



TC07910

*VAT – Local authority – sports and leisure facilities – whether economic activity – Art 9
PVD – whether engaging as a public authority - Art 13 PVD – Note 3 Group 10 sch 9 VATA
1994*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2011/7844

BETWEEN

MIDLOTHIAN COUNCIL

Appellant

-and-

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

Respondents

**TRIBUNAL: JUDGE PETER KEMPSTER
JUDGE ANNE SCOTT
JUDGE ALASTAIR RANKIN**

Sitting in public at Taylor House, London on 23-26 September 2019

Amanda Brown and Adam Rycroft, KPMG LLP for the Appellant

**Raymond Hill of counsel (instructed by the General Counsel and Solicitor to HM
Revenue and Customs) for the Respondents**

DECISION

BACKGROUND

1. A dispute has arisen between local council authorities across the UK and the Respondents (“**HMRC**”) concerning the VAT liability of charges paid by members of the public for access to sports and leisure facilities provided by those authorities. HMRC contend that the charges should bear VAT at the standard rate; the local authorities disagree.
2. In case management of the appeals (of which there is a large number) it was directed that:
 - (1) Consideration may need to be given to the statutory provisions relating to local authorities in the constituent parts of the UK, which vary by jurisdiction.
 - (2) A single lead case (Tribunal Procedure Rule 5(3)(b) refers) should be identified for each of the three territorial jurisdictions: England & Wales, Scotland and Northern Ireland.
 - (3) The nominated lead cases were Chelmsford City Council (TC/2011/7816) for England & Wales; the Appellant for Scotland; and Mid Ulster District Council (formerly Magherafelt District Council) (TC/2011/687 & TC/20102/9253) for Northern Ireland.
 - (4) The Tribunal panel to hear all three lead appeals would consist of three Judges, together qualified in the three jurisdictions. The then Chamber President confirmed the panel as constituted, and nominated Judge Kempster as the presiding member (Senior President’s Practice Statement of 10 March 2009, paras 7 & 8, refers).
 - (5) For administrative reasons, the appeal of Mid Ulster District Council would be heard first, followed by a hearing of the other two lead cases together. The Tribunal’s decisions on the three appeals would be released together.

INTRODUCTION

3. By a voluntary disclosure submitted in September 2010 the Appellant (“**the Council**”) claimed repayment of VAT allegedly overpaid in VAT accounting periods between 2006 and 2010, totalling around £1 million.¹ The claim was rejected by HMRC, and the Council appeals to the Tribunal.
4. In brief summary, the Council contends (and HMRC disputes) that the charges in dispute do not attract VAT on three alternative grounds:
 - (1) Its supplies of sporting and leisure activities to members of the public are not “economic activities”, and are therefore outside the scope of VAT;
 - (2) Its supplies of sporting and leisure activities to members of the public are provided by the Council in its role as a public authority acting under a special legal regime, and therefore it is not a taxable person in respect of those supplies; or
 - (3) Its supplies of sporting and leisure activities to members of the public are provided by the Council in its role as a public authority, and therefore it is not a

¹ There are also disputed claims (on the same basis) proceeding under separate appeals before the Tribunal for periods between 1981 and 2018.

taxable person in respect of those supplies, by virtue of Note 3 Group 10 sch 9 VAT Act 1994.

LEGISLATIVE PROVISIONS

VAT Legislation

5. Article 2 Principal VAT Directive (2006/112/EC) (“**PVD**”), provides, so far as relevant:

“1. The following transactions shall be subject to VAT: ...

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

6. Article 9 PVD provides, so far as relevant:

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

Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity. ...”

7. Article 13 PVD provides, so far as relevant:

“1. States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions.

However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition. ...

2. Member States may regard activities, exempt under Articles 132, ..., engaged in by bodies governed by public law as activities in which those bodies engage as public authorities.”

8. Article 132 PVD provides, so far as relevant:

“Exemptions for certain activities in the public interest

1. Member States shall exempt the following transactions:

...

(m) the supply of certain services closely linked to sport or physical education by non-profit-making organisations to persons taking part in sport or physical education; ...”

9. Article 133 PVD provides:

“ Member States may make the granting to bodies other than those governed by public law of each exemption provided for in points (b), (g), (h), (i), (l),

(m) and (n) of Article 132(1) subject in each individual case to one or more of the following conditions:

- (a) the bodies in question must not systematically aim to make a profit, and any surpluses nevertheless arising must not be distributed, but must be assigned to the continuance or improvement of the services supplied;
- (b) those bodies must be managed and administered on an essentially voluntary basis by persons who have no direct or indirect interest, either themselves or through intermediaries, in the results of the activities concerned;
- (c) those bodies must charge prices which are approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to VAT;
- (d) the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT.

Member States which, pursuant to Annex E of Directive 77/388/ EEC, on 1 January 1989 applied VAT to the transactions referred to in Article 132(1)(m) and (n) may also apply the conditions provided for in point (d) of the first paragraph when the said supply of goods or services by bodies governed by public law is granted exemption.”

10. The relevant UK VAT legislation, which (save as below) does not need to be quoted here, is in ss 1, 4, 5(2), 24, 41A, and 42 VAT Act 1994 (“VATA”).

11. Section 33 VATA provides, so far as relevant:

“Refunds of VAT in certain cases.

(1) Subject to the following provisions of this section, where—

- (a) VAT is chargeable on the supply of goods or services to a body to which this section applies, ..., and
- (b) the supply, ... is not for the purpose of any business carried on by the body,

the Commissioners shall, on a claim made by the body at such time and in such form and manner as the Commissioners may determine, refund to it the amount of the VAT so chargeable.

(2) Where goods or services so supplied to ... the body cannot be conveniently distinguished from goods or services supplied to ... it for the purpose of a business carried on by it, the amount to be refunded under this section shall be such amount as remains after deducting from the whole of the VAT chargeable on any supply to ... the body such proportion thereof as appears to the Commissioners to be attributable to the carrying on of the business; but where—

- (a) the VAT so attributable is or includes VAT attributable, in accordance with regulations under section 26, to exempt supplies by the body, and

(b) the VAT attributable to the exempt supplies is in the opinion of the Commissioners an insignificant proportion of the VAT so chargeable, they may include it in the VAT refunded under this section.

(3) The bodies to which this section applies are—

(a) a local authority ...”

12. Group 10 sch 9 VATA provides, so far as relevant:

“Sport, sports competitions and physical education

Item No ...

3 The supply by an eligible body to an individual of services closely linked with and essential to sport or physical education in which the individual is taking part.

NOTES

...

(2A) Subject to Notes (2C) and (3), in this Group “eligible body” means a non-profit making body ...

...

(3) In Item 3 “an eligible body” does not include (a) a local authority; ...”

Local Authority Legislation

13. Section 14(1) Local Government and Planning (Scotland) Act 1982 (“**LGPSA**”) provides:

“Islands or district council’s duties in relation to the provision of recreational, sporting, cultural and social facilities and activities.

(1) Subject to subsection (2) below and to section 19 of this Act, a local authority shall ensure that there is adequate provision of facilities for the inhabitants of their area for recreational, sporting, cultural and social activities.”

14. Section 15 LGPSA provides:

“Islands or district council’s powers in relation to the provision of recreational, sporting, cultural and social facilities and activities.

(1) The provisions of this section and of the following section are without prejudice to the duty imposed by subsection (1) of section 14 of this Act and are subject to subsection (2) of that section and to section 19 of this Act.

(2) A local authority may provide or do, or arrange for the provision of or doing of, or contribute towards the expenses of providing or doing, anything necessary or expedient for the purpose of ensuring that there are available, whether inside or outside their area, such facilities for recreational, sporting, cultural or social activities as they consider appropriate.”

15. Section 16 LGPSA contains supplementary provisions:

“(1) Without prejudice to the generality of their powers under section 15 of this Act, a local authority may, for the purposes of their functions under subsection (2) of that section—

- (a) provide entertainment of any kind;
 - (b) maintain a body for the promotion of a recreational, sporting, cultural or social activity;
 - (c) permit any facility provided by the authority under the said section 15 to be run by another person on such conditions (including conditions as to the charges if any)—
 - (i) to be imposed on the person in respect of the rights thereby enjoyed by him; or
 - (ii) which may be imposed by the person on members of the public for admission to, or use or enjoyment of, that facility, as the authority think fit;
 - (d) use for the purposes of an entertainment provided, or a recreational, sporting, cultural or social activity provided or promoted, by them any facility (or any part thereof) provided by them under the said section 15;
 - (e) charge for admission to any facility provided by them under the said section 15 or for admission to or participation in, and for any programme supplied at or in connection with, any such entertainment or activity as is mentioned in paragraph (d) above;
 - (f) accept the right to manage and control a park devoted or partly devoted to public use from the owner of that park or from any other person entitled to transmit that right;
 - (g) enter into an agreement with the owner of any park or with any other person whereby—
 - (i) access to the park for the public is obtained or enhanced; or
 - (ii) provision is made for management and control of the park by the authority;
 - (h) let as a shop, stall or restaurant a building in a park under their management and control;
 - (i) set apart some of any such park for any purpose which they consider appropriate having regard to their functions under the foregoing provisions of this section and under the said section 15;
 - (j) do anything necessary to defend a public right in any park; or
 - (k) conduct, either by themselves or in collaboration with a voluntary organisation or other person, a competition in connection with a sporting or recreational activity; and with regard to that competition—
 - (i) paragraph (e) above shall apply as it applies to any such entertainment or activity as is mentioned in paragraph (d) above; and
 - (ii) the authority may provide trophies and prizes.
- (2) Without prejudice to the generality of their powers under section 15 of this Act, a local authority may contribute—
- (a) by way of grant or loan towards expenses incurred, or to be incurred, as regards recreational, sporting, cultural or social facilities or activities by a voluntary organisation or other person, not being a local authority,

in providing or maintaining such facilities (or, as the case may be, in providing or promoting such activities) if the authority have powers themselves, under the said section 15 or under the foregoing provisions of this section, to provide such facilities or activities;

(b) by way of grant towards expenses incurred, or to be incurred, by another local authority in providing or maintaining any such facility or in providing or promoting any such activity;

(c) by way of grant towards expenses incurred, or to be incurred, by a harbour authority (within the meaning of the Harbours Act 1964) in providing, maintaining, managing or improving a harbour which is used (or is to be used) wholly or partly for sporting or recreational purposes; or

(d) towards the cost of maintaining a park owned by another person and to which the public are afforded access for recreation.”

16. Section 1 Local Government in Scotland Act 2003 (“LGSA”) provides:

“Local authorities’ duty to secure best value

- (1) It is the duty of a local authority make arrangements which secure best value.
- (2) Best value is continuous improvement in the performance of the authority’s functions.
- (3) In securing best value, the local authority shall maintain an appropriate balance among –
 - (a) The quality of its performance of its functions;
 - (b) The cost to the authority of that performance; and
 - (c) The cost to persons of any service provided by it for them on a wholly or partly rechargeable basis.
- (4) In maintaining that balance, the local authority shall have regard to –
 - (a) Sufficiency;
 - (b) Effectiveness;
 - (c) Economy; and
 - (d) The need to meet the equal opportunity requirements.”

CASE LAW AUTHORITIES

17. The following cases were cited, and those referred to in this decision notice use the marked abbreviations:

Bromley LBC v GLC [1982] 1 All ER 129 (“**Bromley**”)

C-89/81 *Staatssecretaris van Financiën v Hong-Kong Trade Development Council*

C-102/86 *Apple and Pear Development Council v Customs and Excise Commissioners* [1988] STC 221

Joined cases C-231/87 and C-129/88 *Ufficio Distrettuale delle Imposte Dirette di Fiorenzuola d’Arda v Comune di Carpaneto Piacentino and Ufficio Provinciale Imposta sul Valore Aggiunto di Piacenza v Comune di Rivergara and others* [1991] STC 205 (“**Carpaneto No 1**”)

C-4/89 *Comune di Carpaneto Piacentino and others v Ufficio provincial imposta sul valore aggiunto di Piacenza* [1990] ECR I-1869 (“**Carpaneto No 2**”)

Credit Suisse v Allerdale Borough Council [1996] 4 All ER 129 (“**Credit Suisse**”)

C-155/94 *Wellcome Trust Ltd v Customs and Excise Commissioners* [1996] STC 945 (“**Wellcome Trust**”)

C-230/94 *Enkler v Finanzamt Homburg* [1996] STC 1316

C-247/95 *Finanzamt Augsburg-Stadt v Marktgemeinde Welden* (“**Marktgemeinde**”)

Halki Shipping Corp v Sopex Oils Ltd [1998] 2 All ER 23

C-216/97 *Gregg v Customs and Excise Commissioners* [1999] STC 934

Institute of Chartered Accountants in England and Wales v Customs and Excise Commissioners [1999] STC 398 (“**ICAEW**”)

C-446/98 *Fazenda Pública v Câmara Municipal do Porto* [2001] STC 560 (“**Fazenda Pública**”)

C-142/99 *Floridienne SA v Belgium* [2000] STC 1044 (“**Floridienne**”)

Edinburgh Leisure & others v CCE (2004) VAT Tribunal Decision 18784 (“**Edinburgh Leisure**”)

C-284/04 *T-Mobile Austria GmbH and Others v Republic of Austria* [2008] STC 184 (“**T-Mobile**”)

C-288/07 *Revenue and Customs Commissioners v Isle of Wight Council and others* [2008] STC 2964 (“**Isle of Wight**”)

C-554/07 *Commission v Ireland* [2009] ECR I-128 (“**Ireland**”)

C-246/08 *Commission v Finland* [2009] ECR I-10605 (“**Finland**”)

C-102/08 *Finanzamt Düsseldorf-Süd v SALIX Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Offenbach KG* (“**SALIX**”)

C-180/10 & C-181/10 *Jarosław Ślaby v Minister Finansów and Emilian Kuć and Halina Jeziorska-Kuć v Dyrektor Izby Skarbowej w Warszawie* (“**Ślaby**”)

CEC v Yarburgh Children’s Trust [2002] STC 207

C-378/02 *Waterschap Zeeuws Vlaanderen v Staatssecretaris van Financiën*

CEC v St Paul’s Community Project Limited [2005] STC 95 (“**St Paul’s**”)

C-255/02 *Halifax plc & others v CEC* [2006] STC 919

C-262/04 *Meilicke & others v Finanzamt Bonn-Innenstadt*

C-369/04 *Hutchison 3G UK Ltd & others v CEC* [2008] STC 218 (“**Hutchison**”)

C-408/06 *Landesanstalt für Landwirtschaft v Franz Götz* (“**Götz**”)

Boyle v Secretary of State for Northern Ireland [2010] NICA 5

C-263/11 *Ainārs Rēdlihs v Valsts ieņēmumu dienests* (“**Rēdlihs**”)

Prudential Assurance Co Ltd & another v RCC [2014] STC 1236 (“**Prudential**”)

C-174/14 *Saudaçor—Sociedade Gestora de Recursos e Equipamentos da Saúde dos Açores SA v Fazenda Pública* [2016] STC 681 (“**Saudaçor**”)

C-263/15 *Lajvér Meliorációs Nonprofit Kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Foigazgatósága* ECLI:EU:C:2016:392 (“**Lajvér**”)

R. (on the application of Durham Company Limited (trading as Max Recycle)) v Revenue and Customs Commissioners [2017] STC 264 (“**Durham Company**”)

HMRC v Longridge on the Thames [2016] STC 2362 (“**Longridge**”)

C-520/14 *Gemeente Borsele v Staatssecretaris van Financien* [2016] STC 1570 (“**Gemeente Borsele**”)

C-344/15 *National Roads Authority v The Revenue Commissioners* ECLI:EU:C:2017:28 (“**NRA**”)

C-633/15 *London Borough of Ealing v Commissioners for Her Majesty’s Revenue and Customs* [2017] STC 1598 (“**Ealing**”)

Newey (trading as Ocean Finance) v RCC [2018] STC 1054

R. (on the application of Durham Company Limited (trading as Max Recycle)) v Revenue and Customs Commissioners [2018] UKUT 188 (TCC) (“**Durham PTA**”)

Wakefield College v HMRC [2018] STC 1170 (“**Wakefield College**”)

Pertemps Limited v HMRC [2018] SFTD 1410 (“**Pertemps**”)

RCC v Frank A Smart & Son Ltd [2019] STC 1549

EVIDENCE

18. The Tribunal approved the taking of a transcription of the proceedings, with copies thereof made available to all parties and the Tribunal.

19. We had documentary evidence contained in three volumes, and two volumes of authorities.

20. We took oral evidence from the following witnesses for the Council:

(1) Mr Garry Sheret is the Council’s Head of Property and Facilities Management. He adopted and confirmed a formal witness statement dated 28 October 2016.

(2) Mr Gary Fairley is the Council’s Head of Finance. He adopted and confirmed a formal witness statement dated 25 July 2019. Mr Fairley’s witness statement adopted and to an extent qualified a witness statement dated 28 October 2016 of Mr John Blair, Director of Resources, who was unable to attend the hearing.

21. **Mr Sheret’s evidence** included the following:

(1) He has been with the Council almost 20 years and is currently Head of Property and Facilities Management. This comprises six teams, including the Sports and Leisure team. Within Sports and Leisure, he is responsible for providing the Council with strategic advice as well as proposals for changes to the services, working within the remit given by the Council to improve its leisure service by increasing inclusion and participation in physical activity across the population.

