

LONDON TRIBUNAL CENTRE

Longborough Festival Opera

Appellant

and

Commissioners of Customs and Excise

Respondents

**Tribunal: ANGUS NICOL (Chairman)
 PRAFUL DAVDA FCA**

Sitting in public in London on 18 and 19 November 2004

**Hugh McKay, counsel and Ms Aparna Nathan, instructed by Needham & James,
solicitors, for the Appellant**

**Valentina Sloane, counsel, instructed by the Solicitor for the Customs and Excise, for
the Respondents**

DECISION

1. The broad issue in this appeal is whether or not the Appellant, which stages performances of operas for which it makes charges to the audiences, is making exempt supplies and is therefore not obliged by statute to be registered for VAT.

The statement of case

2. The hearing began on 17 November 2004. In a letter dated 1 November 2004, the Commissioners notified the Appellant's solicitors that they intended to apply for leave to amend the statement of case, a draft of which was attached to the letter. The proposed amendment added to the statement of case further or alternative contentions in support of their case that the Appellant was managed by persons who had a financial interest in its activities. It also added a new contention, that the Appellant was not precluded from distributing any profits that it might make. The Appellant objected to the amendment, and we heard argument from both parties. It was conceded by Mr McKay that there would be no actual prejudice to the Appellant if leave were given, though the Appellant entertained a substantial sense of grievance at this late amendment, which could have been included in the original statement of case or at least made considerably earlier, and presented a different case from that originally pleaded. In view of the facts that no prejudice would result, that the case as now pleaded could be met without an adjournment, and that if leave were refused the consequence would almost certainly be a fresh decision by the Commissioners adverse to the Appellant, and therefore a fresh (and in the circumstances unnecessary) appeal, we gave leave.

The legislation

(1) - European legislation

3. Exemption is governed by Article 13A of the Sixth Directive, which, so far as is relevant in this appeal, provides:

“1. 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.”

4. Article 13A.2(a) gives a discretion to Member States as to the granting of exemption subject to conditions:

“(a) Member States may make the granting to bodies other than those governed by public law of each exemption provided for in 1...(n) of this article subject in each individual case 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 service supplied
- 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
- they shall charge prices approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to value added tax
- exemption of the services concerned shall not be likely to create distortions of competition such as to place at a disadvantage commercial enterprises liable to value added tax.”

(2) - United Kingdom legislation

5. Article 13A is reflected in section 31 of and Group 13 of Schedule 9 to the Value Added Tax Act 1994. Section 31 provides that supplies of goods or services are exempt if they fall within Schedule 9. That Schedule provides, in Group 13, so far as is relevant, as follows:

“Item

2. The supply by an eligible body of a right of admission to—

(a)

...

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

NOTES

(2) 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.”

The evidence

6. Evidence was given, in witness statements and orally, by Mr Alasdair Crombie and Mr Martin Graham, both of whom are directors and trustees of the Appellant. The Commissioners called no witnesses. There was little or no dispute as to any of the evidence, and cross-examination was devoted to clarification of detail. We find the facts to be as given in the evidence, unless we state to the contrary.

7. Mr Graham (who actually gave evidence after Mr Crombie) told us of the background to the starting of the Appellant to stage operas. Mr Graham lives at New Banks Fee, Longborough, in Gloucestershire, and, in 1991, organised the performance of an opera there, in the open air, for charitable purposes. He had arranged a series of chamber music recitals before that. A second purpose was to bring music to wider audiences. Mr Graham had built a large barn at New Banks Fee, originally intended to house cattle, but in the end he never started beef farming. Instead, the barn was used to house the opera performances. He added a “Palladian-style” front (of which he exhibited photographs), added a stage, and installed seating. When it was not in use for performances, it housed chickens. Since those early days, a proper stage has been installed, with an orchestra pit, proper seating and boxes. He obtained seating which had been made redundant when the Royal Opera House was refurbished. Planning permission has now been obtained for the raising of the roof of the barn so as to improve acoustics and insulation.

8. The opera performances were produced and managed at first by Longborough Developments Ltd (“LDL”), a company 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 is a property investment and development company, which was incorporated in 1965. The operas were produced by LDL on a commercial basis, as a business venture, which was only a small part of its overall business activity.

9. By 1999 Mr Graham considered that the opera 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. It would also have the effect of improving the standard and quality of performances, a need which was becoming apparent, and which was reflected by what was going on with other opera companies of a similar nature. Mr Graham mentioned two: Garsington Opera, near Oxford, and Grange Park Opera in Hampshire, both of which were flourishing. However, they were not in competition with the Appellant nor with each other, since each of the three tended to specialise.

10. The Appellant was incorporated in 2000, as a company limited by guarantee, and is registered as a charity. Its principle charitable objects are as set out in paragraph 14 below. Those objects were fulfilled in a number of ways, including allowing young singers to participate in productions and to take part in workshops, taking pupils from a local school on for work experience, holding workshops for pupils from local schools, allowing pupils to attend dress rehearsals without charge, allowing schools to put on their own productions at New Banks Fee, and by assisting some of those who had taken part in operas to put on their own opera.

11. The Appellant has applied, without success so far, for public grants from the Cotswold District Council, South West Arts, and the Arts Council and other charitable trusts. However, it has received support from HSBC plc, the Summerfield Trust, and the Ernest Cook Foundation. The Appellant has also introduced a Friends and Patrons scheme, and now has some 380 Friends and 120 Patrons. These all give regular sums, many of them under Gift Aid, and receive privileged priority booking and parking rights. This scheme provides a regular income, which, in 2004 amounted in all, including gift aid tax relief, to £31,792. The Friends and Patrons are regular opera-goers and supporters of the charitable objects. Sponsorship is actively sought.

12. The opera has, Mr Graham said, between 1992 and 2004, increased from being a small gathering to regular sell-out audiences of 480 each night, with annual ticket sales of about 7,000. In 1992 tickets were sold for £25. In 2004 ticket prices ranged between £30 and £70, the average, Mr Crombie said, being £42. The price in 1992 had been fixed at what Mr Graham thought would be achievable and would result in full houses. When LDL took over the running of the operas, it was also seeking to make a profit. Since the Appellant took over from LDL, prices have been fixed so as to cover the costs of production.

13. In the beginning the target audience was local inhabitants. Now the audiences were national and international, especially for the Wagner productions. Some members of the audience travel substantial distances to attend. Mr Graham said that the audiences ranged from the very rich who arrived by helicopter to persons who were allowed a discount on prices. Many in the audience wear black tie, but a significant number come informally dressed. There is no “dress code”.

14. Our attention was drawn particularly to certain clauses in the Memorandum and Articles. Clause 3 of the Memorandum, the Objects Clause, provides that the objects of the Appellant 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 singing 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”

15. The Memorandum gives the Appellant the following powers in the furtherance of its objects (*inter alia*):

“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....”

16. Clause 5 deals with the application of the Appellant’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

...”

17. The Articles of Association also contain the following:

“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.”

18. Mr Graham dealt with the financial affairs of the Appellant. He said that the Appellant first received income in October 2001 from advanced bookings for the 2002 season. That was the first season of operas organised by the Appellant, and since that year it has arranged of most of them. There have also been productions at Longborough's theatre by two other opera companies, The Opera Project and Visible Music. Mr Graham said that he permitted the Appellant to have the use of the theatre, for which he made no charge; nor was there any written agreement to that effect, though, Mr Graham said, there was a “verbal agreement” that that would continue from year to year. He said that he was content for the Appellant to allow other charitable events to be held in the theatre, because that brought the Appellant's existence to a wider audience. He pointed out that clause 5 of the Memorandum contained an absolute prohibition of the payment of a salary, fees, remuneration or other benefits in money or money's worth to directors of the Appellant, and said that that prohibition had been strictly observed.

19. It was also the case, Mr Graham said, that clause 5.3 of the Memorandum allowed payment of “interest at a reasonable and proper rate on money lent” to the

Appellant by directors, and Clause 5.4 also made provision for payment of “reasonable and proper rent for premises demised or let” to the Appellant by any director. But no such interest or rent had ever been paid. The Commissioners had been approached by the Appellant on one occasion to seek their view of the situation if rent were charged to the Appellant. The view expressed by the Commissioners was that payment of rent would prevent the Appellant continuing to enjoy the cultural exemption from VAT. That proposal had therefore been dropped. Mr Graham added that the directors of the Appellant, known as “Trustees”, would never act otherwise than in accordance with the Appellant’s constitution, that they were aware of their duties, and that they took those duties seriously.

20. The Appellant banks with the same bank as that at which Mr Graham and his companies have been banking for some 30 years. The bank allows the Appellant a small overdraft, though there exists no formal agreement for that facility, nor is there any supporting guarantee or security. Mr Graham said that the only borrowing by the Appellant had been by means of that overdraft, and also when, on a few occasions, LDL had paid some of the Appellant’s expenses. That had occurred on occasions when the Appellant had run out of cheques. Mr Graham said that LDL also paid expenses of the Appellant such as insurance and lighting hire as it had in the past. LDL also paid some other expenses that were properly payable by the Appellant. Mr Graham said that he had not examined the figures, but expected that the bulk of those expenses were paid when the Appellant had run out of cheques. The bank made a charge to the Appellant in respect of each cheque issued. Each year it was necessary for the Appellant to draw several hundred cheques for refunds of ticket applications. In order to minimise the costs of so doing, the repayments were made by Mr Graham on a personal account on which no such charge was levied, and the Appellant reimbursed him each month.

