



TC03445

Appeal number: TC/2011/09925

Value Added Tax – Input tax – Museum making both exempt and taxable supplies – Exempt supplies of admissions to museum and taxable supplies (standard rated and zero rated) of items sold in museum shop – Whether expenditure incurred in creating museum exhibits should be treated as residual input tax – Value Added Tax Regulations 1995, reg 101(2)(b) and (d) and (10) – Appeal allowed in part

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

THE ROALD DAHL MUSEUM AND STORY CENTRE Appellant

- and -

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

**TRIBUNAL: JUDGE CHRISTOPHER STAKER
MS CAROL DEBELL**

Sitting in public in London on 3-4 October 2013

Mr Sarabjit Singh, counsel, for the Appellant

Ms Eleni Mitraphanous, counsel, for the Respondents

DECISION

Introduction

1. The Appellant, referred to below as the “Museum”, is a museum in Great
5 Missenden, Buckinghamshire, relating to the life and works of the late Roald Dahl, a
well-known author.

2. The Museum has paid VAT on certain expenditure incurred in refurbishing or
maintaining museum exhibits. The Museum contends that this VAT should be treated
as residual input tax for purposes of the partial exemption calculation, as the
10 expenditure in question has a direct and immediate link not only with the Museum’s
exempt supplies of admissions to the Museum, but also with taxable supplies made in
the Museum shop. HMRC has decided to reject that claim, and considers that the
VAT is to be treated as exempt input tax. The Museum now appeals to the Tribunal
against the HMRC decision.

15 Procedural background

3. In a letter to HMRC dated 22 June 2011, the Museum contended that amounts
of VAT incurred in 2007-08, 2008-09 and 2010-11 in respect of “exhibition costs”
had previously been incorrectly treated as exempt input tax, and that that these
amounts should have been treated as residual input tax. The Museum sought recovery
20 of £2,632.03, being approximately half of the VAT paid on the “exhibition costs” in
those three years. The 22 June 2011 letter further indicated that the Museum intended
to treat VAT to be incurred on a planned future gallery refurbishment as residual.

4. That claim was disallowed in an HMRC decision of 29 July 2011, which stated
that VAT to be incurred on the costs of the planned future refurbishment would also
25 not be residual input tax.

5. By a letter dated 31 August 2011, the Appellant took issue with the HMRC
conclusion, as a result of which HMRC undertook an internal review of the matter,
leading to a review decision dated 18 October 2011 upholding the HMRC conclusion.
In response to a further letter from the Appellant’s representatives dated 8 November
30 2011, HMRC confirmed in a further letter dated 11 November 2011 that the HMRC
letter dated 18 October 2011 concluded the HMRC views on the matter.

6. By a notice of appeal dated 28 November 2011, the Appellant commenced the
present Tribunal appeal against the HMRC decisions of 18 October 2011 and 11
November 2011.

7. The anticipated future gallery refurbishment was subsequently undertaken. This
involved moving the contents of a hut (referred to below as the “writing hut”) located
in the garden of Roald Dahl’s home into a replica shell of the writing hut situated in a
gallery in the Museum (referred to below as the “Solo gallery”). The original writing
hut was where Roald Dahl worked and wrote many of his books until the end of his
40 career. The contents of the writing hut were moved into the replica shell such that the

interior of the replica shell contained all of the original contents of the writing hut, arranged exactly as they had been in the original writing hut. The creation of this “hut display” involved a complete redesign of the Solo gallery. The ultimate cost of this redesign and refurbishment was £501,336, including VAT of approximately
5 £100,000. It was common ground between the parties that treatment of this VAT is also in issue in the present appeal. The Appellant contends that this VAT should also be treated as residual input tax, while HMRC contend that it is exempt input tax.

8. The Appellant also contends in this appeal that the Museum intends to incur further expenditure on additional future refurbishments to its displays, and that the
10 Tribunal’s decision in this appeal should also apply to VAT to be incurred on such future expenditures.

9. References below to “exhibition costs” are general references to the costs referred to in paragraphs 3 and 7-8 above.

Factual background

15 10. On the evidence presented by the Museum, the Tribunal makes the following background findings of fact, which were essentially uncontested by HMRC.

11. The Museum is a registered charity and a company limited by guarantee. Its object as a charity is to further the education of the public in the art of literature by the provision and maintenance of a museum and literature centre based on the works of
20 the author Roald Dahl. The Museum’s September 2003 mission statement indicates that its mission is “To inspire a love of stories and creative writing in everyone using the Roald Dahl Archive, his stories and his life”. The Museum opened in 2005. In the year ended 31 March 2012, it had 56,075 visitors.

12. The Museum comprises exhibitions in two galleries (referred to below as the
25 “Boy gallery” and the “Solo gallery”), as well as a story centre, a crafts room, a recreation of Miss Honey’s classroom (a character from Roald Dahl’s book *Matilda*) in which workshops are held, a café, and a shop.

13. The Boy gallery is based on the first volume of Roald Dahl’s memoirs entitled
30 *Boy*. It deals with his early life and schooling. The Solo gallery is based on the second volume of his memoirs entitled *Going Solo*. It deals with his early adult life, and how he became a writer. It includes a replica of a Gloster Gladiator aircraft, recalling an aircraft crash that Roald Dahl had while in the RAF, which eventually led to his discharge from flying duties on health grounds and his posting to Washington as air attaché. The gallery includes “lenticulars”, that is to say, pictures that display a
35 different image depending on the angle from which they are viewed, which splice Roald Dahl’s photographs from this period with illustrations by Quentin Blake (the principal illustrator of Roald Dahl’s books).

14. The Story Centre draws upon the works of Roald Dahl and other children’s
40 writers to encourage creative writing and other creative activities in visitors. In the Story Centre, visitors can sit in a replica of the writing hut, play creative writing

5 games, attempt craft activities, and, at weekends and during school holidays, enter Miss Honey's classroom from *Matilda* and listen to dramatic renditions of poems from *Revolting Rhymes* and *Dirty Beasts*. Workshops, including sessions with authors and illustrators, are available to visitors at weekends and in the holidays for an additional fee.

15. Visitors to the museum pay an admission charge. The charge for admission to the Museum is an exempt supply.

16. The Museum also has a shop in which various items are sold. Items sold in the Museum shop are taxable supplies (either standard rated or zero rated).

10 17. In the financial year ended 2012, the Museum's income from admissions was £225,359 (of which £39,524 was school visit income), and the income from the shop was £223,979 (of which £36,625 was e-commerce income).

15 18. The Museum additionally has a venue for corporate meetings and potential entertainment, and this provides another source of income. Museum entry is included in the per capita price for room hire, and this is a key factor in companies choosing this venue. Room hire is a taxable supply because the Museum has opted to tax the building.

19. The Museum also has other revenue streams (donations and grants, investment income, and sundry income), which comprise approximately a third of its revenue.

20 **The issue**

20. The Museum's position is that the VAT that it pays on its exhibition costs is "residual input tax" within the meaning of regulation 101(10) of the Value Added Tax Regulations 1995, that is to say, "input tax incurred by a taxable person on goods or services which are used or to be used by him in making both taxable and exempt supplies". This is because, says the Museum, the exhibition costs are incurred in making both supplies of admissions to the Museum, as well as supplies by way of sales in the Museum shop.

21. The HMRC position is that the VAT paid by the Appellant on its exhibition costs is incurred solely in making exempt supplies of admissions to the Museum.

30 **Applicable legislation**

22. Article 168 of Directive 2006/112/EC (the "Principal VAT Directive") relevantly provides:

35 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; ...

23. Article 173(1) of the Principal VAT Directive (formerly Article 17(5) of the
5 Sixth VAT Directive) relevantly provides:

- 1. 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
10 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.

24. Article 174(1) of the Principal VAT Directive relevantly provides:

- 1. 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;
 - 20 (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.

25. Regulation 101 of the Value Added Tax Act Regulations 1995 (the “**VAT Regulations**”) (made pursuant to Section 26 of the Value Added Tax Act 1994 (“**VATA**”)) relevantly 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.
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- (2) Subject to paragraph (8) below and regulation 107(1)(g)(ii), 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,
 - 35 (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
40 of taxable supplies, shall be attributed to taxable supplies,
 - (d) where a taxable person does not have an immediately preceding longer period and subject to subparagraph (e)

5 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,

...

