

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION

Case No: CH/2001/APP/294

Royal Courts of Justice
Strand
London WC2A 2LL

31 July 2001

BEFORE:

THE HONOURABLE MR JUSTICE PATTEN

WEST DEVON BOROUGH COUNCIL

Appellant

- v -

THE COMMISSIONERS OF CUSTOMS AND EXCISE

Respondent

Mr H McKay (instructed by Dario Garcia) for the Appellant

Mr K Beal (instructed by the Solicitor's Office of the Commissioners of Customs & Excise) for the Respondent

Mr Justice Patten:

Introduction and Summary of issues

1. This is an appeal by the West Devon District Council ("the Council") from the decision of the VAT and Duties Tribunal (Chairman: Mr Paul Heim CMG) released on 20 February 2001. It concerns the validity of an assessment for VAT in the sum of £89,911 with interest made on 13 December 1996 in respect of the period from 1 April 1995 to 28th April 1995. The assessment relates to tax undeclared as a result of various deductions made by the Council in respect of input tax charged by a firm of building contractors (Hayman Building Contractors) ("the Contractors") on invoices for work carried out to premises known as the Wharf in Tavistock as part of its conversion into an Arts Centre. The total cost of this work was some £830,000 of which £720,000 was provided by the Council out of its own funds with the benefit of a grant of £336,667 from the European Development Fund. An additional £130,000 was provided by The Wharf Community Arts Centre Limited ("the Company") under an agreement of 14 November 1994 by which the Council undertook to carry out the works of conversion as specified in the building contract with the Contractors in consideration of the payment of that sum and the Company agreed to enter into an

underlease of the Wharf 14 days after practical completion of the works. The underlease was for a term of 35 years at a peppercorn rent but with full repairing covenants. It was executed on 16 December 1994.

2. The Commissioners disallowed the deductions of input tax on the grounds that they were not attributable to a taxable supply of services the only relevant supply being a grant of the underlease which was exempt. By an amended Notice of Appeal the Council appealed to the Tribunal on four grounds:

(i) that the grant of the underlease at a peppercorn rent was not an activity undertaken in the course or furtherance of a business and that the input tax was therefore recoverable under section 33 VATA 1994;

(ii) that the supply of building services rendered by the Contractors was attributable in any event to a supply of building services by the Council to the Company which was a taxable supply so as to permit the credit of input tax under sections 25 and 26 VATA 1994;

(iii) that the assessment was void under section 73 VATA 1994 because it relates to input tax reclaimed in the period from 1 April 1994 to 31 March 1995. In accordance with section 73(2) an assessment to reverse a repayment or credit of VAT must relate to the relevant prescribed accounting period for the Council which in this case was each calendar month. Separate assessments should therefore have been issued for each of those periods;

(iv) the assessment was not made to best judgment.

3. The contention for the Commissioners was that the underlease had been granted in consideration of a premium of £130,000. It was therefore a business activity within the meaning of section 33. To the extent that the Council had supplied any building services to the Company it was done as an inducement to enter into the underlease and therefore formed part of that exempt supply. The alleged defects in the assessment procedure were also challenged.

4. The Tribunal decided that the sum of £130,000 had been paid as a premium for the grant of the underlease and that the Council did not supply building services to the Company. The only supply it had made was the grant of an interest in land which was exempt. It further held that the supply comprised in the grant of the underlease did not fall within the exemption provided by section 33(1) VATA 1994 so as to entitle the Council to recover the input tax as not attributable to any business. It also rejected the challenge to the assessment under section 73.

5. Against that decision the Council now appeals on two grounds alone: (i) that the Tribunal was wrong to conclude that the section 33 exemption was unavailable; and (ii) that the assessment failed to comply with section 73(2). There is no challenge to the Tribunal's finding and conclusion that the underlease was granted in consideration of a premium of £130,000 and that the only supply of services made by the Council consisted of the grant of that lease. Nor is it any longer alleged that the assessment was not made to best judgment. The principal question therefore for this court is whether the Tribunal was entitled to conclude as a matter of law that the grant of the underlease for a premium of £130,000 in the circumstances found to exist

in this case was not within the provisions of section 33(1)(b) VATA 1994.

