

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 27/01/2006

Before :

THE HONOURABLE MR JUSTICE LIGHTMAN

Between

LANGBOROUGH FESTIVAL OPERA

Appellant

and

HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Ms Aparna Nathan (instructed by **Needham & James, Compton House, Moreton-in-Marsh, Gloucestershire GL56 0AX**) for the Appellants

Ms Valentina Sloane (instructed by **Solicitor for HMRC, Somerset House, West Wing, Strand, London WC2R 1LB**) for the Respondents

Hearing dates: 13th and 16th January 2006

Judgment

Mr Justice Lightman:

INTRODUCTION

1. This is an appeal pursuant to section 11 of the Tribunals and Enquiries Act 1992 by the appellant Longborough Festival Opera (“LFO”) against a decision (“the Decision”) released on the 26th May 2005 of the VAT and Duties Tribunal (“the Tribunal”). The issue before the Tribunal was whether the LFO was entitled to exemption from VAT on the basis that it was an eligible body supplying a right to a musical performance of a cultural nature within the meaning of Article 13A(1)(n) of the EC Council Directive 77/388 of 17th May 1977 on the harmonisation of the laws of Member States (“the Sixth Directive”) which is implemented within the United Kingdom by item 2(b) of Group 13 in Schedule 9 to the Value Added Tax Act (“the VATA 1994”). The Tribunal upheld the contention of the Respondent, the Commissioners to Her Majesty’s Revenue and Customs (“the Commissioners”), that it was not such an eligible body.

FACTS

2. The full facts are set out in the Decision. Counsel have however agreed the relevant facts for the purpose of this appeal as I have set them out below.
3. Mr Graham lives at New Banks Fee, Longborough, in Gloucestershire (“Longborough”). Mr Graham built a large barn at Longborough which he originally intended to house cattle but instead used as an opera house. He added a “Palladian-style” front, added a stage, and installed seating. He later installed a proper stage with an orchestra pit, proper seating and boxes.
4. At first the opera performances at Longborough were produced and managed by Longborough Developments Ltd (“LDL”), a property and development company incorporated in 1965 of which Mr Graham and his wife are directors and in which Mr Graham holds the majority of the shares and his wife the remainder. LDL produced the operas on a commercial basis with a view to profit. This business venture was only a small part of its overall business activity.
5. By 1999 Mr Graham considered that the opera at Longborough had reached a stage at which it would benefit from the support of patrons who might not be so likely to support a commercial venture. The support of patrons would also have the effect of improving the standard and quality of performances. To this end in 2000 Mr Graham incorporated LFO. LFO is a company limited by guarantee and is registered as a charity. The 2002 opera season at Longborough was the first season of operas produced and managed by LFO and in October 2001 LFO first received income in respect of Longborough paid by way of advanced bookings for that season. Since 2002 LFO has produced and managed most of the operas at Longborough. LFO has at all times fixed prices for admission, not to make a profit, but to cover the costs of production.
6. Clause 3 of the Memorandum of Association (the Objects Clause) of LFO (“the Memorandum”) provides that the objects of LFO are “such objects and purposes in any part of the world as are exclusively charitable in accordance with the laws of England and Wales”, and then sets out certain specific objects:

“(i) to promote, maintain, improve and advance the education of the public through the support and encouragement of the art of music (including opera, chamber music, singing and all forms constituting in whole or in part of music) by providing, presenting, producing, organising, managing and conducting performances of opera, music recitals and concerts of cultural value to the community, and in particular for the promotion, encouragement and appreciation of opera, and

(ii) to promote, maintain, improve and advance the education of the local community (in particular professional music students, primary and secondary school pupils) by the organising, managing and conducting of performances of opera in collaboration with local schools, by providing master classes in signing for professional music students and local school pupils and providing work experience for these students and pupils relating to the organisation and presentation of musical performances together with the opportunity for them to attend rehearsal sessions.”

7. Clause 4 of the Memorandum gives LFO (amongst others) the following powers in the furtherance of its objects:

“4 In furtherance of the Objects but not further or otherwise the Company shall have the following powers:

4.1 to purchase, take on lease or in exchange, hire or otherwise acquire any real or personal property and any rights or privileges which the Company may think necessary for the promotion of the Objects, to manage and improve such property and to provide, construct, maintain, alter and equip any facilities, buildings or erections necessary for or conducive to the Objects (subject to such consents as may be required by law)...

4.7 to invest the moneys of the Company not immediately required for its purposes in or upon such investments, securities or property as may be thought fit, in its absolute discretion, with power to vary or transpose any investments for or into others of any nature.”