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

Relevant case law

26. In this appeal, the main cases to which the Tribunal was referred by the parties were Case C-4/94, *BLP Group plc v Customs and Excise Commissioners* [1996] 1 WLR 174 (“**BLP Group**”); Case C-98/98, *Midland Bank plc v Customs and Excise Commissioners* [2000] 1 WLR 2080 (“**Midland Bank**”); Case C-408/98, *Abbey National plc v Customs and Excise Commissioners* [2001] 1 WLR 769 (“**Abbey National**”); *Customs and Excise Commissioners v Southern Primary Housing Association* [2003] EWCA Civ 1662, [2003] STC 209 (“**Southern Primary**”); *Royal Agricultural College v Customs & Excise Commissioners* (decision no. 17508, unreported, 11 January 2002) (“**Royal Agricultural College**”); *Dial-a-Phone Ltd v Customs and Excise Commissioners* [2004] EWCA Civ 603, [2004] STC 987 (“**Dial-a-Phone**”); *HM Revenue & Customs v Mayflower Theatre Trust Ltd* [2006] EWCA Civ 116, [2007] STC 880 (“**Mayflower**”); and *Garsington Opera Ltd v Revenue & Customs* [2009] UKFTT 77 (TC) (“**Garsington Opera**”).

27. Principles relevant to the present case were set out in *Mayflower* by Carnwath LJ, who said that:

30 6. The rules governing cases falling under [regulation 101(2)(d) of the VAT Regulations] are known as the “partial exemption rules”. (It is not suggested that, for the purposes of this appeal, there is any material difference between the Directive and the Regulations.)

35 7. The method prescribed by [regulation 101(2)(d) of the VAT Regulations] mirrors Article 19 [of the Sixth VAT Directive], and is normally referred to as “the standard method”. It applies except where a different “special” method is agreed, or directed by HMRC. For the periods in question in this case (before the law had been clarified by the *Zoological Society* case) no alternative method had been directed.

...

40 8. We have been referred to numerous cases on the application of these rules. ...

9. The main principles derived from these cases are not controversial. ... I extract ... the following points:

i) Input tax is directly attributable to a given output if it has a “direct and immediate link” with that output (referred to as “*the BLP test*”).

5 ii) That test has been formulated in different ways over the years, for example: whether the input is a “cost component” of the output; or whether the input is “essential” to the particular output. Such formulations are the same in substance as the “direct and immediate link” test.

10 iii) The application of the *BLP* test is a matter of objective analysis as to how particular inputs are used and is not dependent upon establishing what is the ultimate aim pursued by the taxable person. It requires more than mere commercial links between transactions, or a “but for” approach.

15 iv) The test is not one of identifying what is the transaction with which the input has the most direct and immediate link, but whether there is a sufficiently direct and immediate link with a taxable economic activity.

v) The test is one of mixed fact and law, and is therefore amenable to review in the higher courts, albeit the test is fact sensitive.

20 28. In *Mayflower*, the appellant was a charitable trust established to run a theatre. The trust did not produce its own performances, but bought in performances from production companies under separate production contracts. It was not in dispute that there was a direct and immediate link between the services supplied to the trust under any given production contract and the sale to the public of tickets admitting them to performances of that production, which was an exempt supply. The question was
25 whether there was also (as contended by the trust) a direct and immediate link between the services supplied under a given production contract and one or more taxable supplies made by the trust. In the proceedings before the Court of Appeal, the trust argued that the services provided to the trust under the production contracts had a direct and immediate link to the following taxable supplies: programme sales, a
30 percentage commission on the sale of the production company’s merchandise, and corporate entertainment.

29. In the proceedings below, the trust had argued that there was a direct and immediate link also with certain other categories of taxable supplies, but these other categories were not pursued in the proceedings before the Court of Appeal. However,
35 although the trust no longer relied on these other categories of taxable supplies, Carnwath LJ pointed out the consequences where the partial exemption rules apply, as follows:

40 19. ... As I understood the argument, it was not suggested that the other items in themselves would bring the case within the partial exemption rules. However, it is common ground that, if the Trust succeeds on any one of the items (or even a part of one item), the calculation under the “standard method” will be the same. It will then be entitled to bring into account all its taxable supplies (regardless of attribution) in calculating the tax deduction. Further, for periods before
45 April 2002, HMRC would have no power to direct an alternative method of apportionment.

20. The practical results may seem surprising at first sight. Although the figures were not referred to by the tribunal or the judge, we were shown a schedule giving the breakdown of taxable supplies for the relevant periods. The amounts under the different items vary substantially. The following figures, taking the approximate totals over the whole period from March 1999 to December 2002, give an indication of the relative scales of the items in Hart J's list. The total taxable supplies for that period amount to a little over £6m. The largest components by far are (ii) (confectionery and drinks – about £3m) and (vii) (supplies to production companies - £2.6m). Item (vi) (sponsorship - £23,000) is much smaller; complimentary tickets offered to sponsors, on which the Trust succeeded before the judge (see below), would have been only part of that figure. Item (i) (programme sales - £87,000) is also a relatively small part of the overall picture. However, it is common ground that success on even one of the smaller items is enough under the standard method to bring in all the taxable supplies. This may seem like the tail wagging the dog. But, as Mr Milne points out, this apparent anomaly should not cloud our interpretation of the law, since it arises from the peculiar circumstances of this case and the retrospective nature of the exercise. In a normal case, HMRC would be able for the future to direct a different method, under which the calculation of the tax deduction better reflects the realities of attribution.

30. Other cases on which the parties relied in the present proceedings provide practical examples of the application of the partial exemption rules. In some of these cases, as in *Mayflower* and in the present case, the appellant was arguing (and HMRC was disputing) that supplies made to the appellant had a direct and immediate link not just to non-taxable supplies made by the appellant, but also to taxable supplies, such that the partial exemption rules applied, and such that the appellant was able to deduct some of the VAT on certain supplies made to it as input tax. In others of these cases, HMRC was arguing (and the appellant was disputing) that supplies made to the appellant had a direct and immediate link not just to taxable supplies made by the appellant, but also to non-taxable supplies, such that the partial exemption rules applied, and such that the appellant was not entitled to deduct all of the VAT on supplies made to it as input tax.

31. In *BLP Group*, BLP sought to claim a deduction of the VAT paid by it on professional services rendered in respect of the sale of its shares, the sale of the shares being a tax exempt transaction. BLP argued that “[t]he sale of the shares represents an incidental financial transaction, which was part of B.L.P.’s overall strategy in the conduct of its core business and the making of its taxable supplies of goods or services” (*BLP* at [16]). The European Court of Justice held at [19] that “to give the right to deduct under [Article 17(2) of the Sixth VAT Directive], the goods or services in question must have a direct and immediate link with the taxable transactions, and that the ultimate aim pursued by the taxable person is irrelevant in this respect”, and at [24] that:

... if B.L.P.’s interpretation were accepted, the authorities, when confronted with supplies which, as in the present case, are not

objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question.

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32. In *Midland Bank*, the bank argued that legal fees incurred in a dispute concerning a proposed takeover by one of the bank's clients was attributable to its supply of taxable financial services to its client, so that VAT on the legal fees was deductible input tax. The European Court of Justice held that:

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29. It should be borne in mind that, according to the fundamental principle which underlies the VAT system, and which follows from art 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components (see, to this effect, *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greece* (Case C-62/93) [1995] STC 805 at 821, [1995] ECR I-1883 at 1913, para 16).

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30. It follows from that principle as well as from the rule enshrined in the judgment of *BLP Group plc v Customs and Excise Comrs* (Case C-4/94) [1995] STC 424 at 437, [1995] ECR I-983 at 1009, para 19 according to which, in order to give rise to the right to deduct, the goods or services acquired must have a direct and immediate link with the taxable transactions, that the right to deduct the VAT charged on such goods or services presupposes that the expenditure incurred in obtaining them was part of the cost components of the taxable transactions. Such expenditure must therefore be part of the costs of the output transactions which utilise the goods and services acquired. That is why those cost components must generally have arisen before the taxable person carried out the taxable transactions to which they relate.