The Facts

6. In relation to the issue which now has to be decided the relevant facts (as found by the Tribunal) can be summarised as follows:

(1) West Devon suffers from a number of economic problems. In 1993 the Council applied for and received a grant from the European Development Fund to assist in the refurbishment and improvement of a site in Tavistock comprising various canalside buildings known as The Wharf. The grant application stated in terms that the project would assist in combating unemployment and developing the local economy of the area by assisting in the creation of a viable and self-sustaining economy and society; by encouraging initiative and enterprise and by promoting economic diversification. In more simple terms it would involve the repair and refurbishment of a listed historic building which would enhance and expand tourism in the area and create job opportunities;

(2) the Council was prepared to commit £720,000 of its own funding to this project of which £632,000 was considered to be eligible for grant aid. A grant was sought of £316,000 towards this work. On 14 December 1993 The Department of the Environment informed the Council that it had been awarded a grant of £336,677 from the European Development Fund;

(3) on 14 December 1993 the Company was registered at Companies House as a company limited by guarantee. It was a non-profit making charity whose objects included the provision of a wide range of projects and facilities for the promotion of the arts, recreation and social welfare;

(4) on 25 February 1994 the Council entered into the building contract with Hayman Building Contractors for the renovation of The Wharf at a cost of £830,000;

(5) on 21 October 1994 the Council provided a guarantee to Lloyds Bank up to the sum of £130,000 to secure the company's borrowings. On 14 November 1994 the Company entered into the agreement for the grant of the underlease to which I have already referred. In consideration of the payment of the sum of £130,000 by the Company (referred to in the agreement as "a payment towards the cost of the works and the Council's professional fees") the Council agreed to carry out the works of refurbishment in accordance with the specification contained in its agreement with the Contractors and to the reasonable satisfaction of the Company's surveyor. Within 14 days of the practical completion of the works the Company would take the underlease for a term of 35 years at a peppercorn rent but on a full repairing basis;

(6) the sum of £130,000 was paid by the Company to the Council in November 1994. The underlease was executed on 16 December 1994. It contains provisions exempting the Company from any liability to repair consequent upon a fault or defect in the design or construction of the demised premises under the building contract and an undertaking by the Council to

enforce at its own expense the terms of that contract against the Contractors;

(7) the evidence of the Council was that it did not intend to make a profit on the Wharf project. The Council became involved in the project not as part of any statutory obligation but as a discretionary matter intended to provide social benefits for its area. The building works were completed by the time that the Company took over the property under its lease. But the project could not have been carried out without the contribution of £130,000 from the Company.

The conclusions of the Tribunal

7. The essential conclusions of the Tribunal are contained in the following passages which deal first with the nature of the supply made by the Council and secondly with whether that supply fell within the exemption provided by section 33(1)(b). The Tribunal stated its conclusions in these terms:

(i) *The nature of the supply*

“As far as that is concerned the Tribunal finds that it is not possible to rely on the terms of the underlease alone to ascertain the correct incidence of value added tax, and this for the obvious reason that the question of value added tax was not fully present in the minds of at least one of the parties to that lease. Second, the arrangement between the Council and the Arts Centre was not, and it was frankly admitted, devoid of an element of artificiality. The Tribunal intends no criticism in making that finding, but the fact is that the underlease was expressed in a particular way, in relation to the building works issue, for a purpose unconnected with the works and the lease. The Tribunal asks itself what was granted by whom and to whom for what money, and reaches the conclusion that in return for the consideration of £130,000 expressed in the lease the Arts Centre received a 35 year interest in the building the subject of the underlease, that building having been refurbished for the purpose. The Council received the services of the building contractors in the refurbishment, having discussed with the Trustees of the Arts Centre the work that was being carried out, and having in accordance with the terms of the underlease authorised inspection by the surveyor of that Centre. However, it is accepted by the parties that the amount of £130,000 represented only a contribution to the building works, and in consequence cannot be attributed to any specific part of those works. The involvement of the Trustees before the execution of the underlease is not in the view of the Tribunal a necessary indication that building services were supplied to the Trustees. It is equally indicative of an interest by the Trustees in the works, preparatory to receiving the benefit of the underlease with the completed works, as supplied to the Council. There is no doubt that the contractors services were supplied to the Council. The question is did the Council make an onward supply of such works, or did it make a supply of the Wharf with the benefit of such works. Considering the chronology of the matter, that the building contract was entered into by the Council with the contractors on 25 February 1994, nearly a year before the execution of the underlease, the fact that the works themselves were much more extensive than the amount of £130,000 to be paid by the Arts Centre represents, and the fact that the Council clearly found it necessary to insist on a payment from the Arts Centre to make the whole project viable, the Tribunal concludes that this amount of £130,000 was nothing other than a premium paid for the underlease, and that the underlease amounted to a

supply of an interest in land.

.....

In the finding of the Tribunal the evidence points to the conclusion that the true construction of the agreement between the parties is that the Council received the benefit of the building supplies and paid for them, and the Arts Centre received the benefit of the lease paying for it in return a peppercorn rent for the period of the lease and, a premium of £130,000, (later adjusted upwards), which was payment for the lease, although expressed as a part payment for work carried out by the Council. The Council did not supply building services to the Arts Centre. It supplied the benefit of grant of an interest in land.”

(ii) **Section 33**

“In the present appeal the Council has made it clear that the totality of its actions in raising money for the refurbishment of the Wharf and furthering the activities of the Arts Centre and its successor body were in pursuance of its vocation as a public authority. The Tribunal considers that the pursuance of that vocation required the Council to enter into two specific agreements of a contractual nature under the conditions applicable to private traders the first being the contract for refurbishment with the building contractors and the second being the underlease with the Arts Centre. Both these were governed by the law applicable to private traders, and under conditions that applied to private traders generally; in neither of these was there any special element that distinguished the capacity in which the Council entered into them from that in which any normal private individual would enter into them. Further, the Tribunal does not think that it is open to it to say that a lease which incorporates not only a peppercorn rent but also a payment of £130,000 is not a normal commercial transaction. Considering the terms of section 33(1)(b) of the VAT Act 1994 the Tribunal is not able to find that the supply of the lease was “not for the purpose of any business carried on by” the Council. The lease was a business transaction. The Council was indeed at pains to present it as such. The consideration paid was substantial. By the underlease the parties entered into a business relationship. The Tribunal so finds.”

8. As indicated in the introduction to this judgment no challenge is made to the findings about the nature of the supply. But the correctness of the Tribunal’s conclusions about section 33 is the principal issue on this appeal.

The relevant legislation

9. The incidence of liability to VAT is laid down in the Sixth Council Directive. Article 4 identifies the categories of persons who are defined as taxable by reference to the economic activities they carry out. Article 4 (so far as material) provides that:

“1. “Taxable person” shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity.

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

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

10. The relevant domestic legislation is contained in the following sections of VATA 1994:

“Section 3

(1) A person is a taxable person for the purposes of this Act while he is, or is required to be, registered under this Act.

Section 4

(1) VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.

(2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.

Section 25(1), (2) and (3)

(1) A taxable person shall -

(a) in respect of supplies made by him, and

(b) in respect of the acquisition by him from other member States of any goods,

account for any pay VAT by reference to such period (in this Act referred to as “prescribed accounting periods”) at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

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

(3) If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then, subject to subsections (4) and (5) below, the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the commissioners; and an amount which is due under this subsection is referred to in this Act as a “VAT credit”.

Section 26 (1) and (2)(a)

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

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

(a) taxable supplies;

Section 94(1)

(1) In this Act “business” includes any trade, profession or vocation.”