8. Clause 5 of the Memorandum governs the application of LFO’s income and property, and includes the following:

“5 The income and property of the Company shall be applied solely towards the promotion of the Objects, and no part thereof shall be paid or transferred directly or indirectly by way of dividend, bonus or otherwise by way of profit, to the members of the Company, and no Director shall receive any salary or fees or remuneration or other benefit in money or money's worth from the Company

Provided that nothing herein shall prevent the payment in good faith by the Company of:

5.1 reasonable and proper remuneration to any member officer or servant of the Company not being a director in return for any services actually rendered to the Company, or

5.2 reasonable and proper professional charges to any member of the Company or a Director or any partner or employee of his or hers for any professional services rendered to the Company....or

5.3 interest at a reasonable and proper rate on money lent to the Company by any member of the Company or by a Director, or

5.4 reasonable and proper rent for premises demised or let to the Company by any member of the Company or by any Director, or

5.5 reimbursement of reasonable out-of-pocket expenses actually incurred by any member of the Company or by any Director, or

5.6 fees, remuneration or other benefit in money or money's worth to any company of which any member of the Company or any Director may also be a member holding not more than 1% of the issued share capital of that company, or

...”

9. Mr Graham gave evidence to the Tribunal that this absolute prohibition on the payment of salary, fees, remuneration or other benefits in money or money's worth to directors of LFO has been strictly observed.
10. Article 31 of the Articles of Association of LFO (“the Articles”) provides that the Board shall consist of not less than two persons. LFO has four directors on the Board, of whom two are Mr and Mrs Graham. Mr Graham is the Chairman. The other two directors are Mr Crombie and Mr de Navarro. The four directors are referred to as “the Trustees” and I shall also refer to them as “the Trustees”.
11. Trustees meetings have taken place three or four times a year. There has never been a Trustees meeting without all four Trustees being present. Every matter on the agenda has always been discussed until agreement has been reached and so there has never been any dissent. The Trustees have at all times been aware of their duties and have taken those duties seriously. In particular Mr de Navarro has examined all financial questions to satisfy himself as to their regularity before making decisions.
12. The Articles also contain the following provisions:

“48 The Board may meet together for the despatch of business.
. . . Unless otherwise determined, two Directors shall be a quorum. Questions arising at any meeting shall be decided by a

majority of votes. In cases of equality of votes the chairman of the meeting shall have a second or casting vote.

...

69 No alterations shall be made to the Articles except by a resolution put to a General Meeting of the Company by the Board (a simple majority of whom at a duly convened Board meeting shall decide to put such resolution to a General Meeting) and passed at such General Meeting (of which at least twenty-one days notice has been given) by three-quarters of those present and voting at such General Meeting provided that no alteration shall be made which shall have the effect of the Company ceasing to be a charity.”

13. Article 66 of the Articles provides that in the management of the affairs of LFO no director shall be liable for any loss to LFO’s property arising by reason of an improper investment made in good faith (so long as he shall have sought professional advice before making such investment). The Memorandum permits LFO to pay the premium of indemnity insurance for the directors and limits the liability of the members upon winding up to an amount not exceeding £1.
14. Mr Graham provided two “letters of comfort” of the 12th January 2002 and the 9th November 2002 (“the Letters”) to the Trustees. The letter of the 12th January 2002 said:

“Further to the minutes of the Trustees' meeting of 13th October 2001 I am writing to confirm that Longborough Developments Ltd and I will provide the appropriate funds to cover any deficit arising from LFO's 2002 season.”

The letter of the 9th November 2002 was slightly different:

“As requested I am writing in my capacities as Director of Longborough Developments and personally to confirm that LDL or I will make good any financial deficiency which may arise from next year's performances and operations.”

There was no mention whether such support, if it were necessary, would have been a gift or a loan, or, if the latter, whether interest would have been charged. Mr Graham told the Tribunal that he had not given any guarantee since 2003.

15. Mr Graham also told the Tribunal that he had written the Letters because Mr Crombie and Mr de Navarro had expressed concern about the possibility of a deficit arising as a result of putting on the *Ring Cycle*, since production costs would be high and ticket sales unpredictable. They were concerned also about the possibility of personal liability in case of a substantial deficit. Mr Graham said he would have honoured the assurance in the Letters had it been necessary.
16. LDL received income from sales in respect of programmes, drinks, and catering services in the 2002 and 2003 seasons. Mr Graham said it was not LDL which sold

programmes, drinks, and catering services. A caterer made all the catering supplies, and LFO received the difference between what the caterer charged and what LFO charged to the opera-goers. Prior to the discussion about the exemption, LDL had received income from the restaurant, but after that discussion that practice ceased.

