



TC04479

Appeal number:MAN/07/0859

VALUE ADDED TAX – input tax – attribution to taxable supplies – partial exemption – standard method override – whether animal related costs of a zoo are attributable to taxable supplies of catering and retail – direct and immediate link – appeal allowed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

NORTH OF ENGLAND ZOOLOGICAL SOCIETY Appellant

- and -

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

**TRIBUNAL: JUDGE JONATHAN CANNAN
 MISS SUSAN STOTT FCA**

Sitting in public in Manchester on 24-26 November 2014

**Roderick Cordara QC instructed by Ernst & Young LLP and Mitchell Moss of
Ernst & Young LLP for the Appellant**

**Richard Chapman of counsel instructed by the Solicitor and General Counsel of
HM Revenue & Customs for the Respondents**

DECISION

Background

1. The North of England Zoological Society owns and operates Chester Zoo. It is a charitable body with a long established world-wide reputation in wildlife conservation and biodiversity management. Chester Zoo is the largest and most visited zoo in the United Kingdom. Depending on the context we shall refer to the appellant as “the Society” and to the activity it carries on as “the Zoo”.
5
2. The Zoo opened in 1931. In 1934 the Society was formed to operate the Zoo. The Zoo is essentially run as a commercial enterprise. Surpluses or profits are used to support the various activities of the Society which are all related to its charitable objects. The Society has an ongoing programme of capital expenditure and improvements at the Zoo.
10
3. In operating the Zoo the Society makes supplies of admission charges which are exempt for the purposes of VAT. It also makes a variety of taxable supplies including catering and retail supplies. We describe the Society’s supplies in more detail below.
15
4. The issue in the present appeal arises from the decision of the CJEU in the case of *Commissioners of Customs and Excise v Zoological Society of London [2002] STC 521*. Following that decision, HM Customs & Excise as it then was accepted that the Society’s admission charges were exempt from VAT. There followed discussions as to the appropriate method to restrict the Society’s input tax recovery.
20
5. The issue in this appeal concerns the extent to which the Society is entitled to recover input tax. It is a partially exempt trader with the result that it is not entitled to recover all the input tax which it incurs in running the Zoo. In particular we are concerned with the extent to which the Society is entitled to recover input tax incurred in respect of keeping and maintaining animals in the Zoo and in respect of improvements and building new animal habitats. The parties describe such costs as “animal related costs” and we shall adopt the same description.
25
6. The position of the parties may be broadly stated as follows:
30
 - (1) The Society contends that the “standard method” of input tax recovery (described below) represents a fair and reasonable apportionment of input tax to taxable supplies. It says that the animal related costs are a cost component of taxable supplies, including catering and retail supplies, as well as the exempt admission income.
 - 35 (2) HMRC contend that the animal related costs are a cost component of the exempt admission charges, but only some of the taxable supplies. In particular they contend that animal related costs are not a cost component of supplies of catering and merchandise. As such the standard method does not give a fair and reasonable apportionment and the standard method override ought to be applied.
- 40 7. The point in issue between the parties is essentially whether there is a sufficient link between the animal related costs and supplies of catering, merchandise and books

to justify apportionment of input tax on the animal related costs to those taxable supplies as well as to other taxable supplies and the exempt supply of admission charges.

8. The assessments under appeal (“the Assessments”) were made by HMRC to recover input tax credit to which they say the Society is not entitled. Following various adjustments the Assessments are as follows:

Date	Period(s) Ending	Amount £
30 June 2006	06/03	81,490
29 June 2007	06/05	136,948
13 March 2009	06/06	316,319
13 March 2009	06/07	344,297
9 May 2012	06/08	83,199
30 January 2013	06/09	87,464
19 April 2013	06/10	64,554
19 April 2013	06/11	68,817
28 November 2013	03/12	126,135

9. We are not concerned in this appeal with the quantum of the assessments. We are solely concerned with the principle as to whether the standard method override should apply in the relevant periods.

10. The Assessments cover the period between April 2003 and March 2012. During that period the Sixth Directive dealing with VAT was replaced by the Principal VAT Directive (“PVD”) but there were no changes of substance for present purposes. We shall therefore refer to provisions in the PVD.

11. We heard evidence on behalf of the Society from Mr John Iles who was until 27 January 2014 the Society’s finance director. Since then he has been the Society’s finance projects manager. He made three witness statements and gave oral evidence before us. His evidence included a short DVD showing a walk through the Zoo. Mr Iles grew up close to the Zoo. He visited it regularly as a child and has taken his children and grandchildren there on many occasions. He has known it for some 65 years. In the early 1990’s he worked for Ernst & Young as a chartered certified accountant and helped to develop a master plan for the Zoo.

12. HMRC relied on witness statements from Ms Margaret Harper and Mr Leslie Evans, both officers of HMRC. There was very little dispute as to the underlying facts. The parties’ submissions were generally directed to the interpretation of the facts and the application of the law to those facts. In the light of the evidence we make the findings of fact set out below. Before doing so we summarise the legal framework.

Legal Framework

13. The parties agreed the following general legal analysis, based on relevant statutory provisions and authorities. We deal in our decision below with points of difference, which essentially involve the application of agreed legal principles to the facts of the present appeal. Whilst the principles were agreed, we set out an analysis of the authorities in some detail because it helps to define the context in which the principles have developed. We have limited this section of our decision to the principal authorities referred to by counsel in their submissions.

14. The following provisions of the PVD are relevant for present purposes (emphasis added):

Article 1:

“The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.

*On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable **after deduction of the amount of VAT borne directly by the various cost components.***

The common system of VAT shall be applied up to and including the retail trade stage”

Article 168:

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

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

Article 173(1):

“In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.

The deductible proportion shall be determined, in accordance with Articles 174 and 175, for all the transactions carried out by the taxable person.”

Article 174(1):

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

- 5 (a) *as numerator, the total amount, exclusive of VAT, of turnover per year attributable to transactions in respect of which VAT is deductible pursuant to Articles 168 and 169;*
- (b) *as denominator, the total amount, exclusive of VAT, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible.”*

10 15. The standard method of apportioning residual input tax is laid down by regulation 101(2)(d) *Value Added Tax Regulations 1995*. It effectively operates by reference to the ratio of taxable turnover to total turnover as follows:

15 *“ (d) ... there shall be attributed to taxable supplies such proportion of the residual input tax as bears the same ratio to the total of such input tax as the value of taxable supplies made by [a taxable person] bears to the value of all supplies made by him in the period.”*

16. Residual input tax is input tax which cannot be attributed exclusively to taxable or exempt supplies, but is used in making both taxable and exempt supplies.

20 17. The standard method must be used unless HMRC either approve or direct the use of a special method. Where they do so, the method is known as a partial exemption special method (“PESM”). A PESM may be used where the circumstances require a different calculation to give a fairer and more reasonable proxy for the use made of inputs by particular supplies.

25 18. If the standard method is applied by a trader, but it does not give a fair and reasonable apportionment, a trader may be required to operate the “standard method override”. Regulations 107A and 107B apply where the standard method results in an attribution which *“differs substantially from one which represents the extent to which the goods or services used by [the taxable person] ... in making taxable supplies”*.