11. An exempt supply is defined in section 31 and Schedule 9 of VATA 1994 as follows:

“Section 31(1)

(1) A supply of goods or services is an exempt supply if it is of a description for the time being specified in Schedule 9 and an acquisition of goods from another member State is an exempt acquisition if the goods are acquired in pursuance of an exempt supply.

Schedule 9

1. The grant of any interest in or right over land or of any licence to occupy land

12. The ability of a local authority to obtain a refund of VAT in relation to supplies of goods and services made to it is governed by section 33 which (so far as material) provides as follows:

“Section 33(1), (2) and (3)(a)

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

(a) VAT is chargeable on the supply of goods or services to a body to which this section applies, and

(b) the supply, acquisition or importation is not for the purpose of any business carried on by the body,

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

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

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

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

(3) The bodies to which this sections applies are –

(a) a local authority;”

The section 33 ground of appeal

13. The scheme of the VAT legislation (like the Sixth Directive) is to concentrate on the nature of the transaction or activity carried out. Supplies of goods or services within the united Kingdom (whether carried out by a local authority or any other person) are taxable unless specifically exempt. A local authority will therefore

charge output tax on any relevant taxable supply it makes and will be entitled to deduct input tax in the ordinary way on supplies of goods or services it receives which are properly attributable to the taxable supplies it makes. If therefore the Council had made supplies of building services to the Company it would under section 25(2) VATA 1994 have made a deduction of the input tax claimed by the Contractors. The same result would have been achieved had k made an election to waive the Schedule 9 exemption in respect of the grant of the underlease. But in order to rely upon section 33 the Council needs to demonstrate that the input tax relates to an inward supply of services which is not made for the purpose of any business carried on by the local authority. This phrase must bear the same meaning as the words "in the course or furtherance of any business carried on by him" in section. 4(1) VATA 1994. The section 33 refund provisions are therefore primarily designed to relieve local authorities of the burden of VAT in relation to supplies made to assist in the carrying out of activities which are not themselves taxable because they fall outside the scope of what can properly be regarded as their business; not because a supply itself is an exempt supply.

14. Section 4 VATA 1994 represents the way in which the United Kingdom has chosen to give effect to the provisions of Article 4 of the Sixth Directive. Article 4(5) makes no reference to the concept of the "business" of a local authority. Rather it concentrates on whether the transaction or other activity it was engaged in as a public authority. Some guidance as to what was intended to be included within the relief can be found in the decision of the European Court of Justice in *Ufficio Distrettuale delle Imposte Dirette di Fiorenzuala d'Arda b. Comune di Carpaneto Piacentino* (Case 231/87) [1991] STC 205. In its judgment the Court of Justice said this:

“13. A definition of the latter condition cannot be based, as has been argued, on the subject matter or purpose of the activity engaged in by the public body since those factors have been taken into account by other provisions of the directive for other purposes.

.....

15. An analysis of the first sub-paragraph of art 4(5) in the light of the scheme of the directive shows that it is the way in which the activities are carried out that determines the scope of the treatment of public bodies as non-taxable persons. In so far as that provision makes such treatment of bodies governed by public law conditional on their acting ‘as public authorities’, it excludes therefrom activities engaged in by them not as bodies governed by public law but as persons subject to private law. Consequently, the only criterion making it possible to distinguish with certainty between those two categories of activity is the legal regime applicable under national law.

16. It follows that the bodies governed by public law referred to in the first sub-paragraph of art 4(5) of the Sixth Directive engage in activities ‘as public authorities’ within the meaning of that provision when they do so under the special legal regime applicable to them. On the other band, when they act under the same legal conditions as those that apply to private traders, they cannot be regarded as acting ‘as public authorities’. It is for the national court to classify the activity at issue in the light of that criterion.”