17. In 2003 a detailed review of the whole of the administration and accounting exercise were carried out, because there were questions which needed to be resolved. The dispute with the Commissioners about the exemption was the catalyst for the review. The purpose of the review and exercise was to achieve a complete and transparent separation of the activities of LDL from those of LFO. After it, income which had accrued to LDL was transferred to LFO.
18. The accountancy exercise revealed £33,183 paid by LDL on behalf of LFO. Consequently, in the accounts of LFO for 2002-03 a prior year adjustment was made to show those expenses against which LDL gave credit for net receipts from running the bar, restaurant and programme sales of £18,451. In the year to 30 September 2003 LDL paid £42,011 on behalf of LFO, against which were offset net receipts from bar, restaurant and programme sales of £14,521. It was decided in 2003 to give full credit to LFO for all receipts which were in any way connected with the opera. LDL has not settled any of LFO's bills since that review.
19. The Tribunal stated: "As to the catering and bar sales, it was our understanding that originally the catering and the bar were the province of LDL and were not provided by [LFO] at all. If that were the case, then what they earned from those sales was never the income of [LFO] anyway. However, even that is not wholly clear. Mr Graham said in evidence that it was not LDL which sold programmes, drinks and catering services, but an outsider caterer made all catering supplies and [LFO] charged and received a small mark-up on the caterer's prices. LDL had, however, Mr Graham said, received income from such sales in the 2002 and 2003 seasons, and that was the subject of the 'prior-year adjustment' whereby it was credited to [LFO]. Mr Crombie said also in a letter to the Commissioners that restaurant facilities were provided by LDL, who bore the cost of making those supplies and to which the income therefore accrued, and had accounted for VAT on such sales".
20. In 2003 the VAT Consultancy wrote to the Commissioners on behalf of LFO stating that LDL intended to charge a rent in respect of the use of the opera house in 2002. They had made inquiries as to what it would cost to hire a similar facility on the open market and had established that LFO would expect to pay a minimum of £20-30,000 for a comparable theatre bearing in mind the benefit accruing to LDL for programme and other sales. In the event no rent has been charged. This proposal to charge rent was dropped when the Commissioners expressed the view that payment of rent would prevent LFO continuing to enjoy the cultural exemption from VAT and no interest has been charged on loans to LFO.
21. The Tribunal found that either Mr Graham or LDL was in a position to charge rent for the use of the opera house, which was in fact contemplated; that LDL was in a position to make charges for the use of the equipment in the opera house; that Mr Graham was at liberty to make a loan (with interest if he chose) under either of the Letters, and did make loans for other purposes, to LFO, as did LDL; that Mr Graham was in control of LDL; that he and Mrs Graham exercised actual control over the Trustees, for in the case of any disagreement between them and the other two Trustees

Mr Graham's casting vote would prevail; and that there was nothing to prevent Mr Graham charging rent under a lease of the opera house to LDL, or to prevent LDL, (a commercial company) from charging a licence fee to LFO.

LEGISLATIVE BACKGROUND

22. Article 2 of the Sixth Directive lays down the general principle that turnover tax is levied on all services supplied for consideration by a taxable person. This general principle is implemented in the United Kingdom by sections 1(1)(a) and 2(1)(a) of the VATA 1994.

23. The Sixth Directive specifies certain limited exceptions. Article 13 of the Sixth Directive (“Article 13”) specifies certain “permanent” exemptions from tax. Article 13A(1)(n) provides as follows:

“Article 13A(1) of the Sixth Directive provides for the exemption of cultural services supplied by cultural bodies recognised by the Member State concerned:

Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any possible evasion, avoidance or abuse:

...

(n) certain cultural services and goods closely linked thereto supplied by bodies governed by public law or by other cultural bodies recognised by the Member State concerned.”

24. Article 13A(2) goes on to provide that Member States may make the granting of the exemption provided for in (n) above to cultural bodies other than those governed by public law subject to one or more of the following conditions:

“ – they shall not systematically aim to make a profit, but any profits nevertheless arising shall not be distributed, but shall be assigned to the continuance or improvement of the services supplied,” [“the First Indent”]

“– they shall be managed and administered on an essentially voluntary basis by persons who have no direct or indirect interest, either themselves or through intermediaries, in the results of the activities concerned.” [“the Second Indent”]

25. Pursuant to Article 13A(2), the Value Added Tax (Cultural Services) Order 1996, which came into force on the 1st June 1996, amended VATA 1994 by introducing the following exemption in Group 13 of Schedule 9:

“2 The supply by an eligible body of a right of admission to –

...
(b) a theatrical, musical or choreographic performance of a cultural nature.”

