



[2022] UKFTT 00110 (TC)

TC 08441

VAT – Partial exemption – Recovery of residual input tax – Whether standard method override guarantees more precise determination of recoverable input tax than standard method – Yes – Appeals allowed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

**Appeal numbers: TC/2018/05373
TC/2021/01140**

BETWEEN

HIPPODROME CASINO LIMITED

Appellant

-and-

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

Respondents

**TRIBUNAL: JUDGE JOHN BROOKS
SONIA GABLE JP**

**Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1 on 24 – 28 January
2022**

**Andrew Hitchmough QC and Ronan Magee, instructed by PricewaterhouseCoopers
LLP, for the Appellant**

**Matthew Donmall, counsel, instructed by the General Counsel and Solicitor to HM
Revenue and Customs, for the Respondents**

DECISION

INTRODUCTION

1. This appeal concerns the method for the recovery of residual input tax during the period from 2012-13 to 2017-18 (inclusive) by the appellant, Hippodrome Casino Limited (“HCL”), which makes taxable supplies of hospitality and entertainment and exempt gaming supplies from its premises, the Hippodrome in London’s Leicester Square.
2. HCL contends that the actual economic use of its overhead expenditure in making taxable and exempt supplies, based on a floor space apportionment, differs substantially from the attribution prescribed by the standard method, under regulation 101 of the Value Added Tax Regulations 1995, which is based on turnover. As such, it submits, it is required to carry out an “override calculation”, a standard method override (“SMO”), in accordance with regulation 107B (this, and all subsequent references to regulations, unless otherwise stated, refer to the Value Added Tax Regulations 1995).
3. However, HM Revenue and Customs (“HMRC”) contend that HCL’s proposed floor space SMO does not represent a more a fair and reasonable proxy for HCL’s economic use of its overhead expenditure than that calculated under the standard method. If HMRC are correct a further issue arises in relation to the correct treatment of business entertainment under the Capital Goods Scheme (‘CGS’).
4. Mr Andrew Hitchmough QC and Mr Ronan Magee appeared for HCL. HMRC was represented by Mr Matthew Donmall. We are grateful for their helpful submissions, both written and oral. However, although carefully considered, when reaching our conclusions we have not found it necessary to address each and every argument advanced or refer to all authorities cited by and on behalf of the parties.
5. Before turning to the evidence and our findings of fact, and to better understand the issues between the parties, we first set out the statutory and legal background to the appeal.

LAW

6. Article 168 of Directive 2006/112/EC (the “Principal VAT Directive” or “PVD”) provides:

In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

- (a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person; [...]

7. Article 173(1) PVD provides:

In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible. The deductible proportion shall be determined, in accordance with Articles 174 and 175, for all the transactions carried out by the taxable person.

8. Article 174(1) makes provision for the standard method:

The deductible proportion shall be made up of a fraction comprising the following amounts:

(a) as numerator, the total amount, exclusive of VAT, of turnover per year attributable to transactions in respect of which VAT is deductible pursuant to Articles 168 and 169;

(b) as denominator, the total amount, exclusive of VAT, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible.

9. Article 175 PVD makes further provision in relation to the standard method – in particular attribution is to be finally determined on an annual basis, and, during the year in question, the previous year’s attribution is to be used on a provisional basis.

10. Article 173(2) PVD makes provision for alternative methods of attribution. In particular, Article 173(2)(c) PVD provides that Member States may:

... authorise or require the taxable person to make the deduction on the basis of the use made of all or part of the goods and services;

11. The PVD provisions are implemented into UK law by the Value Added Tax Act 1994 (“VATA”) and the Regulations made under that Act.

12. Section 24(1) VATA defines input tax:

Subject to the following provisions of this section, “input tax”, in relation to a taxable person, means the following tax, that is to say—

(a) VAT on the supply to him of any goods or services; [...] being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him

13. Section 25(2) VATA provides that a taxpayer’s allowable input tax shall be “credited” against its liability to account for output tax:

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

That credit can be restricted by regulations made under section 25(7) VATA to provide that input tax of certain kinds is not deductible, eg such as that relating to business entertainment.

14. Section 26 VATA and the regulations made under it, in Part XIV of the Value Added Tax Regulations 1995, implement articles 173 – 175 PVD into domestic legislation.

15. Section 26 VATA provides:

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

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

(a) taxable supplies; [...]

(3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above, and any such regulations may provide for—

(a) determining a proportion by reference to which input tax for any prescribed accounting period is to be provisionally attributed to those supplies;

(b) adjusting, in accordance with a proportion determined in like manner for any longer period comprising two or more prescribed accounting periods or parts thereof, the provisional attribution for any of those periods;

(c) the making of payments in respect of input tax, by the Commissioners to a taxable person (or a person who has been a taxable person) or by a taxable person (or a person who has been a taxable person) to the Commissioners, in cases where events prove inaccurate an estimate on the basis of which an attribution was made; and

(d) preventing input tax on a supply which, under or by virtue of any provision of this Act, a person makes to himself from being allowable as attributable to that supply.

(4) Regulations under subsection (3) above may make different provision for different circumstances and, in particular (but without prejudice to the generality of that subsection) for different descriptions of goods or services; and may contain such incidental, supplementary, consequential and transitional provisions as appear to the Commissioners necessary or expedient.

16. It is not disputed that that the supplies of hospitality and of entertainment made by HCL are taxable supplies or that the supplies of gaming are exempt under Group 4 of Schedule 9 VATA (save that, for the period between starting trading and 1 February 2013 the supply of facilities for playing some electronic games of chance was taxable (cf Note 1(d) to Group 4 of Schedule 9 as it stood prior to the amendments made by the Finance Act 2012)).

17. Regulation 101 makes provision for the standard, turnover-based, method of attribution of input tax. In so far as it applies in the present case, regulation 101 provides:

(1) Subject to regulations 102, 103A, 105A and 106ZA, the amount of input tax which a taxable person shall be entitled to deduct provisionally shall be that amount which is attributable to taxable supplies in accordance with this regulation.

(2) ... in respect of each prescribed accounting period—

(a) goods imported or acquired by and ... goods or services supplied to, the taxable person in the period shall be identified,

(b) there shall be attributed to taxable supplies the whole of the input tax on such of those goods or services as are used or to be used by him exclusively in making taxable supplies,

(c) no part of the input tax on such of those goods or services as are used or to be used by him exclusively in making exempt supplies, or in carrying on any activity other than the making of taxable supplies, shall be attributed to taxable supplies,

(d) ... subject to subparagraph (e) below, there shall be attributed to taxable supplies such proportion of the residual input tax as bears the same ratio to

the total of such input tax as the value of taxable supplies made by him bears to the value of all supplies made by him in the period.

(e) the attribution required by subparagraph (d) above may be made on the basis of the extent to which the goods or services are used or to be used by him in making taxable supplies,

[...]

(4) The ratio calculated for the purpose of paragraph (2)(d), (e) or (g) above shall be expressed as a percentage and, if that percentage is not a whole number, it shall be rounded up ...

[...]

(10) In this regulation “residual input tax” means input tax incurred by a taxable person on goods and services which are used or to be used by him in making both taxable and exempt supplies.

18. Regulation 107B sets out the circumstances in which the standard method may be overridden. It provides (so far as material) that:

(1) ... this regulation applies where a taxable person has made an attribution under regulation 107(1)(a) or (d) according to the method specified in regulation 101 and that attribution differs substantially from one which represents the extent to which the goods or services are used by him or are to be used by him, or a successor of his, in making taxable supplies.

(2) Where this regulation applies the taxable person shall—

(a) calculate the difference, and

(b) in addition to any amount required to be included under regulation 107(1)(g), account for the amount so calculated on the return for the first prescribed accounting period next following the longer period or the return for the last prescribed accounting period in the longer period if applicable, except where the Commissioners allow another return to be used for this purpose.

(3) [This makes provision for situations where registrations are cancelled].

19. A difference is “substantial” if it exceeds £50,000 (regulation 107C(a)) or “50% of the amount of input tax falling to be apportioned under regulation 101(2)(d) within the prescribed accounting period referred to in regulation 107A(1), or longer period, as the case may be, but is not less than £25,000” (regulation 107C(b)). It is the regulation 107(C)(a) figure on which HCL relies in this case.

20. Regulation 107E (which does not apply in the present case) provides for a de minimis exception from the requirement to carry out SMO calculations.

21. In determining whether the method adopted for calculating the difference under regulation 107B(2) is a more reliable proxy for the use of overhead costs than the standard method under regulation 101, the calculation need not necessarily be the most precise possible but it must be able to guarantee a more precise result than the result which would arise from the application of the turnover-based standard method (see *HMRC v Volkswagen Financial Services (UK) Limited* (Case C-153/17) [2018] STC 2217 (“VWFS”) at [53]).