21. In 1998, LDL began a four-year program to produce the *Ring* cycle, which would be performed alternately with the other operas being produced. LDL produced a shortened version, which had originally been funded by the Arts Council for the City of Birmingham Opera, and had been performed by that company in 1992 and 1993 but not since. Mr Graham considered that this would be a commercial opportunity for LDL. It is now produced by the Appellant, and attracts good audiences. Since only four opera companies in the United Kingdom ever perform the *Ring*, very good singers who were keen to perform Wagner were available at competitive rates.

22. Mr Graham drew our attention to a print of the Appellant’s website. That contains a brief history of the Appellant, and useful information as to booking and dining during its season, and a list of the operas to be performed in the 2005 season. There is also mention of The Opera Project, a body founded in 1993, described as one of the leading touring companies in the country. It also produces opera at Longborough, and will be presenting the production of *La Bohème* which will form part of the 2005 season. Its relationship with the Appellant was not made clear. In his witness statement, Mr Graham said that sometimes contracts are placed with a touring company to perform at New Banks Fee; sometimes they have been produced

by LDL, but since 2002 the Appellant “has been largely responsible for all productions”.

23. As to the organisation, Mr Graham said that each autumn the Trustees met to decide which operas would be produced in the coming year. That decision is then communicated to the artistic director, who is employed on an annual contract. He will then produce budgets, which are considered and agreed usually before the end of the year. The Trustees also agree the prices of tickets. Mr Graham said that sales were usually predictable from the previous year’s sales. The agreed budget was then given to the artistic director, and he arranged auditions. Contracts with singers were usually entered into in early January. Rehearsals were held in London in April and at Longborough in May, and performances in June and July. Ticket sales began in January.

24. The Appellant also provides a bar and restaurant and sells programmes. A copy of the 2004 programme was exhibited, as were a publicity leaflet and a brochure. Mr Graham said that he makes a building, which is normally a garage, available for the restaurant for no charge. The catering is done by outside caterers, who provide meals at a stated price, to which the Appellant adds a small mark-up. Advertising space, 14 out of 52 pages in the 2004 programme, is sold, and the Appellant seeks to recover the cost of printing and production of the programmes from advertising, so that sales receipts go to meet the cost of production of the operas.

25. Mr Graham said that the Appellant also permits the use, without charge, of the theatre outside the opera season by charities and local organisations for concerts and other activities. This again makes a wider public aware of the Appellant and the theatre. Those other organisations make their own arrangements for catering facilities, which are not provided by the Appellant.

26. Two important documents in this case were two “letters of comfort” of 12 January 2002 and 9 November 2002, written by Mr Graham to the Trustees of the Appellant. The letter of 12 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.”

That letter was signed by Mr Graham, and was written on paper headed Longborough Festival Opera. It was addressed to the Trustees of the Appellant, with copies to Michael de Navarro QC and Charles Crombie, who were the other two Trustees besides Mr and Mrs Graham. The letter of 9 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.”

That letter was written on LDL headed paper, and was also addressed to the Trustees with copies to Mr de Navarro and Mr Crombie. The paper had a brief advertisement for the Appellant's 2002 opera season at its foot. There was no mention of whether such support, if it were necessary, would have been a gift or a loan, nor, if the latter, whether interest would have been charged.

27. Mr Graham said that he had written those two letters because two of the Trustees, Mr Crombie and Mr de Navarro, had expressed concern about the possibility of a deficit arising as a result of putting on the *Ring*, 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. Therefore Mr Graham wrote to them to give "an assurance that either he or LDL would provide funds to cover any deficit in the 2002 and 2003 seasons respectively". Mr Graham wished to give such an assurance so that Messrs Crombie and de Navarro would remain as Trustees of the charity. He did not, he said, expect that it would be necessary for himself or LDL to be asked to underwrite any deficit, nor was it necessary. But, he said, he would have honoured the assurance had it been necessary. He said that he was certain, when writing the letters, that he was not exposing himself to any significant financial risk. The letters demonstrated his willingness to continue using "his resources and those at my disposal" to ensure the continuance of the promotion of opera for the general public and to encourage attendance by those who might not otherwise go to the opera.

28. Mr Graham said that the *Ring* cycle was a special production because, although shortened, it was the first time that it had ever been produced in a private theatre. Having staged it once or twice, the Birmingham company could not continue to do so, and was pleased that the Appellant was prepared to put it on.

29. A bundle of photographs was produced, which depicted the exterior of the theatre, a barn with a Palladian style façade, and the design for a new façade, which is to be built after the 2005 season, and which will allow the height of the theatre to be increased by 10 to 12 feet, in order to improve the sound. There will also be new rehearsal rooms and dressing-rooms. The steelwork of the existing roof will be replaced by a proper roof. The new façade design is based upon the front of the Festspielhaus in Bayreuth, and the interior decoration on that in the Munich Opera House. The new orchestra pit will accommodate 80 players.

30. Trustees' meetings, Mr Graham said, took place three or four times a year. There had never been a Trustees' meeting without all four Trustees being present. The agenda was circulated two weeks before the meeting. There had never been an actual vote at any of the meetings, since there had never been a meeting at which all the Trustees were not agreed. The Trustees often suggested matters for discussion, such as surtitles, or performing the *Ring* in English.

31. Mr Graham said that in the 1990s the performances had been comparatively modest functions run by him through LDL, driven by his own bent for music. He and his wife are the only two directors of LDL. Mr Graham personally owns the land and

the theatre, and LDL owns the infrastructure, which includes the seating, boxes, carpets, and lighting. A letter dated 12 May 2003 from The VAT Consultancy, on behalf of the Appellant, to the Commissioners said that Mr Graham leased the theatre to LDL for a peppercorn rent. That, Mr Graham said, was an error. There was no such lease. It had been suggested that he should lease it to the Appellant for a rent of 1p a year, simply to formalise the existing situation. There was also a letter from Mr Crombie to the Commissioners, dated 6 March 2003, in which he said that Mr Graham had granted a lease of the theatre to LDL, which had in turn granted a licence to the Appellant to stage the operas. That letter asked for confirmation that provided the licence fee did not exceed the open market value the exempt status would not be lost. That, too, Mr Graham said, was in error; Mr Crombie had then been writing on behalf of LDL and not the Appellant. No such lease, between Mr Graham and LDL, or licence between LDL and the Appellant, was produced in evidence.

32. In the report of the Trustees attached to the Appellant’s accounts for the years to 30 September 2002 and 2003, under the side-heading “Related parties”, it is stated that

“Operatic performances staged by the charity take place in a theatre at Longborough in Gloucestershire made available to it for this purpose by Longborough Developments Ltd, a company owned by two of the Trustees, Mr and Mrs Graham. A summary of transactions with Longborough Developments Ltd is set out in note 4 to the financial statements. At 30 September 2002 the charity owed £3,945 to Longborough Developments Ltd.”

(In the accounts for the year to 30 September 2003 the amount stated, in the equivalent paragraph, to be owed to LDL by the Appellant was £1,421.)

33. Note 4 to the 2002 accounts lists the following transactions:

“Advances during the year by LDL to the charity	£64,495
Remitted to LDL by the charity	60,550
Owed to LDL at 30 September 2002	3,945”

In the accounts for the year to 30 September 2003 there is no detailed list of transactions. The equivalent note (note 4) says:

“At 30 September 2003 there was an amount outstanding to Longborough Developments Ltd, a company wholly owned by the Trustees Mr and Mrs Graham, of £1,421 (2002: £18,677).”

It was not clear why the figure for 2002 was £18,677 rather than the figure of £3,945 mentioned in the 2002 Trustees’ report. (But see paragraph 36.) The figure of £18,677 is the sum of the prior-year adjustment in 2003, of £14,732, and the sum of £3,945 owed to LDL at 30 September 2002.

34. The VAT Consultancy also, in the letter of 12 May 2003, said that LDL intended to charge rent in respect of the theatre, and had made inquiries as to what the hire of a comparable theatre would be. Further information was requested by the Commissioners, and was provided in letters of 28 May and 16 June 2003. The Commissioners' response of 2 July 2003 contains much of their case in this appeal. The Commissioners accepted that the Appellant was a charity which was precluded from distributing any profits that it might make, and that such profits would be ploughed back into the facilities made available to visitors. They also accepted that the Trustees were those who made the highest level decisions, and that they received no salary. The Commissioners' letter continued:

“However, it is also necessary to consider whether the charity is managed and administered by anyone who has a direct or indirect financial interest in the opera activities (*c.f.* VATA 1994 Sch 9, Group 13, Item 2, Note (2)(c)). From correspondence and discussions it has been established that Mr and Mrs Graham, two of the four trustees, are directors of Longborough Developments Ltd., which is considering charging a rent to the Charity for the lease of the Opera building. It has also been confirmed that Mr Graham has agreed to personally guarantee any losses of the charity.