(2) The Council’s designated area of responsibility adjoins Edinburgh’s southern boundary, framed by the Pentland Hills in the West and the Moorfoot Hills of the

Scottish Borders in the South. It has a population of around 85,000 mainly centred in and around the towns of Penicuik, Bonnyrigg, Loanhead, Dalkeith, Newtongrange and Gorebridge. The area is surrounded by the local authority areas of Edinburgh, East Lothian, Scottish Borders and West Lothian.

(3) The Council has a statutory obligation to provide adequate recreational and sporting facilities pursuant to s 14 LGPSA. Mr Sheret's understanding was that the leisure facilities provided by the Council are adequate in the sense that they meet the needs of the population and are accessible to them all.

(4) The main leisure activities provided by the Council which generate fees consist of the grant of access to swimming, skiing and snowboarding, tennis, squash, badminton, table-tennis, football, gym facilities and exercise classes, athletics and children's soft play. The Council also offers a range of activities for children during school holidays. The Council operates seven leisure centres at Danderhall, Gorebridge, Loanhead, Mayfield, Lasswade, Newtongrange, and Penicuik, a swimming pool at Newbattle, a Snow Sports centre and also operates 21 Halls and Pavilions associated with playing fields and pitches. Pitches can be hired from the Council for the playing of football, rugby, hockey, netball, cricket, tennis and bowls. The Council also operates a 9-hole golf course within the boundaries of one of its country parks at Vogrie and a state of the art gymnastic facility at Lasswade.

(5) The Council also employs officers to engage with the community including the Active School, Heathy Living, Sport Development and Outdoor Education Teams. There are also other schemes aimed at particular issues or groups such as:

(a) *Midlothian Active Choices* is a physical activity referral service for adults in the Council area who are currently suffering from mild/moderate mental health conditions, weight management problems, or long term or chronic illnesses. The service is an NHS funded partnership project between the East & Midlothian Community Health Partnership and the Council, and is based on the objectives of the National Physical Activity Strategy 'Let's Make Scotland More Active' and the Midlothian Joint Health Improvement Plan. Those who are referred are then able to attend group meetings for an initial 12 week period and are provided with a 'MAC' card which entitles them to reduced cost access to Midlothian Leisure facilities for the cost of £1 per gym session/class/swim, Further support and reduced costs are provided for up to a year after the initial 12 weeks to encourage the client to continue with their physical activity.

(b) *Get Going* is a free eight week family healthy lifestyle programme funded by NHS Lothian. It offers support to help children to get active, eat well and achieve a healthier weight to combat obesity and help reduce the risk of diseases like coronary heart disease, type 2 diabetes, osteoarthritis and some cancers later in life. It is about helping the family unit to work together to make small lifestyle changes. It starts with a one-to-one consultation with the family and a specially trained healthy lifestyle coach. Free sessions take place in Midlothian Leisure Centres or community venues once a week with different issues being covered every week such as 'introducing a healthier

eating plan' together with physical activities for the children and young people.

(c) *Counterweight* is a free 12 month group programme for adults that supports them to make small changes to their diet and lifestyle to help them to manage their weight and become more active and to combat obesity and help reduce the risk of diseases like coronary heart disease, type 2 diabetes, osteoarthritis and some cancers. It is a healthy lifestyle programme funded by NHS Lothian in partnership with local authorities. The initial 11 week group programme consists of six fortnightly dietary and behaviour change sessions which supports clients to make the small changes required to lose 5-10% of their body weight. Each session lasts one hour and the groups are small with a maximum of 12 people. After the 12 week group programme there will be drop-in two weekly weighing sessions and follow up group sessions at six, nine and twelve months.

(d) *Ageing Well* was established in 1999 in partnership with NHS Lothian, It aims to provide a range of opportunities to encourage the over 50s in Midlothian to increase their physical activity levels. Being more active is good for your health and Ageing Well offers a wide variety of activities designed to suit all tastes. Ageing Well also provides a volunteering opportunity for the over-50s. They are encouraged to make a difference to their peers by inspiring them to adopt a more active and healthy lifestyle while enhancing their own skills and knowledge as well as having fun by leading walks, running activity sessions or helping with various events.

(6) When deciding which sports and other leisure activities the Council provides it will, before providing that service, identify if there is a need either from lack of provision or through the communities (through consultation processes or by groups lobbying for new services). If residents can easily access services in neighbouring authorities then the Council is less likely to extend its own provision – for example, neighbouring authorities provide a range of activities that the Council does not such as indoor climbing, bouldering, sailing, wind-surfing, water surfing, go-karting, horse racing, tenpin bowling, ice skating and curling. The Council is less likely to provide services if commercial for-profit operators (“FPs”) are already providing the services to a broad cross-section of the public. The provision made by FPs is relevant in determining what activities to provide and where, and the appropriate price to charge. FPs providing the same or similar types of activities to the Council include Saltire Soccer Centre, Pulse Pilates & Fitness Studio, Fitness Education Academy, and Ryze.

(7) The approach to setting fees is to set them at a cost which will encourage and increase participation, on the understanding that the Council has an obligation to deal with public money responsibly. There is a balance between saving costs for the Council, and ensuring that the inclusionary aim is fulfilled, that residents are provided with 'value for money' and that any pricing is set at a 'fair' level so as to ensure that the overall reputation of the Council is maintained. In terms of priority, to ensure it complies with the overriding aim of inclusion, the Council would never force people away due to overpricing. The Council performs benchmarking exercises to establish pricing structures that are affordable to residents and in line with other authorities' charging structures. This is generally done by examining research such as Scottish

Leisure Networking group information, review of local providers, the Scottish Leisure Network Group Report, sportscotland's research (based on a survey of the Scottish local authorities and their associated Leisure Trusts, covering over 70 different activities or facilities). Also, prices are reviewed year on year with reference to inflation. Councillors are consulted over the implementation and design of charges and concessions. The charges are not set with a view to simply generating income or profit. A charge can be significantly below breakeven but still achieve the Council's objectives if the services deliver wider social benefits from inclusion and participation.

(8) The Council accounts for VAT on all of the services save for some block bookings and supervised coaching sessions, which are exempt. The Council charges the same rates whether or not a block booking qualifies for the VAT exemption.

(9) The Council offers the services on a 'pay-per-play' basis. The Council also offers membership schemes allowing access to a range of different leisure facilities; there are currently four standard memberships: 'Platinum, Gold, Silver and Bronze'. The Council also operates an 'Active Golden Years' membership which is available to the over 65s, and memberships aimed at students, juniors aged 16-18, and younger teenagers. The Council operates a leisure pass scheme which provides access at reduced rates to concessionary groups; the leisure card allows access at £2 before 4:30pm on Monday to Fridays then concessionary rates at other times; the card is given at no cost to concessions but can also be purchased.

(10)The Council provides some leisure services free of charge. Free swimming is provided at each of the four pools operated by the Council, Loanhead, Penicuik, Newbattle, Lasswade and a pool operated by the Public Private Partnership ("PPP") provider at the Dalkeith Schools Community Campus (which houses three separate schools on a single campus, and where the Council pays the PPP Operator for each child who uses the pool in the school holidays). The free swimming is provided to under 18's on weekdays during all school holidays; this was introduced to try to halt a decline in participation in swimming both locally and nationally. The Council also provides a Midlothian Walking Festival which is hosted by the Midlothian Ranger Service, involving a number of free guided walks. If the five-a-side pitches at Newtongrange and Poltonhall are not booked then they are left open in the evening for use; they are floodlit until 10 pm to encourage people to use them after the paying guests have left.

(11)The Council has two country parks, Vogrie Country Park and Roslin Glen, and one regional park, Pentland Hills Regional Park, which are available for use by the public for a range of different leisure pursuits. The Regional Park is shared with Edinburgh Council who manages part of it for the Council under a service level agreement. The Council also funds a ranger service with responsibility for maintaining pathways and directing a programme of hosted events at the public. The Council will also invest in open access facilities such as the skate park at Bonnyrigg; this was funded on the basis that it has appeal to children and teenagers, and it was considered particularly important to the Council to provide facilities to this age-group on the basis that participation in sport and leisure provides the foundation for lifelong participation.

(12)The Council has a team of officers, the Sports Development Team, dedicated to developing opportunities in sport and leisure from grass roots to elite level and covering all ages and all sports and leisure activities. The officers work with sports governing bodies and local sports clubs, aiming to increase participation, develop potential, create sporting pathways (being structured provision to allow development to the very highest levels) and strive for excellence in a range of different sports.

(13)The Council works in partnership with local sports clubs, including by providing grant funding to clubs of up to £3,000 for facilities, and grant funding for talented athletes. Larger grants can also be made - for example, £10,000 to the East of Scotland Junior Football Clubs. Grant funding is only provided to non-profit making bodies. The Council recognises that sports clubs are uniquely placed to be able to provide coaching and access to training and competition in the community.

(14)The Council has developed 'Sport Hubs' with sportscotland which focus on local clubs and other organisations to improve the sport offered in their local community. These are collectives of progressive sports clubs working together in the local community, which develop their own vision and values to ensure all involved are clear on the work they will do together, which is detailed in a simple, clear plan to improve the sports on offer. Each Sport Hub is unique but the common thread is that each of them works to the following five principles (i) growth in participation (ii) engage the local community (iii) promote community leadership (iv) offer a range of sporting opportunities; and (v) bring all appropriate (key) partners/groups/people together. For example, the Penicuik Community Sport Hub, founded in 2012, is a partnership between sports clubs and organisations with 15 clubs represented which aims to encourage participation in sport, provide a forum for clubs to discuss and share best practice and to assist in the development and improvement of sporting facilities available to the community. Meetings are held with partners in the Hub and minuted.

(15)The Council also funds other teams of officers with responsibility for promoting healthy living choices and regular participation by the population in physical exercise in the form of the Active Schools Team, the Healthy Living Team and the Outdoor Education Team. Coordinators are also responsible for the Active Choices, Counterweight, Get Going, and Ageing Well schemes operated by the Council - initiatives aimed at addressing particular issues such as chronic illness, weight management problems, and mental health problems, which can be improved through participation in regular physical activity.

(16)The reason why the Council provides the services is the social benefits that sport and leisure can bring to the community. These include making a significant contribution to social and economic regeneration; developing strong communities and effective services; educational attainment; reduction in crime; improvement of health; fostering a sense of belonging and community spirit amongst the local population; improving the quality of life for all parts of the population; and making sport and leisure accessible to vulnerable or otherwise under-represented parts of the population. The Council identifies target groups where it considers the greatest effort is required to achieve the greatest impact; these are: residents in deprived communities, income deprived, socially excluded, early years (0-6 years), girls aged

11-16, adolescents 13-19, people with a disability, black and minority ethnic groups and older people suffering from health inequalities.

(17) These reasons and objectives are held in common by the Council and Central Government; the latter plays a role in developing policy through the publication of policy documents such as the national strategy for sport in Scotland published in 2007 "Reaching Higher - Building on the success of Sport 21", which outlines an objective of trying to increase participation in sport with an aim of 60% of the adult population participating in sport at least once per week by 2020. Central Government will provide or divert funding to projects meeting the objectives of its strategy – for example, in 2014/15 and 2016/17 the Council obtained funding from NHS Lothian for delivery of its Get Going and Health 4 U programmes, and is seeking funding from the Spirit of 2012 Board to fund provision of the Council's Ageing Well and Transform programmes.

(18) The Council incurs substantial expenditure on its leisure facilities. The Council is generally restricted from undertaking trading activity except through a subsidiary. The Council incurs the expenditure because it recognises that sport and leisure bring about wider social benefits. There is no direct relationship between the price being charged and the cost of provision.

(19) When deciding what activities to provide and where to provide them, the Council takes into account the social attributes of the particular activity and the existing level of provision. Some leisure activities such as swimming are recognised as having high social attributes; swimming is provided by nearly all local authorities on the basis that it appeals to a wide cross-section of the population. Similarly, the social benefits of other activities might be linked to their ability to reach out to particularly vulnerable or under-represented parts of the population.

(20) The Council directs its resources to areas where it will have the maximum social impact. Particular emphasis is given to increasing participation by the young such as through the 'Active Schools' initiative; by establishing participation at an early age the Council hopes to break and establish patterns of behaviour that, if not addressed, will be taken through to adult life. The programme, which is a sportscotland initiative, was identified as a key element of the then Scottish Executive's drive to get more people in Scotland active, a commitment outlined in the National Physical Activity Strategy. The Active Schools Team consists of nine co-ordinators who are assigned to the schools in the area. The Team supports and sustains a network of volunteers, coaches, leaders and teachers who, in turn, deliver extracurricular physical activity and sport before during and after school and in the wider community

(21) The Council takes into account the views of the local population when deciding what activities to provide and how to provide them. This is done on both qualitative and quantitative measures. For example, in 2010 the Council undertook a consultation exercise with the local population to identify what range of activities to provide in a new leisure facility at Lasswade. Following another consultation, the swimming pool opening time at Newbattle was changed from 9 am to 6:15 am.

(22) The Council will also consider, when deciding what activities to provide, the level of provision already in the local area. The Council would not, for example, invest in an ice skating rink on the basis that there are already facilities that residents

can travel to in a neighbouring authority, Edinburgh. Similarly, the Council would be unlikely currently to invest in a full size 50m pool on the basis that there is already a facility in Edinburgh. The Council will also take into account the social benefit when deciding where to site leisure centres - the centres are more likely to be sited in socially disadvantaged areas,

(23) The Council sets prices considering a number of different factors but primarily the prices must be set at a level to increase participation - meaning that it must be affordable to all. The report 'Pricing and Concessions in Leisure' prepared by the Association for Public Service Excellence (a membership based organisation of local authorities to which the Council subscribes) is a resource for local authorities wanting to protect the level of services in the context of cuts to local government spending; it records that overwhelmingly authorities adopt what they consider to be the going rate price although this is rarely an exact science. That is the process adopted by the Council to setting and revising prices; it will 'benchmark' its price by looking at the prices charged for comparable facilities provided by others in the local area including the Leisure Trusts operated by other local authorities and any FP providers. A point made in the paper is that the prices for local authority leisure services tend to be higher in areas where competition is at its greatest – which would suggest a relationship which is inverse to that which would be expected (usually price would be expected to be driven down by competition).

(24) In particular, the Council will study the terms of the benchmark survey prepared by sportscotland ("Charges for sports facilities: Scotland") which reviews the prices for local authority leisure, and reveals wide disparities in charges for sport and leisure facilities across Scotland. In recent years, some charges have been raised by inflation while others have remained unchanged. In general, increases are made in areas where the adjustment has been assessed as being unlikely to have a significant impact on participation.

(25) Whether or not the charges made by the Council carry VAT would not have any impact on the prices charged by the Council. In the current environment, if there is a cost saving arising from a change in the VAT treatment then it would likely be used to cushion the effect of cuts in central government funding in other areas of the Council's operation. Many local authorities provide their leisure services VAT exempt through Leisure Trusts. If VAT was being factored in by those authorities as a cost then the prices of leisure services provided through Leisure Trusts should be lower. The Scottish Leisure Network Group report "Leisure Activity Charges 2011-2012" covered 27 local authorities submitting information, the vast majority of which make provision through a Leisure Trust, The prices charged by the Leisure Trusts are not discernibly lower than the prices charged by local authorities making their own provision.

(26) Other providers offer the same activities as the Council to its residents. The other providers can be not-for-profit sports clubs and associations ('NFP's'), FP's, or sports Leisure Trusts. The Council works in partnership with NFP's in connection with the development of Sport Hubs. NFP's will usually block book their facilities and regularly use the Council's facilities; NFP's can apply for grants to support their activities. Leisure Trusts are NFP organisations which provide public leisure services on behalf of local authorities; a significant proportion of local authorities in Scotland

now provide leisure services to the local population through these Leisure Trusts; one of the advantages is that they are exempt from VAT on leisure services. The Council undertook an options appraisal in 2004 to consider how it delivered its leisure services, in the course of which it considered setting up a Leisure Trust; PwC prepared a report considering the options; while adopting a Leisure Trust would have delivered a VAT saving, the Council decided against it on the basis that it would lose control over the services.

(a) *Swimming* – Swimming is provided by both FP and NFP providers through the likes of gyms and hotels. Gyms tend to provide access to swimming as part of their membership – eg Nuffield Health Fountain Park in Edinburgh. Hotels may operate swimming pools but those pools are typically provided free to guests along with the accommodation – eg Best Western Kings Manor Hotel offers use of a 20m pool and spa facilities; membership packages are available to non-residents. Some FP operators will block book Council or other public facilities (such as those at schools) to provide private swim tuition – eg Swim Easy, which operates out of a number of school swimming pools which will be block booked. There are also NFP's providing regular access to swimming using block bookings – eg Midlothian Swimming Club ("**MSC**") operates on this basis out of various facilities in the Council's area, such as the Newbattle Swimming Pool; MSC also uses facilities in neighbouring West Lothian such as the swimming pool operated by Xcite in Bathgate; MSC operates on the basis of subscriptions, and is an NFP, so all of its supplies of swimming will be exempt from VAT. Organisations like MSC share the same objectives as, and so are supported by, the Council. The coaching they provide, which is mainly delivered through volunteers, acts as a bridge between amateur and professional levels of sport. Neighbouring local authorities use the Leisure Trust model – eg Edinburgh Leisure Trust manages and operates sports and leisure facilities on behalf of Edinburgh Council.

(b) *Skiing and Snowboarding* - In addition to the facilities provided by the Council at the Midlothian Snowsport Centre, skiing and snowboarding is provided in Scotland by FP providers at outdoor ski resorts such as Glenshee, and the Nevis Range. There are also several indoor and dry ski slope facilities on offer by FP providers such as Snow Factor, which has an indoor centre based in Braehead. Facilities are also provided by Leisure Trusts – eg The Falkirk Community Trust operates an artificial ski-slope at the Polmonthill Snowsports centre which is around 20 miles from Edinburgh.