22. “Use”, or in the language of the PVD “used for”, is not defined in the legislation. However, in *Dial-a-Phone Limited v Customs and Excise Commissioners* [2004] EWCA Civ

603 [2004] STC 987 Jonathan Parker LJ, with whom Waller and Dyson LJJs agreed, said at [28]:

“... on the authority of *BLP* and *Midland Bank*, in applying the ‘used for’ test ... the relevant inquiry is whether there is a ‘direct and immediate link’ between the input cost in question and the supply or supplies in question; alternatively whether the input cost is a ‘cost component’ of that supply or those supplies. [Underline emphasis supplied] It is clear from the judgments of the ECJ in *BLP* and *Midland Bank*, as I read them, that there is no material difference between these alternative ways of expressing the basic test.”

He continued, at [29], by referring to the *Abbey National plc v Customs & Excise Commissioners* (Case C-408/98) [2001] STC 297 in which the European Court of Justice had said, at [35], that the question to be asked was not “what is the transaction with which the cost component has the most direct and immediate link but whether there is a sufficiently direct and immediate link with a taxable economic activity.”

23. On this issue, the Court of Justice of the European Union (“CJEU”) observed in *VWFS*:

“41. In accordance also with the Court’s settled case-law, the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to the right to deduct is necessary, in principle, before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement. The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct (judgment of 14 September 2017, *Direktor na Direktsia ‘Obzhalvane i danachno-osiguritelna praktika’ – Sofia v Iberdrola Inmobiliaria Real Estate Investments’ EOOD* (Case C-132/16) EU:C:2017:683, para 28 and the case-law cited).

42. A taxable person also has a right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do have a direct and immediate link with the taxable person’s economic activity as a whole (judgment of 14 September 2017, *Iberdrola Inmobiliaria Real Estate Investments* (Case C-132/16) EU:C:2017:683, para 29 and the case-law cited).

The CJEU went on to explain, at [45], that the “the result” of the economic transactions, ie profit, is “irrelevant” for the right to deduct provided that the activity itself is subject to VAT.

24. In identifying “use” of the overheads, it is clear from the authorities, as Warren J observed in *St Helen’s School Northwood Ltd v HMRC* [2006] EWHC 3306 [2007] STC 633 (“*St Helen’s School*”) at [60], the entitlement to deduct input tax is not determined by motivation of purpose of the taxpayer concerned. However, as Warren J explained:

“a. ... the exclusion of motive or purpose does not allow the tribunal to disregard the observable terms and features of the transaction and the wider context in which it came to be carried out. Although what the judge [Patten J in *Customs and Excise Commissioners v Yarrowburgh Children’s Trust* [2002] STC 207] said was in the context of deciding whether a transaction was an economic activity or not, similar remarks can, I think, be made in relation to establishing the use (for VAT purposes) to which an item of property is put

and in determining what is or is not a valid proxy for that use in determining whether a proposed special method is fair and reasonable.”

25. It is apparent from *St Helen’s School* that it is the economic, as opposed to physical use, of a particular input that is to be identified. As Warren J observed:

“75. I agree with [counsel for the School] that the search in the present case is for a fair and reasonable proxy for the ‘use’ of the sports complex in making the exempt and a taxable supplies made by the School. However, I also agree with [HMRC’s counsel] that the physical use of the complex is not necessarily a fair and reasonable proxy for that use. I consider that her use of the phrase ‘economic use’ is a helpful approach to establishing what the search is for.

76. In that context, it is instructive, I consider, to look at the position had the School not granted the licence at all and had not allowed any out-of-hours use. In those circumstances, there would have been no taxable supply at all. In consequence, none of the input tax would fall to be attributed to taxable supplies as a result of regs 101(2)(b) and (c), reg 101(2)(d) not applying. However, the sports complex is used for the purposes of the School’s (exempt) business. It is so used not because there is a supply to parents of the physical use (by their daughters) of the sports complex to their children, but because the availability of the complex is part of the package of benefits which is acquired by parents for the fees they pay and which constitutes the exempt supply by the School. The use made by the School, for VAT purposes, of the sports complex is its use in providing that package of services, a single supply. There is, of course, no need to identify a proxy for use when there is only an exempt supply since questions of allocation under reg 101 (2) (d) do not then arise. Nonetheless, one can see that the ‘use’ referred in reg 101 (as elsewhere) is not physical use but some special VAT use. It is, I think, the same as what [counsel for HMRC] terms ‘economic use’.”

26. Although the deduction of residual input tax depends on the economic use of VAT bearing overheads it would appear from authorities, such as *Aspinall’s Club Limited v Customs and Excise Commissioners* [2002] Lexis Citation 805 (“*Aspinall’s Club*”), *St Helen’s School, HMRC v Lok’nStore Group plc* [2014] UKUT 288 [2015] STC 112, *HMRC v London Clubs Management Ltd* [2011] EWCA Civ 1323 [2012] STC 388 (“*London Clubs*”), that such use might be accurately measured by means of a physical proxy, such as a floor-space apportionment, particularly where the overheads are substantially property related.

27. In *London Clubs*, having referred, at [40], to *Aspinall’s Club* “as good illustration of the application of the relevant principles in the context of gaming and associated catering”, Etherton LJ (as he then was) said:

“41. That case [ie *Aspinall’s Club*] and the reasoning of the tribunal, with which I agree, is illustrative of three points of principle. First, it shows the importance in these cases of close attention to the facts in order to understand the economic or commercial reality underlying the use of the relevant VAT inputs. Secondly, identification of the source or potential source of profit in a business may be an important feature of a business throwing light on whether or not the standard method or a PESM is a more fair, reasonable and accurate method of attribution. It all depends on the facts of each case: cf *Banbury Visionplus Ltd v HMRC* [2006] EWHC 1024 (Ch) at [68], [2006] STC 1568 at [68]. Thirdly, depending again on the precise factual situation under consideration, the approach of the tribunal in *Aspinall’s Club* (see para 49)

may well be appropriate in a case where the taxable supplies are not, in themselves, a source of profit:

‘49. ... Those costs are funded by the gaming. That in itself does not make them cost components of those exempt supplies. But in this case it is additional proof, if any is needed, that gaming is the foundation of the business and it is the furtherance of that gaming which causes and is seen as justifying commercially the decisions to incur the expenditure ...’

42. As both *St Helen’s School* and *Aspinall’s Club* show, and as was emphasised in *Dial-a-Phone Ltd v Customs and Excise Commissioners* [2004] STC 987 at [72] by Parker LJ (with whom the other members of the court agreed), analysis of attribution for the purposes of art 2 of the First Directive, art 17 of the Sixth Directive and reg 101 is highly fact sensitive.

28. Therefore, and with that in mind, we first turn to the evidence and our findings of fact before setting out the method advanced by HCL for the recovery of its residual input tax.

EVIDENCE

29. In addition to a hearing bundle (of 740 pages), exhibits bundle (of 372 pages) and two supplementary bundles (of 942 and 68 pages respectively) we heard from Mr Simon Thomas, the Chief Executive and Chairman of HCL and Mr Matthew King its Managing Director.

30. We also had the benefit of a visit to the Hippodrome on the first afternoon of the hearing where we were given a guided tour by Mr Thomas.

31. Both Mr Thomas and Mr King were credible and truthful witnesses who sought to assist the Tribunal at all times. However, given the passage of time and the fallibility of human memory, as described by Leggatt J (as he then was) in *Gestmin SGPS SA v Credit Suisse (UK) Ltd & Anor* [2013] EWHC 3560 (Comm) at [15] – [20], we have also paid particular regard to contemporaneous documentary evidence (eg minutes of Board Meetings, Board Packs etc).

FACTS

Background

32. HCL was established in 2005. Mr Thomas has been its Chief Executive and Chairman from its incorporation. He holds (including through indirect interests) a majority shareholding in HCL and is responsible for its strategic decision making on a day-to-day basis.

33. In addition to his role with HCL, Mr Thomas is Director of Next Gen Health and Leisure (Australia) which operates tennis and health clubs in Australia and New Zealand. In June 2018 he became Managing Director of World Bingo Tech Limited, a company operating gambling equipment. Mr Thomas was President of the British Amusement Catering Trade Association between 1999 and 2001 and was on the executive committee of the Bingo Association from 1992 to 2006. He was a member of the top committee of the National Casino Forum (as Chairman between 2016 and 2018) until its merger with the Betting and Gambling Council and is a member of its equivalent committee. He is the seventh generation of his family to work in the gambling industry.