It is Customs view that as a result of standing as guarantor for the losses of the charity, Mr Graham does indeed have a financial interest in the activities of the charity - if the charity makes a loss he will presumably be obliged to pay any bills on its behalf and could indeed be financially compromised. The fact that so far he has not needed to help the charity in this way, or that the charity may undertake its activities so diligently that Mr Graham may never need to help the charity with its debts, is not the issue in question. It is the fact that Mr Graham, by agreeing to stand as guarantor for the charity's losses, cannot avoid having an interest, i.e. his personal financial position is directly affected by what the charity does.

We discussed the meaning of the legislation, particularly Article 13 of the EU Sixth Directive, and the meaning of item [*sic*] 13(A)(2)(a). Customs have deliberately chosen to apply both of the first two conditions here. The first condition (Art. of 13 item 13(A)(2)(a), first indent) covers the treatment of the profits that may be achieved by a cultural body. The second condition (Art. 13, item 13(A)(2)(a) second indent), which refers to ‘direct and indirect financial interest’, must logically refer to some other form of financial involvement that a person could hold in the cultural body. The possibility of a person taking the profits out of the charity has already been addressed in the first condition.

I must therefore conclude that your interpretation of the term ‘direct or indirect interest’ as meaning ‘direct financial gain’ is not correct. If a person who is responsible for directing the activities of the charity also has a financial interest in it - in that they personally stand to lose money - the conditions for exemption are not met. In addition, if Longborough Developments Ltd charge

a rent, as is proposed, to the charity, Mr and Mrs Graham will have a further financial interest, as they are directors of this company.”

They concluded that the Appellant was, therefore, not entitled to treat admission to the operas as exempt supplies, and expressed the view that the Appellant should have been registered for VAT since it took over the production of the operas from LDL. As a result of that letter, Mr Graham said, the idea of charging rent was abandoned. The writer of the letter of 12 May 2003, Mr Graham said, had not understood the distinction between Mr Graham owning the building and LDL owning what was inside the building. Rent never was charged to LDL.

35. It was not LDL which sold programmes, drinks, and catering services, Mr Graham said. But LDL received income from sales in respect of the 2002 and 2003 seasons, which was then credited to the Appellant by a “prior year adjustment” in the accounts. A caterer made all the catering supplies, and the Appellant received the difference between what the caterer charged and what the Appellant 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. In 2003 a detailed review of the whole of the administration was carried out, because there were questions which needed to be resolved. It was considered that the Appellant should be responsible for everything during the opera season. LDL had not settled any of the Appellant’s bills since that review. The dispute with Customs about the exemption was the catalyst for the review. After it, income which had accrued to LDL was transferred to the Appellant. Mr Graham said that he had not given any guarantee since 2003. There was, he said, no reason to suppose that the present financial sponsorship would diminish; it was more likely to increase.

36. Mr Crombie, in his oral evidence, explained a prior year adjustment as being made for the purpose of shewing those expenses against which LDL gave credit for net receipts from running bar, restaurant and programme sales, amounting to £18,341. After that adjustment, Mr Crombie said, LDL was shewn as having been owed £18,677 by the Appellant as at 30 September 2002. The prior year adjustment is not readily discernible in the accounts of either the Appellant nor LDL. We refer to this in more detail in the evidence of Mr Crombie (see paragraphs 41 to 43).

37. The profit and loss account for the year to 30 September 2003 shewed a deficit of £45,559. It also shewed a previously reported deficit brought forward of £45,759 and prior year adjustment of £14,732, which together amounted to £60,491, the deficit carried forward from the year to 30 September 2002. This, Mr Graham said, did not represent money owed; if this appeal were unsuccessful that total amount would have to be made good. The Appellant would have to make a national appeal; but even if that failed the Appellant would still be able to continue.

38. The Trustees’ report for the year 2001-02 relates, under the side-heading “Review of the activities and future developments”:

“...We opened the season with *La Traviata*, a production by The Opera Project.”

In the first paragraph a similar review in the Trustees' report for 2002-03 states:

“In the 2003 season, taking place in June and July, we staged our own new production of Puccini's *Tosca*, a joint production of Mozart's *Così fan tutte* with Visible Music, and The Opera Project's production of Benjamin Britten's *Albert Herring* which was supported by a £1,000 grant from the Britten Estate.”

Although The Opera Project (“TOP”) was tangentially referred to in the evidence, the financial arrangements relating to its productions were not explained at the hearing. It was not, in particular, made clear by whom the proceeds of sales of tickets were received, what the structure of TOP was, or what, if any, its relationship, legal or financial, to the Appellant might be. The joint production of *Così* was not mentioned at all. Again, we heard no evidence, during the hearing, about the destination of the receipts from ticket sales. We assumed, though possibly wrongly, that the expenses of production of the programmes for these years, and the receipts from the programme sales, were all incurred and received, respectively, by the Appellant. Nor were we told anything about the structure of Visible Music (“VM”), nor its relationship, if any, with the Appellant.

39. It was not until some time after the hearing that we learned, from a letter from the Appellant's solicitors in answer to an inquiry by the Tribunal (as an alternative to hearing further evidence on the point) more about TOP and VM and how they and their activities fitted into the pattern of things at New Banks Fee. We summarise the letter. When productions are put on at New Banks Fee by either TOP or VM the takings from sales of tickets and programmes and from catering sales are received by the Appellant. Both TOP and VM make supplies to the Appellant, and neither the Appellant nor LDL makes any supplies to either TOP or VM. VAT is charged upon those supplies, both TOP and VM being registered. No charge is made by LDL to either TOP or VM in respect of the use of the equipment in the opera house. There is no financial or other relationship between either TOP or VM and the Appellant, except that both the Appellant and LDL have in the past contracted with both those companies for some parts of opera productions for which a fee has been agreed and paid. The furnishings and fittings in the opera house which are owned by LDL are made available for use by the Appellant; LDL does not make any charge for this, nor does the Appellant make any payment.

40. Mr Charles Crombie is a chartered accountant and a sole practitioner. He is LDL's accountant, and advises the Appellant on accountancy and financial matters. The Appellant has separate and independent auditors. Mr Crombie was appointed a Trustee of the Appellant in 2000, shortly after it was incorporated, and is responsible for overseeing its financial affairs, while the day-to-day management is undertaken by Mr and Mrs Graham and the staff of the charity. He said that his primary duties were not concerned with either management nor assisting with the opera productions, but were wider than merely financial. He took his obligations very seriously. He was frequently consulted by Mr and Mrs Graham on significant financial decisions. He

reviewed the figures each year before they were sent to the auditors. He had become involved in the opera organisation in the days when the productions were put on by LDL.

41. Mr Crombie said that in practice, after the Appellant had taken over responsibility for the future opera productions, after the 2001 season, LDL continued to meet some of the production expenses. Such amounts were repaid, he said, when funds were available to the Appellant. In the accounts for the year to 30 September 2002, the expenses incurred by LDL on behalf of the Appellant amounted to £64,495. Part of that was due to the fact that the Appellant ran out of cheques. In the same year, the Appellant repaid £60,550 to LDL. Mr Crombie said also that there was an “inevitable” transition period in the change-over when the Appellant took over the productions from LDL, when expenses were being paid by LDL on behalf of the Appellant.

42. During 2003, Mr Crombie said, a very thorough accounting exercise was undertaken so as to ensure that all payments made by LDL in 2001-02 had been identified. This was necessitated by the fact that LDL had run the operas, and continued to pay all costs of the opera house. LDL was therefore paying some opera costs on behalf of the Appellant. The purpose of the accountancy exercise was to achieve the complete and transparent separation of the activities of LDL and the Appellant. The exercise revealed a further £33,183 paid by LDL on behalf of the Appellant. Consequently, in the accounts of the Appellant for 2002-03 a prior year adjustment was made to shew those expenses against which LDL gave credit for net receipts from running the bar, restaurant and programme sales of £18,451. That adjustment having been made, LDL was shewn as having been owed £18,677 by the Appellant as at 30 September 2002. In the year to 30 September 2003 LDL paid £42,011 on behalf of the Appellant, against which were offset net receipts from bar, restaurant and programme sales of £14,521. It was decided, in 2003, to give full credit for all receipts which were in any way connected with the opera. In his statement, Mr Crombie said that that decision was taken in the context of a possible interpretation by Customs and Excise of the requirements of the VAT exemption. The Appellant wished to avoid any area of possible challenge to its exempt status having regard to the financial implication for the charity losing that status.