Note 2 to Group 13 of Schedule 9 of the VATA 1994 (“Note 2”) provides that for the purposes of item 2 “eligible body” means any body (other than a public body) which

—
“(a) is precluded from distributing, and does not distribute, any profit it makes;

(b) applies any profits made from supplies of a description falling within item 2 to the continuance or improvement of the facilities made available by means of the supplies; and

(c) is managed and administered on a voluntary basis by persons who have no direct or indirect financial interest in its activities.”

ISSUE

26. The issue before me is whether on the facts as found by the Tribunal LFO is an eligible body as defined in Note (2), and in particular: (1) whether it is precluded from distributing and does not distribute its profits; and (2) whether the Trustees manage and administer LFO on a voluntary basis and have no direct or indirect financial interest in its activities. The answer to this question turns upon the construction of the First and Second Indents and Note 2.

THE DECISION

27. In paragraph 77 of the Decision the Tribunal set out the issues before it as follows:

“(1) The first issue that we have to decide is the construction to be put on the expressions ‘interest’ in Article 13A.2(a) and ‘financial interest’ in Note (2) to Group 13 of Schedule 9. Do those expressions necessarily mean enrichment of the person with such an interest, or is the meaning wide enough to encompass any interest whether involving gain or loss?

(2) Having decided that, we should then go on to decide whether a body, to be eligible under Group 13, must be incapable of distributing profits or surplus or granting financial advantage to a person concerned in its management and administration or whether it is enough if that body, though not prevented by law from so doing, in fact never does so?

(3) If a person who is involved in the management and administration of a body, making decisions at the highest level, is in receipt of any of the payments permitted to be made to a director by clause 5 of the Memorandum, or is in a position to

receive such payments, is that an interest in the results of the activities of that body?

(4) If such a person guarantees the debts of a body, whether or not he becomes obliged to honour that guarantee, is that a financial interest in the sense that he might wish so to order the affairs of the body that his guarantee will never have to be met?

(5) Was either of the ‘guarantees’ enforceable? (There was no consideration for either, and neither was a deed.) Or was each simply a promise to make a gift to a charity if a particular need arose? What, if any, difference does it make whether it was enforceable or not?”

28. The Tribunal’s answer to these issues were as follows:

- i) (in answer to issue (1)) that, for a person to have an interest, it was unnecessary that he might be enriched: it was sufficient that he might be impoverished and that the absence of the possibility of enrichment did not prevent the Letters creating or constituting a financial interest (para 78);
- ii) (in answer to issue (2)) that in order to qualify as an eligible body it must not be legally possible for any person concerned in the management and administration of the body to derive a financial advantage from that body or “to manipulate it so as to derive personal benefit from it” (para 87);
- iii) (in answer to issue (3)) that entitlement to receipt of payment permitted by the Memorandum and in particular subleases 5.2 (permitting payment of professional charges) 5.3 (permitting interest to be paid on loans) and 5.4 (permitting rent to be paid for premises let) were enough to “brand” the directors with a financial interest in LFO (paras 87 and 93). In paragraph 93 of the Decision the Tribunal said:

“... What emerges plainly is that either Mr Graham or LDL was in a position to charge rent for the use of the theatre, which was in fact contemplated; LDL was in a position to make charges for the use of the equipment in the theatre; Mr Graham was at liberty to make a loan, with interest if he chose, under either of his letters of comfort, and did make loans for other purposes, to [LFO], as did LDL. Mr Graham was in control of LDL, and he and Mr Graham exercised actual control over the Trustees: in the case of any disagreement between them and the other two Trustees, Mr Graham’s casting vote would prevail. There would also be nothing to prevent Mr Graham charging rent under a lease of the opera house to LDL, and LDL, which is already a commercial company, charging a licence fee to [LFO].”

- iv) (as regards issues (4) and (5)), the Tribunal stated in paragraph 94 of the Decision as follows:

“Under issue (3) we have already dealt with these two. We consider that the guarantees do, or at the least may, give Mr Graham a financial interest, in that it would be to his advantage, if he satisfied them by means of a gift, so to manage [LFO] that he was saved the expense of meeting such an open-ended liability. If it was to be done by means of a loan, then Mr Graham would have an interest in ensuring that the loan was repaid, and that interest was paid in the event that it was charged. Under issue (4), in our judgment, in the circumstances of this case, although not legally enforceable, if the circumstances had arisen under which the promises, or either of them, had become relevant it would have been very difficult, if not impossible, for Mr Graham to refuse to meet the guarantees, even if, which we consider unlikely, he had wished to do so.”