34. Mr King has been Managing Director of HCL since December 2012, having joined the company as its Chief Operating Officer in 2011. He is effectively second in command to Mr Thomas and manages the operation of HCL on a day-to-day basis together with its Chief Operating Officer, Mr Josh Edwins, and Compliance Director, Mr Jeremy Delf. The work involves all financial, compliance, business planning and business management matters. Mr

King's role includes managing the heads of all operational departments, including marketing and developing frameworks for the preparation of the operational department business plans based on strategic direction from Simon Thomas. Mr Edwins focuses on financial and contractual matters and Mr Delf on compliance and governance matters.

The Hippodrome

35. The Hippodrome was designed by the theatre architect Frank Matcham (who also designed, the Coliseum, the London Palladium and the Hackney Empire). It was opened in 1900 as an indoor circus with performing elephants, seal lions and other animals in aquatic shows using a specially constructed water tank. Charlie Chaplin was in the cast on its opening night and Houdini performed there in 1904.

36. In 1909 the water tank was covered over and the Hippodrome was converted into a music hall where it hosted everything from the English Premiere of Swan Lake, the first jazz ever to be played in the UK (in 1910) through to the Folies Bergère in the 1950s. In 1958 it was converted into a dinner dance venue, *Talk of the Town*, with performances from high profile artists such as Sammy Davis Junior, Judy Garland (who played her last London concerts there), Stevie Wonder and Tom Jones. In 2003 it was converted into a nightclub by Peter Stringfellow and remained as such until it lost its alcohol licence in October 2005.

37. The Hippodrome was acquired by HCL in 2005. Following a successful appeal against the initial refusal of a gaming licence, the refurbishment of the premises commenced in 2009 taking three years to complete at a cost of approximately £50 million.

38. When the Hippodrome opened there were 24 casinos in London. Mr Thomas explained that these could largely be divided into two groups.

39. The first were the high-end casinos, generally Mayfair town-houses which were similar to private members' clubs, with about 200 customers a week. The second were mass-market casinos which are typically in a basement under a hotel, with ten to fifteen gaming tables with a small bar and restaurant which is focused on the gaming customers. These mass-market casinos have around 2,000 customers a week with a restaurant and bar overseen by the casino's gambling director. Little effort is put into offering the food or drinks as a standalone offering. In addition to competing with these casinos Mr Thomas referred to the "hundreds of restaurants, hundreds of bars, [and] dozens of theatres" against which the Hippodrome had to compete for the "leisure spend" of potential customers.

40. Mr Thomas explained that HCL's intention was for the Hippodrome to be different from any of the existing casinos and provide, as he described it:

"A Las Vegas style experience within the boundaries of the UK legislation and the space available".

By a "Las Vegas style experience" Mr Thomas explained he meant "an iconic entertainment venue with a luxury environment" which catered for a variety of customers with a range of products under one roof.

41. This had not been possible before the changes introduced by the Gaming Act 2005 came into effect. Under that Act casinos were, for the first time, allowed to provide live entertainment, advertise and promote themselves. The legislation also removed the requirement for a customer to be registered with a casino for 24 hours before being permitted to gamble there. These legislative changes, Mr Thomas said, were "key" to HCL's decision to acquire the Hippodrome.

42. To create such an “experience” for its customers the Hippodrome includes over, its five floors, areas for live gaming, higher-stake and lower-stake gaming machines, electronic gaming, poker, eight bars, a restaurant – the Heliot Steak House, private dining/meeting rooms, conference and event areas, outdoor terraces, an entertainment and conference space (Lola’s), lounges, and a theatre which currently hosts *Magic Mike Live*. The premises are currently being extended to add a coffee shop and a Chinese restaurant, as well as a creperie on the outside of the Hippodrome building aimed at passers-by in Leicester Square.

43. The main entrance to the Hippodrome, which was the original entrance to the indoor circus/theatre when it opened in 1900, is on the corner of Charing Cross Road and Cranbourn Street opposite the entrance/exit to Leicester Square Underground Station. Other entrances are to be found in Cranbourn Street and Little Newport Street. The Cranbourn Street entrance leads, via a foyer, to a staircase and lift to other floors. To the left of the foyer are the “Crystal Rooms” which are now used for baccarat and on its right is the *Magic Mike Live* box office. The Little Newport Street entrance in London’s China Town, which was the original stage door of the Hippodrome, is the nearest entrance to a car park and is used by approximately a quarter of its customers.

44. The main atrium, the central feature of the Hippodrome, has a 62 foot high ceiling which has been returned to its original state as part of the refurbishment undertaken by HCL. Although the main entrance leads directly to the atrium, via a foyer which has a cloakroom and corridor with memorabilia on the walls reflecting the Hippodrome’s history, it can be accessed from anywhere in the building via each entrance. The atrium was described by Mr Thomas as one of the Hippodrome’s key draws, something, he said, that makes people “go Wow!”

45. The Hippodrome’s main gaming area is on the ground floor of the atrium overlooked, from what would have been the Dress or Royal Circle of the original theatre, on the first floor by the Heliot Steak House and Penny Bar. It has 26 live gaming tables, each with a dealer, and 88 electronic roulette terminals where those who wish to do so can bet on the on the live roulette games individually away from a table. Mr Thomas explained that gaming on a roulette terminal was:

“... exactly the same as playing on a live roulette table, except you do it remotely at a terminal.”

46. There is also a bar on the ground floor providing waitress service to the gaming tables. The ground floor contains further areas for gaming, including the electronic gaming area, on the lower floor as well as staff areas, office space, customer toilets, a cloak room and desk, a VIP entrance, goods holding area, refuse store and collection, display, reception, cleaning cupboard, staircases and hallways.

47. Although the stairs to the basement can be reached from anywhere in the building, the most direct route is via the Little Newport Street entrance which leads to what is now Lola’s Underground, previously called Lola’s Underground Casino. It opened on 21 May 2014 and is described by Mr Thomas as a “Las Vegas style offering” named after a showgirl called Lola McGuire who ran an illicit under-stage casino in 1900s London. The an entrance to Lola’s Underground is through a barbershop which, Mr Thomas explained, was to give it the feel of an illicit 1920s speakeasy.

48. Lola’s Underground was originally split into two parts and used for both gaming and hospitality. One half was used as a casino, with live tables available for use from 20:00 to 04:00, and the other used for hospitality with a stage, cabaret lighting and sound system, a central 12m screen and four 165cm plasma screens which is open to the public from 18:00.

49. However, by the time of our visit the area allocated to gaming had been reduced and the hospitality area increased. Lola's Underground also has a bar, flexible seating and hosts regular live entertainment and shows live sporting events, such as NFL and the Superbowl, Champions League soccer and rugby matches, on its screens. There is live entertainment every night from Wednesday to Saturday, currently *Overtures* a post-theatre singalong. The space is frequently used for conferences and marketing events during the day. Between November 2019 and January 2020 the Metropolitan Police hired the area as a conference space on more than 25 occasions.

50. In addition to these entertainment, hospitality and gaming facilities the basement also houses an area for CCTV/administration for the casino and hospitality area, a food store, a chilled cellar, a cellar, an ice machine, a secure cellar and pantry. There is also a lift, stairs, transformer, IT hub room, switch room, CCTV rack, cold water break tank and booster, gas meter, incoming gas and electricity as well as staircases and hallways, refuse and recycling stores, rubbish compactor, stores, toilets, lobby, pavement hatch and staff areas (lockers, changing rooms, staff lounge and showers).

51. The Penny Bar, the Boozy Tea Room, Theatre and the first level of the Heliot Steak House (all of which are described in more detail below) are situated on the first floor of the Hippodrome on which there are also four gaming machines, kitchens (for the Heliot Steak House and a 24 hour kitchen which provides food for the bars and to the gaming tables), staircases, lobbies, toilets and lifts.

52. The Theatre's gallery and the second and third levels of the Heliot Steak House are on the second floor. There are also two private dining/conference rooms behind the Heliot Steak House, "Alma's" and "Jimmy's" which are named after Mr Thomas's parents. Also on this floor are star dressing rooms, access shower rooms, theatre technical store, office, IT hub room, cabaret store, as well as the staircases, corridors lifts etc. There is also a Chinese Community Centre which HCL was required to provide as a condition of its planning permission for developing the Hippodrome.

53. On the third floor is a smoking terrace and bar. This is in addition to the poker rooms in the "Cranbourn Rooms", a technical store and technical gallery for the Theatre. Originally the poker rooms were on the fourth floor and the "Cranbourn Club" provided gambling facilities aimed at the wealthy and high stakes gamblers, described by Mr Thomas as "high rollers". However, these were swapped around during the covid lockdowns when the Hippodrome had to be closed.