(c) *Tennis, Squash & Badminton* - FPs such as Virgin Active offer racquet sport facilities as part of a membership package, and hotels offer facilities as part of the room rate or as part of a membership package – eg the Greywalls Hotel in Gullane, East Lothian which provides lawn tennis facilities. There are several private NFP clubs such as the Danderhall Badminton Club which is held at the Council's facilities at Dalkeith School Community Campus, and Penicuik South Badminton Club; both of these clubs will block book facilities in advance so as to be able to run their clubs at regular times of the week. There are also some other NFP clubs, such as Dalkeith Lawn Tennis Club and

Braid Lawn Tennis Club which operate from their own facilities. Tennis courts whilst available for block booking on a paid for basis, are available free of charge at other times in a number of the Council's parks and gardens.

(d) *Table Tennis* - There are no FP providers of table tennis in or around the area. The Council provides table tennis facilities at the Gorebridge Leisure Centre and the Lasswade Centre with prices being charged per table tennis table. The Council also facilitates a club for over-50's. There is a private NFP club, the Penicuik Table Tennis Club which operates from Ladywood Leisure Centre in Penicuik which is a community run leisure centre.

(e) *Football* - There are some FP providers of football pitches such as Saltire Soccer Centre based in Mayfield which provides pitches that can be used for five-a-side and seven-a-side teams and leagues. FP providers enable customers to make block bookings so as to run leagues and competitions and such block bookings will be exempt from VAT. Customers can also make individual bookings which would be standard rated for VAT purposes. Edinburgh Leisure (an NFP Leisure Trust) provides pitch hire on a block booking basis and such supplies will be exempt from VAT.

(f) *Gym & Exercise Classes* - The Council operates seven gyms and one standalone pool which are branded as 'Tonezone' gyms. They contain the latest equipment and employ accredited Fitness Instructors. When joining the gym the Fitness Instructors provide members with a personal welcome session and will sit down and devise an individual exercise programme directed to the individual's needs and objectives. The Council also provides a range of different exercise and activity classes across its seven leisure centres delivered in the exercise studios plus classes in the Council's four swimming pools. There are several FP providers such as Nuffield Health and Bannatynes which operate gyms and provide fitness classes across Scotland. Neighbouring NFP Leisure Trust, Edinburgh Leisure, operates gyms (eg the Leith Village gym).

(g) *Athletics* - There are two NFP athletics clubs in Midlothian: Lasswade Athletics Club trains at the Dalkeith Schools Community Campus and the Lasswade Centre, and Penicuik Harriers train at the Penicuik Centre. The athletics clubs block book the facilities from the Council and this is VAT exempt. There are no FP providers of athletics in the local area.

(h) *Children's Soft Play* - Some of the Council's leisure centres provide children's soft play facilities which are provided on a pay-per-play basis. Children's soft play parties can also be booked at some of the leisure centres and Newbattle Pool through what is called 'Partyzone'. FP providers also provide soft play facilities on a pay-per-play basis and private parties can be booked – eg the Saltire Soft Play Centre and Clownaround. NFP Leisure Trust, Edinburgh Leisure also provides soft play facilities and offers private parties.

(27) In reply to questions in cross-examination:

(a) Provision of leisure and sports facilities involved substantial expenditure and substantial fee income for the Council. There were seven

centres, one stand-alone pool and one snowsports centre; Penicuik was the largest and newest facility.

(b) The main reason for tracking visitor numbers was to measure increasing participation. The principal aim was to increase participation, not to maximise income.

(c) With the exception of the membership schemes the Council did not operate peak and off peak charges.

(d) The main reasons why some charges were higher than others were because the facility was different (eg a larger hall compared with a smaller one, or a private swimming lesson compared with a group lesson or an unsupervised swimming session, or a 3G pitch compared with an astroturf area), and because the local market benchmarking showed that other providers were making a distinction (eg for length of hire of a pitch or court).

(e) Concessions were offered to specified groups but were not individually means-tested. It was correct that other providers also offered concessions on their own terms.

(f) Birthday party packages were offered that used the leisure facilities such as the pool and football; similar deals might be available elsewhere; the Council did not get involved in aspects such as food, party bags etc. It was consonant with getting young people more active. The swimming parties were very popular because the Council is the only provider.

(g) The Council did not offer lawn tennis facilities, only hard court.

(h) It was correct that there are numerous gyms in Edinburgh. The Council could offer small as well as large facilities, and locate them in areas which might not attract other providers. If a resident chose to go to, say, the Nuffield Health gym that that was good news for the Council as it was another individual getting active.

(i) The opening of the Saltire Soccer Centre took all demand away from the Mayfield Leisure Centre facilities – the surfaces at Mayfield were poor while Saltire had allweather and indoor new pitches, so was preferred by users even though it was more expensive.

(j) Ryze offered trampolining.

(k) It was correct that sportscotland had identified that non-local authority providers had expanded their offered facilities rapidly over a relatively short period; that gave more opportunity to users to pick and choose facilities.

(l) The ski slope is the longest dry ski slope in Europe. It was one hour travel to Polmonthill where the facility was not comparable. Travel to Glenshee was at least two hours.

(28) In reply to questions from the Tribunal, Mr Sheret stated that football pitches were open for free use when not booked, but that did not include access to changing rooms.

22. **Mr Fairley's evidence** included the following:

(1) He has been with the Council for over 30 years in a number of finance roles and is now the Council's Head of Finance and Integrated Service Support, responsible for the financial affairs of the Council.

(2) The Council as the elected body has the ultimate decision making power in all areas falling within the Council's responsibility. Its officers are required to make decisions in accordance with the policy aims and objectives set by the Council and within the scope of the authority delegated by it. The Council's objectives are set out in The Single Midlothian Plan, drawn up by partners who are members of the Midlothian Community Planning Partnership. The Plan establishes several medium and long term intended outcomes.

(3) The Council configures its leisure services to support the outcomes identified in the Plan. Leisure has a part to play in a range of different outcomes: it supports the Early Years objectives by encouraging participation in sport and leisure in the young, it supports the tackling of health inequalities, crime, the effects of old age and other social inequalities.

(4) The decision making process in relation to leisure is that officers identify proposals in relation to, for example, opening hours, pricing and scope of provision which are submitted to the divisional management team weekly. That team consists of the Director of Resources and the three heads of services i.e. Property and Facilities; Commercial Operations; and Finance and Integrated Support Services, with the addition of the senior accountant and the HR Business Partner. The team makes operational and service decisions and considers strategic decisions to be referred to the corporate management team which meets on a two weekly basis; that team is chaired by the Chief Executive with the addition of the service directors who cover Education and Communities; Health and Social Services and Resources. Anything that affects the public directly or is of a policy nature will normally be formally referred to the Cabinet or Council for approval. The Council and Cabinet meets once every six weeks and is made up of five elected members in the case of the Cabinet, and all eighteen members in the case of the Council.

(5) In practice this means that any significant changes made to the sports and leisure facilities, such as any changes to the level of provision within the Council's facilities, any investment in new facilities, and any non-standard inflationary increases to price must be referred to the Cabinet for approval. Since the 2008 financial crisis all budget matters must be referred to the Council.

(6) When making decisions in relation to public leisure facilities, the Council must have regard to its statutory obligations and its powers. In the context of leisure facilities the Council must, in particular, have regard to s 14 LGPSA which imposes a duty on the Council to ensure there are recreational, sporting, cultural and social facilities and activities in the area. Mr Fairley's understanding was that as the Council is a statutory body it is generally accepted that it only has power to do that which Parliament has expressly allowed it to.; and in general it is recognised that the Council cannot undertake services or functions without specific statutory authority. The Council cannot raise charges without specific statutory authority.

(7) The leisure services provided by the Council are not provided as part of a service or function; they are provided year on year in the expectation that the services will

incur net expenditure, or in other words will be significantly subsidised by general and Council taxpayers. The subsidy by the general taxpayers arises because approximately 75% of the Council's net service expenditure is funded by central government; the subsidy by the Council's taxpayers arises because the remaining 25% of net expenditure is funded by Council Tax.

(8) At the beginning of the period relevant to the appeal, Leisure Services formed part of the Community Services division, and from 1 April 2007 Sport and Leisure Services transferred into the Education and Communities Division.

(9) Each year Leisure Services prepares a business plan for sports and leisure which outlines the revenue budget and anticipated capital expenditure for the year ahead. The business plan feeds into the overall budget for the Council. The Council is required to operate a balanced budget meaning that any expenditure, such as in relation to sport and leisure, must be covered from the Council's income which is derived mainly from central government grants, Council Tax and fees and charges. Historically, and during the period relevant to the appeal, sport and leisure services have been provided by the Council at a significant subsidy each year.

(10) In evidence were documents providing an overview of the expenditure and income of each of the leisure centres operated by Midlothian from 2006/07 to 2013/14, identifying total costs incurred and the total user income received from people using the facility (which is subject to VAT) in respect of each leisure centre for each year. A summary of the total expenditure on sport and leisure provided across the period is shown in the following table. These figures do not take into account any capital costs or the costs of repaying capital borrowing and interest costs over the life of the asset created. Capital expenditure is accounted for separately and the repayment of loans and interest met from central government grants and Council Tax income; the interest is not charged to the sport and leisure account; the Council does not seek to make any return on capital expenditure.

YEAR	EXPENDITURE on provision of Sport & Leisure at Leisure Centres Only (£)	INCOME from Leisure Centres only (£)	Net expenditure on provision of Sport & Leisure at Leisure Centres Only (£)
06/07	4,736,441	2,888,805	2,447,636
07/08	5,531,002	2,821,355	2,709,647
08/09	6,350,703	3,042,518	3,308,185
09/10	5,807,428	3,134,019	2,673,409
10/11	5,603,745	3,023,831	2,579,914
11/12	5,476,278	3,229,579	2,246,699
12/13	5,688,377	3,404,191	2,284,186
13/14	5,893,871	3,773,500	2,120,371

(11) The reason the Council is willing to expend money from the annual budget to fund these services is because the Council must fulfil its obligations and achieve its objectives in terms of wider social benefits identified in the Plan. Each business plan contains a summary of the planned and approved capital expenditure for Sport and Leisure; for example, the following capital projects were provided in 2007:

- (a) £10 million expenditure on the development of the Penicuik Centre;
- (b) £800,000 on developments at Poltonhall Recreation Ground;
- (c) £80,000 on multi-use games areas (astro turf pitches) at Roslin and Mayfield; and
- (d) £200,000 on the rebuild of Dalkeith Thistle JFC pavilion. This project was funded primarily through Common Good Funding which is used for specific purposes.

The following projects were also approved for 2007/08:

- (e) £63,000 for internal alterations to Loanhead Leisure Centre;
- (f) £125,000 for internal alterations to extend Tonezone with equipment replacement and relocation of the sauna facility at Bonnyrigg Leisure Centre;
- (g) £40,000 for a multi-use games area pitch at Gorebridge; and
- (h) £33,000 for introduction of new till systems at all Leisure Centres.

(12) The Council does not make those capital investments with a view to any particular level of return on the capital expenditure. Neither are the prices set by reference to any particular level of return.

(13) The Council reviews its expenditure on sport and leisure to identify where any potential savings can be made. With a view to that the Council has sought advice in respect of the various operating models available to it including the idea of outsourcing the provision of sport and leisure facilities and setting up a VAT exempt Leisure Trust. By virtue of their charitable status, provision of sport and leisure services by such Leisure Trusts is exempt from VAT. Whilst the Council concluded that potential savings could be made if it operated under a Leisure Trust, it was evident that control over the type and standard of services provided would have to be relinquished by the Council and, in 2006 it was decided by the Council not to transfer Sport and Leisure to a Leisure Trust.

(14) The Council, year on year, incurs significant subsidy of leisure and sports services. As such it acts very differently from organisations directed towards profit. The Council's objectives are not to profit from the activity but to derive the maximum social benefit from its subsidy of sport and leisure.

(15) In reply to questions in cross-examination:

- (a) The expenditure shown in the table excluded any apportionment of central support of capital financing or "horizontal" costs which are items like insurance which are managed by another budget or service. Income included receipts from casual use, classes, hire of facilities, and elements of grant income. It was correct that over the eight years income totalled around £25

million, which represented about 56% of the total expenditure of around £45 million.

(b) Budgets were set and meeting targets was an objective; the aim was to deliver services within budget, which would reduce the burden on the Council. Setting very low charges would affect the breadth of services to be provided.

(a) It was correct that the ToneZones (which was a type of membership of a gym) were successful and helped maximise income, however these were only one item in the overall basket of leisure services set out in a business plan.

APPELLANT'S CASE

23. For the Council, Ms Brown and Mr Rycroft submitted as follows.

Background

The Ealing case and exemption

24. In *Ealing* the CJEU held that sports and leisure activities provided by a local authority fall within the scope of the exemption in art 132(1)(m) PVD which relates to “the supply of certain services closely linked to sport or physical education by non-profit making organisations to persons taking part in sport or physical education”. The question of whether those supplies are or otherwise should be treated as non-taxable activities is antecedent to that of exemption which can only apply to supplies falling within the scope of VAT. The terms of arts 9 and 13 were not considered by the Court in *Ealing* in which the referral was on the basis that neither party claimed that the local authority taxpayer was acting as a public authority.

25. The Council continues to plead its case by reference to arts 9 and 13 rather than relying on the exemption afforded by art 132. That is because different consequences may flow for some local authorities due to the application of purely national law provisions in s 33 VATA which may, depending on the circumstances, place a local authority relying on exemption in a disadvantaged position, as compared to if the same services were to be treated as non-taxable. The Council has previously operated on the basis that VAT incurred by it and relating to its exempt supplies was insignificant. HMRC's guidance (in Notice 749) is that VAT attributable to exempt activities is insignificant only if it amounts to less than one of (a) £7,500 per annum; or (b) 5% of the total VAT incurred on all purchases in any one year. If the Council were to rely on the direct effect of art 132(1)(m) to treat the relevant supplies as exempt, then the VAT relating to them will cease to be insignificant, giving rise to a requirement for the Council to restrict the VAT recovered relating both to its pre-existing exempt supplies and the disputed supplies. The Council has concluded that if it were to rely on art 132(1)(m) then its claim would be extinguished, as the restriction on recoverable VAT would then exceed the VAT declared on the leisure supplies. However, the Council reserved the right to rely on art 132(1)(m) if it lost the current appeal.

Local Government provisions

26. The Council, as a local authority, is a statutory body whose objects and powers are as prescribed by Parliament (either expressly or impliedly). A local authority has a duty to provide public leisure services in Scotland by virtue of s14 LGPSA which provides that

‘[subject] to subsection (2) below and to section 19 of this Act, a local authority shall ensure that there is adequate provision of facilities for the inhabitants of their area for recreational, sporting, cultural and social activities’. The terms of s15(2) set out the scope of the power providing that ‘a local authority may provide or do, or arrange for the provision of or doing of, or contribute towards the expenses of providing or doing, anything necessary or expedient for the purpose of ensuring that there are available, whether inside or outside their area, such facilities for recreational, sporting, cultural or social activities as they consider appropriate’. Section 16 makes it clear that in exercising the power under s 15(2) a local authority may ‘charge for admission to any facility provided by them under the said section 15 or for admission to or participation in, and for any programme supplied at or in connection with, any such entertainment or activity as is mentioned in paragraph (d) above’.

27. The Council is required to make discretionary decisions concerning the range of activities and charges with regard to the wider benefit of those activities to the population in the area of the Council’s responsibility. It is relevant, in that respect, to have regard to the wider legal obligation of the Council under s1 of the Local Government in Scotland Act 2003 to ‘make arrangements to secure the continuous improvement in the way in which it exercises its function of providing public leisure services, having regard to a combination of economy, efficiency and effectiveness’. Also relevant are the Council’s obligations as regards state aid arising from art 107 of the Treaty on the Functioning of the Economic Union (TFEU) which outlaws state aid which is incompatible with the internal market. Whilst state aid is generally outlawed art 107(2)(a) expressly recognises “aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned” as being compatible.

The Council’s activities

28. The witness evidence described how the Council has exercised its discretion to provide fee-generating sport and leisure activities, and the Council’s objectives in providing leisure activities.

29. The reason the Council provides those activities is in view of the social benefits that sport and leisure can bring to the local community and in particular in its contribution to health and wellbeing, social and economic regeneration and the development of strong communities and effective services. The Council’s aim is to increase participation in sport to a level where 60% of the adult population participate in sport at least once a week by 2020.

30. The Council provides some services for free or on an open access basis. The Council provides schemes which are specifically targeted at improving health (Midlothian Active Choices, Get Going, Counterweight, and Ageing Well).

31. The Council does not expect any return on capital expenditure. When deciding what activities to provide and where to provide them the Council take into account the social attributes of that activity and the existing level of provision. Some leisure activities such as swimming are recognised as having high social attributes on the basis of its wide appeal across the population. The Council takes into account the view of the local population when deciding what activities to provide and how to provide them.

32. The price for leisure activities is set with a number of different factors in mind but primarily to increase participation meaning it must be affordable. The activities gave rise to substantial net expenditure by the Council ranging from £2,120,371 in year 2013/14 to £3,308,185 in year 2008/09. Those figures do not include any charge to depreciation on

capital expenditure. The net expenditure is planned for in a business plan each year which outlines the revenue budget and anticipated capital expenditure for the year ahead which feeds into the overall budget of the Council.