15. It is not enough therefore for the local authority to demonstrate that in relation to the transaction in question it acted as a local authority. That would be the case in respect of all its activities. As a statutory body a local authority cannot act in

any other capacity. The determining factor seems to be whether the transaction itself is governed by the ordinary rules of private law or whether it takes effect under what the Court described as a special legal regime applicable to local authorities. This would mean that the letting of commercial premises owned by a local authority would (apart from being an exempt supply) not fall within Article 4(5) because the transaction would be governed by the same legal rules and principles as a letting by a private landlord. By contrast the provision of secure residential accommodation under the Housing Act 1985 would qualify in that the terms of the letting are applicable only to transactions involving local authorities with their particular statutory responsibilities in that field. The decision in *Carpaneto* also makes clear that the application of the Article 4(5) exemption does not depend upon whether the local authority is under a statutory duty to enter into the transaction. What matters is whether the governing legal regime is restricted to the local authority not whether the transaction is mandatory or permissive.

16. Confirmation that this is the correct application of Article 4(5) is contained in a further judgment of the European Court of Justice in *Finanzamt Augsburg-Stadt v. Marktgemeinde Welden* (Case C-247/95) [1997] STC 531 which was concerned with the letting of a building which had been constructed by a German Municipality. The premises were let to a brewery for use as a restaurant. The Municipality waived tax exemption on the rent and sought to recover the input tax it had paid on the costs of erecting the building. The Court of Justice held that Germany was entitled to treat the municipality as exempt under the fourth sub-paragraph of Article 4(5) (i.e. on the basis of the activities listed in Article 13). Exemption could only be established under this sub-paragraph because for the purposes of the first sub-paragraph the letting was governed by the ordinary rules of German private law. In paragraph 18 of its judgment the Court said this:

“18. It does not appear from the case file that the municipality acted as a public authority within the meaning of the first sub-paragraph of art 4(5) of the Sixth Directive. On the contrary, it appears that the letting activity was carried out under the same legal conditions as those to which private traders are subject. Consequently, that provision cannot be used to deny the municipality the status of taxable person.”

17. One of the difficulties inherent in the use of “business” as a test for determining the incidence of VAT is that it carries with it a variety of meanings depending on the context and the type of person in relation to whom it is used. In the case of an individual one obvious distinction is between business and pleasure. The owner of a large estate who invites his friends to join a shoot but asks them to contribute to the costs involved is not conducting a business; see *CCE v. Lord Fisher* [1981] STC 238. On the other hand the absence of profit does not prevent an activity from being a business if it bears all the characteristics of a serious and regular enterprise although run for charitable purposes. In *CCE v. Morrison’s Academy Boarding Houses Association* [1978] STC 1 the appellant company, a charity, owned and operated six boarding houses to accommodate pupils of Morrison’s Academy during their school terms. Fees were charged but they were set at a rate which was designed to cover expenses but not to make a profit. The Association contended that its activities did not constitute a business since they were provided exclusively to pupils of the Academy contained no commercial element and were not operated for profit. The Court of Session rejected these arguments. The Lord President (Lord

Emslie) dealt with the submission based upon a lack of profits in this way:

“.....I observe that nowhere in Part I of the 1972 Act is there any use of the word ‘commerce’ or ‘profit’ in association with the word ‘business’, or otherwise. With this general introduction I now ask myself, first of all, whether the tribunal were correct in concluding that no activities carried on continuously by a taxable person can ever be a ‘business’ if the profit motive is absent. In my opinion they were not. I can discover nothing in the natural meaning of the word ‘business’ so to restrict its scope and there is nothing in the context of the taxing provisions as a whole to require one to read ‘business’ in such a narrow way. The tax is, after all, not a tax on profit or income but on taxable supplies by taxable persons and to make liability to tax depend on the motive with which activities were continuously carried on would lead to the unreasonable result that where two taxable persons make identical taxable supplies in the course of carrying on an identical activity or occupation, in which each makes the same loss, or neither a profit nor a loss, and one has sought to make profit and the other has not, only the former would be accountable for value added tax.....If these activities are, as in this case, predominantly concerned with the making of taxable supplies to consumers for a consideration it seems to me to require no straining of the language of s.2(2)(b) of the 1972 Act to enable one to conclude that the taxable person is in the ‘business’ of making taxable supplies, and that taxable supplies which he makes are supplies made in the course of carrying on that business, especially if, as in this case, the supplies are of a kind which, subject to differences of detail, are made commercially by those who seek to profit by them. For my own part I consider that there is no justification in this case for holding that the activities deliberately and continuously pursued by the association in a business-like way are not a ‘business’ for value added tax purposes merely because the underlying motive is to assist Morrison’s Academy. Further, I see no possible justification for the necessity of there being any ‘commercial element’ in these activities to bring the association’s supplies within the scope of the tax. I am not at all quite clear what is meant by a ‘commercial element’ if it is something different from the pursuit of profit, but if there is a difference it appears to me that all activities customarily carried on by persons actively pursuing an occupation, profession or vocation will normally possess it in the sense that what is done is done for such a return that the operation will not be conducted at a loss.”