43. In 2003 the Appellant paid £44,342 to LDL, and that discharged most of what was outstanding and due to LDL for 2001-02 and 2002-03. As at 30 September 2003, the Appellant owed only £1,421 to LDL. The result has been, Mr Crombie said, that the Appellant has received the full benefit of ticket sales, and of any opera-related income such as bar and restaurant receipts and programme sales and advertising revenue. In his oral evidence, Mr Crombie explained the purpose of the prior year adjustment as being: “to put right the accounts for the future where things which should have been in the accounts were not properly reflected in a prior year. Where certain costs should have been reflected in the previous year, the accountant will quantify it and include it in a subsequent year, so as to put it right.”

44. Mr Crombie said that there were three board meetings a year, all of which he had attended. He confirmed that there had never been a board meeting without all four Trustees being present. Every matter on the agenda was always discussed until agreement was reached, so that there was never any dissent.

45. The year 2003 was the first in which a surplus was made on the opera production, Mr Crombie said. That was the result of LDL's marketing efforts, which gave rise to improved sales, together with better control of the costs of production. He said that he had been involved in fixing the prices of tickets in 2003. The fact that no VAT was included was not a factor in deciding upon prices. Tickets were priced at levels below comparable operas, so as to appeal to a broader audience, though Mr Crombie said that he did not know how much lower.

46. Dealing with the financial statements, Mr Crombie said that the money owed by the Appellant to LDL would be reflected in the cost of sales. Any deficit was carried forward and made up in the following year. The profit of £14,932 in 2002-03 accounted for about a quarter of the deficit of £60,491. Under the heading "Creditors: amounts falling due within one year", was the item "accruals", of £60,588 for 2002-03 and £36,596 for 2001-02. The turn-over shewn in the accounts for each of 2001-02 and 2002-03 was stated net of VAT. In respect of those years Mr Graham had not paid any money under his letters of assurance, because the deficit was almost all due to VAT liability, and nothing had actually been paid out. The deficit carried forward from 2001-02 was the actual loss. Of the £36,596 creditors amounts falling due within one year, about £36,000 was potential VAT liability, and, again, was not money paid out. The £45,759 deficit carried forward was based upon a prudent approach by the Trustees: a potential liability which they were advised by the auditors should be included in the accounts. The £60,491 in the 2002-03 accounts reflected a similar potential VAT liability.

47. In the trading and profit and loss accounts for the two years, Mr Crombie said, there was no entry for programmes, restaurant and bar sales, or advertising, which were shewn in the accounts for 2002-03 which included figures for 2001-02. The prior year adjustment was not shewn in LDL's accounts. It was decided that that income should not go to LDL, mainly because the Trustees wished to make sure that everything to do with the operas was entirely separate from LDL.

48. Mr Crombie was referred to a letter from him, on behalf of the Appellant, dated 9 January 2002, to the Written Enquiries Team of Customs, relating to the exempt status. The third paragraph of that letter said:

"Income is derived solely from admission charges. Expenditure is principally payments for the lease of a theatre, and for theatrical productions, including producer, artists and musicians, and technical services. Administration of the charity's activities is performed on a voluntary basis including by staff seconded from a commercial organisation who are not paid by the charity and who have no financial interest in it."

That letter asked for confirmation that the Appellant qualified as an eligible body and that ticket sales were exempt from VAT under Group 13, Item 2(b), of Schedule 9 to the 1994 Act.

49. On 6 March 2003 Mr Crombie, on behalf of the Appellant, sought further advice from the Commissioner on a point which had arisen:

“The operas are performed at a theatre the freehold of which is owned by Mr Martin Graham, a Director of the Charity. A lease has been granted by Mr Graham to Longborough Developments Ltd., a company controlled by Mr Graham, who have, in turn, granted a licence to the charity to stage its performance. The charity wishes to maintain the exemption for its income and I would be grateful for your confirmation that provided Longborough Developments Ltd does not charge a fee exceeding the open market value for such a licence, the position will not effect [*sic*] the liability of the income of the charity.”

50. Further discussions ensued on the telephone, after which Mr Crombie gave fuller details:

“... I can confirm that the sole trading income of LFO derives from the sale of tickets to performances, which take place in an opera house building at Banks Fee, Longborough, Gloucestershire.

Permission granted by Longborough Developments Ltd to use the opera house building extends only as far as putting on performances. No charge has been made to date by LDL to LFO for this permission.

Income from restaurant and bar sales accrues to LDL itself, which also bears the cost of these activities. Restaurant facilities are provided by LDL in a separate building which does not form any part of the arrangement between LFO and LDL. I would advise you that LDL is registered for VAT ... and has accounted for output tax on restaurant and wet sales, and also on a small amount of income in respect of advertising in opera programmes. Restaurant and bar sales were only £17,000 in 2002.

As the sole source of trading income for LFO derives from the provision of operatic performances provided by an eligible body, and as Mr Martin Graham has no financial interest in the profitability of that charity, please would you confirm that a rent charge to LFO at open market value would not adversely affect the exemption of income from VAT under the provisions of the VAT Act 1994 Schedule 9 Group 13 Item 2.”

51. Asked about those letters, Mr Crombie said that income from activities other than ticket sales accrued to LDL. They were run by LDL as a separate sideline. The decision had not been made that the Appellant should get any credit for it. Those activities were run by LDL staff casual workers, and outside caterers. After the

review in 2003, when that income was put into the Appellant, the VAT position was adjusted.

52. In the Appellant's profit and loss account for 2001-02, the cost of sales of the Appellant is given as £273,605, whilst in that account for 2002-03 the cost of sales for 2001-02 (comparative figures) is shown as £306,788. It is also the case that in the 2002-03 trading and profit and loss account the income details for 2001-02 include receipts for programme sales, restaurant and bar sales, and advertising, amounting to £18,451. The turnover for 2001-02 is given as £236,289, whilst in the 2002-03 accounts, in the comparative figures, it is given as £254,740. Mr Crombie said that the 2001-02 cost of sales included in the 2002-03 accounts was included after the review. The extra £30,000 was never included in LDL's accounts. The review was undertaken to ensure the complete separation between LDL and the Appellant, which had not been the case before the review. In the future, he said, the Appellant will receive credit for all income and pay all expenses. The separation should work on a practical day-to-day basis. The Appellant's accounts are completely separate from those of LDL, and always have been.

53. The accounts of LDL for the years to 5 April 2000 to 2003 show, in the trading, profit and loss account, a debit item of opera costs (under "other income") in each year. In 1999-2000 it was £121,357; the lowest figure was £29,021 in 2000-01, and in 2002-03 it was £45,335. In the notes to the accounts for 2000-01, there was, under "extraordinary items", a prior year adjustment of £56,433, as a receipt by LDL. The opera costs for that year were £100,137. In each year the fixed assets of LDL include a depreciated figure for plant and machinery. There was no indication of what that was: whether it was office equipment, a company vehicle, or the equipment in the theatre was not revealed. The cost or valuation shown for the year 2002-03 was £60,115. The land and buildings shown in the notes to the accounts, valued as at 23 February 2003 at £4,090,318, was not particularised in the evidence, so that we were not informed whether or not it included the opera house. The directors' report in each year made no mention of the opera productions, notwithstanding that those costs were a significant item in the accounts. Only the principal activity of the company, the acquiring and developing of properties, was mentioned.

54. In his witness statement, Mr Crombie dealt with the two letters of comfort which Mr Graham had supplied. He said that Mr de Navarro had asked for the letters because the Appellant had no assets and there appeared to him to be a possibility of making losses, and therefore a possibility of personal liability. Mr Crombie's witness statement continued:

"...I did not consider that LFO would ever trade whilst insolvent because I had reason to believe Mr Graham would make charitable donations to cover any losses should they arise. Mr Graham had always provided an element of subsidy going back over many years and he has the resources to provide that subsidy. Mr de Navarro attends all Trustee meetings and in particular he examines all financial information presented to him in great detail and raises questions to satisfy himself before making decisions.

Knowing Mr Graham as well as I do I was not concerned to seek this assurance. Letters providing the assurances requested by Mr de Navarro were provided for the 2002 and 2003 seasons.”

The Appellant's contentions

55. Mr Hugh McKay appeared for the Appellant, and provided us with a skeleton argument. He began by reminding us that United Kingdom legislation should be interpreted in accordance with Community law: see *Marleasing SA v La Comercial Internacional de Alimentación SA* [1990] ECR I-4135. He contended that the expression “interest” in Article 13A.2(a) meant financial interest, and that it could only mean the sort of financial interest whereby a person is enriched, not impoverished. The first indent of Article 13A.2(a) referred, in the first sentence, to “profit”, which was the allowing of a person to be enriched, and was contrasted with a commercial organisation the aim of which was to enrich. The purpose of the Article was to grant exemption to bodies operating outside commercial spheres, bodies which exist to promote cultural services. The word “profit” in the second sentence was used in the sense of a surplus of income over expenditure. It was the second indent of that Article which the Tribunal would have to construe. The fourth indent made the distinction between this kind of body and a commercial enterprise.