54. The "Gods Casino" gaming area, which is used for roulette and craps and overlooks the gaming area on the ground floor, is on the fourth floor. There is also an outdoor terrace and bar, a second smoking area which has been extended to accommodate gaming tables, including outside gaming tables, and electronic terminals on this floor. Mr Thomas explained that this was because the area is popular with gamblers who like to smoke and are able to do both at the same time. Space is also required for those who wish to smoke but not gamble. A staircase from this terrace leads to the Rooftop Bar and terrace on the fifth floor.

55. In evidence Mr Thomas explained that at the Hippodrome:

"we offer everything ... because we want the building to be attractive to a whole range of customers."

56. While he accepted that gaming was the "greatest" contributor to the Hippodrome's overheads, Mr Thomas said that hospitality and entertainment were "equally important" and

that “we work very hard” to improve all aspects of the business. In 2019 there had been sales of 450,000 pints of beer, 70,000 bottles of wine, 158,000 cocktails. Although some of these sales would have been to gambling customers Mr Thomas considered the majority of these sales were to those who had not come to the Hippodrome to gamble but to eat or drink or had been one of the 315,000 people who went to see *Magic Mike Live* during the year.

57. Mr King, in his evidence, said that HCL was “trying to build very, very strong brands and independent businesses under the roof of the Hippodrome”. He described this as the “Hippodrome experience” which was “delivered by all of the products within the business” with the aim that:

“... each individual product will live to the standards of delivering to the customer a special experience. And overall, coming to the building should be a magical experience for the customer as well.”

58. It is to these individual “products” that we now turn.

Gaming

59. The following gaming is currently offered at the Hippodrome 24 hours a day:

- (1) live gaming (games like blackjack, roulette and craps where a player sits at a table with a dealer and physical chips). The main area for live gaming is on the ground floor and also in the Gods Casino on the top of the original theatre atrium and in the outdoor terraces on the third and fourth floor (gaming tables are largely fixed because they have a lot of electronics attached to them including lighting and CCTV cameras);
- (2) poker in the Cranbourn Rooms on the third floor;
- (3) electronic gaming terminals where players bet at their own terminals on the results of the live gaming tables (mainly adjacent to the main gaming areas); and
- (4) gaming machines on the ground floor at the back of the main gaming area.

60. HCL makes complimentary supplies of food and drink to some of its most valued customers. These are predominantly gaming customers but complimentary food and drink may also be given to others, eg restaurant customers on their birthday. In evidence Mr Thomas said, in relation to 2013-14, that:

“We give away £1.2 million out of £7.2 million hospitality. So it’s circa 20% of the business, 16% or whatever.”

61. The importance of gaming to HCL is clear. Not only does it provide the greatest source of income but it is reflected in the name of the company and its premises, ie the “Hippodrome Casino”. A customer poll taken between 20 December 2016 and 15 February 2017 recorded that 70% of them had come to the Hippodrome for gaming purposes, a number reflected in HCL’s 2018 statutory declaration to the Gambling Commission which estimated that 33% of visits to the Hippodrome did not involve any gambling.

62. Gaming is described as the “principal” activity of HCL in various documents. For example, in its pre-opening Business Plan for the Hippodrome recorded that:

“The principal activity of the business is the operation of a casino, providing a broad mix of casino games, both live table and electronic. The entertainment facilities will be an important part of the overall offer of the casino – the ethos is to provide a fun experience in a safe and welcoming environment.”

63. In a similar vein HCL's accounts for the year ended 31 December 2018 notes that "The gaming licence is fundamental to our primary business activity". The Executive Summary of the 2019 five year strategy plan, *Reaching for Greatness*, states:

"We are a casino based entertainment complex that amazes, surprises and entertains London. Our venue is fun and accessible and we seek to create an extraordinary leisure experience that is both magical and memorable."

It continues:

"Our uniqueness is the experience we provide to customers. This is our primary competitive advantage and source of long term value. The Hippodrome experience is created by the effective deployment of the following assets."

64. The assets to which it refers are the building (its location and "physical aspect"), staff and offer portfolio ("choice and quality and value"). Mr King explained that it was difficult to differentiate one gaming business from another saying that, "a wheel in one casino is a wheel in another casino." However, the fact that the Hippodrome has a "fantastic standalone restaurant, fantastic bars, a fantastic theatre" was, he said, "a help to gaming". He agreed that it was the experience of being in the Hippodrome with the full variety of offers there that set it apart as a gaming venue. However, he said that:

"If one looks at the building, the building almost writes for itself. If everything was just about the gaming, that building [the Hippodrome] wouldn't look anything like what it looks like today. It would be a different animal."

65. The significance of gaming was also accepted by Mr Thomas who agreed in evidence that it was intended at the commencement of its business that gaming would be HCL's principal activity. When referred to documents which stated that this remained the case at 2018, he said:

"And it remains that now, you can see the figures, the greatest contribution to our overheads is from gaming."

66. Contemporaneous documents repeatedly refer to the Theatre, Heliot Steak House and the various bars as "facilities" and "amenities". HCL's accounts for the year ended 31 December 2018 state:

"Consumers are increasingly seeking an experience, not simply direct product purchase and the multi-faceted Hippodrome operations - 3 live gaming areas, electronics, slots, high quality restaurant, bars and live theatre shows provide consumers with multiple reasons to visit.

We continue to focus on improving facilities for customers and reinforcing our unique position in the marketplace ...

The casino market in the early part of 2019 remains challenging. The Hippodrome business is well placed to meet these challenges. We continue to invest in improving facilities for customers and believe that future prospects for the business are strong."

67. This is also the case with promotional material on the HCL's website:

"Casino games are great! The experience gets even better when you have a full-fledged restaurant to satiate your taste buds. However if you smoke, there aren't many facilities like The Hippodrome Casino that have a dedicated smoking terrace for your smoking breaks. The casino houses a two-level smoking terrace that's equipped with a dedicated bar, and offers a wide range

of cigars. You can smoke and drink while sharing your life experiences or just spontaneous laughter with like-minded people at our rooftop smoking terrace.

When you're at The Hippodrome Casino, you don't have to ever worry about getting bored, thanks to the wide assortment of games we have to offer. However when you feel like taking a break, visit the smoking terrace for a quick breather. You can do this without having to worry about getting chilly on winter evenings too, as you can enjoy summer vibes all year long with our heated roof terrace. This smoking oasis is indeed one-of-a-kind and is certain to be a welcome haven in the centre of London's West End entertainment.

So why not sip on your favourite drink and smoke at the rooftop smoking terrace, all the while soaking in the excitement and energy that The Hippodrome Casino exudes. And that's not all; if you want to try out the house special drinks, make sure you ask for a specially designed cocktail from our exclusive list. Now you know why The Hippodrome Casino is one of the most popular, multi award winning casino in the country.

Come visit now and let us lavish you with our specialities and hospitality."

68. Mr Thomas agreed that this confirmed that not only did the Hippodrome have a:

"... great gaming offer but also when you have a break we will have great amenities for you to have a meal at a restaurant or a drink at the bar on the terrace, to have a cigarette or a cigar on the terrace."

He explained that it was "good" for casino customers to have space to have a break and that this was "positively encouraged" as it is "good social responsibility for gamblers to take a break from gambling". He added that if a person is gambling for a long period of time:

"... from a social responsibility point of view we will have an interaction with them and suggest they take a break. It may just be ten minutes away from the tables or having a coffee or whatever but it's quite sensible."

69. Although under the applicable regulatory framework it is mandatory for casinos to have non-gambling areas (which must not consist exclusively of lobbies and lavatory areas) the non-gambling area in the Hippodrome is much greater than the required 20 square metres. Mr Thomas explained that the relatively small requirement was because the Hippodrome was originally licenced under the Gaming Act 1968 rather than the Gambling Act 2005 and has what is described as a "converted licence".

Entertainment

70. The Hippodrome's 326 seat Theatre is currently the London venue for *Magic Mike Live*, directed and created by "Hollywood Star" Channing Tatum. When it opened in November 2018 it was, Mr Thomas says, the sixth highest pre-sold show in London theatre history and has been "phenomenally successful" delivering both quantity and quality of customers paying on average £90 for a ticket (top price tickets are £125) for the 90 minute show.

71. However, this has not always been the case. The September 2014 Board Report records, in relation to the Theatre:

"... an average month on income but a high profile Dire Straits event helped promote the theatre and the building. Next year we plan more of this type of event – using the acts to promote the building and its facilities and put on shows appealing to the higher end gamers."

72. The December 2014 Board Report refers to a “strong line-up of acts for 2015” and an improved focus on using the theatre offer to:

“... drive gamer visits and dwell time. We expect to see a continued improvement in this business in 2015 both in its own right and as an important element in supporting the gaming business.”