29. The Tribunal stated its conclusion in paragraph 95 of the Decision:

“For the above reasons, we have come to the conclusion, with some reluctance, that in the circumstances surrounding the relationships between Mr and Mrs Graham, LDL, and [LFO], and their financial dealings, that Mr Graham had a financial interest in [LFO] on his own account, and that he and Mrs Graham also had such an interest through LDL. It seems to us that the only way to avoid such a situation is probably to observe what the Advocate General said in *London Zoo* in paragraph 32: ‘Certain individuals may have an interest in “the results of the activities concerned” but must not be in a position to influence those results, whilst others, who may be in a position to influence the results must have no interest in them, so that whatever decisions they take will be unaffected by considerations of private gain whether direct or indirect’.”

CONSTRUCTION OF LEGISLATION

30. Article 13A(1) provides that Member States shall exempt cultural bodies recognised by them “under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and preventing any possible evasion, avoidance or abuse”. Article 13A(2)(a) provides that Member States may make the granting to cultural bodies recognised by them subject to one or both of the first two indents. The First Indent starts with the condition that the cultural bodies shall not systematically aim to make a profit. It then goes on to provide that any profits arising shall not be distributed but shall be assigned to the continuance or improvement of the service provided. The Second Indent sets out the dual conditions that the cultural bodies shall be managed and administered: (1) on an essentially voluntary basis; (2) by persons who have no direct or indirect interest, either themselves or through intermediaries in the results of the activities concerned.
31. Before I turn to examine each of the indents in detail, in the light of submissions made to me I should make certain general observations: (1) the VATA 1994 must be interpreted in accordance with Community law and accordingly to accord with the

provisions of Article 13: Marleasing SA v. La Comercial Internacional de Alimentacion SA (1990) ECR I-4135 (“Marleasing”); (2) Article 13A(1) only obliges Member States to exempt cultural bodies recognised by them (and the LFO is such a body), if they comply with the conditions set out in Article 13A(2)(a) as and so far as adopted by the Member States. These conditions are optional: Member States have no obligation to impose them. The United Kingdom for whatever reason has not seen it necessary or desirable to adopt in the VATA 1994 the condition in the first part of the First Indent relating to the systematic aim to make a profit; (3) when adopting in national legislation any condition provided for in Article 13A(2)(a), Article 13A(1) confers on Member States a margin of appreciation in the formulation of those conditions in national law to ensure the correct and straightforward application of the exemptions and to prevent any possible evasion, avoidance or abuse; (4) in paragraph 19 of its judgment in Kennemer Golf Club v. Staatsecretarissen van Financien Case C174/00 (“Kennemer”) the European Court stated:

“Moreover, all the exemptions listed in art 13A(1)(h) to (p) of the Sixth Directive cover organisations acting in the public interest in a social, cultural, religious or sports setting or in a similar setting. The purpose of the exemptions is therefore to provide more favourable treatment, in the matter of VAT, for certain organisations whose activities are directed towards non-commercial purposes.”

But the fact that a cultural body’s activities are directed to a non-commercial purpose does not of itself entitle it to exemption: the conditions laid down in national legislation in pursuance of the provisions of Article 13 must be complied with; and (5) Article 13A(2) First Indent is directed (amongst other things) at preventing the dilution of profits by the conferment by the cultural body of financial benefits on directors, members and others whilst the Second Indent is directed at securing the disinterestedness of those who direct it at the highest level (whom I shall call “the directors”) in the results of its activities.

32. I turn now to the first condition in the First Indent that the cultural bodies to be exempted shall not systematically aim to make a profit. In this condition “profit” means the enrichment of, or conferment of financial advantages on, natural or legal persons and in particular those who control or have a financial interest in or are members of it. The focus is on the aims of the body, and not the results of its activities. The law is succinctly stated by Advocate General Jacobs in Kennemer:

“45. First, I agree ... that the idea of profit-making in this context relates to the enrichment of natural or legal persons—in particular those having a financial interest in the organisation in question—rather than to whether in any given period the organisation’s income exceeds its expenditure. The concept of a non-profit-making organisation contrasts essentially with that of a commercial undertaking run for the profit of those who control and/or have a financial interest in it.

46. Second, in accordance with most of the language versions, the focus must be on the aims of the organisation concerned rather than on its results—the mere fact that an

entity does not make a profit over any given period is not enough to confer non-profit-making status. Moreover, from the fact that ‘non-profit-making’ is used to qualify ‘organisation’, it would seem that the aims in question are those which are inherent in the organisation rather than those which it may be pursuing at a particular point in time.

47. When assessing those aims, therefore, it is necessary but not sufficient to look at the organisation’s express objects as set out in its statutes. It is also necessary however to examine whether the aim of making and distributing profit can be deduced from the way in which it operates in practice. And in that context it is not enough to look simply for an overt distribution of profits in the form of, say, a direct return on the investment represented by contributions to the organisation’s assets. Such distribution might also, at least in some circumstances, take the form of unusually high remuneration for employees, redeemable rights to increasingly valuable assets, the award of supply contracts to members, whether or not at prices higher than the market rate, or the organisation of sporting ‘competitions’ in which all the members won prizes. No doubt further methods of covert distribution can be devised.”