Lord Cameron dealt with the same point (at p.8h):

“The word ‘business’ in its dictionary meaning can include ‘occupation’ or ‘function’ and in my opinion the word ‘business’ as used in s.45(1) and therefore in s.2(2) is sufficiently comprehensive to include within its meaning ‘occupation’ or ‘function’. An occupation does not necessarily have as one of its objects the pursuit or promotion of profit or gain and a function can be discharged without yielding a profit; nor can it be said that the word ‘business’ is necessarily tied to such occupations or callings as are wholly commercial and pursued for the purpose of profit or gain. Indeed it is commonplace that for perfectly sound commercial reasons certain commercial undertakings can be carried on with the deliberate purpose of making neither a profit nor a gain or even in certain circumstances a loss, yet the absence of an objective of profit or gain should not and would not deprive the undertaking of the appellation of business.”

He stated his conclusions as to whether there was a business in these terms:

““But if the making of a profit or gain is irrelevant to the issue of liability

to this tax, then it seems to me absence of such a purpose is equally irrelevant to the issue of whether the potential taxpayer carries on a 'business' in making the taxable supplies. What has to be looked at is the activity itself and so regarding the matter I think it is impossible to resist the conclusion that in pursuing the objects for which the association was formed and is carried on the association are engaged in the carrying on of a business, that of providing boarding house accommodation and facilities for a particular section of the public who are invited to take advantage of the facilities provided, namely the parents of pupils of Morrison's Academy. If the question is put another way, how would this activity be properly described, without any reference to the issues of tax liability? I think the answer would be that it is essentially a business activity of a very usual and normal kind. It has every mark of a business activity: it is regular, conducted on sound and recognised business principles, with a structure which can be recognised as providing a familiar constitutional mechanism for carrying on a commercial undertaking, and it has as its declared purpose the provision of goods and services which are of a type provided and exchanged in course of everyday life and commerce. Not only so, but to some extent the association is necessarily competing in the market with other persons and concerns offering precisely similar services to the same clients or customers, i.e. the parents of pupils of Morrison's Academy who may seek or require residential and boarding accommodation."

18. These decisions help to identify whether a non-profit making activity can nevertheless constitute a business for the purposes of s.4 VATA 1994. The organised undertaking of the Association run on commercial lines although not for profit distinguished it from the informal and amicable arrangements made by Lord Fisher for his shoot. In relation to a local authority the question whether a particular activity constitutes a "business" has to take into account not merely the profitability or otherwise of the undertaking but also the statutory basis for it. This is evident in the present appeal. Mr. McKay for the Council has stressed the lack of commerciality in the arrangements made with the Company for the running of the Wharf. But his primary submission is that the Council entered into these arrangements on what he described as vocational grounds by which I took him to mean that the Council, although under no statutory duty, opted to support the development of the wharf in the social and economic interests of the residents of West Devon. This was in the nature of a social project with no commercial purpose. The letting to the Company did not therefore constitute the carrying on of a business.