56. In Note (2) to Group 13 of Schedule 9 to the VAT Act 1994, the word “profit” was, again, used in the sense of surplus. Note (2)(c) uses the expression “financial interest”, which, Mr McKay contended, also could only refer to a person who had an intention of making money out of it. The purpose of the exemption was to promote cultural activities as being in the public interest, and to exclude charities run by persons who did so for the purpose of enrichment. A contributor to a charity whose only prospect was to be out of pocket did not fall within Note (2)(c). To take the Commissioners’ case to an absurd but logical conclusion, if a person made a covenant in favour of a charity but make no payment, the covenant would be enforceable; but if he paid under the covenant he would only be impoverished. Circumstances in which someone was worse off as a result of an “interest” in a charity was a long way from the scope of the exemption.

57. The underpinning theme of the conditions for exemption was that a commercial body was one which had the enrichment of a legal or natural person as its object: *Kennemer Golf & Country Club v Staatssecretaris van Financiën* (Case C-174/00) [2002] STC 502; *Customs and Excise Commissioners v Zoological Society of London* (Case C-267/00) [2002] STC 521, and *Zoological Society of Wales v Customs and Excise Commissioners* (2004) (Decision No 18786). No mention was made in those cases of a person’s impoverishment or prospect of impoverishment. In this specific context the expression “financial interest” meant “remuneration, distribution of profits and any other financial interest”: see *London Zoo*. But the words “any other financial interest” should, Mr McKay contended, be construed as reflecting the first

two elements, remuneration and distribution of profits. The reasons why they should be so construed, he argued, were, first, that the language used in the expression as a whole carried with it the sense of a person receiving a benefit; secondly, that according to the *ejusdem generis* rule the general term takes its character from the preceding specific terms; and, thirdly, because the purpose of the Community and United Kingdom legislation was the exclusion from exemption of a commercial body. The fact that “distribution of profit” is a wide term (see *Kennemer*, per the Advocate General, at paragraph 47) reinforces the above proposition.

58. In *Kennemer*, the Advocate General (in paragraph 45) said that the idea of profit-making in this context related 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.” That, Mr McKay said, was the essence of the Appellant’s case. The focus was on the aims inherent in the organisation rather than on its results. The types of covert distribution suggested by the Advocate General (paragraph 47) were not present in the instant case. The Advocate General summed it up by saying that a non-profit-making organisation for this purpose was one which did not have as its object the enrichment of natural or legal persons and was not run in such a way as to achieve such enrichment.

59. Mr McKay referred to the judgment of the Court of Justice, which held that the purpose of the exemption was to benefit non-commercial bodies in the public interest. In paragraph 26, the Court said that for the purpose of Article 13A.1(m) an organisation was to be classed as non-profit-making “having regard to the aim which the organisation pursues, that is to say that the organisation must not have the aim, unlike a ‘commercial’ undertaking, of achieving profits for its members...” (The Court referred to the judgment, delivered on that same day, in *London Zoo*, which dealt with Article 13A.1(n).) A commercial body, Mr McKay said, enriches its members, a non-commercial body does not and must not.

60. In *London Zoo*, in paragraph 19, the Advocate General expressed the view that exemptions should be strictly interpreted but should not be whittled away by interpretation, while limitations should not be construed narrowly nor beyond their terms. The aim of the limitation was to preclude exemption where a body was ostensibly non-commercial but in which those operating it in fact did so for commercial gain. The second indent of Article 13A.2(a) reinforced the first, the Advocate General said, by ensuring that a formally non-profit-making organisation did not produce private profit for those who directed its activities (paragraph 21). Mr McKay said that that was clearly what the Advocate General considered to be the correct meaning of the second indent. In paragraph 26, the Advocate General said that the second indent “seeks specifically to exclude the possibility that the persons who manage or administer that entity may have any direct or indirect interest in the financial result of its activities.” In paragraph 30, he continued,

“the second indent of Article 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.”

Mr McKay said that that encapsulated the Appellant’s case, and the Tribunal could have no clearer guidance. That paragraph should be read with paragraph 31, in which the Advocate General said,

“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.”

There was no mention there, Mr McKay pointed out, of private impoverishment. Nor did it repeat the notion that there must be a specific prohibition of enrichment.

61. In the judgment of the Court, in paragraphs 17 and 18, the purpose of the limitations on the exemption was restated, and “financial interest” was specified as being “by means of remuneration, distribution of profits or any other financial interest, even indirect.” Again, Mr McKay said, the concept was of enriching, not impoverishing, the extraction of money or money’s worth from the body concerned into the hands of some other person. In paragraph 26, the Court again encapsulated the purpose of the limitation, by saying that the second indent was intended to distinguish “between the activities of commercial undertakings and those of bodies having no profit-making aim, that is to say those not aiming to achieve profits for their members.” Between them, Mr McKay said, *Kennemer* and *London Zoo* gave a plain and authoritative statement of the law.

62. It followed, Mr McKay contended, that the fact that there was a prospect of Mr Graham or LDL being called upon to provide funds to the Appellant in the event of a loss was not a “financial interest” in the Appellant within the meaning of either Article 13A.2(a), second indent, nor Note (2)(c) to Group 13 of Schedule 9 to the 1994 Act. Mr Graham was incapable of benefiting financially from the Appellant, and there was a prospect of his being worse off as a result of the letters of comfort. Accordingly, the Appellant was an eligible body within the meaning of Note (2)(c), supplies by which were properly exempt.

The Commissioners’ contentions

63. Miss Valentina Sloane, for the Commissioners, said that there were certain overarching points. The Tribunal must focus on the precise issue, of whether the Appellant is an eligible body. There is a strict condition of eligibility in both Community and United Kingdom law, which cannot be manipulated by commercial undertakings to the advantage of the bodies concerned. Any references to the purposes of the bodies does not override the strict condition. Personal integrity is

irrelevant, as is meritorious charitable work. *Bournemouth Symphony Orchestra v Customs and Excise Commissioners* (2004) (Decision No 18799) illustrated this. The benefit to the community was considered not to be relevant; but a person involved in the management was in receipt of fixed remuneration. The purpose of the conditions was to exclude the possibility of commerciality.

64. As a result of the financial guarantee given by Mr Graham, Miss Sloane said, the Appellant is being managed by a person with a financial interest. The required separation of powers is not present. The interlink between LDL and the Appellant was such that the Appellant is not precluded from distributing profits, has in fact done so, and could do so at any time. For the same reason, Mr and Mrs Graham have a financial interest in the outcome of the Appellant's activities. The test is purely objective.

65. It was the Commissioners' case that on the express wording of the first two indents of Article 13A.2(a), a body is disqualified if it is managed by a person who has a direct or indirect financial interest in the results of its activities. The first and second indents are separate and distinct criteria and are cumulative. There is nothing in the legislation which supports the Appellant's case. A financial guarantee given by a person who runs the Appellant ties his personal financial position to the Appellant and therefore fall squarely into Article 13A.2(a). On the ordinary meaning of "financial interest", it covers the situation in this case, since someone running the body, the Appellant, stands to lose personally depending upon the outcome of the Appellant's activities. That is an "interest". That is the starting point; the Appellant must persuade the Tribunal that some other meaning should be applied to "financial interest".

66. It was not in dispute that terms used to specify exemptions were to be interpreted strictly, being exceptions to the general principle that VAT was to be charged upon services supplied for a consideration by a taxable person, and that limitations on such exemptions should be construed broadly. The second indent of Article 13A.2(a) was a limitation, and fell to be construed broadly, and the expression "financial interest" was apt to include a guarantee of the sort given by Mr Graham. In *London Zoo*, the Court in its judgment (paragraphs 17 and 18) said that the legislation distinguished between "the activities of commercial undertakings and those of bodies not aiming to achieve profits for their members" and that therefore exemption was reserved for bodies with no 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 the results, by means of remuneration, distribution of profits or any other financial interest, even indirect."

The first two types of interest, Miss Sloane contended, were illustrative and not exhaustive. Miss Sloane drew our attention to paragraphs 25 and 26 of the Advocate General's opinion, that a concern felt in the drafting of Article 13A was that of

ensuring that certain activities should not benefit from exemption if run for commercial profit. He went on to say that

“The second indent ... seeks specifically to exclude the possibility that the persons who manage or administer that entity may have any direct or indirect interest in the financial results of its activities. The condition ‘on an essentially voluntary basis’ may thus be seen as reinforcing that basic prohibition.”

Paragraphs 30 and 31 made it clear that there must be no link between the charity and the trustees’ personal financial interests. The Advocate General’s opinion was expressed in those paragraphs (see paragraph 60 above). Miss Sloane contended, therefore, that where there is a guarantee such as that in the present appeal there is not the requisite separation of powers, because there is an extraneous factor which can influence the way in which the persons concerned run the business of the charity.

67. It was the Appellant’s case, Miss Sloane said, that “financial interest” in this context must mean enrichment or gain. But the purpose of the exemption was to distinguish between a commercial and a non-commercial undertaking. That purpose, as set out by the Court, is not disputed. The legislation has sought to ensure that the exemption is restricted to truly non-commercial bodies with the two strict conditions. The fact that a body is ostensibly run as a non-commercial enterprise does not answer the question whether or not it is an eligible body. It is not impossible that non-commercial bodies may fail to pass the test of eligibility: that is the price paid for ensuring that commercial bodies cannot manipulate the exemption. The purpose of the exemption does not allow either the Tribunal nor the Commissioners to override the specific requirements. The purpose of the exemption was to exclude the possibility of manipulation.