30 19. The law as to attribution and apportionment of input tax has developed in various domestic and CJEU judgments starting with the decision of the CJEU in *BLP Group plc v Customs & Excise Commissioners [1995] STC 424*. Much of what follows is drawn from the most recent analysis of the case law in *Lok’nStore Group Plc v Revenue & Customs Commissioners [2014] UKUT 288*.

35 20. In considering the case law we have had in mind the distinction between:

40 (1) Determining whether there is a right to deduct input tax at all, which requires a direct and immediate link between the input and at least one taxable supply or in the case of overheads to the taxable person’s economic activity as a whole. In other words whether the input tax can be attributed to taxable supplies. This process may be described as “attribution”, although that term is

also sometimes used to describe the second process of apportionment. For present purposes we use it to describe identification of the link.

(2) The second process involves apportioning residual input tax between taxable and exempt supplies. This process may be described as “apportionment”.

21. The introductory paragraphs of Henderson J in *Lok’nStore*, which was a case about apportionment, describes the distinction [1]:

“ This is a case about the methodology to be applied in apportioning residual input value added tax (“VAT”) incurred on supplies of goods or services which are used by a taxable person for the purposes of making both taxable and exempt output supplies. The input tax in question is “residual” because it cannot be exclusively attributed to either taxable or exempt supplies made by the taxable person. Where input tax is exclusively attributable to taxable supplies, a trader is entitled to deduct it in full from the output tax due on his taxable supplies. Conversely, where input tax is exclusively attributable to exempt supplies, none of it is deductible. Where, however, a trader incurs input tax on supplies (typically overheads) which are used, or to be used, by him in making both taxable and exempt supplies, the input tax has to be apportioned. Only the portion of this residual input tax which is apportioned to the taxable supplies is deductible: the balance, apportioned to the exempt supplies, is not.”

22. Some of the authorities which follow were decided in the context of attribution and identifying the link. Others are in the context of apportionment. It is important to maintain the distinction, however as Henderson J recognised at [40], authorities in relation to one issue may be relevant in relation to the other:

“40. ... it does not follow from this, in my judgment, that the two stages always have to be treated as rigidly distinct from each other. Depending on the precise facts, considerations which are relevant at the first (attribution) stage may also be relevant when examining the economic use made of the overheads at the second (apportionment) stage.”

23. It is convenient to begin with the principles set out by Carnwarth LJ as he then was in *Mayflower Theatre Trust Ltd v Revenue & Customs Commissioners* [2006] EWCA Civ 116 at [9]:

“ (i) input tax is directly attributable to a given output if it has a “direct and immediate link” with that output (referred to as “the BLP test”) [a reference to the decision of the ECJ in Case C-4/94, *BLP Group Plc v Customs and Excise Commissioners* [1995] ECR I-983, [1996] 1 WLR 174];

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

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

5

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

10

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

24. Where the link is to both taxable and exempt supplies, the residual input tax must be apportioned between the two. The process of apportionment was described by
15 Etherton LJ in *Revenue & Customs Commissioners v London Clubs Management Ltd* [2011] EWCA Civ 1323. He endorsed the approach of Warren J in *St Helen’s School Northwood Ltd v Revenue & Customs Commissioners* [2006] EWHC 3306 (Ch) and at [34] stated as follows:

20 “ A fair and reasonable attribution to a taxable supply must, for the purposes of art 17(2) and (5) of the Sixth Directive and reg 101(2)(d) of the Regulations, reflect the use of a relevant asset in making that supply. In assessing that use, and its extent, consideration is not limited to physical use. The assessment must be of the real economic use of the asset, that is to say having regard to economic reality, in the light of the observable terms and features of the
25 taxpayer’s business.”

25. In *St Helen’s School*, Warren J was concerned with apportionment of the inputs associated with constructing a school sports complex which was used primarily for the school’s purposes. It was also licensed to a company which charged for use by
30 third parties out of school hours. Warren J considered the task of assessing the extent of economic use of the inputs in producing the outputs and at [77] stated as follows:

35 “ On the facts of the present case, it seems to me that the overwhelming economic use of the sports complex by the School is in relation to the provision of educational services. In that context, I agree with Miss Simor that the source of funds and the purpose of constructing the sports complex are relevant considerations. To regard those factors as relevant is not, in my judgment, to fall into the error, as Mr Thomas would say it is, of categorising the nature of a supply by reference to the purpose or motive in making it. There is no doubt that in the present case, the supplies are distinct and readily identifiable, that is to
40 say the taxable supply of the licence to [the company] and the exempt supply of education. Nor, in my judgment, is there any question, in taking those factors into account of treating a taxable supply as an exempt supply or vice versa. The question is what ‘use’ is being made of the inputs in producing the outputs. It seems to me that the purpose of the School, objectively ascertained, in
45 constructing the sports complex is a highly relevant factor in attributing cost components between the relevant outputs and is an entirely different issue from

identifying the nature of the output by reference to purpose or motive (which is inadmissible), the issue addressed by Patten J in Customs and Excise Comrs v Yarrowburgh Childrens Trust [2002] STC 207.”

5 26. Warren J went on to find that objectively assessed the principal purpose in
building the sports complex was furtherance of the School’s educational activities and
making exempt supplies of education. The cost of the complex was met out of funds
dedicated to educational purposes and it was never intended that it would be met out
10 of charges to other users. Hence the standard method of apportionment based on
turnover was an appropriate proxy for economic use rather than a calculation based on
actual physical use. It is important to note that the parties had already accepted a
direct and immediate link between the inputs and the commercial income from third
party users.

15 27. Further, it is clear that the profits derived from various activities in a business
may, depending on the facts, be an important factor in identifying the economic
reality for the purposes of apportioning input tax. At [41] of *London Clubs* Etherton
LJ stated:

20 *“41. ... identification of the source or potential source of profit in a business
may be an important feature of a business throwing light on whether or not the
standard method or a [special method] is a more fair, reasonable and accurate
method of attribution. It all depends on the facts of each case ...”*

25 28. In *Volkswagen Financial Services (UK) Ltd v Revenue & Customs
Commissioners* [2012] UKUT 394 the taxable person was a finance company in the
Volkswagen group. It made taxable supplies of vehicles, at cost, and exempt supplies
of finance. The case was concerned with overhead expenditure and how it should be
fairly apportioned between taxable and exempt supplies. At [48] to [78] the Upper
Tribunal (Vos J as he then was and Judge Herrington) set out the development of the
authorities chronologically. We have had regard to that helpful summary but we shall
30 not repeat it here.

29. At [90] the Upper Tribunal summarised the test described by Etherton LJ in
London Clubs as follows:

35 *“90. ...We found most help in Etherton LJ’s judgment in London Clubs
Management where he reminds us that a fair and reasonable attribution to a
taxable supply must reflect the use of a relevant asset in making that supply, and
must be of the real economic use of the asset, that is to say having regard to
economic reality, in the light of the observable terms and features of the
taxpayer’s business. Close attention must be paid to the facts in order to
understand the economic or commercial reality underlying the use of the
40 relevant cost inputs, and the identification of the source or potential source of
profit in a business may be an important feature.”*

30. The Upper Tribunal came to a firm conclusion that the proposed special method attributing 50% of the overheads to taxable supplies of vehicles was not a fair and reasonable apportionment. At [97] it stated:

5 “ 97. What is required is a focus on economic realities. It is true that VWFS’s transactions will always involve a taxable transaction and an exempt transaction inextricably intertwined. But the finance transaction is, to put the matter colloquially, the ‘main event’ for VWFS. It is what VWFS is all about. Without it, VWFS would be a wholly unnecessary intervener.