73. In April 2015 the Board Report notes that there was:

“... an improvement in the performance from the cabaret area in April and the development of the programming shows some promising signs. This business should be a real asset to the building and our focus is on making it just that – a draw for casino players that no competitor can match.”

74. The December 2015 the Board Report states that:

“... a good December performance helping to drive interest in the venue and visits from players throughout December and this despite a poor performing pantomime which we trialled in December as an experiment. The Cabaret space made money in December and helped drive F&B [food and beverage] income whilst continuing to offer acts attractive to our higher level players. 2016 will be a key year in the continued development of the space with bigger name acts aimed at attracting mid-range gamers visiting The Hippodrome for the first time. As I [Mr King] have said on previous occasions we must stay focused on developing the theatre as a strategic gaming asset as opposed to a London cabaret theatre.”

75. By 2015-16 HCL was becoming more confident in its use of the Theatre and the benefits of a “residency” with a long enough run to be marketed. The Board Report for November 2016 recorded that October had been a “strong month” with “Micky Flanagan playing multiple dates and introducing a new audience to the Hippodrome”. Micky Flanagan, a world-class comedian who the HCL could not afford, had asked if he could use the Theatre to try out new material for his act.

76. A French season, which included Laurent Voulzy (who was described by Mr Thomas as “the French equivalent to Tom Jones”), was successful in attracting new customers from the London French community. However, the “break-through” in programming was in August 2016 with the Hippodrome Theatre’s first residence, *Blanc de Blanc* which, over its two to three month run, attracted what Mr Thomas described as a “venue clientele, people who wanted really fun entertainment, fun attending a show”.

77. In evidence, Mr Thomas confirmed that one of the objectives of the Theatre was to put people into the casino to gamble. However, he explained that was also an objective of the Theatre to pull people into the Hippodrome to eat or to drink as “part of the mix of products” there. He explained that by March 2017, when negotiations to bring *Magic Mike Live* to the Hippodrome were underway it had been realised that there was no such thing as an act that “pulls in gamblers”. He said that:

“... it just doesn’t happen. Vegas doesn’t manage to do it and we certainly can’t.”

78. Mr King explained that because of the close relationship with the Cosmopolitan in Las Vegas, whose marketing manager worked for HCL in London for a time, he was able confirm that the benchmark for a Los Vegas casino is for a crossover of 10% of their theatre tickets to gaming. He said that HCL “internally throughout the entire budget process” had considered that they could be “half as good as Vegas because they had been around a long time.” As such,

in terms of budgeting HCL's aspirations were to turn 5% of the theatre goes into gaming customers. When asked if this had ever been achieved, Mr King said it had not, "nowhere near in fact."

79. Although in 2019 (outside the period with which the appeal is concerned) the Theatre did make a small profit following the success of *Magic Mike Live*, this was the first time it had done so notwithstanding the intention, described by Mr Thomas, of wanting each part of the Hippodrome to:

"... operate to the optimum it can. Both as a business in its own right and as an attraction to the business to [pull] in other people who may choose to spend on other ... businesses within the Hippodrome."

He said:

"We're not doing any part of the business for fun."

Hospitality

Restaurant

80. The Heliot Steak House, which Mr Thomas explained was named after a lion tamer, Claire Heliot who fed the lions raw steak on stage at the Hippodrome in the 1900s, has been awarded the "Best Steakhouse in London" three times by *Bookatable*. Its Executive Chef, Ioannis Grammenos, is a celebrity chef from Greece who describes himself as a "meatologist" and offers customers steak masterclasses.

81. The restaurant which has 120 covers is on three levels. The first, in the atrium, overlooks the main gaming floor. The main beam of the cantilever balcony structure, part of Frank Matcham's original design to allow audiences a column free unrestricted view of performances, is visible from the second level while the third level has a traditional, and more intimate, steak-house restaurant setting. The Heliot Steak House, which serves high quality USDA prime steak, competes directly with other similar steak restaurants such as *Hawksmoor* in nearby Air Street. Mr King said in evidence that:

"We price match regularly against *Hawksmoor*, we watch their advertising and promotion. It's mainly digital and online. And we benchmark our digital footprint for the Heliot against the *Hawksmoor's* digital footprint in terms of followers and engagements and posts etc."

82. Before being re-branded in June 2013, the restaurant had been an "American diner with a British twist". However, this was not successful in attracting its own reputation and customers. By contrast, following the re-brand as the Heliot Steak House and adopting a different approach the number of covers increased from 300-500 a week to 1,300 a week by 2017. In 2019 the Heliot Steak House had 71,000 customers and sold some 33,000 steaks and the average spend per customer had increased from £33 in 2017 to £35 by 2019.

83. While a proportion of these customers would have been at the Hippodrome for gaming purposes, Mr Thomas considered that, as food was also available 24 hours a day at the bars and served at the gaming tables, most of the restaurant customers were not there for that reason but accepted that there had been attempts to cross-sell the Heliot Steak House with the Hippodrome's other products.

84. An example of this was a 2014 promotion by the Heliot Steak House to generate business from its gaming clients by giving customers a £5 gaming chip if they bought a steak. Although this was considered to be the fastest and most effective means of generating revenue it did not work. Mr Thomas explained that the customers who received the promotional £5 gaming chip

went onto the gaming floor at busy times (both the restaurant and gaming floor are busy in the evenings) and disrupted experienced gamers as they did not know what they were doing. This, he said, demonstrated not only that customers who were not gamblers were already visiting the Hippodrome in order to use the Heliot Steak House in its own right but that also there was limited potential for cross-over between these business activities

85. Similar promotions which incorporated a gaming deal, eg a fixed priced meal and drink and a £50 win chip have resulted in the gaming chips often not being redeemed. A 2015 transaction report showed that 44% of such vouchers issued were returned unused. When asked if this meant that 56% of gaming vouchers were used Mr Thomas said:

“That’s absolutely correct, but given it was effectively a free bet, it was quite surprising there was only 56%, we were giving people who were going to the restaurant a chip they could put down on roulette number and if it comes up they win £50. You would think logically you’d just do it, but it obviously showed the lack of interest in [gaming by] those customers.”

86. The Heliot Steak House is open from 17:00 each weekday closing at 22:00 (23:00 on Fridays) and 12:00 on weekends closing at 23:00 Saturday and 22:00 Sunday. Like the Theatre, it has not made a profit during the period with which the appeal is concerned.

Bars

87. There are, in total, eight bars at the Hippodrome. However, as Mr King explained the these are not “generic” bars. Each, he said, has to be:

“... very, very carefully thought through, not only price position point but actual product, what mix. Take Champagne for example, what brands of Champagne, because that speaks to the brand of the bar.”

Basement Bar

88. The bar in “Lola’s Underground” in the basement serves customers at the bar as well as providing a table service for those gaming and attending the events and entertainment described above (at paragraph 49) there.

Ground Floor Bar

89. The bar on ground floor bar which is open 24 hours a day predominantly serves generic alcoholic options, such as beer, wine or spirits, or non-alcoholic beverages although, post-covid, this now operates as a “table service only” bar for gamers. Mr Thomas explained that this was because of its popularity with people coming into the Hippodrome for a drink in great numbers, especially on a Friday or Saturday night, and spilling into the gaming are.

Boozy Tea Room,

90. The Hippodrome’s newest bar was designed by the *Magic Mike Live* set designers and opened in 2018. Originally it was not a bar but, as Mr Thomas described it, a lounge that could be used by anyone either wanting a break from gaming or for any other reason. Drinks could also be brought in from the Penny Bar. While there was no requirement to buy a drink whilst sitting there, there was waitress service and anyone without a drink would not be left alone for too long if space was required.

91. HCL advertises the food and drink supplied by the Boozy Tea Room as “the perfect complement if a customer is joining us for Magic Mike”. However, notwithstanding its *Magic Mike Live* connections (it is the only venue in England at which Channing Tatum’s brand vodka “Born and Bred” can be purchased), the Boozy Tea Room is a standalone bar that also serves customers who are not attending a show at the Theatre. An example given by Mr Thomas is its

“Bottomless Prosecco” package at weekends where a customer is provided with a main meal plus two hours of unlimited prosecco for a fixed price of £30.

92. Although not a peak time for gaming customers, the Boozy Tea Room, like the third floor bar, the ground floor bar and the Penny Bar, are open throughout the day.