19. Although I have some sympathy for the Council's predicament I cannot accept this argument. The relevant supply in this case was the grant of the underlease. The letting of property (albeit an exempt supply) can obviously constitute a business. The underlease has all the characteristics of a business activity described in the *Morrison's Academy* case in that it created a legal relationship between the Council and the Company for a consideration of £130,000 upon terms which included lull repairing covenants. We are not here concerned with an arrangement displaying the hallmarks of informality as illustrated by *CCE v. Lord Fisher*. As to Mr. McKay's first point about the lack of commerciality it can be said with some justification that the terms of the arrangements were un-commercial in the sense that the Company received through its lease at only a peppercorn rent a building which had been renovated as an Arts Centre at a cost of £830,000 of which only £130,000 was contributed by the tenant. But given that the centre was to be non-profit-making the

financial burdens on the Company including the repayment of the £130,000 borrowed from the bank and the need to comply with its covenants were not inconsiderable. This is not however the test. For there to be a business profitability is not essential. In *Town Investments Ltd v. Department of the Environment* 119781 AC 359 Lord Kilbrandon (at p.402) described the carrying on of a business as the carrying on of “a serious occupation, not necessarily confined to commercial or profit-making undertakings”. That definition is satisfied in this case. Mr. McKay criticised the decision of the Tribunal when it stated that the Council had been at pains to present the lease as a business transaction. That he said was not supported by the evidence. But even if this was inaccurate it does not detract from the Tribunal's essential reasoning which was that the lease was a business transaction and created a business relationship between the parties.

20. The real question therefore is whether the Tribunal in reaching this conclusion failed to give adequate weight to the social purpose and context of the arrangements as a whole. Iris at this point in the argument that the decisions of the European Court of Justice on Article 4(5) of the Sixth Directive become important. The judgments in *Carpaneto* and *Welden* (supra) make it clear that the subject matter or purpose of the economic activity under consideration do not dictate whether that qualifies for exemption. The deciding factor is the legal regime which actually governs the transaction. This distinction has been adopted in a number of English decisions on the application of what is now section 4 VATA 1994. In *National Water Council v CCE* [1979] STC 157 Neill J held that the mere fact that the services are supplied in performance of a statutory duty did not prevent them from being made in the course of a business. It was necessary to look at the services supplied and the terms of the contract or contracts under which the supply was made.

21. In *City Council of Norwich v. CCE* [VAT Tribunal: Decision Number 11,822: Mr. Stephen Oliver QC] the Tribunal had to consider a promotional scheme under which the Council provided advertising opportunities to commercial sponsors in return for payments which were used to defray the cost of its public functions and duties. The scheme enabled the sponsors to attach their names and logos to such things as litter bins and in various public places under the control of the Council. The Commissioners sought to recover VAT on the sponsorship payments made to the Council on the basis that they were received as part of a business. The Tribunal accepted that argument in these terms:

“In paragraph 16 of the *Carpaneto* decision the European Court drew a distinction between the activities engaged in by public authorities “under the special legal regime applicable to them” on the one hand and those conducted “under the same legal conditions as those that apply to private traders” on the other. Only in relation to the former were the local authorities taken out of VAT by Article 4.5. Here it seems to me Norwich Council is engaging in activities under the special legal regime (the Environment Protection Act ~990 section 45) applicable to it when it actually provides waste disposal facilities and educates the public in their use. But, in raising money from sponsors to help finance the campaign it is conducting its affairs as a private trader. It is doing business with outside sponsors under conditions “that apply to private traders” generally. That the Council is doing sponsorship deals to enable it to further its statutory function is, I think, beside the point; the special legal regime applicable to its activity as a public authority has nothing to do with these. It is simply entering into contractual relationships with outside sponsors under

conditions that apply to private traders generally.”