33. The Commissioners do not and cannot allege the existence of any such aim. There can accordingly be no question of any non-compliance with this condition. But I should refer to the argument before me that by reason of the obligation of the United Kingdom to implement the Directive this condition is to be read into the VATA 1994 under the principles laid down in Marleasing. I have already stated my view that the Directive left it optional for the United Kingdom whether to include that condition in its national legislation: it had no obligation to do so and accordingly no such condition can be read in on this ground.
34. I turn to the second condition in the First Indent that any profits arising shall not be distributed but shall be assigned to the continuance or improvement of the services provided. Note 2 requires that the body is legally precluded from distributing its profits and is required to apply them as there set out. LFO submit that Note 2 goes beyond the provisions of Article 13 by requiring that the constitution of the cultural body or the applicable law precludes application of profits other than to the continuance or improvement of the supply of services. In my judgment this restriction is implicit in the First Indent and in any event, even if this is not so, the provision to this effect in Note 2 falls within the margin of appreciation afforded to the United Kingdom to ensure the correct and straightforward application of the exemption and prevent possible evasion, avoidance or abuse.
35. It is in my judgment quite plain that the First Indent creates no obstacle to the eligibility of LFO, for the necessary constraint is implicit in the Memorandum and Articles of LFO and the fiduciary duties of the Directors. In this condition the word “profits” means surplus or profit on the bodies’ activities. The condition precludes any dilution of such surplus or profit by the entry into contracts not in the best interests of the body or on terms other than the best reasonably obtainable, but does

not preclude the entry into contracts by the cultural body with members, staff or third parties provided that by their true character or terms they are not a method of distribution of profit to another party. If the contract is for goods or services (or in this case the use of the opera house or equipment) needed by the body at the best price reasonably obtainable and is not made with the member, employee or third party because he is such and for his benefit, the provisions of the First Indent are complied with. Accordingly the potential for the making of contracts between LFO and Mr Graham or LDL as contemplated in the Memorandum and as set out in the recited facts does not involve any dilution of the profits of LFO nor will the conclusion of such contracts do so if the Trustees comply with their fiduciary duties to LFO. In full accordance with the condition in the First Indent and Note 2(a) and (b) any contracts on the part of LFO (and in particular the contracts contemplated by clause 5.2-5 of the Memorandum and any contract with LDL) can and should only be entered into if it is in the interests of LFO to do so and if they are entered into on the best terms available and with no aim of benefiting any other party. The Directors (and accordingly LFO) are legally precluded from acting otherwise.

36. I turn now to the Second Indent. No question arises as to the first part, namely whether the Trustees manage and administer LFO on an essentially voluntary basis: the Trustees are unpaid and have no service contract or the equivalent with LFO.
37. I turn therefore to the second part. It is to be noted that, whilst the Second Indent speaks of an interest in the results of the body's activities, Note 2 speaks of an interest in the body's activities. This may mean an interest in the results of its activities or an interest in its activities themselves. I am of the view that the ambiguity should be resolved in favour of the former construction so that the meaning of Note 2 accords with the terms of the Second Indent. It is not apparent to me that the margin of appreciation afforded to the United Kingdom extended to disqualifying from exemption by reference to an interest of a director in an activity of a body or that the United Kingdom intended to take advantage of the margin of appreciation afforded for this purpose.
38. Two important questions arise as to the meaning of a "direct or indirect (financial) interest" in the results of LFO. The first is whether the interest in the results of the activities must be an interest in the sense of some potential or actual enrichment, gain or profit or whether the term "interest" embraces a potential impoverishment e.g. the liability of a trustee, guarantor or covenantor.
39. The question is of substantial practical importance, for if the existence on the part of a director of an actual or potential liability (e.g. under a guarantee or covenant in favour of the body) or of a trustee of a charitable trust (e.g. in respect of the liabilities of the trust) are sufficient to render the company or trust ineligible, this creates a very serious obstacle in the way of companies such as LFO achieving eligibility and insuperable obstacles in the way of charitable trusts. In the latter regard I do not accept the submission of the Commissioners that charitable trustees can overcome the obstacle and achieve eligibility status by the entry by the trustees into trustee indemnity insurance policies. Even assuming that such policies covering all liabilities are generally available (which I doubt) and that the premiums under such policies are affordable (which I also doubt), the underlying liability of the trustees will continue and so will any disqualifying effect which the liability gives rise to.