10 ...

15 100. It is not the case, in our view, that residual input tax can never be deductible when the taxable part of the trader’s business is loss-making or cost-neutral, but in this case it seems really quite obvious to us that a proper application of the correct tests shows that there is no direct or immediate link between the residual input costs in question and the taxable sales of vehicles by VWFS. The direct and immediate link is between the residual input costs and the finance supplies which are predominantly exempt outputs. Likewise, the residual input costs are not, properly regarded, cost components of the taxable part of VWFS’s entire economic activity. They are cost components, as the FTT correctly found, of the financing part of VWFS’s business. That is the economic reality of VWFS. Its overheads are used for its financing business, which is exempt from VAT.”

25 31. In *Dial-a-phone Ltd v Customs & Excise Commissioners* [2004] EWCA Civ 603 the taxpayer marketed mobile phones and accessories and arranged insurance services. Advertisements for mobile phones with airtime service agreements also referred to an initial three month free insurance period but not the opportunity to insure thereafter. The issue was whether the input tax on marketing and advertising services was attributable only to taxable supplies or to both taxable and exempt supplies, the latter being the supply of insurance intermediary services.

35 32. The Court of Appeal in *Dial-a-Phone* held that the supplies were attributable to both taxable and exempt supplies. It rejected the taxpayer’s arguments that the insurance intermediary services were secondary to the taxable supplies and that the timing of the provision of insurance intermediary services coming after the taxable supply was relevant. At [75] Jonathan Parker LJ stated:

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

...

5 77. *As to the suggested 'secondary' nature of the insurance intermediary services, DaP's entitlement to commission under the Heads of Agreement between DaP and Cornhill represented a substantial proportion of its income during the relevant period. Insurance with Cornhill was part of the package of services advertised by DaP. To my mind, the fact that the advertisements referred only to the initial free three-month period of insurance is hardly surprising, and says nothing as to the relative importance to DaP of the insurance element of the package as compared with the making of taxable supplies."*

10 33. In *Mayflower Theatre Trust* the Court of Appeal had been concerned with whether there was a direct and immediate link between the cost to the theatre of buying-in a production and any taxable supplies made by the theatre. The position as a matter of law at the time of the *Mayflower* transactions was that if a link could be established to any taxable supply then the whole of the input tax would be repayable.
15 It is clear therefore that whilst the theatre made a number of taxable supplies, including confectionery and drinks, the decision of the Court of Appeal was limited to considering the taxable supplies where the best case for a sufficient link could be made out. That was essentially the programmes on sale to theatre-goers.

20 34. Carnwarth LJ succinctly set out the distinction to be drawn between residual input tax and overheads. It is particularly relevant in relation to the submissions of Mr Cordara QC in the present appeal and appears at [26]:

25 “26. *Input tax on services may fall within the partial exemption rules, first, where it has a direct link, and is therefore attributable, to both taxable and exempt supplies; or, secondly, where it has a direct link to neither, in other words it is "non-attributable". Both may be described as "residual". The second category, also well-established in the case-law, appears to be more usually (and more helpfully) described by the term 'overheads'.*”

30 35. Carnwarth LJ went on to explain that overheads have no direct and immediate link to any particular supply or supplies, but are linked with the whole economic activity of a taxable person. Hence, at [33] he states:

“ 33. *...The special treatment of 'overheads' or 'general costs' serves a particular and limited purpose in the VAT system, for those inputs which would not otherwise be brought within the calculation. It should not be extended beyond that purpose...*

35 34. *...[the present case] is not about "overheads", but about specific attribution. There is no doubt that the production services can be attributed to specific supplies in the form of the exempt ticket supplies. The only question is whether they can be attributed, in addition, to other (taxable) supplies. I would reject the 'overheads analysis'.*”

40 36. Input tax on overheads will be deductible where it has a direct and immediate link to the economic activity as a whole, subject to an appropriate apportionment.

37. In *Kretztechnik AG v. Finanzamt Linz Case [2005] STC 1118*, the taxpayer applied for admission to the Frankfurt Stock Exchange and was subsequently listed. It issued shares which is a transaction outside the scope of VAT. The tax authority refused to allow it to deduct input tax paid on the services it had used in relation to the admission to the stock exchange. The CJEU decided that those services had a direct and immediate link with the taxpayer's whole economic activity, so that it was entitled to deduct the input tax. At [36] the CJEU said:

“ 36. In this case, in view of the fact that, first, a share issue is an operation not falling within the scope of the Sixth Directive and, second, that operation was carried out by Kretztechnik in order to increase its capital for the benefit of its economic activity in general, it must be considered that the costs of the supplies acquired by that company in connection with the operation concerned form part of its overheads and are therefore, as such, component parts of the price of its products. Those supplies have a direct and immediate link with the whole economic activity of the taxable person (see *BLP Group*, paragraph 25; *Midland Bank*, paragraph 31; *Abbey National*, paragraphs 35 and 36, and *Cibo Participations*, paragraph 33).”

38. A similar case which permitted input tax deduction because the input was linked to the overall economic activity was *Skatteverket v AB SKF [2010] STC 419*. SKF was the holding company of an industrial group providing management services to group companies. The group was to be restructured and in order to raise funds SKF intended to dispose of all its shares in a wholly-owned subsidiary and a minority shareholding in another subsidiary. The CJEU was concerned with whether there was a right to deduct input tax on services obtained for the purposes of the disposal of shares. At [60] it stated as follows:

“ 60. It follows that whether there is a right to deduct is determined by the nature of the output transactions to which the input transactions are assigned. Accordingly, there is a right to deduct when the input transaction subject to VAT has a direct and immediate link with one or more output transactions giving rise to the right to deduct. If that is not the case, it is necessary to examine whether the costs incurred to acquire the input goods or services are part of the general costs linked to the taxable person's overall economic activity. In either case, whether there is a direct and immediate link will depend on whether the cost of the input services is incorporated either in the cost of particular output transactions or in the cost of goods or services supplied by the taxable person as part of his economic activities.

...
62. ... In order to establish whether there is such a direct and immediate link, it is necessary to ascertain whether the costs incurred are likely to be incorporated in the prices of the shares which SKF intends to sell or whether they are only among the cost components of SKF's products.

...

70. *Any other interpretation would burden the trader with the cost of VAT in the course of his economic activity without giving him the possibility of deducting it ...*

5 71. *... a disposal of shares which is exempt from VAT does not give rise to a right to deduct, the fact remains that that interpretation holds true only if a direct and immediate link is established between the input services and the exempted disposal of shares as an output transaction. If, on the other hand,*
10 *there is no such link and the cost of the input transactions is incorporated in the prices of SKF's products, the right to deduct VAT charged on the input services should be allowed."*

39. It is clear from the authorities that the test of a direct and immediate link does not equate to a 'but for' link. This is particularly relevant in relation to the way in which Mr Chapman puts the case for HMRC. It is not sufficient to establish a link
15 simply by saying that but for the input, the taxpayer would not be able to make the output.