33. The Council has considered alternative mechanisms for providing public leisure services. A significant proportion of local authorities in Scotland now provide leisure services to the local population through Leisure Trusts, one of the advantages of which is that they are exempt from VAT. The Council undertook an appraisal in 2004 in respect of how it delivers leisure services. The Council decided not to set up a Leisure Trust in view, in particular, of the fact that it would lose control over the provision of the services.

34. Where a local authority uses a Leisure Trust, the Leisure Trust will typically be funded through a payment made by the local authority which, if it is recognised, falls within the scope of VAT in light of the decision in *Edinburgh Leisure*. HMRC's guidance to local authorities states that "any VAT charged to the local authority by a contractor acting as principal in respect of the management fee or deficit funding will be recoverable in full by the authority subject to the normal rules". It is understood that by this HMRC accept that a local authority will not, in these circumstances, be recognised as acting in the course of a business in providing funding to third parties to discharge their leisure functions.

The issues for determination

35. The issues for determination by the Tribunal are whether in undertaking the activities the Council:

- (1) is undertaking economic activity within the meaning of art 9(1); or
- (2) is to be recognised as engaging in that activity as a public authority within the meaning of art 13(1), which it is agreed falls to be determined by the tests as laid out by the Court which requires that an assessment be made as to whether the activity is undertaken pursuant to a 'special legal regime'; or
- (3) if the Council is not recognised as engaging as a public authority for the purpose of art 13(1), whether the terms of Note 3 to Group 10 VATA operates as an exercise of the discretion permitted under art 13(2) so as to treat the supplies made by the Council as carried out by it as a public authority.

Article 9 - No economic activity

36. The Council accepts that it is supplying "services for consideration" but not that it is "a taxable person" for the purposes of art 2. In those circumstances, the Council as a local authority has a right of refund under s 33 VATA.

37. In referring to "any economic activity" art 9 is only intended to cover activities which essentially concern financial or monetary considerations. That is underlined by the terms of the second sub-paragraph which identifies that the "exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as economic activity". Whilst that wording is linked to the exploitation of property, it has been recognised by the Court as applying to all of the activities referred to in art 9 - see *Götz* at [18].

38. In referring to "purpose" art 9 requires assessment of the underlying rationale for the activity as a whole determining whether it is undertaken for the purposes of obtaining income or for other purposes. Whilst it is necessary to seek to identify the reason for which the

activity is being undertaken, the case law of the Court is clear in recognising that the activity has to be considered per se and without regard to its purpose or results - see for example *Finland* at [37].

39. The legislative purpose of art 9, as it applies to public authorities, is set out in the Opinion of the Advocate General (“AG”) in *Gemeente Borsele*. In general, there is no imperative to impose VAT on services provided by the state as it operates only to reallocate revenue at a national level (between different departments of state) – Opinion at [23]. However, the very structure of arts 9 and 13 recognise that at least some activities of public authorities are considered, in principle, as capable of falling within the scope of VAT as economic activities – Opinion at [24]. There are two reasons for taxing those transactions: the first is to prevent distortions of competition within a relevant and identified market; and the second is to ensure, in accordance with the principle set out in the fifth recital to the PVD, that final consumption is effectively taxed such that if the state provides services culminating in final consumption then such consumption is taxed. The examination of whether a public activity constitutes an economic activity pursuant to art 9(1) “is subject to manifestly stricter criteria than would apply in the case of an activity carried on by a private individual” – Opinion at [27]. In the current appeal taxation of the Council’s supplies is not justified either on the grounds of distortion of competition or final consumption. There is no particular reason, with regard to the PVD, as to why treating leisure activities as not being economic activities should give rise to distortions in competition - the treatment of the activities as exempt or non-taxable gives rise to essentially the same results so far as concerns the PVD; that is reflected in the terms of art 13(2) which make it clear that Member States can treat exempt activities as non-taxable activities. Neither is there any imperative to capture and recognise the value of those activities as representing final consumption by the users of the facilities; as activities which are in principle exempt from VAT at European level (as has been established in *Ealing*) are assimilated to acts of final consumption, exemption, non-economic activities and final consumption, all having the same chain breaking effect on recovery of VAT paid on supplies received.

40. *Wakefield College* concerned the correct VAT characterisation of further education courses provided to students paying fixed fees representing only 30-35% of the costs of providing the courses. The courses were provided at below cost due to grant funding provided by the Learning and Skills Council. Those activities were considered against the wider factual background in which the college provided the same courses to some students, representing the majority, for no fee, and other courses where no remission was available and the fees were designed to cover the full costs (‘full cost courses’). The agreed position of the parties in that appeal, in respect of those other activities, was that the services provided for no consideration did not amount to the carrying on of a business, but the provision of ‘full cost courses’ did. The Court of Appeal identified (at [51] to [59]) the factors relevant to identifying whether the activities fall within the scope of art 9.

41. The concept of ‘market participation’ is in some respects an overarching test. In *Gemeente Borsele* (at [30]) the Court stated: “Comparing the circumstances in which the person concerned supplies the services in question with the circumstances in which that type of service is usually provided may therefore be one way of ascertaining whether the activity concerned is an economic activity”. The AG (Opinion at [65]) notes that the fact that only a small percentage of the costs are recovered is not typical conduct of a market participant. The relationship between income and expenditure was also considered relevant in *Finland* in

which the Court considered whether VAT should be applied to payments made by individuals to the public legal aid office in return for the provision of representation. In *Hutchison* the Court (at [35 - 36]), considering whether the grant by the government of mobile telecommunications licences to private corporations, recognises that activity as essentially amounting to the grant to economic operators to access the market (as distinguished from actual participation in that market). That is also reflected in the judgment in *ICAEW* in which the House of Lords considered whether VAT should be applied to registration fees charged by the ICAEW as a ‘recognised professional body’ to its members in discharge of a statutory regulatory function; their Lordships recognised (at 402j to 405a) that the activity was not economic activity with regard in particular to the fact that it was essentially exercising powers of the state.

42. A precondition for determining whether an activity is an economic activity is the identification of the activity itself. In *Gemeente Borsele* the transport provider charged in full to parents whose children travelled less than 6km, for those travelling 6-20km parents paid a price equivalent to taking public transport for a distance of 6km, and over 20km the charge was set taking account of the parent’s income. As a result, two thirds of parents did not pay any contribution. The AG stated (Opinion at [71]), “... the requirement of market participation on the part of a public activity must in principle be assessed in relation to the activity as a whole and does not necessitate the analysis of each individual transaction”. The Court’s judgment proceeds on the basis that both activities fall to be assessed together – (at [33]): “[t]he contributions at issue in the main proceedings are not payable by each user and were paid by only a third of the users, with the result that they account for only 3% of the overall transport costs, the balance being financed by public funds”. A similar analysis was applied in *Finland* in which, in having accepted the relevance of the general income and expenditure relating to the activity, the Court considered that the activity falling to be assessed included both paid for and unpaid for activities. The activities being undertaken by the Council include both activities which are provided in return for consideration and those which are provided without any charge; that approach is consistent with the approach of the Court in *Borsele* and *Finland*, where it was accepted that the same paid-for and unpaid-for activities should be considered as a whole.

43. In *Wellcome* the Court concluded that the activities in that case, which concerned the buying and selling of shares, did not amount to an ‘economic activity’. In coming to that conclusion the Court relied on the fact that the trust had no power to engage in trading activities and was also precluded from taking majority holdings in other companies. The approach of the Court in *Wellcome* was considered by Patten J in *Yarburgh* (at [22]-[23]) – whilst he accepts the submission on behalf of HMRC that the motive of the person supplying the services is not relevant, he also states ‘the exclusion of motive or purpose in that sense does not require, or in my judgment, allow the tribunal to disregard the observable terms and features of the transaction in question and the wider context in which it came to be carried out’. In *Floridienne* (at [28]) the Court held that an economic activity had to have a “commercial purpose, characterised by, in particular, a concern to maximise returns on capital investments”. That would appear to be a relevant factor on the facts of the present case in which capital investment is made by the Council with no expectation of return. A similar approach was taken by Evans-Lombe J in *St Paul’s* which considered whether a charity was in business in providing the activity of a day nursery which had been undertaken for social reasons to support disadvantaged children. In giving judgment in favour of the

charity the judge (at [54]) identifies the factors which weighed heavily in his assessment including that the fees charged were significantly lower than those charged by commercial nurseries and pitched at levels designed only to cover the costs after grants and donations were taken into account.

44. In the current appeal, the Council's provision of the activities does not represent market participation:

(1) The Council incurs substantial net expenditure in its provision of both the disputed supplies considered in isolation and in connection with the provision of leisure activities taken as a whole and that such expenditure is planned for in advance. A loss is not of itself sufficient to identify an activity as falling outside the scope of economic activity and thereby 'non-taxable'; however, the fact that the loss is habitual and planned for with no expectation of any return provides a wider context indicating that the Council is not involved in market participation.

(2) There is an absence of any account of capital expenditure which goes to make up the facilities – that represents an approach which is at odds with market participation where capital outlay is made in anticipation of reward.

(3) The Council receives income in the form of grants such as those from Sport Scotland. The existence of grants is indicative that the activities do not represent 'market participation' – grants do not represent the ordinary operation of a market;

(4) A substantial proportion of the activities are provided for free such as free swimming provided to the under-18s and free guided walks. The existence of free leisure facilities serves, objectively, to demonstrate that the activity is not dependent upon the stimulus of income.

(5) The activities are provided in the context of the law as it applies to public authorities – whilst on the face of it a local authority has wide discretion as to what leisure facilities it provides and as to the charges to be made for those services that discretion must be exercised in view of the legitimate and stated objects. The activities cannot be pursued with the primary objective of making profit and as outlined in the evidence, the Council does not recognise surplus as being a measure of success. The Council has identified the legitimate objects it seeks to achieve through the provision of leisure services – those objects are directed towards social purposes such as the use of sport to improve the health and welfare of the population.

(6) As identified in the evidence, the manner of provision varies greatly with that available in the for-profit sector – the Council is providing leisure services in a manner which seeks to make provision which is not met by the market – capital expenditure is directed towards areas of relative deprivation which are not served by the market.

(7) The facilities are made available to a range of different organisations who operate as partners in achieving the Council's objectives, in particular its objective in increasing participation in sport in the area. The fees are set with a view to ensuring that the facilities are accessible to the wider population and so set at an affordable level and allowing 'pay-per-play' access.

45. Where a local authority chooses to exercise its statutory powers through a third party, such as in *Edinburgh Leisure*, then it is clear that the activity undertaken is essentially ‘noneconomic’. That is consistent with HMRC’s view that such authorities are entitled to recover VAT on the associated third party supply. There is no reason, from the perspective of a local authority, why that activity should fall to be assessed any differently whether undertaken ‘in house’ or by a third party.

Article 13 - Public authority acting under a special legal regime

46. Article 13 PVD provides that local government bodies are not to be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection those activities or transactions. Article 13 in referring to ‘activities’ is essentially referencing the ‘economic activity’ as referred to in art 9 and, in referring to ‘transactions’ is referencing the terms of art 2 relating to the identification of a supply.

47. In order to be acting as a public authority the Council must, in accordance with *Fazenda Pública* be acting pursuant to a ‘special legal regime’. In the AG’s Opinion it is stated that it is the legal way in which the activity is carried out which is relevant, although the attendant factual circumstances may be taken into consideration as an indication as to the classification of an underlying legal relationship. The Court (at [21]) suggests that it is necessary to “analyse all the conditions laid down by national law for the pursuit of the activity at issue in the main proceedings, to determine whether that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same legal conditions as those that apply to private economic operators”. The Court (at [22]) accepts that “the fact that the pursuit of an activity such as that at issue in the main proceedings involves the use of public powers, such as authorising or restricting parking on a public highway or penalising by a fine the exceeding of the authorised parking time, shows that this activity is subject to a public law regime”.

48. In *Finland* the AG (at Opinion [55] to [67]) noted that:

- (1) bodies engage in activities ‘as public authorities’ when they do so under the special legal regime applicable to them. On the other hand, when they act under the same legal conditions as those that apply to private traders, they do not engage in such activities;
- (2) the fact that businesspeople or private practitioners are present in the same sphere of activity does not preclude a finding that a body is acting ‘as a public authority’, and that the term ‘as a public authority’ must be given a broad interpretation, encompassing both tasks which are essentially public, which private persons are prohibited from carrying out, and those in which a competitive situation arises with the private sector;
- (3) having considered the claim made by the Commission that the public legal aid offices and private practices were operating under the same legal regime on the basis that the same legislation applied to them, the AG rejected this, relying on an assessment that ‘the private operators work, by special authority of the law, within a legal framework applicable to public bodies and not the reverse, as the Commission

appears to suggest’ – the AG essentially concludes that private operators are, in this respect, acting within the scope of the public law.

49. In *T-Mobile* the AG recognised (at Opinion [115, 117 & 122]) that:

- (1) a body is not precluded from being recognised as acting within a legal regime simply by reason of the fact that the activities involve the application of civil law procedures;
- (2) it is the manner in which the activities are carried out which is crucial and that assessment “depends primarily on whether private individuals can engage in any comparable activity at all on the basis of the relevant legislation”; and
- (3) it is not inconsistent for the wider legal context of an activity to be taken into account.

50. It is irrelevant that the activities are pursued in view of essentially social objectives – per *Carpaneto* (at [13]) the “subject matter or purpose of the activity is not relevant for the purpose of Article 13”. The amount of revenue that is derived from the activity is largely irrelevant (*T-Mobile* per AG Opinion at [123]).

51. Whilst an assessment is made as to whether the application of a special legal regime is different than that applying to private traders, it is not a requirement that a ‘special legal regime’ should operate so as to take those supplies wholly out of the scope of competitive activity. That follows from a structural review of art 13 which is subject to the second subparagraph which excludes from its scope supplies made pursuant to a special legal regime where “their treatment as non-taxable persons would lead to significant distortions in competition”. Article 13 pre-supposes, therefore, that supplies made pursuant to a special legal regime are capable of giving rise to distortions in the market.

52. In *Durham Company* Warren J stated (at [103]): “I have no doubt that section 45(1)(b) Environmental Protection Act 1990 [under which a waste collection authority has a duty if requested by the occupier of premises in its area to collect any commercial waste from the premises, to arrange for the collection of the waste....] is, or at least is capable of being, a ‘special legal regime’. This is demonstrated by consideration of a LA [ie local authority] which provides a commercial waste collection service only if requested to arrange for such collection by an occupier of premises and does so for a reasonable charge which, taking the provision of the service to occupiers generally, results only in cost recovery and no surplus”. The reference there to “reasonable charge” reflects the wording of s 45(2) Environmental Protection Act 1990 (“EPA”) which provides that a person shall be liable to, and a collection authority is required to recover, a reasonable charge for such collection and disposal.

53. It is necessary to identify legal rules which apply to the activity and which are exclusive to the public authority (i.e. which do not apply to the private sector). Having identified those rules it is then necessary to consider whether the effect of those rules is such that those supplies cannot be recognised as being made under the same legal conditions as apply to private traders.

54. LGPSA requires the Council to ‘ensure that there is adequate provision of facilities for the inhabitants of their area for recreational, sporting, cultural and social activities’. LGPSA does not provide for, and nor can any be implied, an entitlement for the Council to provide facilities with commercial objects in mind. The Council will clearly have a margin of

discretion in identifying what is ‘adequate’. Such a discretion must be exercised in accordance with the principles applying to public administrative law. There does not appear to be any case authority which considers the discharge of the duty/exercise of the power under ss 14-19 LGPSA. A duty, such as that contained in s 14 LGPSA to provide ‘adequate’ facilities to the local population must be exercised with regard to the legitimate needs of the local population. The question whether a particular level of provision is ‘adequate’ must be assessed by reference to factors such as health, social inclusion, wellbeing, education, prevention of crime etc. In general the level of ‘adequate’ provision would vary by reference to the locality and so it is to be expected that provision would be relatively higher in relatively deprived areas. The power to charge must be exercised subject to the obligation to provide adequate facilities – the power to provide facilities would not be properly exercised if charges did not allow access to those whose needs need to be met.

55. In *Edinburgh Leisure* the Tribunal considered LGPSA and concluded that it imposed a wide ranging duty which:

“would be capable of enforcement if the local authority failed to ensure not only adequate provision of facilities in the sense of structures and equipment, but also failed to ensure that the inhabitants of their area were provided adequately with facilities. The inhabitants of a local authority area consist not only of the fit and able bodies, they also consist of persons who are subject to disadvantages whether physical, mental, social or economic. Adequate provision requires to be made for such people. Accordingly a local authority cannot for example point to private provision of leisure centres as satisfying the requirements of the statute when only provided by the private sector at an economic charge, they must do more and ensure that there are adequate facilities for people who cannot for social or economic reason make use of facilities supplied for profit which as a result are costly. A local authority may include such facilities as fulfilling part of their overall duty but require to fulfil the further duty of ensuring availability to the inhabitants of their area. This duty they could perform by running loss making social and leisure departments and funding these by way of direct grant or subsidy.”.

The Council argues that this is at least indicative of a special legal regime concerning the operation of the facilities.

56. When a power is conferred on a local authority then it must act both within the width of that power and also for the purpose for which that power was conferred. This was the approach adopted in *Credit Suisse* in which the Court of Appeal considered facts relating to the establishment by a local authority of a subsidiary company to operate a leisure facility which included time-share units.

57. A power to set charges encompasses a legal obligation to consider the level of charge in view of the fiduciary duties to ratepayers and in view of the legitimate objectives against which that expenditure is made. The relevance of such fiduciary duties in setting charges was considered by the House of Lords, albeit in a different context, in *Bromley*. The Council is required to set charges in the context of the pursuit of its legitimate objects of providing those services (such legitimate objects excluding any activity the purpose of which is to generate a profit as the Council is not empowered to trade). It is not necessary to define the precise scope of the boundaries of a Council’s legitimate objects – the absence of case law

concerning the issue might imply that local authorities act well within the boundaries of their legitimate objects in their provision of public leisure services.