40. Whether the terms “interest” and “financial interest” extend to liability to make payments under guarantees or covenants or liability in respect of obligations incurred as trustees, the question whether they do so must turn on the context, and accordingly whether the terms “interest” in Article 13 and “financial interest” in Note 2 are intended to go beyond an interest in the nature of financial gain. In my judgment in the context of the legislation in question the crucial distinction is being made between commercial profit-making and non-commercial non-profit making bodies. It is sufficient to set out paragraphs 25, 26 and 30, 31 and 32 of the Opinion of Advocate General Jacobs and paragraphs 17 and 18 of the European Court in Customs and Excise Commissioners v. Zoological Society of London [2002] STC 521 (“London Zoo”). The Court held in that case (agreeing with the Opinion of the Advocate General) that the aim of the Second Indent was to distinguish between commercial undertakings and bodies not aiming to achieve profits for their members and to reserve the exemption to the latter by requiring that the persons participating in the management and administration (meaning those designated in the body’s constitution to direct it at the highest level or who in fact so direct it) had no financial interest in their results by means of remuneration, distribution of profits or any other financial interest.
41. In London Zoo the Advocate General said:

“25. It seems clear to me from the wording [of the First Indent] that the condition in question reflects [a] concern which was manifestly felt in the drafting of Article 13A, that of ensuring that certain activities should not benefit from exemption if they are run for commercial profit....

26. The [S]econd Indent reflects a slightly different aspect of the same concern. Rather than focusing, like the [F]irst [I]ndent, on the approach of the entity to the making and use of profit, it seeks specifically to exclude the possibility that the persons who manage and administer the entity may have any direct or indirect interest in the financial results of its activities. The condition “on a voluntary basis” may thus be seen as reinforcing that basic prohibition.”

Opinion

30. In line with the view I have taken above (at para 26), the [S]econd [I]ndent of art 13A(2)(a) concerns those who run the organisation in question and seems clearly designed to preclude their being in a position to run it in such a way as to further their own enrichment.

31. If a member state applies that indent alone, the aim and effect appear to be a ‘separation of powers’. Certain individuals may have an interest in ‘the results of the activities concerned’ but must not be in a position to influence those results, whilst others, who may be in a position to influence the results, must have no interest in them, so that whatever

decisions they take will be unaffected by considerations of private gain, whether direct or indirect.

32. I therefore take the view that the management and administration referred to concern activities which may influence financial results – and indeed also the use made of the resources thereby arising, in so far as both those aspects may have an effect on the interests of the persons concerned.”

The Court of Justice in paragraph 18 of its judgment said:

“17. As for the interpretation of that extra condition, to the effect that a body availing itself of one of the exemptions in art 13A(1) of the Sixth Directive must be managed and administered on an essentially voluntary basis, it follows from the legal context in which that condition occurs that the Community legislature wanted to make a distinction between the activities of commercial undertakings and those of bodies not aiming to achieve profits for their members (see in relation to the exemption under art 13A(1)(m) of the Sixth Directive, *Kennemer Golf & Country Club* (Case C-174/00 [2002] STC 502, para 34).

18. The aim of that condition is therefore to reserve the VAT exemption for bodies which do not have a commercial purpose, by requiring that the persons who participate in the management and administration of such bodies have no financial interest of their own in their results, by means of remuneration, distribution of profits or any other financial interest, even indirect.”

42. In this context the disqualifying “financial interest” is plainly directed at potential enrichment and is not designed to preclude participation in management by persons who for the benefit of the cultural body assume responsibility for some one or other liability of the body and accordingly the risk of an actual impoverishment. As Mann J said in paragraph 50 of his judgment in Bournemouth Symphony Orchestra v. Customs and Excise Commissioners [2005] STC 1406 (“Bournemouth”): “The condition provides that those with [a financial interest in the performance of an entity] should not take part in the high level management of the entity, presumably so that their activities are not motivated by an element of personal gain”. It may be that the actual or potential liability of a director will be in the mind of the director when managing and administering the body. Whether that is desirable or not (or indeed inevitable), that is not (as it seems to me) the mischief at which the Second Indent and Note 2(c) is directed. For this reason I do not think that any liability of Mr Graham under the Letters can or does disqualify LFO from being eligible. Still less can the Letters disqualify since, in view of their invalidity as guarantees, they can at best impose a moral, but no legal, obligation. For the same reason the grant of interest free loans, as were made in this case by Mr Graham and LDL cannot give rise to a disqualifying financial interest since their grant cannot give rise to the enrichment of Mr Graham or LDL.