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31. It follows that, contrary to what the *Midland* claims, there is in general no direct and immediate link in the sense intended in *BLP Group*, between an output transaction and services used by a taxable person as a consequence of and following completion of the said transaction. Although the expenditure incurred in order to obtain the aforementioned services is the consequence of the output transaction, the fact remains that it is not generally part of the cost components of the output transaction, which art 2 of the First Directive none the less requires. Such services do not therefore have any direct and immediate link with the output transaction. On the other hand, the costs of those services are part of the taxable person's general costs and are, as such, components of the price of an undertaking's products. Such services therefore do have a direct and immediate link with the taxable person's business as a whole, so that the right to deduct VAT falls within art 17(5) of the Sixth Directive and the VAT is, according to that provision, deductible only in part.

33. In *Abbey National*, the bank sought to deduct the VAT on professional fees on the sale of its rights to a lease. The sale of the rights to the lease was not a taxable supply. However, the bank charged VAT on the rent it received from the tenants under the lease. The bank argued that the fees incurred were directly and immediately linked with the taxable supplies. The European Court of Justice rejected this argument, holding that:

32. That argument cannot be accepted. First, it is clear from article 17(2) of the Sixth Directive that a taxable person may deduct only the VAT on the goods and services used for the purposes of his own taxable transactions. Secondly, in any event, the amount of VAT paid by the transferor on the costs incurred for the services acquired in order to carry out a transfer of a totality of assets or part thereof does not directly burden the various cost components of the transferee's taxable transactions, as required by article 2 of the First Directive. Those costs do not form part of the costs of the output transactions which use the goods and services acquired.

34. In *Southern Primary*, the taxable person purchased land with VAT added, then sold the land to a housing association and at the same time entered into a contract with the housing association to build houses on the land. The Court of Appeal held that the input tax paid on the purchase of the land was not recoverable. It held:

32. ... The land purchase transaction was commercially necessary to make its performance commercially possible, but it was not a cost component of the contract itself in the same way as the costs of materials used. There is a link with the contract but the link was not direct and immediate. The development contract would not have been made but for the associated land purchase and sale. But "but for" is not the test and does not equate to the "direct and immediate link" and "cost component" test.

33. One can look at it another way. There is nothing about the development contract as such which makes the land purchase and sale essential. If the housing association had already owned the land or had bought it from some third party, the inputs of the development contract would have been just the costs of carrying it out. The fact that there were commercially linked land transactions does not mean that those transactions are directly linked to the costs of the development contract. One would not say that the cost of buying the land was a cost of the development contract itself. It follows that the input tax on that cost is not a cost of the contract.

34. ... the principle of neutrality — namely that "all economic activities, whatever their purpose or results, are taxed in a wholly neutral way" ... would be violated if this development contract were taxed differently from an exactly similar "freestanding" contract.

35. Again if one applies the "fundamental principle" that "VAT applies to each transaction by way of production or distribution or deduction of the VAT directly borne by the various cost components" (Midland para 29) one is driven to ask whether the land purchase price is a cost component of the development contract — which to my mind it is

5 obviously not. And, if one adapts Midland para.30 to the case the test is whether the expenditure on the land purchase was part of the costs of the development contract which used the land acquired. It did not. The carrying out of the development was on the land acquired, but did not utilise the land, whose ownership was irrelevant. My common sense differs in this respect from Sir Donald Rattee's.

10 36. Midland para. 31 is also in point — there the Court said that lawyers' fees were not “generally part of the costs of the output transaction” and “therefore” did not have any direct and immediate link with the output transaction.” Again the Court is focussing on the objective, transaction-by-transaction nature of VAT law. The price of a land purchase is not “generally” part of the costs of a development contract and therefore does not have any direct and immediate link with it.

15 37. Turning back to the Tribunal, it concluded that there was a direct and immediate link between the land purchase and both the land sale and development contract, with both an exempt and a non-exempt transaction. VAT law does not work in such a generalised way. You have to look at transactions individually, component transaction by component transaction. They may be linked in the sense that one would not have happened without the other, but they remain distinct transactions nonetheless. Only if one transaction is merely ancillary to a main transaction can one disregard the distinct nature of each transaction (see *Card Protection Plan v CCE Case C-349/96* [1999] *STC* 270, para. 29). If that were not so, the principle of neutrality would be violated. Moreover there would be intractable problems as to which input was being attributed to which part of the “overall transaction”. You may find, as here, taxable and exempt transactions all mixed up in the same “overall” transaction — which is illegitimate.

30 35. In *Royal Agricultural College*, the question was whether the costs of marketing to students by a college had a direct and immediate link only to the exempt supply of education, or whether these costs also had a direct and immediate link to the taxable supplies that it made of providing conference facilities and selling goods in its shop and bar. The Tribunal found the former to be the case, stating that:

35 28. ... on the authority of BLP and Midland Bank , in applying the ‘used for’ test prescribed by article 17(2) of the Sixth Directive 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. 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

...

45 36. In *Dial-a-Phone*, the question was whether a mobile telephone retailer’s advertising and marketing costs were attributable solely to its taxable supplies of mobile telephones (so that all of the VAT paid on those costs was deductible), or whether those costs were attributable also to its exempt supplies of insurance

intermediary services (so that only a proportion of the VAT paid on such costs was deductible). The Court of Appeal found the latter to be the case, finding that:

5 28. ... on the authority of BLP and Midland Bank, in applying the
‘used for’ test prescribed by article 17(2) of the Sixth Directive 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. It is clear from the judgments of the ECJ
10 in BLP and Midland Bank, as I read them, that there is no material
difference between these alternative ways of expressing the basic test
...

15 36. ... Southern Primary is authority for the proposition that the mere
fact that ‘but for’ the input cost in question taxable supplies would not
have been made is not enough to establish the requisite ‘direct and
immediate link’ between the input cost and the taxable supplies ...

20 71. The word ‘*attributable*’ and ‘*attributed*’ in regulation 101 fall to be
interpreted by reference to article 2 of the First Directive and article 17
of the Sixth Directive, and in accordance with the principles enunciated
by the ECJ in BLP and Midland Bank. Those authorities establish that
the appropriate test of attributability in this context is the ‘direct and
immediate link’/‘cost component’ test referred to paragraph 28 above.
For convenience, I will refer to it hereafter as “the BLP test”.
Moreover, as the ECJ made clear in paragraph 25 of its judgment in
Midland Bank ..., it is for the national courts to apply the BLP test to
25 the fact of the case, “and to take account of all the circumstances
surrounding the transactions at issue”. That, therefore, was the task
facing the Tribunal in the instant case.

30 72. By its very nature the BLP test is fact-sensitive, in the sense that its
application inevitably requires a qualitative judgment to be made on
the basis of the facts (as found or admitted) relating to the transactions
in question. ...

35 74. ... it is important to bear in mind that ... a ‘direct and immediate
link’ may exist between the marketing and advertising costs and the
insurance intermediary services despite the fact that there may be an
even closer link between those costs and DaP’s taxable supplies. In
other words, the quest is not for the closest link, but for a *sufficient*
link.

40 75. It follows that it matters not that the insurance intermediary
services may be viewed as being in a commercial sense secondary to
the making of the taxable supplies, or even that they may be provided
only after a taxable supply has been made, *provided that a sufficient*
‘direct and immediate link’ exists between them and the marketing and
advertising costs.

45 37. In *Mayflower*, the Court of Appeal ultimately held that that there was a direct
and immediate link between the services supplied to the trust under a production
contract and the trust’s taxable supplies of theatre programme. Carnwath LJ said:

36. The Trust was responsible for production of the programmes, as the tribunal explained (para 21):

5 “The Appellant produced and sold programmes for each production. The programme would contain information about the show, cast members, the director, the writer and other information specific to the production. The programme was sold separately from the ticket. The price for the programme was fixed at £3 which did not vary between productions. The principal drivers of the programme price were preparation costs together with an assessment of what the purchaser would pay. The Appellant did experiment with a price of £3.50 but encountered considerable consumer resistance to the increased charge. The sale of programmes was zero-rated for VAT purposes.”

15 In the Miss Saigon contract there is specific provision for programmes:

“The (Trust) retains the right to produce the Theatre programmes and reserves the right for it or its agent to obtain four weeks in advance from the Touring Manager, adequate logos, photographs, casting information etc.” (cl 16.1)

20 37. The Trust's argument on this item is simple:

“The programme itself uses the production: it contains photographs of the production, it contains photographs and details of the actors, it describes the play or work (often giving a synopsis of the work – particularly opera), and gives details of the playwright or composer. The production of the programme is dependent upon, and actually *uses* the production. There is plainly a direct and immediate link.”