58. The interests of the residents in having to fund expenditure have to be balanced against the benefits of providing funded leisure services. The Council sets prices so as to encourage participation in sport across the area of the Council's responsibility but with regard to the fact that the net expenditure is to be funded by ratepayers. That creates a legal requirement, as regards selecting services and setting prices, which is materially different from that applying in a market where the nature of the supply and the price determined is driven by the financial return. The legal obligation on the Council is to consider both the financial cost and the social return.

59. The "best value" rules form part of the wider context in which those legal obligations are exercised.

60. The existence of a 'special legal regime' cannot be defined simply by the volume of legislation or the strictness or detail of the provisions laid out – a detailed legal scheme may give rise to supplies which are in substance the same or substantially similar to those in the general market. In *Durham Company* it appears to have been accepted that the requirement for a 'reasonable charge' on the face of it gave rise to a requirement to set charges at or around the cost of providing the services. A legal regime which requires charges to be set at a level so as to recover costs shares some similarities with the wider market in the sense that price is often set in the general market by reference to cost (albeit in that case there would also be an additional notional 'profit cost'). On the facts of this case the legal obligation to set such charges as the Council "considers fit", and which carries with it the requirement to undertake a wider assessment of benefits accruing to those living within the area of the Council's responsibility, is further removed from the ordinary operation of the market.

61. It is agreed between the parties that the question of whether, if the Tribunal finds that the supplies do fall within the first subparagraph in art 13(1), the supplies then fall to be excluded by reason of the second subparagraph, which applies where non-taxation is likely to give rise to distortions of competition should be excluded from the scope of the present hearing. However, the Council reserves its position as to whether that issue requires any (or any substantial) evidence on the basis of its provisional assessment that non-taxation cannot be recognised as giving rise to distortions of competition in circumstances where similar supplies, made by non-profit making organisations, already qualify for non-taxable status.

Note 3– Supplies treated as made by a public authority

62. The Note 3 Issue is relevant only if the Tribunal determines that the Council is engaged in an economic activity, and does not operate under a special legal regime.

63. Item 3 Group 10 Sch 9 VATA 1994 exempts the supply of sports services by an 'eligible body'. Eligible body is defined in Note (2A); on the face of note (2A), a local authority would fall within the general description of an 'eligible body'. However, Note 3 specifically excludes local authorities from the scope of the definition of eligible body and thereby from the exemption.

64. The UK initially applied taxable treatment to supplies of sporting services (i.e. services of a kind now falling within art 132(1)(m) PVD), at the time adopted pursuant to a

permitted derogation, but subsequently conferred exempt status, with effect from 1 January 1994, in the same terms as now set out in Item 3 to Group 10 Schedule 9.

65. In *Ealing* the Tribunal referred three questions to the CJEU. The AG (at Opinion [31] to [38]) had difficulty in reconciling the legislative background, as presented, to the questions referred. The Tribunal had essentially asked the Court to consider whether the UK was entitled to apply the exemption as it applied to public bodies subject to the condition as set out in art 133(d), which provides that Member States may make the granting to bodies other than those governed by public law of the exemption provided for in art 132(1)(m) subject, in each individual case, to the condition that the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT. However, the UK legislation did not in its terms operate so as to apply the competition condition to the exemption as it applied to the individual case of public bodies. There is no indication of the intention or rationale for the provisions of Note 3, simply a statement that local authorities are excluded from the exemption. There is no evidence that the UK intended Note 3 to relate to the competition condition; rather, the desire was to preserve recoverability for local authorities under s 33.

66. The Court stated that the structure of art 133 is not designed to place non-profit-making bodies governed by public law in a more favourable position than other non-profit-making bodies. The Court then goes on, in answering the hypothetical question referred, to answer that art 133 must be interpreted as precluding national legislation which applies the competition condition to supplies by organisations governed by public law whilst failing to apply that same condition to those same organisations who are not so governed.

67. The referral to the Court was made on a mistaken premise: that Note 3 had taken effect so as to exclude public bodies from the scope of art 132(1)(m) pursuant to art 133. That interpretation cannot hold at any level – the UK legislation does not in its terms apply that condition to public bodies but, even if it did, it is clear that it would not be entitled to do so unless it also applied that condition to other non-profit-making organisations. Following *Ealing* it is clear that art 132(1)(m) cannot form the basis for taxation of the disputed supplies. The question that then arises in this appeal, in light of *Ealing*, is as to what the effect is of Note 3? The Council contends that Note 3 represents the de facto exercise by the UK of the derogation provided to it under art 13(2), which operates so as to treat services which are exempt, such as those identified in art 132(1)(m), where provided by public bodies, as being excluded from exemption in favour of treatment as activities of a public body acting as such. HMRC, in their internal manual, state that they have not exercised the option open to them under art 13(2).

68. The terms of UK law are consistent with the art 13(2) derogation insofar as they do not require that Note 3 activities be treated as taxable supplies. Section 4(2) VATA defines a taxable supply as a supply of goods or services made in the United Kingdom other than an exempt supply. The disputed services do not fall to be treated as taxable under the terms of s 4(2) as the services remain exempt (those exempt services are deemed or treated as non-taxable activities).

69. In *Marktgemeinde* the Court held (at [19]) that “Member States are authorised to exclude from treatment as taxable persons bodies governed by public law which carry out activities exempted under Article 13 of the directive, even if they are performed in similar manner to those of a private trader.” In *SALIX* the Court noted that (i) the provisions of the

Directive need not be incorporated verbatim into domestic law provided that the domestic provisions in context are sufficiently clear and precise (at [40] – [42]) with the Member State choosing the legislative technique it regards as most appropriate (at [56]); (ii) as the exception is optional for Member States, the State must choose to exercise the exception (at [52] and [55]) to thereby exclude certain activities performed by a public authority as from the scope of an economic activity (at [53]); and (iii) as the exception is thereby a derogation from the general rule, it should be strictly construed.

70. Accordingly, where the derogation is implemented the effect is to take economic activities undertaken by a public authority which fall within the scope of the exemption and deem them, nevertheless, to be activities undertaken by a public authority acting as such. The only restriction on such treatment then being that it must not result in significant distortions of competition either against or in favour of the public authority concerned. The Member State must legislate so as to implement the derogation, such legislation arising as a result of a choice to rely on the derogation. The principle of declaratory effect of judgments of the Court means that the judgment in *Ealing* has effect as if the relevant provisions were so understood at the time they came into force (in 1994). When Note 3 is read in light of the judgment in *Ealing* it cannot be recognised as having the effect of requiring the taxation of such supplies for which there is no basis in the PVD. In light of the judgment Note 3 can only fall within the framework of art 13(2) PVD. Further, on the basis that Parliament is presumed not to legislate for no purpose and/or not deliberately to enact legislation which is ultra vires, this Tribunal should seek to determine an interpretation of Note 3 which is compliant with the provisions of the Directive and otherwise achieves the legislative intent of Parliament, in this case excluding local authorities from the exemption.

71. UK legislation must be interpreted so far as possible in conformity with the requirements of EU law – the *Marleasing* principle - see, for example, *Prudential* at [101]. The Council contends that the words used in Note 3, simply read and with no need to stretch their language, can be interpreted to be in conformity with the provisions of the PVD if construed as the exercise of the art 13(2) discretion. Such interpretation gives the statutory provision meaning and relevance rather than concluding it is otiose. Further, to interpret it in this way also achieves the outcomes which appear to have underpinned the decision to exclude local authorities from exemption, i.e. recovery of input tax associated with the provision of sporting services – see the 2017 parliamentary review of the sports exemption following a concern raised by the commercial or proprietary golf sector concerning distortions of competition. In light of s33, interpreting Note 3 as the exercise of the discretion in art 13(2) achieves a result compliant with the PVD, gives meaning to the provisions of Note 3, and achieves the outcome sought by local authorities otherwise concerned as to the recovery of the VAT paid to suppliers in connection with the provision of sports services. The UK has left Note 3 on the statute book, despite *Ealing*.

72. Section 41A(1) VATA provides the general vires for non-business treatment under art 13(1) and addresses the treatment of certain activities as explicitly taxable under the terms of the PVD. Sporting services are explicitly exempt and Note 3 is the enactment of the discretion exercised under art 13(2) so far as it relates to sporting services. Note 3 excludes exemption in favour of treatment of those same activities, where provided by the bodies mentioned in Note 3, as ‘non-economic’ activities.

RESPONDENTS' CASE

73. For HMRC, Mr Hill submitted as follows.

74. Following the CJEU decision in *Ealing* HMRC accepted that the sporting services exemption (art 132(1)(m) PVD) applied to sports centre entrance fees charged by local authorities – therefore, local authorities can reclaim overpaid output VAT wrongly charged on those fees. The Council maintains that its supplies are accordingly exempt if they are economic activities which were not provided under a special legal regime.

The economic activity argument

75. From the caselaw it was established that in determining whether there was an economic activity the following matters were not relevant:

- (1) Whether the activities were carried out with a business or commercial motive, or intention of profit – see *Finland*, *Gemeente Borsele* and *Longridge*.
- (2) Whether the activities were carried out in the public interest – see *Finland*.
- (3) Whether the activities are duties conferred by law – see *Finland* and *Saudaçor*.
- (4) How the activities are financed – see *Lajvér*.

76. In *Wakefield College* the Court of Appeal (at [52]) drew a distinction between consideration for the purposes of art 2 and remuneration for the purposes of art 9. The Council has conceded that it receives art 2 consideration. The Court stated, “A supply for consideration is a necessary but not sufficient condition for an economic activity.”

77. The Tribunal was required to look widely at the circumstances of the case (per Arden LJ in *Longridge*) and conduct a wide-ranging, fact-sensitive, entirely objective enquiry (per David Richards LJ in *Wakefield College*). Factors may assume different relative importance in different cases (*Wakefield College* at [58]).

78. In *Finland* the Court of Justice noted that only about a third of the users of the Finnish legal aid offices paid even the basic contribution – and the contributions covered less than 8% of the operating costs of the legal aid offices – and held that, in those circumstances, there was no economic activity. The link between the services and the payment was not sufficiently direct for the services to be regarded as economic activities, since the link between the part payment made by recipients and the actual value of the services provided varied in strength according to the recipient’s circumstances. This suggested that the part payment borne by recipients should be “regarded more as a fee”. Importantly though, the Court indicated that an economic activity for the purposes of VAT “does not necessarily have to be a business activity designed to make a profit” and could be an activity carried out “without any business or commercial objective”.

79. This was supported by Arden LJ in *Longridge* where she stated (at [94]) that the fact that Longridge’s predominant concern in carrying out its activities and setting prices for them was to further its charitable objectives and “its considerable use of volunteers” which allowed it to reduce costs were irrelevant to whether its activities were economic. This was because “economic activity is assessed objectively and so the concern of Longridge, which is its reason for providing the services which it does provide, is not enough to convert what would otherwise be economic activity into an activity of a different kind for VAT purposes”. The calculation of the charges supported the existence of an economic activity, since “the amount of the charge was more than nominal in amount and was directly related to the cost of the

activity. ... The concessionary charges were also not an indicator against the existence of an economic activity because the economic activity springs from the receipt of income, not profit.” Arden LJ took into account, in deciding that Longridge’s activities were economic, not just “the fact that it operated in a market where similar services were supplied on a commercial basis”, but also the fact that Longridge conducted its activities on a “substantial” scale, applying “prudent financial management”.

80. The Court of Justice in *Gemeente Borsele* said (at [31]) it was relevant to look at “the number of customers and the amount of earnings.” The Court noted in that “the municipality of Borsele recovers, through the contributions that it receives, only a small part of the costs incurred. The contributions at issue in the main proceedings are not payable by each user and were paid by only a third of the users, with the result that they account for only 3% of the overall transport costs, the balance being financed by public funds. Such a difference between the operating costs and the sums received in return for the services offered suggests that the parental contribution must be regarded more as a fee than as consideration”. The Court did not adopt the factors discussed by AG Kokott (at [25-27 & 68-69] of her Opinion) that it would not make sense to tax activities carried out by public bodies unless there was either a risk of distortion of competition or that there was a possibility of untaxed final consumption.

81. In *Wakefield College*, David Richards LJ noted (at [75]) “in *Finland* and, to an extent, in *Borsele*, the charges paid were fixed by reference to the means of the recipients. Second, and as a necessary corollary, the charges were only partly fixed by reference to the cost of the service. Third, the total amount raised by charges was insubstantial, both in absolute terms and relative to the cost of the service”. The college charged fixed fees which were significantly less than the cost to the college of providing the courses; the Court of Appeal (at [81-84]) took into account that the fees “made a significant contribution to the cost of providing courses to the students paying those fees, to the extent of some 25-30%”. The fees paid by the group of students paying subsidised fees were “significant in amount”, their level was fixed by reference to the cost of the courses and was “not fixed by reference to the means of the students or employers or others paying the fees”. Although the college might have “charged less than it was entitled to, as a response to prevailing economic circumstances in its local catchment area, ... that is a factor that any economic activity must take into account and is not comparable to an individual means-tested basis for fixing fees”. There was a market in the provision of further and higher education and there was “no reason to suppose that the College [was] other than a typical participant in that market or that it provides courses to students paying subsidised fees on anything other than a typical basis”. That was so, even though the College was itself a charity and its viability was underpinned by a combination of grant aid and fees.

82. The position of the Council can be distinguished from that of the municipality in *Gemeente Borsele* on four grounds:

(1) *Most of the users of the Council’s sports and leisure facilities pay something.* In both *Gemeente Borsele* and *Finland* only a third of users were required to make any contribution; the present case is more similar to *Longridge*, where Longridge charged for the majority of its courses, but offered discounts or waived charges where it considered it justified. The only completely free provision by the Council was for school holiday swimming, unbooked 5-a-side pitches, open access skate parks, and walks.

(2) *The relevant charges are based on the leisure or sports activity chosen by the participant and the number of times that they wish to undertake that activity.* In *Gemeente Borsele* the parental contribution to the transport costs was not linked to either the number of kilometres travelled per day, the cost price per journey for each pupil transported, or the frequency of the journeys. In *Finland*, the Court commented (at [48]) that the charges for legal representation depended not on the complexity of the case concerned or the number of hours worked by the legal advisor in question, but on the recipient's income and assets. In contrast, the charging structure adopted by the Council is similar to that adopted by Longridge, which depended on the activity chosen by the participants and whether it was a single activity or course that was chosen. It is true that the Council has various concessionary rates for activities carried out by individuals and groups, but that was also the case in *Longridge*.

(3) *It is relevant (though not conclusive) to look at the percentage contribution of users of the service towards the cost of providing the service – see Gemeente Borsele (at [33]).* In the eight year period between 2006 and 2014 56% of the Council's expenditure on provision of sport at leisure centres was recovered through customer charges. This is far above the 3% contributions received by the municipality in the *Gemeente Borsele* case. In taking into account the percentage contribution by users of the relevant services, the relevant question is whether the Council was exploiting its facilities in order to obtain income therefrom. As the Court of Justice stated in *Lajvér* (at [35]), "it is irrelevant whether the exploitation is intended to make a profit". The Council obtained very substantial income from providing leisure and sports facilities – its income from its leisure centres and snowsports centre in each of the years from 2006 to 2015 varied between approximately £2.3 million and £4.1 million. Penicuik had 200,000 visits in one year. It is irrelevant whether the Council was subsidised through grants – see the Court of Justice in *Lajvér* (at [38]).

(4) *The Council offers its leisure and sports services on the general market – see Gemeente Borsele (at [35]).* Anyone who wants to take part in sport or leisure activities can choose to use the facilities offered by the Council or can choose to use the facilities offered by commercial entities. Nor are the Council's services excluded from being provided on the general market on the basis that they are a precondition for the access of economic operators to the market, rather than participation in the market (see *T-Mobile* at [42] and *Hutchison* at [36], which AG Kokott referred to in footnote 41 of her Opinion in *Gemeente Borsele*). The Council operates on the general market for sports and leisure services in the sense that (a) selling access to sports and leisure facilities is inherently a market activity, which is capable in principle of being carried out by economic operators; (b) it has very substantial numbers of customers and derives very substantial income from its sporting and leisure activities; and (c) it has taken active steps to manage and market its sporting and leisure services, including via its Internet webpages (see *Staby* at [39], and *Rēdlihs* at [36]). The fact that the Council offers leisure and sporting services on the general market in fulfilment of statutory duties is not relevant in assessing whether those services are offered on the general market (see *Finland* at [40]). Nor does it matter that the services are provided in the specific context of the law applied to public authorities or in a manner which seeks to make provision where the activity is not in fact met by the market. In *Götz* the Court held that the nature of the activities, in which farmers could

buy and sell milk quota, a price could be struck and payments could be effected, was an economic activity since that activity “does appear to be capable, as a matter of principle, of being carried out by economic operators”.

83. Accordingly, the present case is not in the exceptional category of cases, such as *Finland* and *Gemeente Borsele*, where the amounts paid by users of the relevant services were to be regarded as symbolic amounts which had an insufficient link with the services provided. Rather, as in *Wakefield College* and *Longridge*, the financial contribution made by users of the services in the Council’s case is consideration for the services in question – and those services are an economic activity.

