chose not to apply the *Lennartz* mechanism until it made this claim as it did not account for 'private use' of the buildings within Article 6(2)(a).

81. This is consistent with the finding at paragraph 29 in *Wellcome Trust 2008* about the consideration Wellcome gave to applying the *Lennartz* mechanism before making its claim in respect of Babcock House. This notes that Mr Hemming was

aware of professional advice to the effect that it was difficult to apply *Lennartz* and that he saw complications in keeping records of expenditure, monitoring use, allocation of business/non-business use and how to deal with that within a capital goods scheme and partial exemption. As the Tribunal held in *Wellcome Trust 2008*, we find from Mr Hemming's evidence that, in the absence of evidence being provided of accounting for 'private use', Wellcome must be taken to have considered but rejected the possibility of a *Lennartz* claim in respect of 'private use' of the adjacent Wellcome Building and 210 Euston Road until after the evidence was given in the *Wellcome Trust 2008* hearing.

Decision

82. For these reasons set out above the appeal is refused.

83. 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.

VICTORIA NICHOLL
TRIBUNAL JUDGE

RELEASE DATE: 1 FEBRUARY 2016

Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on