...

42. ...

30 i) The lack of a direct relationship between the price of the output supply and the consideration paid for the input is not determinative. I would adopt Hart J's comment, based on *Dial-a-Phone*:

35 “..., in finding that... the *BLP* test was satisfied in that case, no reliance was placed either by the Tribunal or the higher courts on any finding that the price charged for the insurance intermediary services had been calculated by reference to the cost of the advertising and marketing inputs. These were nonetheless found to have been “used for” supplying those services. A sufficient nexus existed without it being necessary to show that those inputs were a “cost component” of the price charged for the relevant outputs in the very narrow sense adopted by the Tribunal in the present case.” (para 44)

40 ii) The company's accounts may be of some relevance, but they are unlikely to be conclusive. Their purpose is to give a fair view of the business, not of the relationships between particular inputs and outputs for VAT purposes.

5 iii) That the patron has a choice whether to buy is true of any retail sale, but seems to me irrelevant to the question of attribution. That might have been relevant to an argument (which has not been advanced) that there was one composite supply of the ticket and the programme, but not to the nature of the link within any particular supplies.

10 iv) The tribunal seems to have misunderstood the “breaking the chain” rule. That would only come into play if the two transactions were links in the same chain, in the sense that one was “a cost component” of the other (see point (viii) in para 11 above). However, the ticket sales and the programme sales are not linked in that way; they are separate transactions. The mere fact that one precedes the other in time, as Miss Hall accepts, is not enough. The question is, not whether they are links in the same chain, but whether each of them has a sufficiently direct link with the production supplies to satisfy the *BLP* test. The misapplication of the “breaking the chain” rule was another error of law, which entitles us to re-open the tribunal's conclusion.

20 43. On this point I accept the Trust's submissions. Applying the *Beynon* approach (see para 10 above), I think we are entitled to draw our own inference from the primary facts which are not in dispute. I would in any event be prepared to go further, if necessary, and say that, applying the *BLP* test correctly, the only reasonable view is that there was a direct and immediate link between the production services and the programmes. It is true that the production companies were not directly responsible for the programmes, other than the provision of information. But the productions for which they were responsible, and which provided the subject-matter of the contracts, also provided the subject-matter of the programmes. To that extent, they were as much part of the raw material used in preparing the programmes, as the paper and ink from which they were physically made. That in my view is an objective link, sufficiently close to satisfy the test.

35 38. On the other hand, the Court of Appeal did not consider that it had been established that there was a direct and immediate link between the services supplied to the trust under a production contract and the trust's taxable supplies of sales of the production company's merchandise or corporate sponsorship. In relation to the former, Carnwath LJ said:

40 49. ... precise nature of the link remains unclear. I infer that the “show-specific” merchandise is part of the production company's general stock, rather than (like the programmes) being produced for the particular production which is the subject-matter of the contract. If that is correct, the tribunal would have been entitled in my view to conclude that the link was not sufficiently direct.

In relation to the latter, Carnwath LJ said:

45 52. In my view, the tribunal was entitled to attach importance to the lack of a direct connection between the sponsorship and a particular production, or group of productions. That indicates a link with the

5 activities of the theatre as a whole, rather than with the subject-matter of the production contracts. Thus, for example, curtain sponsorship is no doubt directed at theatre-goers, including those attracted by individual productions. But the tribunal would be entitled to regard that link as insufficiently “direct and immediate” to satisfy the test. ...

10 39. In *Garsington Opera*, the question was whether the costs of the production of operas had a direct and immediate link only to the exempt supply of tickets to performances, or whether these costs also had a direct and immediate link to the taxable supplies of programmes and libretti, compact discs of productions, advertising space within the programmes, hire of costumes and equipment to other theatrical companies, and licencing to other opera companies of the “concept” of operas. The Tribunal found for the opera in relation to all points in dispute. For instance, in relation to the programmes, the Tribunal at [45] said that the “production provides the essential editorial ingredients for the programme”, and recalled what was said by Carnwath LJ in *Mayflower* at [43]. In relation to the compact discs, HMRC accepted that the direct costs of recording were allowable inputs, but argued that inputs relating to the opera production (such as purchase of costumes, sets and props) were not. The Tribunal rejected this argument, stating at [54] that:

20 The production and presentation of the particular opera is in a real sense a source of the CD. Without its appearance as an operatic event during the season there would have been no CD. There had to be rehearsals and a live presentation to make the recording possible. It was only made possible by the prominence it had given to an otherwise unknown opera that underwriters could be recruited and a market for the sales of the eventual CDs could be developed. We think therefore that there was a direct and immediate link between the two productions and the recordings made of them. The relevant input tax is therefore allowable.

The evidence

30 40. In addition to the documentary evidence, oral evidence was given by Ms Amelia Foster, who has been the director of the Museum since January 2006. Her witness statement stated amongst other matters as follows.

35 41. Moving the contents of the writing hut into the Solo gallery was an expensive process. A considerable amount of conservation work on the contents was required before the hut interior could be reinstalled within the replica shell. In order to accommodate the hut interior, a complete redesign of the Solo gallery was necessary.

40 42. In the financial year ended 2012, the Museum’s income from admissions and its income from the shop were almost equal (see paragraph 17 above). The shop is therefore essential to the funding of the Museum, and the Museum budgets with an expected shop spend per visitor. The stock sold in the shop is designed to complement the displays and it is very much part of the visitor experience.

43. The items sold in the shop fall into five categories.

44. First, there are products that interpret and reproduce the displays. The shop sells products that illustrate and interpret the displays and exploit the various rights and permissions that the Museum holds. The new display has given the Museum new opportunities as the Museum has the right to exploit the design of the galleries for commercial purposes, subject to the terms of its contract with the designers of the gallery. Examples of this exploitation include postcards of the displays, and postcard versions of the lenticulars. There is also a book entitled *Inside Roald Dahl's Writing Hut* (referred to below as the "**Hut Book**"), which was written as part of the gallery refurbishment, and which contains depictions and explanations of over 150 items in the hut exhibit. Since opening the new gallery these new products, which are taxable supplies for VAT purposes, have proved popular with visitors and the Museum continues to investigate new products to be added to this category. The expenses incurred on the new displays were cost components of these new products. In particular, the decision to create a book to interpret the contents of the writing hut (as opposed to a touch-screen or labelling approach, for example) was both a commercial and a curatorial one. It was decided from early on that choosing this method of interpretation would allow the Museum to sell the book and so the design of the Hut Book, funded from the gallery budget, was informed by what would make it a commercial as well as a curatorial success. Thus, the cost of writing, designing and producing the initial print run of the Hut Book were part of the overall gallery design costs.

45. Secondly, there are books and materials by Roald Dahl or based on his works or illustrations referred to in the displays. The link between shop sales and the exhibition are clear. *Boy* and *Going Solo* are the best selling books in the shop, but are not amongst Roald Dahl's best sellers within the UK or internationally. Sales of *Revolting Rhymes* and *Dirty Beasts* (which are used in storytelling in the Museum) are also far higher than would be expected based on UK sales.

46. Thirdly, there are books and materials not by or directly connected to Roald Dahl but which are referred to in displays in the Museum (such as US yellow legal paper and yellow Dixon Ticonderoga pencils, on which and with which he always wrote).

47. Fourthly, there are gifts and toys that reflect Roald Dahl's life and interests in some way (such as joke toys reflecting the fact that he was a keen practical joker, and seed pods reflecting the fact that he was a keen gardener).

48. Fifthly, there are books by other authors, including those by visiting authors and illustrators.

49. There are a number of business models for museums. Some charge a higher admission fee and accept a lower visitor retail spend. Others have free admission and generate income from other sales. The Museum is required to strike a balance between the two in order to maximise income. If the admission charge was too high, visitor numbers would fall, and so would shop income. If admission was free, the increased shop sales would not compensate for the lost admission income. The VAT-bearing costs of maintaining and altering displays are used not only to generate

admission income but also to generate sales within the shop. They would be incurred regardless of the museum business model adopted. Even if the admission fee was abolished and the Museum relied on shop sales alone, this VAT would be incurred.