40. In *Customs & Excise Commissioners v Southern Primary Housing Association Ltd [2003] EWCA Civ 1662* the taxpayer purchased land at a price including VAT, sold the land to a housing association and then entered into a development contract
20 with the housing association to build houses on the land. The taxpayer argued that there was a direct and immediate link between cost of the land and the supply of developing houses. The Court of Appeal held that there was no direct and immediate link as follows:

25 "32. *...The land purchase transaction was commercially necessary to make its performance commercially possible, but it was not a cost component of the contract itself in the same way as the costs of materials used. There is a link with the contract but the link was not direct and immediate. The development contract would not have been made but for the associated land purchase and sale. But 'but for' is not the test and does not equate to the 'direct and immediate link' and 'cost component' test."*
30

41. Both parties relied on a number of VAT Tribunal and First-tier Tribunal decisions in their submissions. They are not binding on us, although they do illustrate the application of relevant principles in different factual situations. We do not propose to refer to them all, but we shall at this stage refer to the decision in *Town and County Factors Ltd v Revenue and Customs Commissioners (Decision 19616)* relied on by Mr
35 Cordara and the decision in *The Roald Dahl Museum and Story Centre v Revenue and Customs Commissioners [2014] UKFTT 308* relied on by Mr Chapman.

42. *Town and County Factors* concerned whether the cost of information and television broadcast services supplied to Ladbrokes betting shops was attributable
40 solely to exempt over-the-counter ("OTC") betting or to its supplies generally. Those supplies included taxable supplies through certain gaming machines. The services were displayed on television screens in the betting shops. The Tribunal found at [16] as follows:

“ 16 ...The Appellant uses the inputs not only for taking OTC bets but to advertise the LBOs [Licensed Betting Offices] by making these and other facilities available to those visiting them in the hope that the public will visit LBOs or stay in them longer and purchase any supplies that are available to them. We appreciate that the Appellant's aim is not the issue but, regardless of the aim, it is objectively the case that the screens, particularly the central one showing the sporting event and the Sky screen, can be seen and enjoyed by anyone visiting the LBOs whether or not he places an OTC bet. As such it encourages the customer to enter the LBO and use any of the facilities available for purchase there.”

43. At [18] the Tribunal also stated in relation to a ‘but for’ link:

“... The point, it seems to us, is that a "but for" connection is not sufficient; the converse, that if there is a "but for" connection there cannot be a direct and immediate connection, does not follow..”

44. *Roald Dahl Museum* concerned a small museum in Great Missenden with two galleries, a crafts room, a café and a shop. The charge for admission was exempt. The issue concerned the input tax on exhibition costs. In particular whether it was residual input tax or linked only to the exempt admission charges. The Tribunal found that it was linked only to the exempt admission charge. At [84] it stated:

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

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

45. Factually this was similar to the issue in the present appeal, although it did not concern inputs having the effect of increasing dwell time at the museum which, as we shall see, is a fundamental part of Mr Cordara's argument. Mr Cordara made sustained criticisms of the decision in *Roald Dahl Museum*. We shall not rehearse those criticisms because the decision is not in any event binding on us. At most it illustrates the approach that particular tribunal took in circumstances similar to the present.
46. We should mention that the reference at [85] to *Royal Agricultural College* is to a VAT Tribunal decision (Decision 17508) in which it was held that there was no link between advertising inputs and taxable supplies from the college bar. The advertising inputs were plainly directed towards recruiting students and the exempt supply of education.
47. The parties agreed that certain principles emerge from the authorities which have particular relevance for the present appeal and which we must apply to the facts found. We can re-state them as follows:
- (1) Input tax will be recoverable where it has a direct and immediate link or is a cost component of taxable outputs of the business. The taxable outputs may be individual outputs or part of a class of taxable outputs.
 - (2) Cost components may be linked to a particular supply or supplies, or they may be linked to supplies generally, in which case they are overheads. Both can generate a sufficient link to lead to input tax being recoverable.
 - (3) Any given input may be a cost component of more than one category of supply. It may be more closely connected to one supply than another. The search is for a 'sufficient link', not the closest link. In other words the search is for a direct and immediate link, not the most direct and immediate link.
 - (4) Where an input is a cost component of both taxable and exempt supplies it will be treated as residual input tax and must be apportioned using an appropriate methodology.
 - (5) The enquiry as the sufficiency of the link will turn on an economic analysis of the relevant business and the use made of the input in an economic sense.
 - (6) There is a limit to any enquiry into the subjective motives of the trader in incurring the input. However the economic purpose of the trader in incurring the input, objectively ascertained, is relevant.
 - (7) Where an input is used to "hook" customers, such as the use of advertising, then it may at least be possible to link the input to all the various categories of supply which benefit from the hook.
 - (8) The degree to which the cost of an input is borne by the output is highly material.

(9) The degree of profit derived from potentially linked supplies will be a relevant factor in the enquiry as to economic use, as will the relationship between the cost of the input and the price of the output to which it might be linked.

- 5 48. There was initially an issue between the parties in relation to point (7) above. In the event however there was no real issue of principle. The difference between the parties extended only to the application of the principle to the facts of the present case.

Findings of Fact

- 10 49. Our findings of fact are directed primarily to the position in the years covered by the Assessments, that is 2003 to 2012. It is necessary to put the way in which the Zoo operated in those years into a historical context and into the context of the Zoo's plans for the future which were developed during those years. Having said that, we are conscious that it is the position in the years of Assessment which is relevant.

- 15 50. The Zoo was opened in 1931 by George Mottershead and his family, who lived at Oakfield Manor. The Society was established in 1934. The Zoo has grown considerably over the years and now covers an area of over 500 acres. It is the largest and most visited zoo in the UK and regarded as one of the top 15 zoos in the world. It has also been recognised as one of the UK's most successful visitor attractions.

- 20 51. The Society's charitable objects include promoting the conservation of animals and their habitats and the advancement of education in the same areas. More specifically they are defined as follows:

“(a) to promote the conservation of the physical and natural environment by promoting biodiversity; and

- 25 *(b) to advance the education of the public on the conservation of the physical and natural world and the promotion of biodiversity;*

in particular by but not limited to the provision of public education, scientific study and the maintenance of endangered animals, plants and habitats in both protective and natural environments.”

- 30 52. The control and management of the Society rests with its trustees. Everything the Society does is geared towards promoting its charitable objects. In addition to operating the Zoo, the Society supports over 60 projects worldwide. The majority of the Society's funding is derived from the Zoo.

- 35 53. The Zoo houses some 8,000 animals in 170 buildings and includes animal exhibits, shops, restaurants, and administration offices. It also has award winning gardens and several children's playgrounds. Visitors can make their way around the Zoo on footpaths and also via a monorail and a waterbus.

54. Catering facilities at the Zoo include:

- (1) Café Bembe (previously known as Café Tsave) at the main entrance.
- (2) June's Pavilion (previously called the Ark Restaurant) near a Children's "Fun Ark" and the tiger enclosure.
- (3) The Oakfield Restaurant and Acorn Pub located in Oakfield Manor, near the lion enclosure.
- (4) The Jaguar Coffee House.
- (5) Oaks Coffee Cabin.
- (6) Several kiosks located around the Zoo, called "Safari Snacks".
- (7) Various picnic lawns where visitors can take food they have purchased.