Public authority acting under a special legal regime

84. From the caselaw on art 13 the following principles could be drawn:

- (1) Any economic activity is normally taxable and thus the PVD has a wide scope – see *Ireland* at [39], *Isle of Wight* at [28] and *Saudaço* at [48].
- (2) A public law body is normally taxable – see *Ireland* at [39].
- (3) Article 13 is a derogation from that general rule and so must be interpreted strictly – see *Ireland* at [40-41] and *Saudaço* at [38-39].
- (4) It is not an objection to the existence of a special legal regime that private bodies can carry out similar activities – see *Isle of Wight* at [33].
- (5) A special legal regime is not created simply by operating within a statutory framework – see *Ireland* at [49].
- (6) The activity in question must be carried out in exercise of rights and powers of the public authority – see *Fazenda Pública* (at [22]).
- (7) The subject-matter or purpose of the relevant activities are irrelevant in deciding whether they were carried out by a body governed by public law under a special legal regime applicable to it - see *Saudaço* (at [70]).

85. The case of *NRA* does not provide the Tribunal with any assistance on the special legal regime issue. In that case, it was common ground, not just that the NRA was a body governed by public law (at [9]), but also that the NRA was such a body “acting as a public authority as regards the activity of making road infrastructure available on payment of a toll” – and was thus prima facie not to be regarded as a taxable person (at [22]). Indeed, the Court rejected an attempt by the European Commission to reopen that issue (at [30-34]). Thus, there was no issue in that case whether the NRA operated under a special legal regime. The only issue (as set out in the questions referred by the national court (at [29 & 35])) was whether treating the NRA as non-taxable would lead to significant distortions of competition, applying the second sub-paragraph of art 13(1) - and not whether the NRA should prima facie be regarded as a taxable person, applying the first sub-paragraph of art 13(1). That is confirmed by the Court’s answer to the questions referred (at [52]).

86. *Durham Company* was a judicial review concerning the lawfulness of treating local authorities which collected and disposed of trade waste as being non-taxable persons under art 13(1). Warren J applied *Fazenda Pública*, *Isle of Wight* and *Saudaço* (at [12-21]). Therefore, *Durham Company* does not purport to establish any new legal test of the existence

of a special legal regime, but simply to apply the test laid down by the CJEU in those previous authorities to the particular facts of the case. Furthermore, Warren J’s decision was that the relevant statutory provision – section 45(1)(b) EPA (which required a local authority to arrange for the collection of any commercial waste which the occupier of premises in its area requested it to collect) was “at least ... capable of being ... a “special legal regime”” (at [103]). Warren J expressly stated that “whether any particular LA is acting as a public authority” will depend on the facts relevant to that local authority (at [104]).

87. The Council argues that it provides its sports facilities pursuant to a special legal regime, relying on the duty under s 14 LGPSA to ensure there is adequate provision of recreational, sporting, cultural and social facilities for the inhabitants of its area. The fact that the Council provides such services under a statutory duty does not mean that engaging in its activities “necessarily involves the exercise of rights and powers of the public authority”. In *Ireland* the member state made the same point – that Irish local authorities act only pursuant to powers conferred on them by statute and cannot engage in commerce in competition with private traders. Therefore, Ireland argued that they “necessarily act in their capacity as public bodies” (at [11 and 38]). On that basis, Ireland argued that there was no need for it to make provision for any services provided by local authorities to be taxable – since none could be. Nevertheless, the Court held that, despite the statutory derivation of all of the powers of Irish local authorities, it was nevertheless possible for their services to be taxable – and therefore Ireland had to make provision for the taxation of economic activities provided by its local authorities. Therefore, it is not enough for the Council to say that it acts in accordance with duties conferred upon it by statute. Rather, what is necessary is that the pursuit of the sporting activities involves the exercise of the rights and powers of a public authority. Those rights and powers have to “amount to an instrument” which are used by the Council in order to carry out the sporting activities (per *Saudaçor*).

88. The Council does not use the relevant statutory provisions as an instrument in order to carry out the relevant sporting activities. The situation is not like *T-Mobile* where only the public authorities could carry out the activities in question (auctioning mobile phone spectrum) and nor are they like *Fazenda Pública*, in which the public authorities exercised public powers in order to carry out activities where comparable activities were also provided by private operators (car parking) but in which the specific activity in question was both authorised by and delimited by the use of public powers (on-street car parking). So the Council’s situation is not a case in which the exercise of public powers was necessary to create or carry out the specific activity in question - any organisation could in law provide sports and leisure facilities similar to those provided by the Council, without recourse to public powers.

89. Whether or not the purpose of the Council in providing sports and leisure facilities differs from that of other organisations providing similar facilities is irrelevant in assessing whether they are acting as public authorities – see *Fazenda Pública* and *Saudaçor*.

The Note 3 Issue

90. This is a new argument, first set out in detail in Ms Brown’s skeleton argument.

91. The Council contends that, when implementing the sporting exemption in UK law, Schedule 9, Group 10, Item 3 VATA, which exempts the supply of sporting services made to individuals by eligible bodies, is subject to the exception in Note 3 under which the term “eligible body” does not include local authorities.

92. In *Ealing* the Court held that the UK was not entitled to rely on the risk of distortion of competition under Article 133(d) PVD to exclude sporting services from the Article 132(1)(m) exemption where they are provided by local authorities but not to apply the same condition to other non-profit making organisations.

93. The Council appears to be arguing that, since the UK was not entitled to legislate so as to single out sporting services provided by local authorities for exclusion from the exemption, Note 3 must be interpreted as being an election by the UK to rely on Article 13(2) PVD, under which Member States have a discretion to regard activities by public bodies which would otherwise be exempt under Article 132 as falling within Article 13(1) (i.e. as not being provided by a taxable person).

94. However, the effect of the Court's judgment in *Ealing* is clear. The UK should not have singled out local authority sporting services for exclusion from the exemption. In those circumstances, local authorities have a directly effective right to rely on the exemption under Article 132(1)(m) PVD; they do not need to rely on a conforming interpretation of national law under the *Marleasing* principle, as they are asserting their rights under the Directive against the State.

95. The Council has chosen not to rely on its directly effective right to exemption of its sporting services; but that does not mean that Note 3 has to be interpreted as being a UK election to rely on Article 13(2). If that were the case, then Note 3 would have to be interpreted in the way suggested by the Council in every case involving a local authority claiming overpayment of output tax during the relevant period. Therefore, *Ealing* and any other local authority which wished to rely on direct effect to claim the exemption under Article 132(1)(m) would not be able to do so. All local authority sporting supplies during the relevant periods would be treated as falling within Article 13(1) and not Article 132(1)(m) – despite the fact that the services in question were economic activities, did not otherwise fall within Article 13(1) and despite the fact that the local authorities in question have a directly effective right to rely on Article 132(1)(m) to claim exemption. The *Ealing* judgment most certainly does not require the UK courts to deny *Ealing* and other local authorities which wish to claim exemption for their sporting services the chance to do so. Indeed, it would be wholly contrary to legal certainty now to regard Note 3 as being an election by the UK to rely on Article 13(2). In *SALIX*, on which the Council relies, the Court of Justice stated (at [42]):

“Each Member State is bound to implement the provisions of directives in a manner that fully meets the requirements of clarity and certainty in legal situations imposed by the Community legislature, in the interests of the persons concerned established in the Member States. To that end, the provisions of a directive must be implemented with unquestionable legal certainty and with the requisite specificity, precision and clarity”.

96. The Court went on to point out (at [51-55]) that, because the transposition of art 13(2) was not obligatory, it followed that, “in order to use the option provided for by that provision, the Member States are required to make a choice to rely on it”. Because the exercise of the option was a derogation from the general rules of the Directive, the Court held that it fell to be strictly construed and accordingly “in order to rely on the option ... the Member States must make a specific choice to that effect”. In the present case, the UK made no such specific choice to rely on the derogation in Article 13(2). Indeed, as the Council itself submits (in paragraph 9 of Ms Brown's skeleton) the UK only expressly implemented Article 13 PVD by introducing a new section 41A VATA through the Finance Act 2012.

97. Note 3 makes no attempt to specify that local authorities are to be treated as non-taxable persons – rather they are excluded from the exemption – the effect of which is therefore that the default position applies and their sporting services are treated as taxable.

98. As the passage from the 2017 Review cited by the Council makes clear, “It had been intended that exemption would be extended to supplies made by local authorities, but in May 1995 Customs confirmed that these supplies would continue to be standard rated”, following lobbying by local authorities themselves. That is confirmed by the Hansard passages referred to in footnote 27 of the Review. In those circumstances, it is simply impossible to say that the UK made a specific choice to rely on Article 13(2). To construe Item 3 as being the exercise of such a choice would amount to a retrospective amendment of the VATA, which would be wholly contrary to legal certainty.

CONSIDERATION AND CONCLUSIONS

99. We find as fact the witness evidence of Mr Sheret and Mr Fairley set out above.

100. The Council advances three alternative arguments why its supplies of sporting and leisure activities to members of the public do not attract VAT.

101. First, the supplies do not constitute an economic activity within art 9 PVD; therefore the Council is not a taxable person within the meaning of art 9; therefore there is no taxable supply under art 2 PVD. We shall call this “**the Article 2 Argument**”.

102. Secondly, the supplies are made by the Council in its role as a public authority for the purposes of art 13 PVD; it operates as such under a special legal regime; and its consequent treatment as a non-taxable person does not lead to significant distortions of competition. We shall call this “**the Article 13 Argument**”.

103. Thirdly, the terms of Note 3 to Group 10 sch 9 VATA 1994 operate as an exercise of the discretion permitted under art 13(2) so as to treat the supplies made by the Council as carried out by it as a public authority, and thus by a non-taxable person (“**the Note 3 Argument**”).

The Article 2 Argument

104. Article 2 PVD subjects to VAT “the supply of services for consideration within the territory of a Member State by a taxable person acting as such”. Article 9 PVD defines “taxable person” as “any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity ... Any activity of ... persons supplying services ... shall be regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity.”

105. These provisions were considered by the Court of Appeal in *Wakefield College* where David Richards LJ reviewed the relevant caselaw (which we cover in more detail below) and analysed the current legal position as posing two separate questions:

“[52] Whether there is a supply of goods or services for consideration for the purposes of art 2 and whether that supply constitutes economic activity within art 9 are separate questions. A supply for consideration is a necessary but not sufficient condition for an economic activity. It is therefore logically

the first question to address. It requires a legal relationship between the supplier and the recipient, pursuant to which there is reciprocal performance whereby the goods or services are supplied in return for the consideration provided by the recipient: see, for example, the judgment in *Borsele* at para 24. That is what is meant by 'a direct link' between the supply of the goods or services and the consideration provided by the recipient: see *Borsele* at para 26 and contrast *Apple and Pear Development Council v Customs and Excise Comrs*. There is no need for the consideration to be equal in value to the goods or services. It is simply the price at which the goods or services are supplied. This requirement was satisfied in both *Finland* and *Borsele*.

[53] Satisfaction of the test for a supply for consideration under art 2 does not give rise to a presumption or general rule that the supply constitutes an economic activity. However, as Mr Puzey for HMRC pointed out, the Advocate General remarked in her opinion in *Borsele* at para 49, 'the same outcomes may often be expected.'

106. On the Court of Appeal's first question, the Council accepts (and we agree) that the fees the Council receives do constitute consideration for the purposes of art 2. Moving to the Court of Appeal's second question:

“[54] Having concluded that the supply is made for consideration within the meaning of art 2, the court must address whether the supply constitutes an economic activity for the purposes of the definition of 'taxable person' in art 9. The issue is whether the supply is made for the purposes of obtaining income therefrom on a continuing basis. For convenience, the CJEU has used the shorthand of asking whether the supply is made 'for remuneration'. The important point is that 'remuneration' here is not the same as 'consideration' in the art 2 sense, and in my view it is helpful to keep the two terms separate, using 'consideration' in the context of art 2 and 'remuneration' in the context of art 9.

[55] Whether art 9 is satisfied requires a wide-ranging, not a narrow, enquiry. All the objective circumstances in which the goods or services are supplied must be examined: see the judgment in *Borsele* at para 29. Nonetheless, it is clear from the CJEU authorities that this does not include subjective factors such as whether the supplier is aiming to make a profit. Although a supply 'for the purpose of obtaining income' might in other contexts, by the use of the word 'purpose', suggest a subjective test, that is clearly not the case in the context of art 9. It is an entirely objective enquiry.

[56] In describing the relationship between the supply and the charges made to the recipients in the context of art 9, the CJEU has used the word 'link'. In *Finland* at para 51, the court concluded that 'it does not appear that the link between the legal aid services provided by public offices and the payment to be made by the recipients is sufficiently direct ... for those services to be regarded as economic activities'. Likewise, in *Borsele* at para 34, the court adopted precisely those words in concluding that the provision of the school transport was not an economic activity.

[57] Mr Prosser QC for the College submitted that whether there was 'a sufficiently direct link' between the services and the charge made was an important circumstance, while Mr Puzey submitted that 'direct link' does not feature in the analysis.

[58] I regard this as a largely semantic point. The word 'link', whether 'sufficient' or 'direct', is used as no more than shorthand to encompass the broad enquiry as to whether the supply is made for the purpose of obtaining income. It is not a separate test, or one of the factors to be considered when addressing the central question. For my part, I think it is apt to cause some confusion to use the same word for both art 2 and art 9 and I have not myself found it particularly helpful or illuminating in considering whether there exists an economic activity.

[59] Each case requires a fact-sensitive enquiry. While cases concerning the supply of legal aid services or school transport will provide helpful pointers to at least some of the factors relevant to the supply of subsidised educational courses, there is not a checklist of factors to work through. Even where the same factors are present, they may assume different relative importance in different cases. The CJEU made clear in *Borsele* at para 32 that it was for the national court to assess all the facts of a case.”

107. We look first at the CJEU cases referred to by the Court of Appeal in the passages quoted above. In *Finland* the CJEU summarised the position of the caselaw of the Court (at [37]):

“... the scope of the term economic activities is very wide and ... the term is objective in character, in the sense that the activity is considered per se and without regard to its purpose or results ... An activity is thus, as a general rule, categorised as economic where it is permanent and is carried out in return for remuneration which is received by the person carrying out the activity ...”

108. Finnish law provided for provision of legal aid financed out of public funds, and for charging a contribution to the recipient of the legal services. The payment made to the public office by the recipient of the services was a contribution limited to 20%-75% of the amount of fees on the case (there was provision for additional contributions but these were unlikely to be levied) and was further means tested by reference to the income and assets of the recipient.

“48 ... Thus, it is the level of the [recipient’s income and assets] – and not, for example, the number of hours worked by the public offices or the complexity of the case concerned – which determines the portion of the fees for which the recipient remains responsible.

49 It follows that the part payment made to the public offices by recipients of legal aid services depends only in part on the actual value of the services provided – the more modest the recipient’s income and assets, the less strong the link with that value will be.

50 ... that finding is borne out by the fact that ... the part payments made in 2007 by recipients of legal aid services provided by the public offices (which relate to only one third of all the services provided by public offices) amounted to EUR 1.9 million, whilst the gross operating costs of those offices were EUR 24.5 million. Even if those data also include legal aid services provided other than in court proceedings, such a difference suggests that the part payment borne by recipients must be regarded more as a fee, receipt of which does not, per se, mean that a given activity is economic in nature, than as consideration in the strict sense.

51 Therefore, in light of the foregoing, it does not appear that the link between the legal aid services provided by public offices and the payment to be made by the recipients is sufficiently direct for that payment to be regarded as consideration for those services and, accordingly, for those services to be regarded as economic activities ...”

109. In *Geemente Borsele* a Dutch municipality was required to meet stated transport costs of school pupils. For shorter journeys parents paid a price equal to the cost of public transport, and for longer journeys the charge was means tested (at [10]). The Court emphasised (at [29]) that all circumstances must be considered, and stated:

“30. Comparing the circumstances in which the person concerned supplies the services in question with the circumstances in which that type of service is usually provided may therefore be one way of ascertaining whether the activity concerned is an economic activity ...

31. Other factors, such as, inter alia, the number of customers and the amount of earnings, may be taken into account along with others when that question is under consideration ...

33. ...first, ... the municipality of Borsele recovers, through the contributions that it receives, only a small part of the costs incurred. The contributions at issue in the main proceedings are not payable by each user and were paid by only a third of the users, with the result that they account for only 3% of the overall transport costs, the balance being financed by public funds. Such a difference between the operating costs and the sums received in return for the services offered suggests that the parental contribution must be regarded more as a fee than as consideration ...

34. It therefore follows from that lack of symmetry that there is no genuine link between the amount paid and the services supplied. Hence, it does not appear that the link between the transport service provided by the municipality in question and the payment to be made by parents is sufficiently direct for that payment to be regarded as consideration for that service and, accordingly, for that service to be regarded as an economic activity ...

35. ... second, that the conditions under which the services at issue in the main proceedings are supplied are different from those under which passenger transport services are usually provided, since the municipality of Borsele ... does not offer services on the general passenger transport market, but rather appears to be a beneficiary and final consumer of transport services which it acquires from transport undertakings with which it deals and which it makes available to parents of pupils as part of its public service activities.”

110. In *Wakefield College* the Court of Appeal provided a helpful summary of the factors taken into account in those two CJEU cases:

“[75] Turning to the contentious issue of economic activity, both parties drew attention to factors taken into account in *Finland* and *Borsele*, while accepting that ultimately each case depends on its own facts. Those factors were, first, that in *Finland* and, to an extent, in *Borsele*, the charges paid were fixed by reference to the means of the recipients. Second, and as a necessary corollary, the charges were only partly fixed by reference to the

cost of the service. Third, the total amount raised by charges was insubstantial, both in absolute terms and relative to the cost of the service. Fourth, in *Borsele*, the municipality did not offer services on the general passenger transport market and appeared more to be the final consumer of the transport services provided by the transport undertakings engaged by it. Fifth, other factors mentioned in those cases were a comparison of the supply in question with the circumstances in which the relevant type of service is usually provided, and the number of customers.”