5 50. When the Solo gallery was redeveloped, the Museum considered that this would generate an increase in visitor admission and shop sale income. So far the evidence is that this was a correct assumption.

51. At the hearing, Ms Foster adopted her witness statement, and said in examination in chief amongst other matters as follows.

10 52. The cost of redevelopment of the Solo gallery included not only moving the contents of the writing hut into the gallery, but also reinterpreting and redesigning the whole gallery around the writing hut and creating new exhibits for that purpose. The idea was to attract new visitors and to get them to spend more in the shop. Decisions made in the redesign of the gallery were based on what would sell well as well as on correctly interpreting the exhibits. The design of the gallery was intended to
15 demonstrate the links between Roald Dahl's memoirs and his other books.

53. To undertake this redevelopment, the Museum entered into a contract with a consultant, Outside Studios Ltd, which provided services in two stages: "concept development services to confirm the narrative and design approach for the Solo Gallery", followed by "interpretation development and delivery services". The
20 "interpretation services" were to make the exhibits accessible to visitors, and included the design of the Hut Book. The gallery was completely changed and everything was new, apart from a couple of display cases. The contract with the consultant originally provided for a budget of £200,000 for the project, but it was later realised that this was not sufficient and the cost was ultimately £501,336.

25 54. The payment to Outside Studios included the construction of the replica Gloster Gladiator aircraft. This was designed to be safe for children to climb. When the Hut Book was produced, it was intended to be used as an interpretive tool but also to produce income by being sold in the shop. When coming up with ideas for the design
30 of the new gallery, everything was considered on the basis of not only what would look good in the gallery but what would sell well. Postcards sold in the shop are direct reproductions of the lenticulars on the gallery wall. Some planned items for sale in the shop have not yet been proceeded with, such as cloth bags and height charts, but these may be brought out in the future. For companies hiring rooms at the Museum for corporate events, admission to the Museum is a key attraction and part of
35 the corporate away day.

55. In cross-examination, Ms Foster said amongst other matters as follows.

56. It is possible to go into the shop without going into the Museum, and some people do, but this is true of all museums. The shop is consistent with the Museum's mission statement, which states that the Museum is to be economically viable. The
40 Museum could not fulfil its charitable objectives if it did not exist, and the shop is necessary to stay afloat.

57. There are different ways to interpret objects in a museum. The Museum looked at different options and came up with the idea of the Hut Book. There are tethered copies of the Hut Book in the gallery, and it is also a source of income. At the time that the original contract was entered into with Outside Studios, it was not known that there would be a Hut Book as the process of interpreting had not yet begun, but it was known that the Museum wanted to sell items that would be created from the gallery.

58. Ms Foster was unable to say whether the Hut Book would be of sufficient interest to Roald Dahl fans to sell well on the Museum's website.

59. In relation to the claimed exhibit costs for 2007-08 to 2010-11, Ms Foster could not remember what these were for, but considered that these would have been for replacing elements of the galleries, for instance, in cases where an exhibit breaks.

60. In re-examination, Ms Foster said amongst other matters as follows. It is not possible to say how many people go into the shop without visiting the Museum, but the number would be very small. The Museum has always intended to have a rolling programme of refurbishment.

The Appellant's submissions

61. On behalf of the Appellant, the following submissions were made.

62. As was made clear by the Court of Appeal in *Mayflower*, it is important to consider the different types of taxable supplies made by the Appellant and address the particular characteristics of each supply. As in *Mayflower*, all that the Museum needs to do to succeed is to show that there is a sufficiently direct and immediate link between the taxable inputs and at least one particular type of taxable supply, as that will be enough to defeat the Respondents' claim that the inputs are directly and immediately linked only with exempt supplies of admission.

63. As to the products that interpret and reproduce the displays (see paragraph 44 above), these are analogous to the programme sales in *Mayflower*. The Hut Book and certain postcards sold in the shop have as their very subject matter the writing hut display. In *Mayflower*, the Court of Appeal found that there was a direct and immediate connection between theatre productions bought in by a theatre trust and taxable supplies of programmes sold to theatre customers. The reason why the Court of Appeal found there to be a direct and immediate link is not the reason suggested in HMRC Revenue and Customs Brief 65/09 issued on 14 October 2009. The Court of Appeal's reasoning in *Mayflower* at [43] was that the theatre productions for which the production companies were responsible provided the subject-matter of the programmes, and to that extent the theatre productions "were as much part of the raw material used in preparing the programmes, as the paper and ink from which they were physically made". In the present case, the museum exhibits provide the subject matter of the Hut Book and the postcards of the exhibits. The evidence of Ms Foster is that the expenses incurred on the new display were cost components of the Hut Book and the postcards, and that the decision to create the Hut Book was both a commercial and a curatorial one.

64. The present case is distinguishable from *Royal Agricultural College*, in that the expenditure on refurbishing the galleries in the present case was incurred not only to attract members of the public to pay an admission charge to enter the Museum, but also to attract members of the public to buy items in the shop. The evidence suggests that this expectation was borne out: after the redesigned gallery was opened, there was an increase in the number of visitors and in the amount spent in the shop.

65. It would be possible to operate the Museum without charging an admission fee if the shop could provide a sufficient income, and in that event, all of the VAT incurred on the exhibit costs would be attributable to taxable supplies in the shop. If the Museum then decided to charge a small admission fee, it would be absurd to claim that all of the VAT incurred would suddenly be attributable exclusively to exempt admission income. The costs would still be attributable in part to the taxable shop sales.

66. The Museum does not need to show that the prices charged for the items in the shop are calculated by reference to the exhibit costs, and it does not matter that visitors have a choice whether or not to purchase items in the shop. In *Mayflower*, not all customers purchased theatre programmes, and in *Dial-A-Phone Ltd* not all customers took up insurance. As in *Garsington Opera*, the relevant goods and services on which the Museum has paid VAT were essential ingredients in each onward supply, both taxable and exempt, and were cost components of each supply.

67. The exhibit costs fall to be treated as residual even under HMRC's own policy, since Revenue and Customs Brief 65/09 states that "Production costs only become partly deductible (residual) if there is a firm intention to make taxable as well as exempt supplies when the costs are incurred". The evidence in the present case is that at the time that the exhibit costs were incurred, there was a firm intention to make taxable supplies of items in the shop as well as exempt supplies of admission.

68. As to the books and materials by Roald Dahl or based on his works or illustrations referred to in the displays (see paragraph 45 above), the items that have direct links to the displays in the Museum represent a higher percentage of the sales than in the UK generally. In particular, the two galleries of the Museum are named after and illustrate the contents of the two volumes of Roald Dahl's memoirs, *Boy* and *Going Solo*. These two books represent 8.41% of sales of Roald Dahl's works in the Museum shop but only 3.03% of UK trade sales. Similarly, the poetry books *Revolting Rhymes* and *Dirty Beasts*, which are used in storytelling in the Story Centre in the Museum, represent 14.95% of sales of Roald Dahl's works in the Museum shop but only 3.32% of UK trade sales. The difference in sales proportions makes it clear that the Museum's exhibition display is important in generating sales of these works. Significantly closer links exist between the exhibit costs and the sales of these books in the Museum than existed in *Mayflower* between the theatre production costs and sales of beer during the performance interval. In *Mayflower*, the beer did not form the subject matter of the theatre production, and the theatre production would not promote sales of the beer.

69. As to the books and materials not by or directly connected to Roald Dahl but which are referred to in displays in the Museum (see paragraph 46 above), the Museum exhibits plainly act as an incentive to visitors to purchase the items, for example in order to practice their creative writing skills using the same raw material that Roald Dahl used.

70. As to the gifts and toys that reflect Roald Dahl's life and interests in some way (see paragraph 47 above), it is from the Museum exhibits that visitors will learn facts about Roald Dahl's life, and they will then be incentivised to purchase items reflecting Roald Dahl's life from the shop. Therefore a sufficiently direct link exists between the exhibit costs and the sale of such items.

71. As to the books by other authors (see paragraph 48 above), the exhibits encourage children to read and to develop a love of reading, and the Museum shop accordingly sells books by visiting authors and illustrators and sells books on the reading list of the eponymous heroine of Roald Dahl's novel *Matilda*. There is therefore a sufficiently direct and immediate link between the exhibits and the sale of books by authors other than Roald Dahl.