10

55. Retail facilities at the Zoo include:

- (1) The Gift Shop located at the entrance to the Zoo.
- (2) The Fountain Shop in the middle of the Zoo near the popular lion and tiger enclosures.
- (3) Various small temporary kiosks located around the Zoo.
- (4) Mobile sellers moving around the Zoo.

15

56. In 2010 the Zoo had over 1.2 million visitors. The following year that increased to 1.4 million. At the time the increase was attributed by the Zoo to investment in new animal exhibits, major events and fully refurbishing the restaurants.

20

57. Customer research shows that visitors come to the Zoo with one or more of the following intentions - to experience the animals, engage in various activities on offer such as rides and face painting, to eat and drink using the catering facilities and to shop in the retail outlets. In 2012 some 69% of visitors used the cafés and restaurants and 62% used the retail outlets. 75% of visits to the retail outlets resulted in a purchase.

25

58. A recent report which is representative of the period covered by the Assessments shows an average spend per visitor of £17.12 in 2010. The average spend may be broken down between spending on admission, food and drink, retail and other extras as follows:

30

Admission	Gift Aid on admissions etc	Catering	Retail	Extras (rides etc)
£9.44	£1.27	£3.58	£2.26	£0.57

59. The Zoo encourages visitors to spend as long a time as possible at the Zoo ("dwell time"). It does this through marketing literature and information identifying all the attractions and facilities. Activities include "Keeper for a Day", "Gardener for

a Day”, and animal adoptions for which there is a separate charge. These are supplies which, as their name suggests, involve a greater degree of interaction with the Zoo’s animals and exhibits than simply paying the admission price and entering the Zoo. In 2013 the cost of keeper for a day was £250, available for adults only.

5 60. There are attractions and facilities aimed at younger children including play areas, face painting, airbrush tattoos and junior membership of the Zoo. On average visitors spend 4 ½ hours at the Zoo on each visit. The Zoo carries out sophisticated market research with a view to identifying how the time spent at the Zoo by visitors can be increased. There are two obvious reasons why the Zoo wants to increase dwell
10 time. Firstly, to increase the educational benefit of visits, consistent with the Society’s charitable objects. Secondly, to increase the average spend of visitors to the Zoo.

61. Not surprisingly the attractions and facilities including catering and retail facilities all have animal themes, to a greater or lesser extent. The sight lines of restaurants are carefully planned to interact with the animal exhibits, more so in recent
15 years. The Zoo aims to create in so far as possible a seamless animal experience with themed zones flowing easily into one another. That approach was embodied in what is called the “*Natural Vision Master Plan*” produced in August 2010. It made provision for substantial capital investment in the Zoo in the period 2012 to 2024. Extending the dwell time of customers is fundamental to that plan. The long term aim of the Zoo is
20 to become what Mr Iles described as a “super zoo”. By that expression he meant a zoo which, amongst other attributes, gives an “all-immersive experience”.

62. In many respects the Master Plan reflects what the Zoo was already seeking to do during the earlier years relevant to the Assessments, albeit in a less sophisticated way. For example the Jaguar Coffee House includes a collection of artefacts from the
25 Amazon, which is the home of the jaguar. Café Bembe represents Africa and serves food inspired by traditional African meals. June’s Pavilion is named after the daughter of the Zoo’s founder, George Mottershead. It was refurbished and renamed in 2011 and features prints from her collection of photographs of the Zoo taken over the years. The Safari Snack kiosks are situated near to animal enclosures and feature pictures of
30 those particular animals. Some of the food and confectionery sold in the catering outlets is themed so as to appeal to children, such as “gorilla juice”.

63. Café Bembe is at the entrance to the Zoo. The main entrance to the Zoo was recently re-modelled so that visitors to Café Bembe can use the café to view rhinos and warthogs without having to enter the Zoo or pay the admission charge. The Gift
35 Shop can also be used without having to enter the Zoo. It is fair to say that there are not many people who use these facilities without entering the Zoo.

64. Oakfield Manor is a Victorian Grade II listed building which was where the Zoo first started in 1931. It contains a restaurant, a pub and conferencing facilities. It does not have animal themes as such, but the facilities and décor do reflect the heritage of
40 the Zoo.

65. It is certainly the case that the catering facilities have been improved and integrated into the experience of the Zoo over the years. In particular since 2009 when

the Zoo commissioned consultants to report on catering facilities. It was always the intention to have an integrated catering offering but until this report was commissioned the integration fell short of what was desired.

5 66. The retail offerings are to a large extent designed around species of animals found in the Zoo, for example soft toys of giraffes and African painted dogs. Until recently there has been an Animal Workshop outlet where visitors can stuff and dress a range of soft toys such as penguins, zebras and lions which have enclosures at the Zoo. There are ranges of other animal related merchandise such as games, clothing, crockery, kitchenware, postcards and artwork. For example T-shirts depicting the
10 Zoo's rhinos and prints depicting specific animals from the Zoo's exhibits. Animal related merchandise is approximately 70% of total merchandise sales. The other 30% is confectionery, drinks and ice creams.

15 67. The retail outlets also include a range of books for adults and children tailored around the animal collection and the Zoo itself. For example, to reflect the butterfly house a book entitled "What am I? Asked Butterfly" was commissioned by the Zoo and is offered for sale at £5.99. There are also guidebooks available for purchase with maps of the Zoo and relevant commentaries. Some books relate to specific animals in the Zoo but that is a small minority. Most are only generically linked to species of animals exhibited at the Zoo.

20 68. Mobile sellers move around the Zoo offering face painting and tattoos. For example a child might have his or her face painted as a tiger outside the tiger enclosure.

25 69. Catering and retail offerings are both affected by changes in the Zoo's animal exhibits. For example when a new elephant was born in the Zoo in July 2010 sales of soft toy elephants increased significantly. Similarly when the African painted dog exhibit opened, sales of painted dog merchandise increased significantly.

30 70. The Society seeks to maximise income streams. For example when the African painted dogs exhibit opened, a kiosk selling relevant merchandise was located close to the enclosure. The merchandise was also displayed prominently in the Gift Shop. Meal offerings are also themed around new exhibits.

35 71. The Zoo seeks to ensure that the retail offering has strong messaging about animals at the Zoo. However the Zoo does sell or has sold ranges that are not related to animals at the Zoo. For example it has in the past sold model planes, helium balloons and white tigers which are not exhibited at the Zoo. In 2011 approximately 12% of retail ranges were not driven by the Zoo animals or its exhibits, events and conservation messages. Helium balloons accounted for 8% of retail sales in 2010 but have since been dropped because of the environmental damage they cause.

40 72. The retail and catering strategies adopted by the Zoo have changed over the years covered by the Assessments. It is fair to say that they have become more focussed on animals at the Zoo in the later years as a result of market research carried out and reports commissioned from retail consultancies.

73. The Zoo commissioned a retail consultant to report in 2008. The report suggested improvements that could be made, in particular enhancing the themes of retail offerings. The Zoo had always tried to offer relevant and themed retail ranges but it became more sophisticated in its approach following this report.