68. It was clear from the case law, Miss Sloane contended, that a director who was paid more than nominal remuneration by a charity had a financial interest in its activities, even if the remuneration was not linked to profits. The mischief aimed at was the possibility that such a director might run the business with one eye to ensuring that there would be a surplus, so that he should receive the remuneration which he might lose if the results were poor. There was no difference between that and the position where a director ran a company so as to make a profit so that he will not have to make good any deficit. Either example offends the principle of the separation of powers and the need for there to be no possible extraneous influence through the director’s personal finances: that might be permissible in a commercial body but not in an eligible body. Mr Graham’s guarantee is directly concerned with the outcome of the Appellant’s activities. Merely being indebted, as under a covenant to a charity, is not the same. The Commissioners relied upon the express wording of the legislation, the well established principle that a limitation on an exemption should be construed broadly, and the Court of Justice’s decision in *London Zoo* at paragraph 18, as well as the Advocate General’s opinion, which construe “financial interest” in a way which covers the guarantee in the present case. The Appellant’s contention that a

limited construction should be preferred places a misguided reliance on the purpose of the exemption and makes an artificial distinction.

69. Miss Sloane advanced a separate or alternative argument, based upon the proposition that an eligible body must not distribute, and must be precluded from distributing, any financial advantage to its members. She referred to two cases as illustrations of this: *Hangleton Farm Education Ltd v Customs and Excise Commissioners* (2004) (Decision No 19001) and *Messenger Leisure Developments Ltd v Customs and Excise Commissioners* (2003) (Decision No 18300) and [2004] EWHC 1761 (Ch). In the first, the Tribunal held that the appellant failed to meet the criteria for eligibility by reason of the fact that although precluded by its Memorandum and Articles from distributing profits, did so in practice by paying a licence fee to a director which was variable by him or at his request, and was capable of including a percentage of the appellant's turnover. Other fees were paid to another company of which the same director was sole shareholder and by which he was remunerated. In *Messenger*, the Tribunal held that it was not enough to say that because the appellant satisfied all the requirements of a non-profit-making body as derived from *Kennemer (supra)* that appellant was an eligible body, where a director of the body concerned was in a position to decide what was done with any surpluses. The Tribunal's decision was upheld on appeal. While neither of those cases was on all fours with the present appeal, Miss Sloane contended that a payment, such as rent, could constitute a distribution: see *Kennemer* at paragraph 33.

70. As to whether distribution of profits was precluded, the Tribunal must look at the substance and reality of the circumstances, and at whether distribution payments were capable of being made even if there were no present intention to do so. That, Miss Sloane contended, made obvious sense where there was someone with effective control over a commercial entity and a related purported eligible body: there would be obvious scope for manipulation. For sensible and practicable administration, the Commissioners must be able to look at the possibility of a distribution of profit, and not have to keep a constant eye on what the intention was. It was clear from the evidence that Mr and Mrs Graham controlled LDL, the commercial company. They also had effective control of the Appellant: see articles 48 and 50 of the Articles of Association. A quorum was two, and the chairman had a casting vote. The Appellant was not precluded from distributing profit: the Memorandum enables it to pay rent in clause 5.4. In *Hangleton* it was held that the payment of rent was a distribution.

71. Apart from the written documents, as a matter of substance and reality, Miss Sloane said, the relationship between the Appellant and LDL is, or was before the 2003 review, such that income relating to the opera activities could be allocated either to LDL or to the Appellant. Mr Crombie accepted that before the review there had not been a transparent separation between the accounts of LDL and the Appellant, and little scrutiny of what went on either by Mr Crombie or by the Trustees. Also, there was the question whether Mr and Mrs Graham could in future extract profit. They could, by means of rent. The answer to the question whether the Appellant had distributed profit was, that it had, in that money attributable to programmes and bar sales had been allocated to LDL, as shewn by the accounts. Until the 2003 review,

which took place in the context of the BAT dispute, that income had been going to LDL. That did not take place inadvertently; the operation was on the understanding that income from bar, restaurant and programmes was accruing to LDL. After the review, it was properly shewn in the Appellant's accounts.

72. The second aspect of the link between LDL and the Appellant, Miss Sloane contended, was that the Appellant was not run by people with no financial interest. The loan of a substantial sum by LDL to the Appellant constituted a financial interest. It was obviously in the interests of LDL, and therefore of Mr and Mrs Graham, that the Appellant should be in a position to repay that sum. On any view, there was a financial interest because of the possible enrichment or, even if the Commissioners were to accept the Appellant's view on enrichment, because of the possibility that LDL could extract income from the Appellant. Mr Crombie said that income from the bar, restaurant and programmes could be allocated to either LDL or the Appellant. At any time it would be open to Mr and Mrs Graham to charge rent to the Appellant, or to retain income from programmes and other sales for LDL, of which they were the two directors and shareholders. That did not fit within either of the alternatives suggested by the Advocate General in *London Zoo* at paragraph 31. The test was objective.

The Appellant's reply

73. Mr McKay contended that the Commissioners' case was based upon a misunderstanding of the exemption and of the meaning of "profits", and that, placing too much reliance upon objectivity, they had failed to explore certain topics with the witnesses. The Appellant is a charity, and has four Trustees all of whom take their duties seriously. They are not like the directors in the cases of *Hangleton* or *Messenger*, who were able to do whatever they liked untrammelled by any Trustees. This appeal was concerned with the interpretation of statute, not with strict interpretation, and with establishing the meaning of "financial interest".

74. Paragraph 31 of *London Zoo* refers to "consideration of private gain", not of private loss. In *Welsh Zoo*, the Tribunal did not accept the Commissioners' argument that "the results of the activities concerned" meant interests of any nature. The liability of the Trustees if the Appellant were trading whilst insolvent would be an interest in the results. But any person, subject to any duties as a trustee or under the Companies Acts, has an interest: this is a *reductio ad absurdum*. The Appellant draws the line between enrichment and impoverishment; to make the exemption work such a line must be drawn. The public interest is so great that it overrides the principles of neutrality. It cannot be the case that the exemption does away with any prospect of there being rich patrons of the arts. It cannot be correct that underwriting the losses of a charity is having a financial interest in it.

75. As to the secondary argument of the Commissioners, Mr McKay said that the ancillary matters, supplies of programmes and catering, had never been transferred from LDL to the Appellant. The Commissioners say that the receipt of income from those supplies by LDL is a receipt of profit. But in fact LDL had retained those sales,

which it already had, for itself. The prior year adjustment must be seen in the light of the VAT dispute. The review took place more than a year before the Commissioners' secondary argument saw the light of day, and a tidying-up exercise would have taken place at some time in any event. But no profit of the Appellant from sales of programmes or food and drink ever found its way to LDL. Any such transfer to LDL would have been *ultra vires* the Memorandum and Articles of the Appellant.

76. In both *Hangleton* and *Messenger* the businesses were the private playthings of the directors. In *Hangleton*, the director could have charged any rent he wished, and it would have included a proportion of turn-over, but the Memorandum of the Appellant allows only "reasonable and proper" rent. The opera is not the Appellant's or Mr Graham's private plaything with which he can do what he might wish, it is a trust. In *Kennemer* the Court said that one should look at what went on in practice. The Tribunal may not invent a state of affairs in the absence of evidence: the Commissioners failed to put the necessary questions to the witnesses. A failure to pay a debt is not a distribution; but it is argued that if it is the other way round, and LDL is owed money, that is a distribution. But the Appellant might never pay its debts. It would be *ultra vires* the Memorandum if the Appellant allowed LDL a profit-making opportunity at its expense. But it would not *be ultra vires* for the Appellant to pay a reasonable and proper rent to the Grahams. In *Hangleton* the rent was a distribution, because profits were being leached out of the company by the structure of the arrangement. In *Welsh Zoo*, however, there was no suggestion that it was greater than the market rate. The Appellant is absolutely prohibited from distributing any surplus by clause 5 of the Memorandum. The Advocate General, in *Kennemer* at paragraph 47, was dealing with covert ways of leaking value out of a business into the hands of members. He said that it was necessary to examine whether the aim of making and distributing profits could be deduced from the way in which the business was operated in practice. It was not enough to look only for overt distribution, which might take the form of unusually high remuneration or other methods of paying money to members. In *Welsh Zoo*, the Tribunal did not regard a rent which was not greater than the commercial rate as being a distribution. The Commissioners, on the other hand, say that any payment of rent would take the Appellant out of eligibility. The Trustees, who take their duties seriously, know this and cannot allow such a state to exist.

The issues

77. (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?