72. As to the Museum's hire of rooms for corporate meetings (see paragraphs 18 and 54 above), companies choose the Museum as a venue for such meetings because it is an inspirational venue, and museum entry is included in the per capita price for the hire of a room. There can therefore be no doubt that the exhibit costs are sufficiently directly and immediately linked with and a cost component of the taxable hire of such rooms.

The HMRC submissions

73. As to the products that interpret and reproduce the displays (see paragraph 44 above), the HMRC submissions were as follows.

74. In the context of this case, the relevant input tax is the VAT that the Appellant has incurred in relation to its exhibits, the only particular of which that has been provided is the cost of creating and refurbishing the hut exhibit of £501,336 including VAT. The Museum accepts as it must that this input tax is attributable to the exempt supply of admissions to the museum. The question is whether it is also attributable to various of its taxable supplies so that it is residual input tax.

75. It is not enough to meet the *BLP* test that the ultimate aim or use in a general sense of the goods or services on which input tax has been paid is for a taxable person's taxable transactions. It is likely that all of a person's input tax is incurred in order to facilitate its taxable transactions to some degree. What is required is something more than this mere commercial and subjective link between inputs and outputs for the direct and immediate link required to be established. According to *Midland Bank*, *Southern Primary* and *Dial-a-Phone*, the link must be between a particular input and a particular output, and a generalised link will be insufficient. In *Midland Bank*, the solicitors' fees were incurred as a consequence of the supply of financial services, but they could not objectively have been said to be inputs directly

and immediately linked to the supply of financial services, and they were not cost components of the supply of financial services. In *Southern Primary*, it was held that the relationship must be direct and immediate in the sense that it can rightly be said of the input that it is a cost component of the output in an objective sense. It is not sufficient to establish merely that “but for the input, the output would not have occurred”. In *Dial-a-Phone*, it was held that the cost component test was the correct test, this being the same as the direct and immediate link test. In *Mayflower*, the Tribunal rejected the appellant’s claim that the cost of purchasing a production was used in the supply by the appellant of its own merchandise, confectionary and drinks, and these items were not pursued by the appellant in the proceedings before the Court of Appeal. The Court of Appeal held that there was no link as regards “show specific” merchandise, notwithstanding the appellant’s claim that this merchandise was only marketable because the purchasers were going to or had seen the show. The Court of Appeal found that there *was* a direct and immediate link between the production costs and the programme sales of the particular show bought, but this was because the expense of buying the production included the provision of programme information, and the production company was under a contractual duty to provide this information. That information was therefore a cost component of the programme supply. Thus, the theatre trust was buying the information that went into the programmes. The rejection of the claim in respect of the “show specific” merchandise indicates that it was insufficient that the programmes were “show specific”.

76. In the present case, the Museum’s exhibition costs were not directly and immediately linked to merchandise featuring the hut display, such as postcards and publications.

77. It is insufficient that the exhibits provide the subject matter of these items in the shop. The Museum wrongly focuses on the use to which the exhibit was put rather than the use to which the costs of building the exhibits was put. Unlike in *Mayflower*, the Hut Book and postcards, while they may show photographs of the hut display, do not show photographs of the relevant input, which was the service of moving the writing hut contents into the Museum and the redesign of the gallery. Thus any link is indirect. Cost components of the Hut Book and postcards were the paper, ink and information, whether written or photographic, but not the cost of arranging the exhibit itself. If it were correct (as the Museum claims) that the costs of writing, designing and producing the initial print run of the Hut Book were part of the overall gallery design costs, then the inputs relating to the taxable supply of the book would also be residual, and the input tax incurred in producing the Hut Book and postcards would be residual and only partially deductible. This would place the Museum in a worse position. The Museum’s subjective intention that the redesign of the Solo gallery would not only attract admissions to the Museum but also customers to the shop is insufficient, as *BLP* and *Southern Primary* indicate. The Museum incorrectly argues that if it charged nothing for admission to the Museum, the exhibition costs would be attributable wholly to taxable supplies in the shop. In that scenario, the input tax would fall to be treated under section 24(5) VATA.

78. As to the books and materials by Roald Dahl or based on his works or illustrations referred to in the displays (see paragraph 45 above), books and materials not by or directly connected to Roald Dahl but which are referred to in displays in the Museum (see paragraph 46 above), gifts and toys that reflect Roald Dahl's life and interests in some way (see paragraph 47 above), and books by other authors (see paragraph 48 above), the Museum relies on a test rejected in the case law, namely a claim that "but for" the exhibits, shop customers would not purchase items in the shop, or would not purchase items in the shop in the same numbers. This "but for" test has been consistently rejected in the case law. The fact that the existence of Museum customers made sales of items in the shop a viable commercial prospect was not alone sufficient to meet the direct and immediate link test. The items in the shop could have been sold in any shop, and would not properly be said to have different cost components if sold in any other shop.

79. As to the Museum's hire of rooms for corporate meetings (see paragraphs 18 and 54 above), there is no reference to this item in the Museum's grounds of appeal, and HMRC therefore objects to the Museum's reliance on this item. In any event, the claim made in relation to room hire is an attempt to resurrect the "taxable tickets" argument that was rejected in *Mayflower*. In *Mayflower*, theatre tickets were sold not only individually as exempt supplies, but also sold as part of a package together with other kinds of (taxable) supplies such as corporate sponsorship. The appellant in that case argued that the latter tickets were "taxable tickets", and were as directly and immediately linked to the production costs as the exempt tickets. The Court of Appeal found that the supply of tickets stood or fell with the arrangement of which it formed part (that is, sponsorship), and that as there was no direct and immediate link between the production costs and sponsorship, there was no direct and immediate link between the production costs and the "taxable tickets". In the present case, unless the Appellant shows a direct and immediate link between the exhibit costs and the hire of rooms, it cannot succeed on a "taxable ticket" argument.

The Tribunal's findings

General

80. It is common ground between the parties that there is a direct and immediate link for purposes of the *BLP* test between the exhibit costs and the exempt supply of Museum admissions. The issue in dispute is whether there is also a direct and immediate link between the exhibit costs and one or more taxable supplies made by the Museum.

81. It was also common ground between the parties that the whole of the VAT paid by the Museum on exhibit costs will be residual input tax if there is a direct and immediate link between those exhibit costs and at least one taxable supply. This means that all of the VAT paid on all of those exhibit costs will be residual input tax even if there is only a single item sold in the Museum shop with a direct and immediate link to the exhibit costs, no matter how small sales of that item may be as a percentage of all taxable supplies made by the Museum. As Carnwath LJ said in *Mayflower* at [20], this "may seem surprising at first sight", but this is nonetheless the

effect of the applicable legislation in circumstances where HMRC has not directed a different method. HMRC has not done so in the present case. As Carnwath LJ stated, “this apparent anomaly should not cloud our interpretation of the law”.

5 82. It is furthermore common ground between the parties that for purposes of the *BLP* test, the “direct and immediate link” test is the same thing as the “cost component” test. Use of either of these expressions below is to be understood as a reference to that single concept.

The items referred to in paragraphs 45, 46, 47 and 48 above

10 83. The Tribunal finds that all of these items could be sold in any shop anywhere, regardless of whether or not the Museum exhibits existed. Indeed, it seems not to be disputed that all of these items *are* sold in other shops totally unconnected with the Museum, either in the UK or in other countries.

15 84. The exhibit costs were not a cost component of the production of these items. The only way in which the exhibit costs are said to be a cost component of the supply of these items is that the exhibits are said to attract visitors to the Museum and to stimulate their interest in the items on sale in the shop, leading to greater sales of those items than would be the case if the exhibits did not exist.

20 85. The Tribunal does not consider this argument to be relevantly different to the argument that was rejected in *Royal Agricultural College* in relation to goods sold in the college shop and bar, and in *Mayflower* in relation to the “show specific” merchandise (see paragraph 38 above). The Appellant’s argument in relation to these items is also similar to the argument that was rejected in *Southern Primary* (see paragraph 34 above). In relation to these items, the purchase of stock by the Museum shop, and the sale of items from such stock to customers, is an event that is
25 “freestanding” from the admission of visitors to the Museum. This is apparent, apart from anything else, from the fact that a member of the public could go into the Museum shop and purchase such items there without paying for admission to or entering the Museum exhibits. The Tribunal considers that it is immaterial that it would be rare that someone would make purchases at the Museum shop without
30 visiting the Museum exhibits, or that sales of these items in the Museum would be lower or non-existent if the Museum exhibits were not there, or that the proportions of various items sold are different to the UK national averages and instead are consistent with the focus of the Museum exhibits.