111. From the passages quoted above from *Wakefield College* we understand that the approach we are to adopt to the question whether the Council makes the supplies for remuneration, is to make a wide-ranging (not a narrow) fact-sensitive enquiry, examining all the objective circumstances in which the services are supplied; it is an entirely objective enquiry, and does not include subjective factors; there is not a checklist of factors to work through, and even where the same factors are present, they may assume different relative importance in different cases.

112. We consider that the relevant factors in the current appeal for the purposes of arts 2 and 9 are as follows, and we give our findings on each:

(1) *The supply to local residents of facilities for leisure, sporting and physical recreation is a core activity of the Council.* See the evidence of Mr Sheret ([21(3), (18) & (27a)] above). That is in contrast to the provision of school transport by the municipality in *Geemente Borsele*, and the provision of legal aid by the public office in *Finland*, which in each case was very much ancillary to the respective body’s principal activities.

(2) *The number of customers and the total revenue raised by the Council for the supply of facilities for leisure, sporting and physical recreation are both significant.* See the evidence of Mr Fairley ([22(9-11) & (15a)] above) and Mr Sheret ([21(27a)] above). The CJEU in *Geemente Borsele* said (at [31]) it was relevant to look at “the number of customers and the amount of earnings.”

(3) *Although concessionary fees are available to qualifying users, (almost) all users pay something for use of the facilities.* In contrast, in *Geemente Borsele* (at [33]) only one-third of transport users paid contributions, and in *Finland* (AG Opinion para [50]) only 34% of users paid any contributions.

(4) *Although the cost of providing the facilities exceeds the fees received from users, the fees do make a significant contribution to the costs of provision.* Fees collected accounted for over one half of costs - see the evidence of Mr Fairley ([22(9-10) & (15a)] above). That is in contrast to the position in *Geemente Borsele* (at [33]) where the charges covered only 3% of costs, and in *Finland* (at [50]) where the charges covered only around 8% of costs. It is more in line with the situation in *Wakefield College* where, after noting (at [75]) that in both *Geemente Borsele* and *Finland* “the total amount raised by charges was insubstantial, both in absolute terms and relative to the cost of the service”, the Court of Appeal (at [82]) stated: “the subsidised fees made a significant contribution to the cost of providing courses to the students paying those fees, to the extent of some 25–30%.”

(5) *The fact that the Council does not aim (and has never aimed) to break even (let alone make a profit) on the provision of the facilities does not matter.* That is a

subjective factor only and must be ignored – see, for example, *Wakefield College* at [55], *Longridge* at [84], and *Lajvér* at [35].

(6) *The fact that many users pay concessionary rates does not matter.* Per Arden LJ in *Longridge* (at [93]): “The concessionary charges were also not an indicator against the existence of an economic activity because the economic activity springs from the receipt of income, not profit.”

(7) *The fact that the costs of providing the facilities for leisure, sporting and physical recreation are subsidised in large measure by grants from UK central government (see the evidence of Mr Fairley ([22(7) & (11)] above) and Mr Sheret ([21(17)] above)) does not matter.* Per the CJEU in *Lajvér* (at [38]):

“... the fact that the investments were largely financed by aids granted by the Member State and the European Union cannot have a bearing on whether or not the activity pursued or planned by the applicants in the main proceedings is to be regarded as an economic activity, since the concept of "economic activity" is objective in nature and applies not only without regard to the purpose or results of the transactions concerned but also without regard to the method of financing chosen by the operator concerned, which also holds true in relation to public subsidies.”

(8) *The fact that the leisure, sporting and physical recreation facilities are provided in fulfilment of statutory duties does not matter.* Per the CJEU in *Finland* (at [40]):

“It must first of all be stated that, in view of the objective character of the term ‘economic activities’, the fact that the activity of the public offices consists in the performance of duties which are conferred and regulated by law, in the public interest and without any business or commercial objective, is in that regard irrelevant.”

113. Taking together all those factors and our findings, we conclude that the provision of the leisure, sporting and physical recreation facilities by the Council constitutes the supply of services for remuneration, and thus that supply constitutes economic activity within art 9 PVD.

114. Accordingly, we do not accept the Article 2 Argument advanced by the Council.

The Article 13 Argument

115. Article 13 PVD provides, so far as relevant:

“1. States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions.

However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition. ...”

116. The Council submits that its supply of leisure, sporting and physical recreation facilities constitutes activities in which the Council engages as a public authority. Further, that its

consequent treatment as a non-taxable person would not lead to significant distortions of competition in respect of those activities.

117. In *Carpaneto No 2* at [10] the CJEU emphasised that art 13 did not apply to activities engaged in by the body as a body governed by private law rather than by public law; thus it is essential to identify the legal regime applicable under national law in relation to the activities:

“According to [*Carpaneto No 1* at [15]], it is the manner in which the activities are carried out that determines the scope of the treatment of public bodies as non-taxable persons. In so far as that provision makes such treatment of bodies governed by public law conditional upon their acting 'as public authorities', it excludes therefrom activities engaged in by them as bodies governed not by public law but by private law. Consequently, the only criterion making it possible to distinguish with certainty between those two categories of activity is the legal regime applicable under national law.”

118. The Courts have since expressed this as requiring a “special legal regime”. Per *Fazenda Pública*:

“21. The national court must, in accordance with the case law ..., analyse all the conditions laid down by national law for the pursuit of the activity at issue in the main proceedings, to determine whether that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same legal conditions as those that apply to private economic operators.”

119. In *Ireland* the CJEU stated (at [49]):

“... bodies governed by public law act as public authorities when they engage in activities which, while fully economic in nature, are closely linked to the exercise of rights and powers of public authority (*Isle of Wight Council and Others*, paragraph 31). ...”

120. In *Sauđaçor* the CJEU stated:

“69. ... only activities carried out by a body governed by public law acting as a public authority are to be exempted from VAT.

70. The court has consistently held that such activities are activities carried out by those bodies under the special legal regime applicable to them and do not include activities pursued by them under the same legal conditions as those that apply to private economic operators. The court has also made it clear that the subject matter or purpose of the activity is in that regard irrelevant and that the fact that the pursuit of the activity at issue in the main proceedings involves the use of powers conferred by public law shows that that activity is subject to a public law regime (see to that effect, inter alia, judgment in *Fazenda Pública v Câmara Municipal do Porto* (Case C-446/98) [2001] STC 560, [2000] ECR I-11435, paras 17, 19 and 22).

71. In that context, the court has stated that the exemption provided for in the first subparagraph of art 13(1) of Directive 2006/112 covers principally activities engaged in by bodies governed by public law acting as public authorities, which, while fully economic in nature, are closely linked to the exercise of powers conferred by public law (judgment in *Revenue and Customs Comrs v Isle of Wight Council* (Case C-288/07) [2008] STC 2964, [2008] ECR I-7203, para 31).”

121. It is clear from those cases, and the other authorities cited to us, that the decision whether art 13 applies in particular circumstances is highly fact-specific. The Council referred us to two cases where it was held that a public body *was* engaging in activities under a special legal regime. The first is the CJEU case of *NRA*; we do not find this case of assistance as the parties there had agreed as common ground that the special legal regime test was met: at [22]. Any comments by the Court (eg at [50]) concerning the test were made against the backdrop of the test already being accepted as satisfied; the meat of the case concerns the second paragraph of art 13 – whether treatment as a non-taxable person would lead to significant distortions of competition in respect of those activities.

122. The second case is *Durham Company* which was an application for judicial review before Warren J sitting in the Tax & Chancery Chamber of the Upper Tribunal. The applicant, TDC, was a commercial company which carried on business as a provider of commercial waste services, including “trade waste collection” services, consisting of emptying wheelie bins used by occupiers of non-residential premises. TDC charged VAT to its trade waste collection customers. Local authorities did not charge VAT on similar services and TDC applied for judicial review against HMRC (and HM Treasury) concerning the lawfulness of the VAT treatment afforded to local authorities carrying out certain trade waste services. The preliminary issue to be determined was, where a local authority that was a waste collection authority (for the purposes of the EPA) was making supplies of trade waste collection services to entities occupying non-residential property in its area, whether those supplies by the local authority were activities in which it was engaged as a public authority, within the meaning of art 13 (and/or the domestic legislation in s 41A VATA). HMRC, opposing the application, contended (at [77]) that the legal basis on which local authorities provide commercial waste collection services is contained in s 45 EPA, and that is not only the legal basis on which the services are provided but is also a special legal regime.

123. The Upper Tribunal determined the preliminary issue:

“[109] The preliminary issue is to be answered in the sense that, where an LA [local authority] is making supplies of trade waste collection services to business customers in its area and does so in the performance of its duties under s 45(1)(b) EPA 1990, the supplies are 'activities in which it is engaged as a public authority' within the meaning of s 41A(a) VATA 1994 and art 13(1). Whether an LA is in fact providing its commercial waste collection services under s 45(1)(b) is a matter to be determined on the facts of each case.”

124. Warren J explained:

“[103] I have no doubt that s 45(1)(b) EPA 1990 is, or at least is capable of being, a 'special legal regime'. This is demonstrated by consideration of an LA which provides a commercial waste collection service only if requested to arrange for such collection by an occupier of premises and does so for a reasonable charge which, taking the provision of the service to occupiers generally, results only in cost recovery and no surplus. It would appear that this is the position with North Lincolnshire Council. Indeed, TDC itself does not deny that an LA that is actually arranging a collection in response to a request under s 45(1)(b), and then levying a charge under s 45(4) for the reasonable costs of that collection, may be 'acting as a public authority'.

[104] Since it cannot be said that s 45(1)(b) is not ever capable of constituting a special legal regime, it must follow, even on TDC's case, that whether any particular LA is acting as a public authority will depend on the facts relevant to that LA. As I have already observed, I do not know the detailed facts in relation to any particular LA to say which of the factors relied on by [TDC's counsel] ... might even arguably apply quite apart from the responses to those factors I do not even have the relevant details in relation to the activities of the LAs in whose areas TDC operates. Although this is not a matter relevant to the preliminary issue, I would have thought that, if TDC is to succeed in an application for judicial review of HMRC and HMT, it is essential for it to show that it is affected by the activities of those LAs. For all I know, each of those LAs is one where commercial waste collections are carried out only following a request and for a reasonable cost reflecting cost recovery and no surplus.

[105] It is therefore impossible, even on TDC's case, to answer the preliminary issue with the answer 'No' (so that the VAT derogation does not apply) since there are at least some, and may be many, LAs who are not to be regarded as taxable persons in relation to supplies of commercial waste collection services. The answer, on TDC's case, would have to be 'it all depends'.

[106] However, once it is accepted, as it must be, that s 45(1)(b) EPA 1990 is capable of constituting a special legal regime in some cases, then in my view any activities carried out by an LA pursuant to that special legal regime fall within the VAT derogation, subject always to the competition proviso. As the cases show, the only criterion making it possible to distinguish with certainty between activities as a public body and activities subject to private law is 'the legal regime applicable under national law'. I accept, of course, that not every activity carried on by an LA is subject to a special legal regime simply because some statutory basis has to be found for that activity. But once a legal regime has been identified as a special legal regime in accordance with the case law, it would defeat the purpose of that clear criterion—namely to provide a clearly and readily applicable test—to require national courts to enter into a further inquiry as to whether particular activities within that legal regime are entitled to the benefit of the VAT derogation. In the present case, the difficulty in drawing lines between what would, and would not, qualify for exemption is, I suggest, obvious. It is no answer for TDC to say (without any, or any adequate, evidence I add) that, wherever lines are to be drawn, there are many cases which exhibit all of the factors identified by [TDC's counsel] ... and which should not, on his approach, attract the exemption. ...”

125. We also have the benefit of the decision of Nugee J refusing TDC permission to appeal to the Court of Appeal against Warren J's decision (*Durham PTA*):

“6 ... The first, Ground 1, is that the Upper Tribunal erred in law in concluding that Waste Collection Authorities that chose to engage in providing trade waste collection services in competition with private sector providers are (or at least may be) performing their duty under section 45(1)(b) of the EPA 1990.

7 It is pointed out in support of this ground that section 45, as I will refer to it, does not require local authorities to collect waste themselves. All that it

requires of them is, on request, to arrange for the collection of commercial waste and it is then under a statutory duty to levy a reasonable charge for doing so. Mr Bates [for TDC] says that what local authorities are doing when they are going into competition with private sector providers is something quite different from that statutory regime.

8 I have had great difficulty in understanding this point. It does seem to me, and I think Mr Bates accepted this, that it is a possible response to the section 45 duty for a Waste Collection Authority not only to wait until it is requested on each occasion to arrange for the collection of waste, but to arrange in advance with a business that wants its commercial waste collected to do so under a contract for, say, the next 12 months and that there is nothing incompatible with section 45 for the local authority to specify in the contract the reasonable charge that it proposed to charge under that contract. That seems to me to be an example of premises within the local authority area requesting the local authority to collect its waste for the next 12 months and the local authority making a charge for doing so. The fact that it chooses to do that through the means of a contract does not, I think, and I did not understand Mr Bates to suggest it necessarily would, take the matter outside section 45. Once that is accepted, it is difficult to see why the sort of arrangements which are referred to in the decision could not be arrangements by which the local authority was discharging its statutory duty under section 45.

...

11 ... I see no error in Warren J's conclusion that local authorities who provide collection services in their area may, depending on the facts, be operating under section 45 and since that is what he decided, I do not myself see that there is a reasonable prospect of success in challenging that in the way that Ground 1 seeks to do.

12 Ground 2 is as follows: Even if and insofar as the Upper Tribunal was correct that local authorities' supplies of waste collection services constitute a discharge of the duty imposed by section 45, the Upper Tribunal erred in law in deciding that authorities providing such supplies were doing so under a "special legal regime". In relation to this ground, Mr Bates's argument was that what the European jurisprudence requires is an analysis of the way in which the activities are carried out.

13 I do however, for my part, think that Warren J was entirely right and that there is no real prospect of challenging the analysis he adopted which is that if local authorities are operating under section 45, then that is a special legal regime which is applicable to them in their capacity as public authorities exercising public duties and which is different from the legal regime which applies to private sector businesses such as the claimant even though, from the point of view of the consumer, the services provided may be indistinguishable. That is because, as Warren J sets out, the section 45 power is hedged around by a number of constraints.

14 The ones he identified were that, firstly, a local authority is obliged to make an arrangement in relation to any commercial waste from any premises within its area, an obligation which does not apply to those who are operating in the private sector; secondly, that there are constraints in the charges that can be made because section 45(4) imposes the limitation that

the charge must be reasonable, which does not apply to private sector operators; and thirdly, that there are obligations in relation to disposal under section 48; see what he says as to the flexibility available to a private operator in this regard at [41], which refers to some evidence which he had which I have not seen and which is not set out in his decision. Mr Peretz [for HMRC] also relied on one other matter, the environmental obligations, which Warren J deals with at [39] of his decision.

15 Mr Bates says that none of these things necessarily has any practical impact on the way in which local authorities are able to compete with his client and other operators and therefore they do not amount to a special legal regime, but they do seem to me to be exactly what the European jurisprudence is referring to, namely, that the legal conditions under which the local authorities are providing services are different, because of their function as public authorities, from the legal conditions under which their private sector counterparts are providing what may, as I say, from the point of view of the consumer, be indistinguishable services. In those circumstances, I do not regard Ground 2 as having a reasonable prospect of success either.”

126. Turning to the current appeal, the approach we adopt is that stated by the CJEU in *Fazenda Pública* (summarising the Court’s own caselaw):

“16. ... it is the way in which the activities are carried out that determines the scope of the treatment of public bodies as non-taxable persons (see *Ufficio Distrettuale delle Imposte Dirette di Fiorenzuola d'Arda v Comune di Carpaneto Piacentino* (Joined cases 231/87 and 129/88) [1991] STC 205 at 235, [1989] ECR 3233 at 3275, para 15, and *Comune di Carpaneto Piacentino v Ufficio Provinciale Imposta sul Valore Aggiunto di Piacenza* (Case C-4/89) [1990] ECR I-1869 at 1886, para 10).

17. It is thus clear from the settled case law of the court that activities pursued as public authorities within the meaning of [art 13] are those engaged in by bodies governed by public law under the special legal regime applicable to them and do not include activities pursued by them under the same legal conditions as those that apply to private economic operators (see in particular *EC Commission v France* (Case C-276/97) (2000) Transcript (Judgment) (Eng), 12 September, para 40, *EC Commission v Ireland* (Case C-358/97) (2000) Transcript (Judgment) (Eng), 12 September, para 38, *EC Commission v United Kingdom* (Case C-359/97) [2000] STC 777 at 787–788, para 50, *EC Commission v Netherlands* (Case C-408/97) (2000) Transcript (Judgment) (Eng), 12 September, para 35, and *EC Commission v Greece* (Case C-260/98) (2000) Transcript (Judgment) (Eng), 12 September).

...

19. In determining whether such an activity is engaged in by [the taxpayer] as a public authority, it must be noted, first, that this cannot depend on the subject matter or purpose of the activity (see *Ufficio Distrettuale delle Imposte Dirette di Fiorenzuola d'Arda v Comune di Carpaneto Piacentino* [1991] STC 205 at 235, [1989] ECR 3233 at 3275, para 13).

...