(1) – The construction of the expressions “interest” and “financial interest”

78. In the context of this appeal, it was submitted by the Appellant that the expression “interest” in Article 13A.2 meant financial interest, and that it could only mean an interest as a result of which the person concerned was enriched, and not one in which he was impoverished. A contributor to a charity, Mr McKay contended, who had no prospect but to be out of pocket had no such interest as is contemplated by Note (2)(c) to Group 13 of Schedule 9. There are two reasons why we disagree with that contention. First, it is by no means unknown for a person with a financial stake in a company such as is, on any view, a financial interest, to run the risk of being impoverished, possibly even very seriously impoverished, as well as having a real hope of enrichment. Secondly, in the case of the two letters of comfort which are at the centre of this case, it was certainly in Mr Graham’s interests that the Appellant should be so administered that it would be unnecessary for him to be impoverished by meeting his undertaking under those letters. It seems to us, therefore, that that qualification alone does not prevent the two letters creating or constituting a financial interest in the Appellant. Whether they did or not is another, separate, question.

(2) - In order to qualify as an eligible body, must it be legally impossible for that body to distribute profits? Can it qualify if, though legally permitted to make distributions, it does not do so as a matter of policy?

79. This appears to us to be the key issue in this appeal. We begin by referring again to the Memorandum of the Appellant (see paragraph 16 above). Clause 5 prohibits the payment of any part of the Appellant’s income or property, directly or indirectly, by way of dividend, bonus or otherwise by way of profit to the members of the company, and also prohibits the payment of any salary fees or remuneration or other benefit to any director. Specifically, clause 5.1 prohibits payment of

remuneration to any director for services actually performed, whilst allowing such payment to other members, officers or servants of the company. Clause 5 is qualified, however, by a number of subclauses, which do permit certain categories of payment to directors. Subclause 5.2 permits the payment of professional charges to a director for professional services; subclause 5.3 permits interest to be paid on a loan made by a director; sub clause 5.4 permits rent to be paid to a director for premises let to the Appellant; subclause 5.5 permits reimbursement of out-of-pocket expenses to a director; and 5.6 permits the payment of fees, remuneration or other benefit to a company of which a director is a member holding not more than 1 per cent of the issues share capital of that other company. In the context of this case, therefore, there are three subclauses under which a director could receive payment. The evidence has also shewn that there have been payments made to LDL by the Appellant. The question is, therefore, whether the fact that such payments as are permitted, whether any such payments are actually made or not, is enough to brand the directors, or any of them, with a financial interest in the Appellant. We therefore turn to the authorities for guidance.

80. In *Kennemer*, the Advocate General, in paragraph 45 of his opinion, said that the concept of profit-making involves the enrichment of natural or legal persons. He went on to say, in paragraph 47, that it was the aims which were inherent in the organisation, not the results, which would shew whether the organisation was a profit-making one. It was necessary but not sufficient to look at the express objects set out in the statutes of the organisation. The aim may also be deduced from the way in which the organisation operates whether the aim of making and distributing profits is present. That is not limited to overt distribution, but

“Such distribution might also, at least in some circumstances, take the form of unusually high remuneration for employees, redeemable rights to increasingly valuable assets, awards of supply contracts to members.... No doubt further methods of covert distribution can be devised.”

In its judgment, the Court said, in paragraph 19, that the purpose of the exemption provided by Article 13A.1 was to provide more favourable treatment for certain organisations the activities of which were directed towards non-commercial purposes. In paragraph 25, the Court stressed that the most important consideration was whether the organisation aims to make a profit and not the fact that it actually makes a profit. In paragraph 26, the Court said:

“On that point, it must be observed first of all that it is clear from Article 13A.1(m) of the Sixth Directive that an organisation is to be classed as being ‘non-profit-making’ for the purposes of that provision by having regard to the aim which the organisation pursues, that is to say that the organisation must not have the aim, unlike a ‘commercial’ undertaking, of achieving profits for its members (see, as regards the exemption provided for in Article 13A.1(n) of the Sixth Directive, the judgment given today in *Customs and Excise Commissioners v Zoological Society of London* (Case C-267/00) [2002] STC 521, paragraph 17.)”

And in paragraph 33:

“...As the Advocate General points out in paragraphs 57 to 61 of his opinion, it is not profits (‘benefices’), in the sense of surpluses arising at the end of an accounting year, which preclude categorisation of an organisation as ‘non-profit-making’, but profit (‘profit’) in the sense of financial advantage for the organisation’s members.”

On that point, the Court concluded that an organisation may be categorised as non-profit-making even if it systematically sought to achieve surpluses which it then used for the purposes of the provision of its services.

81. We obediently turn to paragraph 17 of the *London Zoo* case, pausing on the way to see what the Advocate General’s opinion on the point was, at paragraph 26:

“The second indent [of Article 13A.2(a)] reflects a slightly different aspect of the same concern [that certain activities should not benefit from exemption if they are run for commercial profit]. Rather than focussing, like the first indent, 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 or administer that entity may have any direct or indirect interest in the financial results of its activities. The condition ‘on an essentially voluntary basis’ may thus be seen as reinforcing that basic prohibition.”

Later, the Advocate General said:

“31. In line with the view I have taken above (at paragraph 26), the second indent of Article 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.

32. If a Member State operates that [second] 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.”

In its judgment, the Court said, dealing with the second indent of Article 13A.2(a),

“16. In that respect it should be noted at the outset that the second indent of Article 13A.2(a) of the Sixth Directive is an optional condition which Member States are at liberty to impose additionally for the grant of certain exemptions mentioned in Article 13A(1) of the Sixth Directive.

17. As for the interpretation of that extra condition, to the effect that a body availing itself of one of the exemptions in Article 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 Article 13A.1(m) of the Sixth Directive, *Kennemer Golf & Country Club* (Case C-174/00) [2002] STC 502, paragraph 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.”

The Court went on to hold that that condition applied only to the person directly associated with the management and administration of the organisation in question, and not to the persons working for reward in one way or another in the administration.

82. The Court dealt next with the part (b) of the referring court’s question, which it reframed as follows:

“24. ...whether, on a proper interpretation of the second indent of Article 13A.2(a) of the Sixth Directive, the words ‘on an essentially voluntary basis’ refer to the composition of the organs entrusted with the tasks of managing and administering a body, in the sense that it would be permissible, exceptionally and in a peripheral manner, for certain persons having a financial interest in the body to be involved in those tasks, or whether the words mentioned above refer to the reward which those persons receive, in the sense that it would be permissible, exceptionally and in a symbolic manner, to grant them certain financial advantages.

25. The Zoological Society, the United Kingdom government and the Commission are agreed that, on a proper construction of the words ‘on an essentially voluntary basis’, even if all the management of the body must be carried out by unpaid persons, the fact that paid staff take part occasionally or peripherally in the adoption of certain decisions, or that small or token payments are made to those staff, is not sufficient to deprive their activity of its essentially voluntary character and to justify the conclusion that the body pursues a disguised commercial purpose.

26. In that respect, it is apparent from the purpose of the second indent of Article 13A.2(a) of the Sixth Directive, as explained in paragraph 17 of this judgment, that the condition laid down by that provision is intended to make a distinction between the activities of commercial undertakings and those of

bodies having no profit-making aim, that is to say those not aiming to achieve profits for their members. The words ‘on an essentially voluntary basis’ thus refer both, on the one hand, to the composition, in terms of membership, of the directing organs or, as the case may be, to the persons who actually direct without being designated by the constitution, and, on the other hand, to the reward which the latter may receive, habitually or by way of exception, from the body concerned.”

83. These two decisions have been considered in a number of cases in, and on appeal from, this Tribunal. The first of these, in date order, was *Messenger Leisure Developments Ltd v Customs and Excise Commissioners* [2004] EWHC 1761 (Ch), on appeal from the Tribunal. In that case the appellant company was the wholly-owned subsidiary of a company which was a commercial organisation. The Tribunal found that the appellant had no business purpose independent of that of its parent, which was not a non-profit-making organisation, and that the parent company could at any time alter the constitution of the appellant and could alter the manner in which profits were deployed. Hart J upheld that decision, without finding it necessary to analyse the meaning of “financial interest”. Next came *The Zoological Society of Wales v Customs and Excise Commissioners* (2004) (Decision No 18786). In that case a member of the appellant’s council of management held a debenture from the appellant giving the right to repayment and interest, which were always waived, and also received rent for a small garage, and a small pension in respect of previous service with the appellant’s predecessor company. The Tribunal held that the appellant was a body having no profit-making aim, in the sense that it did not seek to make profits for its members. It held that that member of the committee of management did not receive any reward or financial advantage because she provided commercial consideration for each of the payments made to her; therefore she had no financial interest. In paragraph 49 the Tribunal said:

“Of course, in the present appeal, the issue is not whether the appellant is non profit making but whether the payment of a market rent and a pension earned by long service with the appellant’s predecessor company and the entitlement (but not the receipt) of interest on, and repayment of, a debenture amount to an interest in the results of the activities of the appellant. However, the same nexus of legislation is in issue and we find it of interest that the Advocate General includes in the meaning of ‘profits’ any return on an investment in the assets of the organisation; unusually high (but not normal) remuneration; and other methods of covert distribution. This would seem to us to exclude payments made in consideration of supplies at a market rate; normal remuneration (or deferred remuneration such as a pension), and payments at a normal rate of interest on loans (or debentures). However, as the issue in *Kennemer* was not the same as the issue in this appeal we have relied for our decision only on the principles established by the Court of Justice in *London Zoological Society*.”