Penny Bar

93. The Penny Bar, with a walkway comprising 114,000 pennies, is situated on the first floor of the Hippodrome between the Theatre and the Boozy Tea Room. It sells a variety of cocktails and contains a large wine fridge with an extensive selection of fine wine and contains two large screens which promote *Magic Mike Live* or show sport. Mr Thomas described its clientele as including Heliot Steak House customers, *Magic Mike Live* audiences, theatre goers from other West End shows and others having a pre or post dinner drink in addition to people just coming in for drinks/cocktails, watching sport or those who want to relax in a space that is separate from the gaming floor.

Heliot Steak House bar

94. The purpose of the Heliot Steak House bar is to serve drinks to the restaurant

Third Floor Bar

95. The bar on the lower floor of the smoking area (adjacent to the Cranbourn Club on the third floor of the building) is open on a 24 hour basis and serves a range of beverages. There are three gaming tables on this floor.

Fourth Floor Bar

96. A Cuban-themed bar area which sells variety of cocktails and cigars on the upper floor of the smoking area. It is open in the evenings and has no gaming tables. It sells a different range of beverages to those sold in the bar on the floor below.

Rooftop Bar

97. This bar, which opened in 2020, has heating and a retractable roof and while it can be used throughout the year it is particularly popular in the summer months.

HCL’S SMO METHOD

98. There are five elements to HCL’s Method under regulation 107B for the recovery of its residual input tax. These are as follows:

- (1) An allocation (the “Allocation”) of floor space to:
 - (a) taxable supplies (“Hospitality” and “Entertainment”);
 - (b) exempt gaming supplies; and
 - (c) neither taxable nor gaming supplies (“Other Areas”).
- (2) The Hospitality area is then adjusted “to take account of the use of these areas for the provision of complimentary food and drink”, by the following ratio (“the Hospitality Adjustment”):

$$\frac{\text{Taxable supplies of food and beverage (A) + Value of food and drink provided to employees for free (B)}}{A + B + \text{Retail value of food and drink provided to customers for free}}$$

- (3) The Theatre area is adjusted “to take account of its occasional use for poker tournaments (‘the Poker Adjustment’):

Man hours spent on taxable shows and events

Total annual man hours (excluding general/maintenance time)

(4) A percentage is then derived (the “Recovery Percentage”), from the following calculation:

$$\frac{\text{Adjusted Area allocated to Taxable Supplies}}{\text{Area Allocated to Taxable Supplies and to Exempt Supplies}}$$

(5) That Recovery Percentage is then applied to all HCL’s residual costs, including all residual costs related to the Other Areas and all other non-property related residual costs.

99. Applying such a method there is, as the following table illustrates, a substantial difference (ie greater than £50,000) between the HCL’s SMO and the standard method (“SM”):

Year	Total Overhead VAT £	Recoverable under SMO (£)	Recoverable under SM (£)	Difference (£)
2012-13	1,629,304.28	870,054.37	276,981.73	593,072.64
2013-14	1,677,077.82	859,198.01	218,020.12	641,177.89
2014-15	1,232,885.61	648,707.29	172,603.99	476,103.30
2015-16	1,361,765.19	520,900.90	163,411.82	357,489.08
2016-17	1,705,065.27	815,620.23	221,658.49	593,961.74
2017-18	1,803,814.70	846,011.02	216,457.76	629,553.26

100. Although allocations based on use of the floor space have been made by HCL for all of the years under appeal (see Appendix 1) the only floor plan that has been provided, and on which Mr Thomas was cross-examined, was for the allocation as at 2013-14.

101. HCL’s residual costs are summarised in an appendix in a letter of 31 January 2017 from PricewaterhouseCoopers LLP (“PwC”) to HMRC. In 2014 the five largest items were rent, building maintenance (which includes costs of utilities and air conditioning), cleaning, marketing, and security which amounts to some 73% of the whole.

102. A cost allocation exercise in 2017, also undertaken by or for PwC, identifies fixed costs. These include rent (£1.1 million) and utilities (over £500k). A table (reproduced at Appendix 2) shows that, between 2012 and 2018, 67% to 87% of HCL’s fixed costs related to property.

103. In support of a floor space (as opposed to a turnover based) approximation of these costs the majority of which relate to property, Mr King gave the example of an electronic roulette terminal which sits on a space of 1.2 square metres and can only be used by one person at a time who sits on a stool taking up a further 0.3 square metres. Such a terminal has a turnover of £400,000 a year. By contrast, a table in the Heliot Steak House also sits in a space of approximately 1.5 square metres. However, it is normally used by two people at a time who sit on chairs and needs 0.4 metres of space from the next table. The Heliot Steak House table also required a bar, kitchen and point-of-sale machine all of which take up a further 115 square metres and has a turnover of £50,000 per year.

DISCUSSION AND CONCLUSION

104. Although Mr Hitchmough contends that we should first consider whether the standard method, as prescribed by regulation 101, attributes HCL’s residual overhead expenditure to its

taxable supplies in a manner that reflects the economic use it makes of that expenditure in making those supplies, we agree with Mr Donmall that our focus should be on the SMO advanced by HCL. This is because the standard method is, as is clear from the PVD and regulation 101, the default position, the starting point, and appropriate method to be applied in such circumstances. However, as the CJEU observed in *VWFS* at [51], a method other than the turnover-based method may be applied:

“... on condition that the method used guarantees a more precise determination of the deductible proportion of the input VAT than that arising from the application of the turnover-based method.”

105. In this case it is for HCL to establish that the SMO, based on a floor space apportionment, provides a more fair, reasonable and precise (although not necessarily the most precise possible) proxy for identifying economic use than the standard method. If so, as the difference between the floor space method advanced by HCL and the standard method is “substantial” (see paragraph 99, above), were we to conclude that the floor space method does represent a more reliable proxy, regulation 107B is engaged and HCL would be required to apply the SMO.

106. It is therefore necessary to determine whether the SMO rather than the standard method should be applied in this case. We consider such an approach to be consistent with the view of the Upper Tribunal in *HMRC v Temple Finance Limited* [2017] STC 1781 in which:

“59. [Counsel for HMRC] submitted that the FTT had adopted the wrong approach in asking itself whether it preferred TFL’s approach or HMRC’s approach to the calculation of recoverable input tax on overheads. The correct approach was to (a) decide what the use of the input tax was, (b) consider the standard method and whether the SMO applied, (c) if the SMO applied, consider whether TFL’s calculation fairly and reasonably reflected use, (d) if it did not, consider whether HMRC’s calculation did so, and (e) if neither calculation fairly and reasonably reflected use, impose its own use-based calculation.

60. We do not agree. Only two methods were before the FTT, TFL’s and HMRC’s. The FTT was not required to make its own enquiry as to whether there might be another method that was preferable. As Lord Carnwath said in the Supreme Court’s decision in *VWFS* [2017] UKSC 26, [2017] STC 824 (at [7]), where the parties are substantial litigants represented by experienced counsel the tribunal ‘is entitled to assume that the parties will have identified with some care what they regard as relevant issues for decision’.

61. HMRC’s arguments also do not take sufficient account of the fact that the starting point is the standard method. As discussed further below in relation to Ground 7, that method is the appropriate method unless a special method applies or the proportion of recoverable input tax ‘differs substantially’ from what would be recoverable under a use-based method, so that the SMO applies. ... The FTT rejected HMRC’s approach for the reasons set out at paras [231]–[235], including that TFL’s residual input tax is incurred to collect the weekly payments that relate to the sale price of the goods as well as the finance element. This effectively left the default standard method contended for by TFL as the applicable one. ...”

107. As to whether a floor space apportionment provides a more precise proxy for economic use of the Hippodrome by HCL than the standard method, it is clear from the authorities to which we have referred that this is a very fact sensitive issue. Accordingly very little, if any,

assistance can be derived from the conclusions in these or any of the other cases cited by the parties to which we have not referred.

108. For HMRC, Mr Donmall contends that not only did HCL make economic use of the areas in the Hippodrome allocated to hospitality and entertainment for those purposes but also used those areas for its gaming supplies, ie there was dual use of these areas. He says this was because gaming customers were attracted to the Hippodrome and encouraged to stay there because of the entertainment and particularly the hospitality and that this strengthened its gaming proposition over that provided by its competitors. This not only complied with the letter and spirit of the regulations requiring non-gaming areas to be available in a casino and for gamblers to take breaks, which Mr Thomas accepted (see paragraph 68, above), but also gave HCL the opportunity to cross-sell gaming to customers who initially came for other purposes.

109. Mr Donmall submits that such economic use is reflected by the fact that HCL, between 2012 and 2019, pursued both hospitality and entertainment despite these being unprofitable. He also refers to the customer poll and statutory declaration to the Gambling Commission which estimates that 30% to a third of HCL's customers do not go the Hippodrome for gaming purposes (see paragraph 61, above) and asks how this equates with the almost 50% recovery rate of the overhead VAT produced by the SMO (see paragraph 99, above) advanced by HCL.