It seems to me that precisely the same analysis can be and was applied by the Tribunal to the transaction in the present case. Although the purpose of the underlease was to put into operation the Arts Centre for the public benefit the means adopted involved a business transaction under which the Council was able to raise an additional £130,000 which was essential to the scheme. It was doing so on terms applicable to private traders generally and not under any special regime. The Tribunal correctly directed itself and no grounds have been made out for interfering with its conclusions.

The section 73 ground of appeal

Section 73 VATA 1994 provides as follows:

“(1) Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.

(2) In any case where, for any prescribed accounting period, there has been paid or credited to any person -

(a) as being a repayment or refund of VAT, or

(b) as being due to him as a VAT credit,

an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly.”

22. The Council reclaimed input tax charged by the Contractors in each month in which a relevant invoice was received and paid. The details were entered on its monthly returns between April 1994 and March 1995. The assessment relates to the period from 1 April to 28 April 1995. It was issued in this form in reliance upon paragraph 4.4. of VAT Notice 749. This deals with the power of the Commissioners under section 33(2) VATA 1994 to allow recovery of input tax incurred in the making of exempt supplies where it represents in the opinion of the Commissioners only an insignificant proportion of the total tax incurred. Rule 4.4 sets out the limits which must not be exceeded in order for the allowance to be made. The input tax must be not more than £7,500 per annum or less than 5% of the total VAT incurred on all purchases in a year including those for non-business activities.

23. In order to apply this test the Notice stipulates that an annual calculation must be made for each financial year and any adjustments accounted for on the next VAT return. To comply with this the Council should have submitted details of any input tax wrongly reclaimed in the return for April 1995: i.e. the first month after the end of the relevant financial year. Because they failed to do this the assessment to recover the disputed tax was raised in respect of that period of assessment. The Council contends that once the disputed deductions had been identified there should have been separate assessments for each relevant accounting period in which the tax was reclaimed. This would require separate assessments to be issued for each relevant

month between April 1994 and March 1995.

24. Any refund of VAT pursuant to s.33 VATA 1994 can be made at such time and in such form and manner as the Commissioners may determine: see s.33(1). It seems to me that this provision entitles the Commissioners to lay down guidelines in the form of Note 749 indicating the procedure to be followed if a claim under s.33(2) is made. Given that the relief under s.33(1) was not available to the Council for the reasons already stated this is the only basis upon which the Council might have been able to reclaim the input tax relating to the exempt supply it had made. The Commissioners (through their officer Mr. Crouch) applied the guidelines contained in Note 749 and determined that no allowance was available under section 33(2). No challenge is made to that determination. In these circumstances the officer raised the disputed assessment based on a failure to account for the deductions of input tax in the return for April 1995. Retook that as the period of assessment in which the error arose.

25. If that assessment was made under the power contained in section 73(2) VATA 1994 then it was in my judgment incorrect. The power of the Commissioners to allow deduction of input tax attributable to exempt supplies on the basis specified in section 33(2)(b) fails to be exercised in accordance with Rule 4.4 of Note 749. The calculation is carried out at the end of the relevant financial year in relation to the return for the next prescribed accounting period. But if the limits are exceeded and no allowance therefore falls to be made then the result is that section 33 has no application at all and the taxpayer is left in the position of having made incorrect returns for each of the prescribed accounting periods in which the deduction of input tax was wrongly made. It is to those periods, not to the period relevant to a claim under section 33 that an assessment under section 73(2) should be directed.

26. But the answer to this ground of appeal is that the procedure laid down by section 73(2) is not mandatory. Although the power contained in section 73(2) is exercisable in any case where there has been an incorrect credit or refund of VAT in a prescribed accounting period I do not read that subsection as requiring the Commissioners to proceed under that power in every such case. They may, if they wish, exercise the power contained in section 73(1) on the basis that the returns that have been made are incomplete or incorrect. An assessment made under this power is not limited to any one prescribed accounting period. The two provisions are not mutually exclusive and if the assessment can be justified under either part of section 73 it will be upheld: see *Football Association v. CCE* (1985) VATTR 106. This ground of appeal also fails.

Conclusion

27. I will therefore dismiss the appeal.