43. I turn to the second question which is whether the existence of the legal possibility of or the contemplation of entry, or actual entry, into a commercial contract between a body and a director disqualifies that body from eligibility for exemption. In my judgment a body is not disqualified because it legally can and in fact does enter into commercial contracts with a director so long as the contract does not confer any interest in the body's results or profits. This conclusion flows from the terms of the Second Indent and paragraph 3 of Note 2 which (as I have already held) are directed at precluding a director of a body not from having a contract with the body, but from having an interest in its results.
44. Support for this proposition is also to be found in the judgment of Mann J in Bournemouth. He there expressed the view that the mere facts that a contract (in that case of employment of a managing director) is concluded between a body and a director of the body and remuneration is paid to the director will not without more give the director a financial interest for the purposes of this legislation: for the contract to give the director such an interest it is necessary that the terms of the contract themselves give to the director such an interest e.g. by calculating his remuneration by reference to the results of the body.
45. For these reasons neither the legal possibility nor contemplation that LFO may enter into commercial contracts with Mr Graham for a lease or licence in respect of the opera house or with LDL in respect of the equipment nor the actual entry into such contracts will disqualify LFO if their terms are not such as to give Mr Graham and LDL an interest in the results of LDL: commercial contracts providing the essentials for the conduct by LFO of its business need not do so.
46. That conclusion is in my judgment entirely consistent with the doctrine of the separation of powers expounded in the Opinion of the Advocate General in London Zoo. That doctrine requires that, in the interests of securing that decisions of directors are unaffected by considerations of personal gain, persons who are interested in the results of a body should not be in a position to participate in or influence decisions of the body which may affect those results. That requirement is fully satisfied in this case by reason of the incorporation into the Articles of Article 94 of Table A to the Companies Act 1985 which provides as follows:

“Save as otherwise provided by the articles, a director shall not vote at a meeting of directors or a committee of directors on any resolution concerning a matter in which he has, directly or indirectly, an interest or duty which is material and which conflicts or may conflict with the interests of the company unless his interest or duty arises only because the case falls within one or more of the following paragraphs—

....”

None of the following paragraphs referred to are relevant.

47. Article 94 of Table A is incorporated in Table C (the table applicable to companies limited by guarantee and not having share capital) and accordingly in the Articles; and the Articles do not “otherwise provide”. Mr and Mrs Graham are accordingly disqualified from voting on any contract contemplated by clauses 5.2, 5.3 or 5.5 of the

Memorandum in which they are directly or indirectly interested, and that includes contracts between LFO and LDL. The only decision-makers will be Mr Crombie and Mr de Navarro. It is accordingly for this reason not legally possible (leaving aside their fiduciary duties) (in the language of the Tribunal) for Mr and Mrs Graham to “manipulate” LFO so as to derive personal benefits from it or (in the language of the Advocate General in London Zoo) to run it in such a way as to further their own enrichment.

48. This is not a case where it matters that LFO can change its Articles: such a change cannot alter its charitable status nor without the prior consent of the Charity Commissioner affect the manner in which its property may be used or applied: section 64 of the Charities Act 1993. There is no prospect of a change in the Articles which might undermine the objectives of the exemption (contrast Messenger Leisure Development Ltd v. Revenue and Customs Commissioners [2005] STC 1078 at 1102 (paras 96-8).
49. The Tribunal did not rest its decision on the receipts or profit from or in respect of bar sales, catering and programmes. I do not see how or why arrangements originally made or any temporary apparent uncertainty as to entitlement to the receipts and profits in these regards and their subsequent satisfactory resolution can affect the outcome of this case.

CONCLUSION

50. Turning once again to the recital of the questions raised in paragraph 77 of the Decision, the answers (as it seems to me) are as follows:
- i) the terms “interest” and “financial interest” connote possible enrichment of the person with such an interest and there is present in this case no such interest;
 - ii) under the First Indent and Note 1 (a) and (b) the eligible body must be legally incapable of distributing its profits or diluting its profits in favour of its directors or members and must not do so, and LFO satisfies this condition;
 - iii) the mere fact that a director is not legally prohibited from receiving a payment for which provision is made under clauses 5.2 to 5.5 of the Memorandum, and indeed in fact receives such a payment, does not disqualify him from eligibility. Whether a body is disqualified turns upon the terms of any contract made and the terms of the body’s constitution and applicable law regarding the director’s participation in any decision-making regarding contracts which might confer a financial interest in the body’s results upon him. Mr Graham has not entered into any relevant contract and is excluded from any participation in the decision-making whether LFO should enter into any contract with him or LDL;
 - iv) a director does not have an “interest” or “financial interest” merely because he gives the body a guarantee or an interest free loan, still less if the guarantee is unenforceable.
51. I accordingly allow this appeal and hold that LFO is eligible for exemption from VAT and is therefore not obliged to be registered for VAT.