35 86. Suppose, for instance, that the Museum had no shop at all. Suppose, however, that an independent retailer, having no connection with the Museum whatsoever, set up a shop next door to the Museum, selling exactly the same items. It may be that the vast majority of that shop’s customers would be people who had come to Great Missenden in order to visit the Museum. It may be that the shop’s sales would be lower or non-existent if there was no Museum next door. It may also be that the
40 proportions of various items sold in the shop would be different to the UK national averages and instead reflect the focus of the Museum exhibits. However, all of this

would not mean that the Museum's costs of creating and maintaining its exhibits would be a cost component of the items sold by that unrelated trader.

5 87. Another obvious example might be a trader who sells the works of William Shakespeare and works of other writers with some connection to William Shakespeare. The trader might for good reason decide to set up shop next door to a theatre that regularly stages performances of plays by Shakespeare. Without the trader having any connection with the theatre at all, it could be expected that the volume of the trader's sales would be greater than if there was no such theatre next door, and that the relative numbers of copies sold of different works might be
10 influenced by which particular plays are being staged next door, and therefore might differ from UK national averages.

15 88. The Tribunal does not consider that a different conclusion is justified by the mere fact that in this case the shop is owned by the same entity that owns the Museum exhibits. As the Court of Appeal said in *Southern Primary* at [34], the principle of neutrality would be violated if sales in the Museum shop were treated differently to sales of exactly the same items by unrelated "freestanding" vendors.

20 89. For this reason also, the Tribunal does not accept the Appellant's argument (see paragraph 65 above) that all of the exhibit costs would be attributable to taxable supplies in the shop if the Museum decided to charge no admission fee. The Tribunal considers that sales in the shop and admissions to the Museum are separate and "freestanding" supplies. If a person makes two separate supplies, one at a profit and one at a loss, and uses the profits from the former to finance the loss on the latter, that does not mean that the costs of supplying the former are a cost component of the supply of the latter. It is simply a case of profits from one activity being spent for the
25 purpose of subsidising or financing a separate activity.

30 90. Similarly, the Tribunal considers that the *BLP* test would not be satisfied merely because one activity is being run at a loss but for the purpose of generating customers for a separate activity that is profitable. The tax treatment does not depend on the ultimate aim or intention of the trader, and the existence of mere commercial links between activities does not mean that the costs of supplying one is a cost component of the other (*Mayflower* at 9(iii); *BLP Group* at [24]). The Tribunal therefore does not accept the Appellant's argument referred to in paragraph 64 above in relation to these items.

35 91. For these reasons, the Tribunal finds the HMRC argument referred to at paragraph 78 above to be correct in relation to these items.

The Museum's hire of rooms for corporate meetings

40 92. The Tribunal cannot accept the Museum's argument referred to at paragraph 72 above. In *Southern Primary* at [37], the Court of Appeal recalled the principle in Case C-349/96, *Card Protection Plan v Customs and Excise Commissioners* [1999] 2 AC 601 at [30]: "There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more

elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied”.

5 93. The *Card Protection Plan* principle was also referred to in *Mayflower* at [55]-[56].

94. In the present case, when the Museum hires out rooms for corporate events, it is clearly the use of the room for the corporate event that is the principal service. Corporate clients are not motivated to use this venue because they want their
10 employees to visit a museum. They use this venue because they wanted a venue for a corporate event. Ms Foster’s witness statement states that “We find that companies that hire our rooms are not only interested in our reasonable rates but are very much looking for an inspirational venue for their meetings and therefore that unlimited access to our galleries is a key factor in them choosing us”. However, the corporate
15 events in question could still be conducted successfully without any of the participants visiting the Museum exhibits. The ability of event participants to visit the exhibits free of charge might make the venue a desirable one for corporate events. However, that could also be said, for instance, of a corporate event venue located next to a museum that did not charge for admission, where the trader providing the corporate
20 event venue has no connection at all to the museum. Indeed, the same could be said of any corporate event venue that is located in an historic, picturesque or otherwise interesting locality.

95. From the evidence, it is clear to the Tribunal that for corporate clients, admission to the Museum is not an aim in itself, but rather, a means of better enjoying
25 the principal service supplied. Thus, as Carnwath LJ found in *Mayflower* at [56], the complimentary admission to the Museum for participants of corporate events stands or falls with the arrangement of which it forms part.

The items referred to in paragraph 44 above

96. In Ms Foster’s witness statement, there are identified four types of items sold in
30 the shop that fall within this category, namely (1) lenticular postcards, (2) postcards of the Museum displays; (3) the Hut Book, and (4) cloth bags.

97. In her oral evidence, Ms Foster clarified that the Museum had in fact not so far produced or sold any cloth bags, although the possibility of doing so was contemplated for the future. The Tribunal therefore does not give further
35 consideration to this item.

98. As to the lenticular postcards, the evidence was as follows. New displays that were added to the Solo gallery as part of the refurbishment included “lenticular” pictures displayed in the gallery. A viewer looking at one of the lenticulars sees one of two different images, depending on the angle from which the lenticular is viewed.
40 The images seen on the lenticulars include photographs of Roald Dahl, illustrations by Quentin Blake, and a postage stamp from the period in question. Each lenticular

postcard sold in the shop displays the same two images as one of the lenticulars displayed in the gallery.

5 99. Outside Studios did not own the images displayed in the lenticulars. It seems that the Museum owns the Roald Dahl photographs, and it seems that permissions were obtained to use the postage stamp and the Quentin Blake illustrations. The Museum's case is that the lenticulars were the design or idea of Outside Studios, and that the fee paid to Outside Studios was thus a cost component of the lenticular postcards.

10 100. This contention is said to be supported by the terms of the Museum's contract with Outside Studios. The contract describes the services to be provided by Outside Studios as "concept development services to confirm the narrative design approach for the Solo Gallery". Clause 3.1 of the terms and conditions of the contract provided that "any design right" would remain vested in Outside Studios, but that the Museum
15 "shall have an irrevocable royalty-free licence to copy and use the Documents and to reproduce the designs and contents of them for any purpose related to the Project". The Museum's case is that this last clause envisaged that the Museum would use designs from the gallery refurbishment to produce items for sale in the Museum shop, and that this was always the Museum's intention. The Museum relies on *Mayflower*, in which it was held that the production costs for theatre productions were cost
20 components of theatre programmes sold at performances, and in which it was found that the former were "as much part of the raw material used in preparing the programmes, as the paper and ink from which they were physically made".

25 101. The Tribunal is not persuaded that the theatre programmes in *Mayflower* are a valid analogy to the present case. In *Mayflower*, the theatre productions bought by the appellant formed the very content of the programmes: "The programme would contain information about the show, cast members, the director ..." and "it contains photographs of the production, it contains photographs and details of the actors" (*Mayflower* at [36] and [37]). In contrast, in the present case, the lenticular postcards are not photographs of the lenticular pictures displayed in the gallery. Rather, they
30 simply use the same images as are used in the lenticulars in the gallery (which Outside Studios did not own), and present them in a lenticular way similar to the lenticulars displayed in the gallery. In other words, the lenticular postcards use the same ideas as were used for the lenticulars displayed in the gallery, but the latter do not form the very subject matter of the former.

35 102. The Tribunal is also not persuaded on the evidence that it was part of the services of Outside Studios to develop the concept of the lenticular postcards. The contract stated that Outside Studios was contracted to provide "the narrative design approach *for the Solo Gallery*" (emphasis added). The Tribunal finds that the Museum took an idea from Outside Studios' work on the redesign of the Solo Gallery, and used this idea to produce the lenticular postcards. It may be that the contract
40 permitted the Museum to do this, and that the Museum from the beginning intended to do something of this nature. However, the Tribunal is not persuaded that this is sufficient to make the fees paid to Outside Studios a cost component of the lenticular postcards. The Tribunal finds that in principle, costs incurred in making one supply

are not cost components of a second supply, merely because the second supply uses ideas that have been generated by or arisen in the course of making the first supply.