5 74. It is clear from the approach the Zoo takes to investment in animal exhibits and facilities generally that its aims are not just to increase admission income, but also to increase catering and retail income.

75. The investment decision process of the Society changed in 2012 when the Natural Vision Master Plan was introduced. The Master Plan included various themes and strategic objectives which governed investment decisions in a more sophisticated way. It has resulted in more commercial scrutiny of decisions. Whenever the Society considers investment decisions on capital expenditure it now consciously takes into account projections of all revenue streams, including admissions, catering and retail. Prior to 2012 it was more of a working assumption that regular new animal exhibits were required to maintain and increase visitor numbers and all income streams. It was also a working assumption that increasing dwell time was desirable and would lead to increased income from catering and retail outlets. We are satisfied that the underlying relationship between investment decisions and maximising income streams from all sources was recognised by the Society prior to 2012.

20 76. The Zoo operates a membership scheme and as of March 2013 it had some 47,000 members. The annual membership is currently about £60 compared to an adult admission cost of £22. Members receive annual passes for unlimited entrance, special events, discounts on purchases and a quarterly magazine.

25 77. The Zoo also holds seasonal events such as a Frost Fair in the winter months which comprise an ice skating rink, Victorian style rides, a Christmas Market and themed entertainment. It also hosts weddings, conferences, Christmas parties and children's parties at Oakfield Manor.

30 78. The income of the Society is derived from various types of supply for VAT purposes together with income from donations and gift aid. The supplies made by the Society include the following:

- (1) Admission charges to the Zoo;
- (2) Monorail and waterbus rides;
- (3) Animal encounters, animal adoptions and "keeper for a day";

35 79. Payment of the exempt admission charge entitles a visitor to enter the Zoo and to remain at the Zoo until closing time. It also gives access to all the facilities offered by the Zoo, many of which entail a further charge.

40 80. The Society also owns all the shares in Chester Zoo Enterprises Ltd ("the Company"). The Company was formed in 1991 in order to carry out commercial operations which the Society had previously carried out itself but which were not within the Society's charitable objects as such. It is the Company which makes

5 catering and retail supplies at the Zoo. The profits of the Company are gift aided to the Society. Those profits are used by the Society to pursue its charitable objects, including investment in the Zoo and supporting its conservation programme. The Society and the Company together form a VAT group of which the Society is the representative member.

81. The animal related costs include the cost of animal feed, veterinary services, fuel to animal houses and maintaining animal enclosures. They also include the capital costs of new and improved animal enclosures and displays.

10 82. In the 10-year period from 2003 to 2013 retail and catering have contributed 67% of the overall surpluses of the Zoo. In the absence of those surpluses, the Society would have reported a net operating deficit in 5 of those years. We are satisfied that without the contribution to profits of retail and catering supplies the Zoo would have been forced to substantially contract its operations. The contribution may be summarised as follows:

Year	Society's Surplus/Deficit £'000	Contribution to Surplus/Deficit by Catering/Retail £'000	Society's Surplus/Deficit Without Contribution £'000
2003	2,299	1,283	1,016
2004	10,097	1,273	8,824
2005	2,432	1,269	1,163
2006	663	1,113	(450)
2007	781	1,545	(764)
2008	(200)	1,861	(2,061)
2009	3,625	2,114	1,511
2010	661	1,989	(1,328)
2011	1,116	1,709	(593)
2012	2,535	2,098	437
2013	3,125	1,915	1,210
£'000	27,134	18,169	8,965

15 83. The catering and retail contribution in the table are the catering and retail income less labour costs and cost of goods sold.

20 84. Monthly management accounts for the Society identify various income streams, the most significant of which are gate income, gift aid and donations, catering, retail and membership and adoptions. Key performance indicators and ratios are identified including number of visitors, sales per visitor, gross retail margin and gross catering margin.

85. Financial information for the year 2012 may be viewed as broadly representative of all the years covered by the Assessments. In 2012 the income of the Society may be summarised as follows:

The Society - 2012	£
Visitor Admissions	12,476,000
Memberships	2,411,000
Monorail / Boats	505,000
Other	351,000
Donations and Gift Aid	1,776,000
Animal Adoptions	192,000
Grants and Other Donations	67,000
Investment Income	147,000
Total Income	£ 17,925,000

- 5 86. In broad terms the whole income is available to fund the Society's charitable activities, because the Zoo itself is part of those activities. These figures do not include the catering and retail operations which are carried out by the Company. The Company's results for 2012 may be summarised as follows:

The Company - 2012	£
Catering and Retail Income	7,464,000
Labour and Cost of Goods	(5,366,000)
Operating and Support Costs	(1,228,000)
Property Rents	(562,000)
Profits Gift Aided to Society	£ 308,000

- 10 87. The operating and support costs reflect costs incurred by the Society and re-charged to the Company. The Society also charges rent to the Company for use of the catering and retail outlets. There is no re-charge of the animal related costs. This is because there would be no commercial or management benefit to be gained from such a re-charge. The animal related costs are treated for accounting purposes as part and
15 parcel of the Society's overall operations. Similarly the animal related costs are not directly reflected in the prices charged for catering and retail offerings, or indeed the price of admission. Prices charged for admission, catering and retail offerings reflect the UK market for "Large Visitor Attractions". The Zoo is classed as a large visitor attraction together with places such as Alton Towers, Legoland, the Eden Project as
20 well as other zoos such as London Zoo and Bristol Zoo.

88. Mr Iles' evidence was that capital expenditure on new animal exhibits was incurred in order to generate additional revenue from admissions, catering, retail and other income streams. We are conscious however that we must consider an objective analysis, by reference to the observable terms and features of the Zoo. We are
5 satisfied from the evidence we have seen that the Society operates its activities including the Zoo as a single entity. The total income from all income streams is available to the Society to fund the operation, general upkeep and maintenance of the Zoo, capital expenditure and the Society's conservation activities. Over the last 5 years the Zoo incurred animal related capital expenditure of approximately £14
10 million covering 21 different projects. Projects can take anything from several months to several years to complete. The costs range from £100,000 to £3.6 million.

89. Mr Iles referred to the relationship between income and expenditure as a "virtuous circle" and we are content to adopt that description. The better the collection of animals and habitats, the greater the income produced from all income streams.
15 That in turn provides funding to improve the animal collections and habitats.

Reasons

90. The Society has apportioned input tax on animal related costs using the standard method. This uses the ratio of the total value of all taxable supplies to the total value
20 of all taxable and exempt supplies made by the Society.

91. HMRC consider that a standard method override should be applied. The calculation used for the Assessments involves allocating residual input tax, including that associated with animal related costs, to two separate pots. Pot 1 comprises input tax having a link to all supplies, such as overheads. Pot 2 comprises input tax on
25 animal related costs. The recoverable input tax is the recoverable proportion of input tax in both Pot 1 and Pot 2.