84. *Bournemouth Symphony Orchestra v Customs and Excise Commissioners* (2004) (Decision No 18799) concerned the payment of a salary to the managing

director of the orchestra who was also a member of the Board which managed the affairs of the orchestra. Referring to paragraph 18 of the judgment in *London Zoo*, where the Court said that the test was whether “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 other financial interest, even indirect”, the Tribunal continued, in paragraph 22,

“As the Court has emphasised, someone receiving remuneration from BSO is for the purposes of the test someone who has a financial interest in BSO. It was argued that a salary that does not contain any performance-related element and is purely flat rate does not in substance constitute a financial interest in the employer. We reject that argument. The words just repeated from the European Court’s decision [in *London Zoo*] deal with the matter directly. And, with respect, we would expect that to be so. Remuneration is an obvious way of extracting value from a body whether it is overtly profit-making or not. And the recipient of the remuneration has an obvious financial interest in the body paying it.”

The Tribunal dismissed the appeal.

85. The most recent Tribunal case was *Hangleton Farm Education Ltd v Customs and Excise Commissioners* (2004) (Decision No 19001). In that case a licence agreement between the sole director and the appellant provided for a licence fee to be paid to the director. The agreement also provided that the fee could be amended unilaterally by the director. The Commissioners’ case was that that was a covert distribution, and could be varied to adjust the licence fee to the precise amount of the surplus under the licence agreement. Having considered the principles set out in *Kennemer*, the Tribunal held, at paragraph 52:

“The Appellant company, although precluded by its Memorandum and Articles of Association from distributing any profit does in practice distribute ‘profit’ for VAT purposes by paying a licence fee to Mr Ellis which is variable by him or at his request. It is currently £700 per month but could include a percentage of Education’s turnover under the licence agreement.”

(In fact there were other payments which were made to Mr Ellis as well.)

86. Those Court of Justice decisions, followed as they have been in the other cases referred to above, establish the following. First, that exemption is only available to organisations which do not aim to make a profit. Whether they do so aim is to be discovered from the constitution, or from the Memorandum and Articles, of the organisation. But it is not enough simply to provide, in the constitution, that the organisation is precluded from distributing profit to its members. The test is whether the persons who manage and administer the organisation have a financial interest of their own in the results of the organisation's activities, by means of remuneration, distribution of profits or any other financial interest, direct or indirect. Those who

manage such organisations must not be in a position to run them so as to influence the results or to further their own enrichment.

87. It appears to us, therefore, that the conditions require that it shall not be possible for any person who is concerned in the management and administration of such a body to derive a financial advantage from that body. It is of no relevance that in any given case those who manage and administer the body are persons of manifest integrity, nor that they have a genuine desire to manage and administer the body so that it confers a benefit on the public even at their personal expense. If it is possible for those who manage it to manipulate it so as to derive personal benefit from it, then the body is not eligible for the exemption.

(3) - Is receipt, or entitlement to receipt, of any of the payments permitted by clause 5 of the Memorandum to be made to a director a financial interest in the Appellant?

88. The decisions of the Court of Justice in *Kennemer* and *London Zoo* make it clear that what would amount to a “distribution” for the purposes of Article 13A.2(a) extends to a wide range which includes remuneration (whether unusually high or not), distribution of profits, or any other financial interest, even indirect. It was submitted for the Appellant that “any other financial interest” must be construed *ejusdem generis* with remuneration and distribution of profits. We do not accept that. It appears to us that the “or” is disjunctive, and that the word “other” clearly contemplates types of financial interest which are not of the type of remuneration or distribution of profits. In *Kennemer* the Advocate General suggested other forms of distribution, and added “No doubt further methods of covert distribution can be devised.” The gravamen of the authorities in this context appears to us to be that the use of covert methods of distribution, or the capability of a body to put such covert methods into practice, is what takes such a body out of the definition of management on an “essentially voluntary basis”, and therefore out of the scope of eligibility for exemption. It is also clear from these authorities that distribution specifically out of profits is not a necessary ingredient of such covert distribution, since the examples given, such as remuneration and rent (“and no doubt further methods”), may not necessarily come out of profits, but would undoubtedly be means of transferring value from the body to an individual or through another body to an individual.

89. The Commissioners rely heavily upon the two letters of comfort as shewing that Mr Graham had a financial interest in the Appellant, since it was to his advantage to ensure that the Appellant so performed that he would not be called upon to subsidise it. Those two letters themselves raise a number of questions. In the first place, it does not appear that the two guarantees are enforceable: they are not deeds, and there is no consideration. On the other hand, having written such letters, although legally Mr Graham could decline to honour them, he would be under a very heavy moral obligation, and would risk the resignation of the other two trustees, the very possibility that he was trying to avoid. Further, it is not clear what exactly Mr Graham is promising to do, and he did not explain it during his evidence. Was he intending, if the need arose, to make a charitable gift to the Appellant, or would it have been a loan? If a loan, was it intended that the Appellant should pay interest

thereon, as permitted by the Memorandum? None of these things do we know, nor do we propose to guess at them.

90. The Commissioners also made the point that income was accruing to LDL which should have been that of the Appellant from the catering and bar sales, and that LDL was also in a position to charge, if it so wished, for the use of the equipment in the opera house. 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 the Appellant at all. If that were the case, then what they earned from those sales was never the income of the Appellant 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 the Appellant 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 the Appellant. Mr Crombie said also, in a letter to the Commissioners (see paragraph 50 above) 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.

91. Another area of uncertainty was that of the opera house itself. We have no reason not to believe that it was the property of Mr Graham. But what happened between Mr Graham's ownership and its use by the Appellant was explained in a number of mutually incompatible ways. Mr Crombie said, in a letter of 6 March 2003 (see paragraph 49 above) that Mr Graham granted a lease to LDL, which granted a licence to the Appellant for the purposes of staging the operas. It was at one stage proposed (see paragraph 50) that LDL should charge a rent to the Appellant, but that was abandoned on advice from the Commissioners that that would make the Appellant no longer eligible for exempt status. Mr Graham said that he permitted the Appellant to use the opera house, under a "verbal agreement" which continued from year to year, no charge being made for such use. Mr Graham said that Mr Crombie was in error in saying (as he had in two letters to the Commissioners) that he had granted a lease of the theatre to LDL. But it was also the case that the Trustees' reports attached to each of the years to 30 September 2002 and 2003, that the theatre was "made available" to the Appellant by LDL. Mr Crombie, as a trustee, must have known what the true situation was, so why he and Mr Graham differed on that matter is difficult to understand.

92. It was also shewn in the accounts for the year to 30 September 2002 that LDL had made advances to the Appellant which had been largely repaid. It does not appear that interest was paid, though there is no reason why LDL should not have charged interest had it so wished. The reason for the advances given by Mr Graham was that there had been occasions when the Appellant had run out of cheques when it was necessary to write large numbers of cheques for refunds of payments for tickets. It is a little difficult to understand how an organisation like the Appellant can run out of cheques for long enough for that to be necessary. There were also loans by Mr Graham himself to the Appellant, in order to avoid excessive bank charges, since the

Appellant was charged for each cheque, whereas Mr Graham was not. Again, it appears that no interest was charged, though it was permitted by the Memorandum.

93. It may be that the reality of the legal situation relating to the opera house, the nature of Mr Graham's promised subventions, and the supply of bar and catering services and programmes is of secondary importance. 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 the Appellant, as did LDL. Mr Graham was in control of LDL, and he and Mrs 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 the Appellant.

(4) - Do the "guarantees" given by Mr Graham create a financial interest in the Appellant?

(5) - Are the "guarantees" enforceable; does it make a difference if they are not?

94. 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 the Appellant 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.

Conclusion

95. 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 the Appellant, and their financial dealings, that Mr Graham had a financial interest in the Appellant 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."

96. Accordingly, this appeal must be dismissed.

97. The Commissioners indicated at the end of the hearing that they would not, in the event of their being successful, be seeking their costs. On behalf of the Appellant, Mr McKay asked for the costs of the Commissioners' late amendment of their statement of case in any event, as a mark of disapproval of such a tardy step and the extra work involved. The application for leave to amend was allowed, on Mr McKay informing the Tribunal that no actual prejudice was caused thereby to the Appellant. The purpose of the amendment was not insignificant, and was represented in the decisions in *Messenger Leisure* and *Hangleton*. It does not appear that any or any significant amount of costs has actually been incurred following the amendment, and the Commissioners have succeeded in this appeal including on the relevant point. In that event, we do not think that it is appropriate to make an award of such costs, which might be difficult to quantify, solely in order to shew a mark of displeasure. However, we do take the view that such an application could perfectly well have been and ought to have been made at a much earlier stage.

98. Before parting with this appeal, we would like to express our deep regret and sadness at the death of Hugh McKay, who had so ably and energetically presented the Appellant's case in what was by no means an easy appeal.