110. In addition Mr Donmall contends that it is clear from the contemporaneous documents that HCL's principal activity is the operation of a casino which, he says, is supported by the reference to the Theatre and various bars in the Hippodrome in HCL's accounts as "facilities" (see paragraph 66, above), the reference in its Business Plan as the "operation of a casino" as its "principal activity" and the "entertainment facilities" being "an important part of the overall offer of the casino" (see paragraph 62, above) and indeed by its very name, the Hippodrome Casino.

111. However, Mr Hitchmough, who accepts that the gaming is clearly important to HCL, refers to hospitality and entertainment being operated from separate discrete areas of the Hippodrome and, as such, should be regarded as standalone attractions in their own right.

112. He submits that in that regard the present case is similar to *London Clubs* in which the First-tier Tribunal found, at [48] of its decision, that catering activities although not "currently profitable" were "businesses in their own right" and "not merely ancillary to the gaming business", a conclusion upheld by the Court of Appeal, at [78] of its decision, as a finding of primary fact that was "impossible to disturb".

113. Although *Etherton LJ* had, at [71], because of the unprofitability of the catering activities in *London Clubs*, described that conclusion as "remarkably benign" he went on to say at [84]:

"As I have said earlier in this judgment, what is or is not a suitable PESM is highly fact specific. Furthermore, as I have also said, in looking at economic reality in this context, profit may be an important factor, but it is not necessarily so, and in some cases it may be entirely irrelevant."

We would add, as is apparent from the decision of the CJEU in *VWFS* at [45], that although profitability is one factor to be taken into account it is not determinative in itself.

114. Although, as Warren J observed *St Helen's School*, the motivation or purpose of HCL is not determinative, the observable terms, features and context in which the input tax was incurred should not be disregarded (see paragraph 24, above).

115. Accordingly, it is necessary to bear in mind that HCL was seeking to create a "Las Vegas experience" at the Hippodrome for a variety of customers and provide a range of products

under one roof (see paragraph 40, above). In this context, the offerings of the Hippodrome can be contrasted with those of other casinos with which it is in competition in that it is not a private members' club type of casino, like in *Aspinall's Club*, or a mass-market casino such as those described by Mr Thomas (see paragraph 39, above).

116. In addition to those other casinos the Hippodrome is also in competition with “hundreds” of restaurants and bars and “dozens” of theatres in London’s West End. In this respect its bars are not generic but have their own particular branding, eg the Penny Bar and the Boozy Tea Room with its particular brand of vodka which is only available there. As Mr King said in evidence this is something that is very carefully considered not only as regards price but also the products and brands that are available which, he said, “speaks to the brand of the bar” (see paragraph 87, above).

117. The restaurant, the Heliot Steak House, with its celebrity chef, was similarly deliberately branded as a standalone feature of the Hippodrome and, as such, has been awarded the accolade of “Best Steakhouse in London” three times by *Bookatable*. The restaurant competes with other similar steak restaurants, particularly the nearby *Hawksmoor* restaurant whose advertising, promotions and digital footprint is monitored and used as a benchmark by HCL (see paragraph 81, above).

118. There is a limited crossover between restaurant and gaming which is apparent from the 2014 promotion in which restaurant customers, who did not understand the operation of the casino, disrupted experienced gamers when using their free £5 gaming chips. Another illustration of the limited crossover by restaurant customers to gaming is the limited use of the “free bet” vouchers in 2015 of which 44% were not redeemed (see paragraphs 84 and 85, above).

119. Notwithstanding the aspiration, as stated in the Board Reports, to use the Theatre to “drive gamer visits and dwell time” (see paragraph 72, above) and making it a “draw for casino players” (see paragraph 73, above) the evidence was that this was not the case and that “nowhere near” the 5% crossover from the theatre audience to gaming had been achieved.

120. Not only are the Theatre, restaurant and bars identifiable features of the Hippodrome but each is operated from clearly recognisable and defined spaces – as indeed are the gaming areas. As Mr King said in evidence “if everything was just about the gaming” the Hippodrome “wouldn’t look anything like what it looks today. It would be a different animal” (see paragraph 64, above).

121. Adopting the approach of Warren J in *St Helen’s School* who, at [76], considered it “instructive” to look at what the position would have been in the absence of any taxable activity we consider that in contrast to that case there would have been a difference in the present case without the Theatre, bars and restaurant.

122. Taking a similar approach to *Aspinall’s Club*, which Etherton LJ in *London Clubs* considered to be a “good illustration of the application of the relevant principles in the context of gaming and associated catering”, the decision of the Tribunal, at [49], continues after the passage cited by Etherton LJ in *London Clubs* (see above at paragraph 27) as follows:

“... Here there is capital expenditure and ongoing expenditure incurred specifically to create and maintain the opulence and luxury, especially in the creation of spacious surroundings and general ambiance, which is seen as commercially necessary to promote the highly profitable gaming business.”

123. In our judgment it is clear from this that the expenditure in *Aspinall's Club* would have been incurred whether or not it made taxable supplies of food and drink. In contrast, given its scale and extent, the expenditure incurred by HCL was not merely to provide an attractive atmosphere to gamers but to promote and gain additional income from the theatre, bars and restaurant which are of an altogether different nature from the hospitality supplied in *Aspinall's Clubs*.

124. However, we would agree with the Tribunal in *Aspinall's Club* that being funded by gambling does not in itself make the expenditure cost components of exempt gaming supplies. We also note that a concern in *Aspinall's Club* that complimentary food and drink was not reflected in the floor based method proposed in that case does not apply in the present case as the complimentary hospitality is recognised in the SMO advanced by HCL.

125. For the reasons above, and having regard to all the circumstances, we have come to the conclusion that, given their extent and nature, the supplies of entertainment and hospitality from discrete and defined areas of the Hippodrome by HCL cannot be regarded as merely an adjunct to, or an amenity for, gaming.

126. We also consider that the general space, ie corridors, lavatories, staircases, lifts, walkways etc, is used to serve the building as a whole and that it therefore follows that it is appropriate to consider its use in the same way. We also take account of the fact, as is apparent from Mr King's comparison of an electronic roulette terminal and table in the Heliot Steak House (see paragraph 103, above), that gaming generates higher turnover per square foot than hospitality.

127. As such, we find that the floor space method, as set out in HCL's SMO calculation, does provide a more fair, reasonable and precise proxy of its economic use of its overhead expenditure than the turnover based standard method, particularly given that most of those overheads are property related. Accordingly HCL's appeal succeeds on this issue.

128. The other issue between the parties relates to the CGS to which there are two aspects.

129. The first concerns whether HCL's SMO is to be preferred to the standard method in the determination of the capital goods in question. For the reasons above we consider that it does.

130. The second aspect of the CGS concerns how the use of the Hippodrome for the purposes of business entertainment – the provision of complimentary food and drink (see paragraph 60, above) – should be dealt with under the CGS. However, this only applies in relation to the standard method. HMRC accept that it does not arise if we were to find in favour of HCL, as we have, because the SMO does take into account business entertainment and identify the entitlement to deduction in respect of capital goods for subsequent intervals. As such the CGS issue does not arise.

131. Other than formally to allow the CGS appeal, given our conclusion in relation to the SMO, it is not necessary for us to express any view in relation to the CGS issue.

132. Therefore, for the reasons above, the appeals are allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

133. 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.