92. In Pot 1 the standard method is applied. The proportion of Pot 1 input tax recoverable is:

$$\frac{\text{Total Value of Taxable Supplies}}{\text{Total Value of Supplies}}$$

30

93. In Pot 2 a special method is applied. The proportion of Pot 2 input tax recoverable is:

$$\frac{\text{Total Value of Taxable Supplies Linked to Animal Related Costs}}{\text{Total Value of Supplies Linked to Animal Related Costs}}$$

35

94. In Pot 2 the numerator and the denominator include animal encounters such as keeper for a day but exclude supplies of catering and retail. HMRC have accepted that other taxable supplies such as face painting and monorail rides should be included, even though HMRC do not accept that those supplies have a direct and immediate link to the animal related costs. The reason given is that HMRC say they are seeking to address what they perceive to be the main distortion in the standard method used by the Society

95. The principal issue is whether the animal related costs have a direct and immediate link to the catering and retail supplies. We can start from an agreed position that the animal related costs give rise to residual input tax. Both parties agree that the costs relate not only to exempt admissions, but also to taxable supplies such as animal encounters, animal adoptions and “keeper for a day”.

96. Strictly therefore the present case is about apportionment of residual input tax. However the real issue is one of attribution. In order to arrive at a fair and reasonable apportionment, it is necessary to resolve whether the animal related costs have a direct and immediate link to the catering and retail supplies.

97. Mr Cordara put forward two arguments. Firstly that there is a direct and immediate link between the animal related costs and the catering supplies. Secondly, what he described as an ‘overhead analysis’. That there was a direct and immediate link to all supplies because of the existence of a “unitary commercial offering”.

98. We accept Mr Chapman’s submission, based on *Mayflower*, that the overheads analysis and attribution to the economic activity as a whole only arises where inputs are not attributable to any taxable or exempt supplies. It cannot arise on the present facts because both parties accept that there is a direct and immediate link at least to the exempt admission charges and to some of the taxable supplies.

99. In any event and with respect, we do not consider that Mr Cordara’s second argument adds anything to the first. The Society’s economic activity as a whole comprises income from various streams. What Mr Cordara seeks to establish is effectively that there is a direct and immediate link between the animal related costs and each income stream. If that is right, he then says that the costs are linked to the economic activity as a whole. However, there is no need for the Society to make that second step. A sufficient link to each income stream including catering and retail supplies puts the Society in a position to attribute the input tax to all the income streams.

100. We shall therefore concentrate on Mr Cordara’s first argument. The burden is on the Society to establish a direct and immediate link. It is convenient however to commence with Mr Chapman’s submissions.

101. We can deal briefly with Mr Chapman’s submission that in some way the fact that the catering and retail supplies were made by the Company whereas the Zoo was operated by the Society meant there could be no sufficient link. We do not consider

that fact affects the analysis or the economic reality. The Society is the representative member of a VAT group and is treated as making the supplies made by the Company.

102. Mr Chapman relied on four propositions in support of his overall submission that the animal related costs had no direct and immediate link to catering and retail supplies:

(1) The Commissioner's acceptance of a direct and immediate link between the animal related costs and taxable supplies such as face painting and the monorail does not affect his overall submission.

(2) The link in the present case is nothing more than a "but for" link.

(3) The economic reality is that the animal related costs were incurred for the purposes of the Society's educational and conservation objects and not to generate catering and retail supplies.

(4) The economic reality is not affected by the unitary commercial business model identified by the Society.

103. We accept Mr Chapman's first proposition. Mr Cordara had submitted that it was inconsistent for HMRC to accept that the animal related costs have a direct and immediate link to face painting but not to catering and retail. In particular, in circumstances where the Society was arguing that the animal related costs were linked to the economic activity of the Zoo as a whole.

104. We do not consider that there is any material inconsistency in the approach of HMRC. It is a pragmatic concession which deals with what they allege is the distortive effect of including catering and retail supplies in a standard method calculation, and it simplifies at least to some extent the standard method override which they have adopted. They acknowledge that the standard method would not give rise to any material distortive effect in relation to less significant supplies such as face painting and monorail rides if those supplies did not have a direct and immediate link to animal related costs.

105. We shall deal with Mr Chapman's remaining three propositions compendiously. They are all factors which we must assess in determining whether there is a direct and immediate link, taking into account the evidence as a whole.

106. Mr Cordara submitted and we accept that in an input tax case it is the objective purpose of the supplier that is relevant, rather than the objective purpose of the customer. The purpose of the Society in incurring the animal related costs must be objectively ascertained from the evidence and from the observable terms and features of the Zoo.

107. At one stage Mr Cordara submitted that if we are satisfied customers consume the catering and retail offerings because of the animals, then a sufficient link would be established. We do not accept the submission in those terms, which amount to a "but for" link which is clearly insufficient on the authorities. It also seems to us that it wrongly put the focus on the purposes of the customer, rather than the supplier. Having said that, we do accept Mr Cordara's further submission based on *Town &*

County Factors that the existence of a “but for” link is not the end of the story. It is necessary to look further to see if there is a direct and immediate link. .

108. Mr Chapman submitted that the animals essentially provided the occasion for the supplies of catering and retail. We accept that the animals certainly provide the
5 setting in which all the supplies take place. In itself we agree that does not take matters beyond the stage of “but for”. It is clear from *Southern Primary* that a commercial link may satisfy a “but for” test but that is not the test. There must be something closer than merely a commercial link. The VAT Tribunal found something more in *Town & County Factors*. The services were equivalent to marketing services
10 and attracted customers into the betting shops with a view to using any of the different types of gambling on offer, not just exempt forms of gambling such as over the counter betting.

109. Mr Cordara argued by analogy with *Town and County Factors* that the animals at the Zoo were “the hook” to get people to spend money. Not just on admission to the
15 Zoo, but on other facilities, including catering and retail.

110. What Mr Cordara described as the hook, Mr Chapman submitted was the “main event”, in the words of the Upper Tribunal in *Volkswagen Financial Services*. The catering and retail supplies provided a revenue stream to fund the animals. In that sense he submitted that the link was the wrong way around. He also submitted that it
20 would be odd if the main event was also the hook to get people to use the catering and retail supplies.

111. We consider that is an artificial way of looking at matters. The economic reality is that the Society funds its costs from all income streams. Animal related costs are a significant element of those costs, as one might expect in a zoo. This is not a case
25 such as *Volkswagen Financial Services*, where the main event of the financing transaction was what the finance business was all about. Here, the admission to see the animals may well be described as the main event, but the catering and retail supplies are economically significant in their own right. We consider the relative significance of supplies further below.

112. Mr Chapman submitted that it was important to recognise that maintaining the animals at the Zoo was part of the charitable objects of the Society. The primary purpose of the Society in incurring the animal related costs was fulfilment of its charitable objects. We accept that everything the Society does, including operating the Zoo, is geared towards promoting the Society’s charitable objects. The Zoo does that
30 in two ways. It educates those who attend the Zoo. It also provides revenue streams which are used to fund the Zoo and the Society’s wider charitable activities.

113. Mr Chapman invited us to regard the charitable objects as in some way “overtaking” our consideration of the economic reality. As we understand it Mr Chapman submitted that the charitable objectives excluded the possibility of a direct
40 and immediate link between the animal related costs and the catering and retail supplies.