21. The national court must, in accordance with the case law referred to in paras 16 and 17 above, analyse all the conditions laid down by national law for the pursuit of the activity at issue in the main proceedings, to determine whether that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same legal conditions as those that apply to private economic operators.”

127. In determining whether an activity is being engaged in under a special legal regime, the following factors are irrelevant:

- (1) the subject matter of the activity (*Fazenda Pública* at [19]);
- (2) the purpose of the activity (*ibid*); and
- (3) the fact that private providers carry out similar activities (*Isle of Wight* at [33]).

128. The first step is to identify the applicable legal regime under which the Council engages in the activities. In *Durham Company* HMRC maintained that the local authorities provided commercial waste collection services pursuant to the legislation in s 45 EPA. Warren J (at [97-99]) agreed with that analysis, holding that “the only available power is to be found in s 45(1)(b) EPA 1990.”

129. In the current appeal, the Council maintains that it provides the sports and leisure facilities pursuant to s 14 LGPSA. Section 14 imposes a duty to provide adequate facilities – see [13] above. It was never put to the witnesses that there were alternative legislative duties or powers for local authorities in Scotland to provide such facilities, and we understand that is not part of HMRC’s case. The witness evidence (which we accept) was that the Council’s provision of the sports and leisure facilities arose from the Council’s duty under s 14 (see Mr Fairley at [22(6)] above and Mr Sheret at [21(3)] above). Mr Sheret’s evidence (see [21(18)] above) was that the Council is generally restricted from undertaking trading activity except through a subsidiary; our understanding of the relevant provisions of the Local Government in Scotland Act 2003 (not cited to us) is that Scottish councils have power to trade for profit, without establishing a separate company, if they exercise the power under the heading of advancing well-being; however, that detail does not affect our overall conclusions on this point.

130. We understand what had irked the applicant in *Durham Company* was that a local authority could charge a fee without VAT, thereby apparently under-cutting TDC for the business, but then subcontract the job and so not do the work itself. That, said TDC, was really just the local authority “going into business as a matter of choice” rather than complying with its duties under EPA (see [91a]). As already stated at [128] above, Warren J rejected that argument and concluded that “the only available power is to be found in s 45(1)(b) EPA 1990.” Nugee J then determined that there was no reasonable prospect of challenging that conclusion (*Durham PTA* at [11]).

131. We reach a similar conclusion in the current appeal. The Council’s provision of the facilities is not done because it is “going into business as a matter of choice”. We find that the Council’s provision of the sports and leisure facilities during the period under appeal was all made pursuant to the duty imposed on it by s 14 LGPSA, and thus the applicable legal regime under which the Council engages in the activities is s 14.

132. The second step is to determine whether s 14 constitutes a special legal regime. Warren J in *Durham Company* dealt with this briefly; his view (at [103]) was that as the activities

were engaged in under s 45 EPA then that was a special legal regime and the local authorities were acting as public authorities for the purposes of art 13. Nugee J went into more detail when considering the permission to appeal application (*Durham PTA* at [13-15]):

“13 I do however, for my part, think that Warren J was entirely right and that there is no real prospect of challenging the analysis he adopted which is that if local authorities are operating under section 45, then that is a special legal regime which is applicable to them in their capacity as public authorities exercising public duties and which is different from the legal regime which applies to private sector businesses such as the claimant even though, from the point of view of the consumer, the services provided may be indistinguishable. That is because, as Warren J sets out, the section 45 power is hedged around by a number of constraints.

14 [Nugee J sets out those constraints]

15 Mr Bates [for TDC] says that none of these things necessarily has any practical impact on the way in which local authorities are able to compete with his client and other operators and therefore they do not amount to a special legal regime, but they do seem to me to be exactly what the European jurisprudence is referring to, namely, that the legal conditions under which the local authorities are providing services are different, because of their function as public authorities, from the legal conditions under which their private sector counterparts are providing what may, as I say, from the point of view of the consumer, be indistinguishable services. In those circumstances, I do not regard Ground 2 as having a reasonable prospect of success either.”

133. We reach a similar conclusion in the current appeal. The duty under s 14 LGPSA is to “ensure that there is adequate provision of facilities for the inhabitants of their area for recreational, sporting, cultural and social activities”. While “adequate provision” is not defined by the legislation, some guidance can be obtained from the central government (ie at that time (2007) the Scottish Executive) policy document “Reaching Higher”, referred to by Mr Sheret (see [21(17)] above). Some of the actions identified for local authorities by the Scottish Executive include: identify categories of non-participants and develop and target policies which will stimulate an interest; apply locally-responsive community development and innovative approaches to widening and increasing participation; consider the sporting needs of an ageing population; the race, gender and disability equality schemes are to be integrated and implemented within local authority strategic plans; develop and support local infrastructures, working with all partners in areas from local sports councils to colleges and universities. Mr Sheret explained that the Council developed its strategy and objectives in common with the central government policy, and that enabled it to obtain central government funding for certain projects and initiatives. Those requirements operate to hedge around the s 14 regime with a number of constraints (to use the description of Nugee J). They also steer the approach of the Council as described throughout Mr Sheret’s evidence, to provide leisure facilities that (in his words) “meet the needs of the population and are accessible to them all”.

134. Furthermore, s 1 LGSA, and in particular s 1(4), imposes a further and not inconsiderable statutory constraint.

135. Any private sector business providing sports and leisure facilities in the Council’s area – even ones indistinguishable to the consumer from the Council’s facilities – would be doing so not under the s 14 regime but instead under the general legal regime applicable to all

facilities operators. Accordingly, the legal conditions under which the Council is providing services are different, because of its function as a public authority, from the legal conditions under which its private sector counterparts are providing perhaps indistinguishable services. Thus the Council's provision of the facilities is being engaged in under a special legal regime applicable to a body governed by public law.

136. For completeness, we note that the CJEU in *Ireland* (at [49]) and *Saudaçor* (at [71]) stipulated that the activities should be "closely linked to the exercise of rights and powers of [the] public authority". We consider that is self-evident here; it is the subject matter of Article 10 itself.

137. For those reasons we determine that the first paragraph of art 13 is satisfied in relation to the Council's provision of the sports and leisure facilities.

Significant distortions of competition

138. Moving to the second paragraph of art 13, this provides an exclusion from the non-taxability of public authorities:

"However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition. ..."

139. Both parties acknowledged that if consideration of this point arose then it may be necessary for the Tribunal to hear further evidence and submissions thereon. We agree, and so we reach no conclusions here on the applicability of the second paragraph of art 13. That will require a continuation hearing dedicated to evidence and submissions on that point. We GRANT leave to the parties to apply for such a continuation hearing, any such application to be accompanied by proposed case management directions (agreed, if possible) to facilitate such hearing.

The Note 3 Argument

140. The Note 3 Argument is relevant only if the Tribunal determines that the Council is engaged in an economic activity but does not operate under a special legal regime. As we have concluded (at [137] above) that the Council *does* operate under a special legal regime, the Note 3 Argument is not relevant to our determination of the appeal. However, as we heard full argument from both parties, we give our views below, in case they should become relevant at any later stage of these proceedings.

141. The Note 3 Argument is put as: whether the terms of Note 3 operate as an exercise of the discretion permitted under art 13(2) PVD so as to treat the supplies made by the Council as carried out by it as a public authority.

142. We have set out above (at [62-72] above) the Council's submissions on this point. In summary, the argument is: The national legislation (Note 3) must be read so as to conform with the directly applicable EU legislation. Note 3 is clear and specific; it excludes local authorities from the exemption provided by Item 3 Group 10. The only PVD-compliant way of doing that is via art 13(2), with the UK regarding the otherwise exempt activities as being engaged in by the Council as a public authority; and the result is that the Council has no economic activity.

143. Having carefully considered those arguments (and HMRC's contrary position) we have determined that they do not support a conclusion that the Council's supplies of the relevant services are not exempt supplies for VAT purposes.

144. The background, context and effect of Note 3 were exhaustively considered in *Ealing*. The legislative background to the *Ealing* referral is set out by AG Wathelet in his Opinion as follows:

“23. Under art 132(1) of Directive 2006/112, member states are required to exempt a large number of cases, in favour of certain activities of general interest, including, in point (m) of that provision, sporting services, where they are supplied by non-profit-making bodies. The objective sought by the EU legislature is to encourage involvement in sport and physical activity, owing to the benefits which these provide for the population in terms of physical development and health.

24. By way of derogation from the rule laid down in art 132(1)(m), the first paragraph of art 133 of that directive confers on member states the option to make the grant of the exemption to non-profit-making bodies other than those governed by public law subject to four different conditions, including, in point (d) of that provision, the condition relating to competition. According to that condition, 'the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT'.

25. All member states may apply that derogation.

26. In only the member states which, pursuant to Annex E to the Sixth Directive, on 1 January 1989 applied VAT to sporting services, the second paragraph of art 133 of Directive 2006/112 offers the possibility of an additional derogation, whereby those states may make the grant of the exemption to non-profit-making bodies governed by public law subject only to the condition relating to competition, namely the condition set out in point (d) of the first paragraph of art 133 of that directive. It is true that the other conditions set out in that provision and, in any event, the conditions set out in points (a) and (b) are addressed more naturally to non-profit-making bodies governed by private law.

27. It follows from the foregoing that more favourable tax treatment is reserved for non-profit-making bodies governed by public law both in member states which, pursuant to Annex E to the Sixth Directive, on 1 January 1989 applied VAT to sporting services and in member states which had not made use of that option.

28. In short, member states which, pursuant to Annex E to the Sixth Directive, on 1 January 1989 applied VAT to sporting services may make the grant of the exemption subject to compliance with the four conditions laid down in the first paragraph of art 133 where the supplier of the sporting services at issue is a non-profit-making body other than one governed by public law, whereas in the case of non-profit-making bodies governed by public law, the grant of that exemption can be made subject only to the condition relating to competition.

29. Member states which had not made use of the option offered by Annex E to the Sixth Directive can make only the exemption granted to non-profit-making

bodies other than those governed by public law subject to conditions, as non-profit-making bodies governed by public law are definitively exempted on the basis of art 132(1)(m) of that directive. If the member states do not impose such conditions, the services in question are definitively exempted for all non-profit-making bodies.

30. It is apparent from the request for a preliminary ruling that the United Kingdom is one of the member states which on 1 January 1989 applied VAT to sporting services in application of Annex E to the Sixth Directive.”

145. The Court determined as follows (at [33]):

“... the second paragraph of art 133 of Directive 2006/112 must be interpreted as precluding national legislation, such as that at issue in the main proceedings, where that legislation provides that compliance with the condition laid down in point (d) of the first paragraph of art 133 of that directive is a prerequisite for the grant of a VAT exemption to non-profit-making organisations governed by public law making supplies of services closely linked to sport or physical education, within the meaning of art 132(1)(m) of that directive, but fails also to apply that condition to non-profit-making organisations other than those governed by public law that make such supplies of services.”

146. We agree with the summary and explanation of the effect of the *Ealing* decision provided by HMRC in their Revenue & Customs Brief 6/2017:

“The Court of Justice of the European Union found, in the case of the London Borough of Ealing (Case C 633/15), that the UK had incorrectly excluded local authorities from the exemption for the provision of sporting facilities. Local authorities had been excluded from the exemption to ensure that there was no distortion of competition. However, the court decided that any restriction on those grounds had to be applied to both public bodies as well as private non-profit-making bodies providing sporting facilities. It followed that the local authorities were entitled to claim direct effect and therefore to treat those supplies as exempt from VAT provided that they did so on a consistent basis. HMRC has accepted the decision.

This means that local authorities are entitled to recover any net over-declarations they have made as a result of having treated the supplies as taxable rather than exempt. The net over-declarations are calculated after deducting from the over-declared output tax any input tax wrongly claimed by prescribed accounting period (VAT return) on the assumption that the supplies in question were taxable and not exempt, unless that input tax is treated as insignificant ...”

147. Ms Brown for the Council emphasises that Note 3 does not reference the competition condition in art 133(d), and the AG’s comments (at Opinion [32]) that “that condition is nowhere laid down in the United Kingdom legislation or the explanatory notes issued by the United Kingdom administration” and “The court might thus take the view that the questions referred for a preliminary ruling are purely hypothetical”. The AG points out that if the competition point was not invoked then, “It would then be necessary to conclude that the VAT applied to the sporting services supplied by non-profit-making bodies governed by public law had no legal basis, since the rule is exemption, possibly subject to conditions, which is not the case in regard to the United Kingdom rule, which, as the United Kingdom stated at the hearing, quite simply excludes the supply of those services from the exemption.”

148. While Note 3 does not on its face refer to the competition condition (ie art 133(d)), it is not the case that this condition was not addressed by the parties to *Ealing*; on the contrary, all the parties had identical views on the matter, as is clear from the AG's Opinion:

“33. All of the parties which took part in the hearing confirmed, moreover, that the United Kingdom legislation does not refer expressly to the condition relating to competition set out in point (d) of the first paragraph of art 133 of that directive.

34. Nonetheless, the referring tribunal, the parties to the main proceedings and the Commission proceed on the assumption that the exclusion of local authorities from the benefit of the exemption from VAT on the supply of sporting services is the consequence of the United Kingdom's use of the option granted to it by the second paragraph of art 133 to make the grant of the exemption to non-profit-making bodies governed by public law subject to fulfilment of the condition that it is not 'likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT'.

35. At the hearing, the London Borough of Ealing stated that the United Kingdom authorities claim that they are entitled to rely on the condition relating to competition, a concept which is to be understood as the manifestation of their decision to exclude local authorities from the exemption because their activities necessarily cause distortions of competition.

36. The United Kingdom government's representative agreed with the London Borough of Ealing's comments on that point, taking the view that that position was justified by the danger that local authorities would subsidise sports activities and that a distortion of competition was the result of their 'likely conduct'.

37. The Commission took the same view and recognised that the condition relating to competition was nowhere expressly stated in the United Kingdom legislation, but that that was not necessary owing to the latitude left to member states by that directive.

38. On the assumption that the court accepts the argument that the United Kingdom legislation implicitly imposed the condition relating to competition, I shall base my reasoning in the remainder of this opinion on the assumption that, so far as the United Kingdom legislature and tax authority are concerned, the grant of the exemption from VAT on sporting services supplied by non-profit-making bodies governed by public law is 'likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT' *in all cases*. Although the condition is implicitly present in the United Kingdom legislation, it is presumed, however, that it is never fulfilled.”

149. We conclude that any suggestion that Note 3 was not motivated by the competition condition is speculation. The AG was correct to point out that unless the UK had used the option available to it under art 133 to make the grant of the exemption to non-profit-making bodies governed by public law subject to fulfilment of the competition condition, then the consequences would be as he set out in the extract above (from Opinion [32]). However, that observation and caution was then rendered academic because of the clear statements by all the parties quoted above (from Opinion [34-37]) that the option had indeed been so used.

150. Ms Brown places some weight on the fact that Note 3 has not been amended by Parliament, despite the *Ealing* decision. We do not consider that is persuasive. It is certainly desirable that the published UK tax code should reflect the current state of the law; ideally, Group 10 should by now have been amended to reflect the effect of the *Ealing* decision of the CJEU; one might wonder why, as HMRC had carefully explained the (correct) position post-*Ealing* in their R&C Brief 6/2017, they could not persuade a Treasury Minister to incorporate a short legislative amendment in one of the Finance Bills that have flowed through Parliament since the *Ealing* decision. However, the fact that Note 3 remains unamended on the statute book does not mean that there must be some deep and meaningful interpretation to be applied to the continued existence of the provision; it is simply that the statute has not yet been amended. There are, regrettably, other instances where tax provisions which have been discredited by the courts remain unaltered in the tax code – for example, s 84(3C) VATA (which purports to deny any right of onward appeal against a determination by this Tribunal of a “hardship” application) was ruled ultra vires and ineffective by the Court of Appeal (unanimously) in October 2012 (*R (oao ToTel Ltd) v First-tier Tribunal* [2013] STC 1557 at [37, 38 & 45]) but the offending provision still sits unamended over half-a-dozen years later, poised to trap an unwary litigant (or judge).

151. Our conclusion on the Note 3 Argument is that Note 3 is ineffective (per *Ealing*) so that local authorities (as non-profit making bodies) do constitute “eligible bodies” for the purposes of Group 10 sch 9, and thus their supplies of services within Item 3 are exempt supplies. That treatment is, as both parties acknowledge, available to the Council, as to all other UK local authorities.

Conclusions

152. As stated at [113-114] above, we do not accept the Article 2 Argument advanced by the Council; we conclude that the provision of the leisure, sporting and physical recreation facilities by the Council constitutes the supply of services for remuneration, and thus that supply constitutes economic activity within art 9 PVD.

153. As stated at [137] above, we accept the Article 13 Argument advanced by the Council insofar as the first paragraph of art 13: the supplies are made by the Council in its role as a public authority for the purposes of art 13 PVD, and it operates as such under a special legal regime. We make no finding as to the second paragraph of art 13, namely whether the Council’s treatment as a non-taxable person would lead to significant distortions of competition.

Quantum

154. Finally, we understand that both parties would have further work to perform and discussions to continue in relation to the figures contained in the voluntary disclosures. Therefore nothing in this decision notice expresses any conclusions as to quantum.

DECISION

155. Subject to the second paragraph of art 13 PVD, the Council is not a taxable person in relation to its supplies of the relevant sports and leisure facilities in the period under appeal. The applicability of the second paragraph of art 13 PVD will be determined at a continuation hearing, if the parties so request – as to which, see [139] above.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

156. 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.

**PETER KEMPSTER
TRIBUNAL JUDGE**

Release date: 17 October 2020