**JOHN BROOKS
TRIBUNAL JUDGE**

Release date: 22 MARCH 2022

**APPENDIX 1
HCL’s SMO Floor Space Allocations (M²)
2012-13**

Floor	Gaming	Bars	Restaurant	Entertainment	General	Admin & IT	Plant	CCC*
Crystal Rooms 370.04 x ⁵ / ₁₂								
Basement	352.70	331.60			721.50	14.50		
Ground	559.70	99.10		18.70	498.40			10.60
First	27.30	309.99	273.81	246.60	225.70		83.90	
Second		82.56	186.84	126.00	176.80	7.70	2.70	318.00
Third	300.10	120.00		99.90	320.30	7.70	73.60	
Fourth	140.10	52.60			70.60	126.10	617.80	
Total	1,379.90	995.85	460.65	491.20	2,013.30	156.00	778.00	328.60
	Included				Excluded			

* Chinese Community Centre which is housed at the 2nd floor of the Hippodrome and provided in accordance with planning permission (see paragraph 52, above)

2013-14

Floor	Gaming	Bars	Restaurant	Entertainment	General	Admin & IT	Plant	CCC
Crystal Rooms 370.04 x ⁵ / ₁₂								
Basement	324.13	237.82			771.21		128.11	
Ground	500.31	83.10		14.63	625.03		44.41	33.45
First	11.93	321.73	273.81	199.62	346.60		64.46	23.47
Second		86.08	186.84	121.51	218.68		81.65	352.99
Third	287.80	123.43		92.31	440.16		166.13	
Fourth	120.92	58.68			220.55		489.79	
Total	1,245.09	910.84	460.65	428.07	2,622.23		974.55	409.91
	Included				Excluded			

2014-15

Floor	Gaming	Bars	Restaurant	Entertainment	General	Admin & IT	Plant	CCC
Crystal Rooms 370.04 x ⁵ / ₁₂								
Basement	262.35	299.60			771.21		128.11	
Ground	500.31	83.10		0.00	625.03		44.41	33.45
First	8.93	324.73	273.81	199.62	346.60		64.46	23.47
Second		83.08	186.84	121.51	221.68		81.65	352.99

Third	299.07	103.16		92.31	440.16		175.13	
Fourth	120.92	58.68			220.55		489.79	
Total	1,191.58	952.35	460.65	413.44	2,639.86		983.55	409.91
Included					Excluded			

2015-16

Floor	Gaming	Bars	Restaurant	Entertainment	General	Admin & IT	Plant	CCC
Crystal Rooms 370.04 x ⁵ / ₁₂	154.18							
Basement	262.35	299.60			771.21		128.11	
Ground	500.31	83.10		0.00	625.03		44.41	33.45
First	8.93	324.73	273.81	199.62	346.60		64.46	23.47
Second		83.08	186.84	121.51	221.68		81.65	352.99
Third	299.07	103.16		92.31	440.16		175.13	
Fourth	120.92	58.68			220.55		489.79	
Total	1,191.58	952.35	460.65	413.44	2,639.86		983.55	409.91
Included					Excluded			

2016-17

Floor	Gaming	Bars	Restaurant	Entertainment	General	Admin & IT	Plant	CCC
Crystal Rooms 370.04	370.04							
Basement	262.35	299.60			771.21		128.11	
Ground	500.31	83.10		0.00	639.66		44.41	33.45
First	8.93	324.73	273.81	199.62	346.60		64.46	23.47
Second		83.08	186.84	121.51	221.68		81.65	352.99
Third	299.07	103.16		92.31	440.16		175.13	
Fourth	120.92	58.68			220.55		489.79	
Total	1,561.62	952.35	460.65	413.44	2,639.86		983.55	409.91
Included					Excluded			

2017-18

Floor	Gaming	Bars	Restaurant	Entertainment	General	Admin & IT	Plant	CCC
Crystal Rooms 370.04	370.04							
Basement	262.35	299.60			771.21		128.11	
Ground	500.31	83.10		0.00	639.66		44.41	33.45
First	8.93	324.73	273.81	199.62	346.60		64.46	23.47
Second		83.08	186.84	121.51	221.68		81.65	352.99
Third	299.07	103.16		92.31	440.16		175.13	
Fourth	120.92	58.68			220.55		489.79	
Total	1,561.62	952.35	460.65	413.44	2,639.86		983.55	409.91
Included					Excluded			

APPENDIX 2
Table of Fixed Costs

Description	Property Related	2012			2013		
		Total	Property	Non-Property	Total	Property	Non-Property
Quality Assurance	N						
Computer/Phone	N	123,264.55		123,264.55	79,521.81		79,521.81
Rent	Y	57,651.75	57,651.75		216,683.63	216,683.63	
Building	Y	2,481,556.68	2,481,556.68		960,903.54	960,903.54	
Building Maintenance	Y	75,522.11	75,522.11		273,330.49	273,330.49	
Building Decorations	Y				23,031.00	23,031.00	
Security	Y	43,102.43	43,102.43		237,048.32	237,048.32	
Signage	Y	20,056.31	20,056.31		11,519.16	11,519.16	
Cleaning	Y	30,042.45	30,042.45		246,613.27	246,613.27	
Building Legals	Y	6,868.38	6,868.38		7,481.26	7,481.26	
Storage	N				119.99		119.99
Phones	N	3,791.39		3,791.39	12,150.03		12,150.03
Marketing	N	175,446.77		175,446.77	310,864.28		310,864.28
Taxi and travel	N						
Other Legals	N	48,791.45		48,791.45	103,790.33		103,790.33
Staff	N	36,225.60		36,225.60	45,645.07		45,645.07
Office	N	9,223.19		9,223.19	15,739.21		15,739.21
Other	N	566.00		566.00	635.94		635.94
Total (£)		3,112,109.26	2,714,800.41	397,308.85	2,545,038.11	1,976,611.05	569,427.06
%			87%	13%		78%	

Description	Property Related	2014			2015		
		Total	Property	Non-Property	Total	Property	Non-Property
Quality Assurance	N				1,202.20		1,202.20
Computer/Phone	N	49,226.30		49,226.30	57,612.12		57,612.12
Rent	Y	303,508.72	303,508.72		337,885.47	337,885.47	
Building	Y	16,073.88	16,073.88		31,862.36	31,862.36	
Building Maintenance	Y	251,181.24	251,181.24		203,922.97	203,922.97	
Building Decorations	Y	16,422.78	16,422.78		8,127.90	8,127.90	
Security	Y	141,535.59	141,535.59		145,225.03	145,225.03	
Signage	Y	6,230.89	6,230.89		8,466.55	8,466.55	
Cleaning	Y	169,143.23	169,143.23		160,653.53	160,653.53	
Building Legals	Y	3,151.89	3,151.89		6,554.86	6,554.86	
Storage	N				5,053.80		5,053.80
Phones	N	8,232.24		8,232.24	11,532.28		11,532.28
Marketing	N	157,733.77		157,733.77	151,019.21		151,019.21
Taxi and travel	N				140.00		140.00
Other Legals	N	43,961.41		43,961.41	98,833.03		98,833.03
Staff	N	39,462.17		39,462.17	75,377.51		75,377.51
Office	N	15,119.98		15,119.98	14,202.49		14,202.49
Other	N						
Total (£)		1,221,074.09	907,298.22	313,775.87	1,357,671.63	942,698.77	414,972.86
%			74%	26%		69%	31%

Description	Property Related	2016			2017		
		Total	Property	Non-Property	Total	Property	Non-Property
Quality Assurance	N	1,656.00		1,656.00			
Computer/Phone	N	90,059.98		90,059.98	98,878.59		98,878.59
Rent	Y	494,898.47	494,898.47		674,591.98	674,591.98	
Building	Y	860.75	860.75		4,388.27	4,388.27	

Building Maintenance	Y	237,854.15	237,854.15			337,738.06	337,738.06	
Building Decorations	Y	3,672.05	3,672.05			10,337.06	10,337.06	
Security	Y	162,679.35	162,679.35			230,412.53	230,412.53	
Signage	Y	5,967.82	5,967.82			11,445.38	11,445.38	
Cleaning	Y	123,685.54	123,685.54			130,185.10	130,185.10	
Building Legals	Y	6,896.46	6,896.46			5,722.20	5,722.20	
Storage	N	6,026.01		6,026.01		7,588.67		7,588.67
Phones	N	6,315.17		6,315.17		22,915.82		22,915.82
Marketing	N	99,228.83		99,228.83		46,229.59		46,229.59
Taxi and travel	N	140.00		140.00				
Other Legals	N	177,759.01		177,759.01		103,538.06		103,538.06
Staff	N	62,984.46		62,984.46		75,102.55		75,102.55
Office	N	18,507.75		18,507.75		34,793,897.02		34,793,897.02
Other	N							
Total (£)		1,498,264.30	1,035,587.09	462,677.21		1,793,897.02	1,404,820.58	519,245.72
%			67%	31%			78%	22%

Description	Property Related	2018		
		Total	Property	Non-Property
Quality Assurance	N			
Computer/Phone	N	160,097.65		160,097.65
Rent	Y	623,072.53	623,072.53	
Building	Y	27,983.39	27,983.39	
Building Maintenance	Y	308,171.23	308,171.23	
Building Decorations	Y	9,260.88	9,260.88	
Security	Y	216,345.77	216,345.77	
Signage	Y	17,662.39	17,662.39	
Cleaning	Y	138,621.45	138,621.45	
Building Legals	Y	5,816.90	5,816.90	
Storage	N	11,698.37		11,698.37
Phones	N	19,951.14		19,951.14
Marketing	N	52,654.52		52,654.52
Taxi and travel	N			
Other Legals	N	148,437.03		148,437.03
Staff	N	96,542.77		96,542.77
Office	N	29,864.74		29,864.74
Other	N			
Total (£)		1,866,159.76	1,346,934.04	519,245.72
%			72%	28%