114. We do not agree. We accept Mr Cordara's submission that the context of the Zoo, in the sense that it was operated in order to fulfil the Society's charitable objects, does not exclude a direct and immediate link in relation to supplies other than exempt supplies of admission or the taxable supplies involving direct animal encounters. The animals are the "main event" but not just in terms of fulfilling the Society's charitable objects. The Zoo is an economic activity for VAT purposes. The purpose of the Society in incurring the animal related costs objectively ascertained is a relevant factor. It is the economic purpose that we are concerned with. We are not concerned with the fact that there is a non-economic charitable purpose in operating the Zoo. It seems to us that Mr Cordara's submission is consistent with St Helens School, where the supply of education was made for charitable purposes. It remained the economic use made of the sports complex costs which was relevant.

115. We consider that we should not focus on the charitable objects of the Society, but on the commercial operation of the Zoo. The educational element inherent in the Zoo is not provided for free. It is provided as part of the Zoo's overall economic activities.

116. Ultimately we consider that the existence of a direct and immediate link in a case such as the present is a matter of degree involving various factors relevant to economic use.

117. The extent of integration experienced by visitors observing the animals and enjoying the catering and retail offerings is a relevant factor. Mr Chapman effectively took a step towards recognising as much when he said that HMRC's position might be different if the Zoo was what was described by Mr Iles as a "super zoo" involving an all-immersive experience incorporating catering and retail offerings. However he submitted that in any event on the facts the Zoo was not, during the periods of the Assessments, sufficiently all-immersive. For example the catering offering was not such that the restaurants themselves were almost like an exhibit. He gave as an example a Disney theme park. In the period 2003 to 2012 he submitted that the Zoo was nowhere near such an all-immersive experience.

118. We are satisfied that "*the core of the Zoo's commercial proposition*" to use Mr Cordara's words is the animals. To a greater or lesser extent everything is driven by the animals. We accept that there are or were some products where the link to animals is weak or non-existent. For example helium balloons. However we consider that looked at in the round there is a strong economic link between the catering and retail offerings and the animals. Catering outlets and shops are carefully positioned and themed by reference to the animals. The Zoo is operated in a way designed to increase dwell time. This is done by improving and renewing animal exhibits and the other facilities offered by the Zoo, including catering and retail facilities. This is what Mr Iles described as a "virtuous circle". The better the collection of animals and habitats the greater the income from all income streams. In turn, that provides funding to improve the animal collections and habitats.

119. It is clear to us from an objective analysis of the terms and features of the Zoo as a commercial enterprise that the Zoo, in seeking to increase dwell time, has two purposes:

- 5 (1) The increase and improve the educational experience of visitors, consistent with the charitable objects of the Society, and
- (2) To increase revenue from admissions and from all the other income streams, including catering and retail.

120. Mr Cordara submitted that it was impossible to try and disentangle all the income streams. Each feeds upon the others. This was what he described as a “unitary commercial model”. In making that submission he described the animals as the “central draw” which was thereby a cost component of all economic activity at the Zoo.

121. Mr Chapman accepted that there was a link between the animal related costs and the catering and retail supplies. However he submitted that the link was indirect. He also submitted that the link only arose, as a matter of timing, subsequent to the costs being incurred. He accepted that animal feed costs and the like were an ongoing expenditure, but maintained that capital expenditure had to be paid for out of future revenue. We do not agree that there is any timing issue here. A similar situation arose in *St Helens School*, which was an apportionment case. It was accepted by both parties in that case, rightly we consider, that there was sufficient link to both income streams to satisfy the first stage of attribution.

122. We must focus on the extent to which the animal related costs are economically linked to particular supplies. The extent to which particular supplies make economic use of the animal related costs. Both parties accept that a “but for” link is present. If it were not for the animals and the animal related costs there would be no or much reduced catering and retail outputs. However that is not the test. The link must be closer than that. Whether one uses the term “cost component” or looks for the economic use that is made of the animal related costs.

123. This is not a case like *St Helens School* where the principal purpose of the school in building the sports complex was the furtherance of the educational activities of the school. The commercial use of the sports complex was never intended to fund the costs of the sports complex.

124. For the reasons given above one cannot say that the sole purpose of the Society in incurring the animal related costs is the furtherance of its educational objects. The purposes, objectively ascertained, include maintaining the income streams of the Zoo from all sources. Even if one could say that the principal commercial purpose was to generate admission income, the position would not be dissimilar to *Dial-a-Phone*. At [75] to [77] of the judgment in *Dial-a-Phone* the fact that insurance intermediary services may be viewed as secondary in a commercial sense was said to be irrelevant. What is relevant is the existence of a direct and immediate link.

125. Mr Chapman submitted that the Society would still incur the animal related costs even if there were no catering and retail facilities. Again we consider that is an artificial argument which does not accord with economic reality. It is clear that if there were no catering and retail facilities then the Zoo would have to operate on a much smaller scale. In that sense it supports the Society's case that the Zoo as an economic activity relies heavily on the income stream from catering and retail outlets, which in turn rely on the animal exhibits.

126. It is significant in our view that the catering and retail supplies were profitable, in the sense that they made a significant contribution to expenditure of the Society in all years under consideration. That is highlighted by the fact that in 5 out of the 10 years to 2013 the Society would have made a deficit without that contribution. During the course of those 10 years, catering and retail supplies made a contribution of some £18m to a surplus of some £27m.

127. Mr Chapman accepted that profit was relevant for the purposes of the present analysis, however he submitted that it was not particularly significant because the Society is a charity. We do not see how that affects the significance of profit in the present analysis. It may be more accurate to talk of catering and retail supplies making a contribution to the expenditure of the Society in pursuing its charitable objects. However the fact that the contribution is necessary for the Society to fulfil its objects at the level at which it does remains a significant factor in the analysis. The source of funding was certainly a significant factor in *St Helens School*.

128. We accept that there is a closer link between the animal related costs and the exempt supply of admission to the Zoo. The Society wants people to come to see the animals. It also wants people to come and spend a day at the Zoo using the facilities to the fullest extent possible. The more people come to see the animals and the longer their dwell time, the more money will be spent on catering and retail.

129. The degree to which the animal related costs are borne by the catering and retail supplies is a key factor.

130. It is true that the animal related costs are not directly reflected in the prices charged for catering and retail offerings. Nor are they directly reflected in the prices charged for admission. Prices are set by reference to the market for large visitor attractions rather than the costs incurred. Having said that, of course it is necessary for the Society to cover its costs from all its income streams. That is a factor highlighted by Mr Cordara. The Society's business model, in commercial terms exploits the animals in order to achieve various income streams, the most significant of which are admissions, catering and retail. In that sense the animal related costs are borne by all those supplies.

131. Standing back to look at the overall picture, it seems to us that in the particular circumstances of the Society's economic activities the animal related costs have a direct and immediate link to the catering and retail supplies. We are satisfied that economically the animal related costs are a cost component of the catering and retail supplies.

132. Notwithstanding our finding of a direct and immediate link between animal related costs and retail sales generally, we would have found in any event that the guidebooks are equivalent to the programmes in *Mayflower*. They are specific to the animals in the Zoo's collection and there must be a sufficiently direct and immediate link to those supplies. The same would apply to other retail products related to specific animals in the Zoo.

Conclusion

133. For the reasons given above we allow the appeal.

134. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**JONATHAN CANNAN
TRIBUNAL JUDGE**

RELEASE DATE: 19 June 2015