103. The Tribunal turns then to the postcards of Museum displays. The evidence included four such postcards. Three, entitled “A curious collection”, “Roald Dahl’s writing hut” and “Cross your finger for luck” are simply photographs of exhibits in the Solo Gallery. Most or all of these exhibits were in Roald Dahl’s writing hut, and were only brought into the Museum as a result of the services of Outside Studios. However, Outside Studios did not create the objects. They all existed and could have been photographed before Outside Studios undertook its work. Indeed, on the evidence, the contents of the writing hut when brought into the Museum were arranged identically to how they were when in the original writing hut. Any photograph taken of the items before they were moved into the Museum would have been virtually indistinguishable from the photographs that appear on these postcards.

104. There was some suggestion that it might not have been practically feasible to photograph these objects while they were still in the original writing hut. The Tribunal is not persuaded on the evidence that this is the case. However, even if it were the case, the Tribunal does not accept that the costs of the services of Outside Studios were a cost component of these postcards. On the evidence, the items were not moved into the Museum in order that they could be photographed for use in postcards. They were moved in order to create a display within the Museum. As has been noted, the contract with Outside Studios was for “the narrative design approach *for the Solo Gallery*” (emphasis added). Once the refurbishment of the new gallery was completed, the Museum was able to take photographs of objects within it. However, that does not mean that the refurbishment of the gallery was a cost component of taking the photograph.

105. The logical consequence of the Museum’s argument would be as follows. In any case where a postcard is produced containing a photograph of an exhibit in a museum, the cost components of that postcard would include the museum’s expenses in acquiring that exhibit, transporting it to the museum, fitting out the gallery in which it is displayed, and possibly even the cost of constructing the museum building in which the gallery is located. The Tribunal cannot accept that argument, which goes well beyond anything decided in *Mayflower*. In *Mayflower*, the contract with the production company contained an express provision relating to programmes, and required the production company to provide relevant information for inclusion in the programmes (at [36]). The performance provided by the production company was the very content of the programme. But for the provision by the production company of what it was contracted to provide, there simply would have been nothing that could have been depicted in the programmes. In the present case, the contract with Outside Studios said nothing about postcards, and Outside Studios did not create or provide the objects that were the subject matter of the photographs. The Tribunal finds that in principle, costs incurred in making one supply are not cost components of a second supply, merely because the practical effect of making the first supply is that it becomes feasible, or easier, to make the second supply.

106. A fourth postcard, entitled “Shot down over Libya?”, contains a photograph of the replica Gloster Gladiator aircraft. The evidence is that this object *was* constructed as part of the contract with Outside Studios. In the case of this postcard, at least, it *can* be said that but for the provision by Outside Studios of what it was contracted to provide, there would have been no replica aircraft to be photographed for the postcard. Nevertheless, the Tribunal still considers that it would go well beyond anything decided in *Mayflower* to suggest that this means that the construction of the replica aircraft was a cost component of the postcard. The decision in *Mayflower* concerned theatre programmes, which by definition are intended for patrons of live events and have as their subject matter the live event in question. Without the live event, not only would there be no content for a programme, but there would simply be no *purpose* in providing a programme. The production company in *Mayflower* was required by the contract to provide both the live performance and information for the programme relating to that live event. In the circumstances, it is understandable that the services provided by the production company would be considered cost components of both tickets for admission to performances as well as well as of the programmes.

107. The present case is different. The replica aircraft is a permanent display. It was constructed by Outside Studios as a museum display. The contract with Outside Studios said nothing about postcards. Once this museum display had been constructed, the Museum was permitted to take photographs of it and sell them. However, this does not mean that the costs of construction of this museum exhibit are a cost component of the postcards containing photographs of it. The logical consequence of the Appellant’s argument would seem to be that if the owner of a newly constructed building sells postcards containing pictures of the building, then the cost of constructing the building is a cost component of the postcards. This cannot be correct.

108. The final item that needs to be considered is the Hut Book. The HMRC case is that the Hut Book is essentially no different to the postcards. It merely contains photographs of items in the hut display and an explanation or description of each of those items. Furthermore, the contract between the Museum and Outside Studios says nothing about the production of a Hut Book.

109. However, on the evidence before it, the Tribunal is persuaded that the circumstances of the Hut Book are different. The evidence of Ms Foster was as follows. Outside Studios was contracted in relation to “the narrative and design approach for the Solo Gallery”. At the time that the contract was entered into, it was not known what the narrative and design approach would be, since it was necessarily only after Outside Studios had provided its services that this was decided. There are many different ways to interpret objects in a museum, and different options were looked at. The idea that was finally adopted was to have a Hut Book interpreting the objects inside the Hut Display, rather than having for instance touch screen displays in the gallery explaining to visitors what items were, or traditional labels on the exhibits. There are tethered copies of the Hut Book inside the gallery, which visitors can look at when viewing the hut display. The decision to create a Hut Book as the means for interpreting the objects in the gallery was consistent with the Museum’s desire from

the beginning to create items from the gallery that could also be sold in the shop. The decision to create the Hut Book was therefore a curatorial as well as a commercial one, and the Hut Book was a key part of the gallery refurbishment.

5 110. Ms Foster also said in her evidence that the costs of producing the Hut Book were included in the fee paid by the Museum to Outside Studios. Outside Studios were responsible for the production of the Hut Book, which they sub-contracted to another company. The Hut Book had an initial print run of 1,000 copies.

10 111. The Tribunal accepts the evidence of Ms Foster in this respect. A copy of the Hut Book is included in the evidence. It begins with a brief introduction describing how the contents of the writing hut were moved into the Museum. The introduction concludes with the statement that “With this book you can use the numbered keys at the start of each section to discover more about the hut contents”. The book then contains an overview photograph of the entire hut interior, labelling different areas of the hut (“wall behind table”, “window wall”, “nest”, “table” and “wall behind
15 armchair”). The book then contains separate sections dealing with each of these areas. Each section begins with an overview photograph of the relevant area of the hut interior, on which various objects in the photograph are numbered. The remainder of each section then contains individual photographs of each of the numbered items, giving a label and description to each item. The Tribunal considers it clear that the
20 book has been designed to be used by someone looking at the hut display, in order to understand and appreciate what they are looking at.

25 112. The Tribunal thus accepts the Museum’s claim that the cost of writing, designing and producing the initial print run of the Hut Book was part of the overall gallery design costs. The Tribunal also accepts that the Hut Book was an integral part of the gallery display, being the means by which it is explained to visitors what they are looking at.

30 113. The Tribunal thus concludes that there is a direct and immediate link between the services supplied by Outside Studios and the Hut Book. As the Hut Book is not only used in the gallery as part of the display, but is also sold in the Museum shop as a taxable supply, it follows that there is a direct and immediate link between the cost of the services supplied by Outside Studios and one of the taxable supplies made by the Museum.

35 114. In view of what is stated in paragraph 81 above, the Tribunal therefore concludes that the VAT paid by the Museum as part of its £501,336 payment to Outside Studios was residual input tax.

Other claims

40 115. The Museum also contends that amounts of VAT incurred in 2007-08, 2008-09 and 2010-11 in respect of “exhibition costs” should have been treated as residual input tax (see paragraphs 3 and 59 above). No clear details were given of what these expenses were for. Ms Foster said in her evidence that she did not remember exactly, but that these would have been expenses for replacing elements of a gallery when

something breaks. The Tribunal is not persuaded on the evidence that there is any direct and immediate link between these expenses and any taxable supply made by the Museum.

5 116. The Museum also states that it intends to undertake further gallery refurbishments in the future, and asks the Tribunal to find in principle that the VAT to be paid on the expenses of such future refurbishments will be residual input tax. The Tribunal declines to make any such finding. Apart from anything else, the Tribunal has no jurisdiction to give advisory rulings on the tax treatment of proposed future transactions. However, even if it could, it follows from what is stated above that the
10 question whether such VAT would be residual input tax would depend very much on the facts and circumstances of the expenditure in question and of the taxable supply with which it is claimed to have a direct and immediate link.

Conclusion

15 117. For the reasons above, this appeal is allowed to the extent indicated in paragraph 114 above.

118. 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
20 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.

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**DR CHRISTOPHER STAKER
TRIBUNAL JUDGE**

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