CA-2024-000806

IN THE COURT OF APPEAL

ON APPEAL FROM THE UPPER TRIBUNAL

(TAX AND CHANCERY CHAMBER)

Judge Rupert Jones and Judge Vinesh Mandalia

BETWEEN:

HIPPODROME CASINO LTD ("HCL")

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS ("HMRC")

Respondents

HMRC's REPLACEMENT SKELETON ARGUMENT

15 JULY 2024

References

- To the Appellant's skeleton: [AS/paragraph]
- To the judgment of the First-tier Tribunal: [FTT/Paragraph]
- To the judgment of the Upper Tribunal: [UT/paragraph]
- Otherwise, to the Core Bundle [Core/page] and the Supplementary Bundle [Supp/page]

Introduction

1. HMRC respectfully contend that there was no error of law in the UT's detailed judgment. Taking HCL's four grounds in turn:

    a. There was no error of law in the UT's approach to the FTT's decision. The UT was entitled to find for the reasons it gave at [UT/63-81] that the FTT had failed to give any reasons for rejecting the core argument advanced by HMRC.

    b. The UT was correct to find that the Tribunal can only direct a method other than the turnover-based method if it guarantees a more precise determination of the deductible proportion of input VAT. Hence the focus of the appeal must be on HCL's proposed method ('HCL's SMO Method'), with HCL bearing the burden of establishing that this threshold is met.

    c. The UT's observation on the facts before it that customer numbers were not a good proxy for economic use was an entirely reasonable one.

    d. There was no error of law in the UT's approach to how the block on input tax recovery for business entertainment works. The Value Added Tax (Input Tax) Order 1992 expressly excludes input tax credit in respect of goods and services used for the purposes of business entertainment. HCL's contentions are to the contrary effect.

2. HMRC would note, at the outset, that HCL do not appeal against the UT's finding at [UT/186] that HCL's SMO Method "*is critically flawed as HMRC claim. Whilst the*

premise of the floorspace SMO was that the gaming business was entirely separate, for the reasons that we have already set out, that was not the economic reality." The UT found substantial dual use of the areas identified as bars, restaurant and theatre, and HCL implicitly accept that this was a finding that the UT was entitled to reach.

Background

3. To help contextualize the grounds of appeal, HMRC would highlight the following.

4. HCL commenced business in July 2012.[1] HCL makes exempt gaming supplies ('the Gaming Supplies') and taxable supplies of Hospitality (food and drink) and Entertainment (collectively 'the Taxable Supplies') [UT/153].

5. The two appeals principally concern HCL's claim for greater input tax deduction for tax years **2012/13[2] to 2017/18** [UT/1]. That claim is advanced on the basis that the percentage of residual input tax recovered should be determined by way of its floorspace method ('HCL's SMO Method'), rather than the standard method. The value of the claim over those 6 years is set out at [UT/151]: over £3.2 million in aggregate.

6. The residual costs at issue – i.e. those costs which are not exclusively attributable to Gaming Supplies nor to Taxable Supplies – were detailed in [FTT/Appendix 2]. The five largest items in 2014 (some 73% of all residual costs) in order were rent,

[1] Witness statement Matthew King para 30 [Supp/63]
[2] 2012/13 was for the period of trading from July 2012, when the Hippodrome Casino opened, to March 2013. Thereafter, the years run April to March, i.e. quarters ending June, September, December, March.

building maintenance (which includes costs of utilities and air conditioning), cleaning, marketing, and security. Between 2013 and 2018, 67% to 78% of HCL's fixed costs related to property.[3]

7. HCL's SMO Method is described at [FTT/98] and [UT/187]. It is based on an allocation of the floor space across the six floors of the Hippodrome building, either to Taxable Supplies (Bars, Restaurant or Entertainment), or to Gaming Supplies, or neither ("Other Areas" – being "General", "Admin+IT", "Plant" and "CCC"[4]). The plans showing that allocation for 2013-14[5] are at [Supp/215-220].

8. The respective sizes of the areas in the allocation are identified in each of HCL's SMO calculations, so for example for 2014-15 at [Supp/4-5]. As HMRC noted before the UT:[6]

    a. Of the 7,051m2 of total floor area, 57.2% was allocated to neither taxable nor exempt supplies. In other words, the apportionment under HCL's SMO Method was governed by allocations of a minority of that space.

    b. The area allocated to bars totalled 952m2, more than double that allocated to either the restaurant (461m2) or the theatre/cabaret space (413m2). The issue of Dual Use of the bar areas is therefore of particular importance to the reasonableness of HCL's SMO Method.

[3] In 2012 the figure was 87%, but that includes costs which pre-dated the periods in the appeals.
[4] Chinese Community Centre which HCL was required to provide as a condition of its planning permission for developing the Hippodrome [FTT/52].
[5] There are only plans for 2013-14 [UT/136].
[6] HMRC skeleton UT, para 26 [Supp/232]

9. After the initial allocations, there is then a limited adjustment for complimentary food and drink provided to high value customers. This does not answer the Dual Use issue, because it only relates to the provision of free food and drink to some high value customers, whereas HMRC's case is that the economic use of the bar and restaurant for the purposes of the gaming business extends far beyond that.

10. Revenue is the key performance indicator used by HCL across all aspects of its business [UT/195]. As the Managing Director, Matthew King, set out in his witness statement, *"Revenue is the key performance indicator used by HCL because driving revenue levels up has been a major focus of the business since opening in July 2012"*[7].

11. The turnover figures are set out in HCL's SMO calculations, by quarter [Supp/2-15]. The table below aggregates them for each year, with the resultant recovery percentages under the standard method, and those under the HCL Method:

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Taxable Turnover, £m	4.2	6.4	7.6	7.3	8.3	9.0
Gaming Turnover, £m	20.9	42.6	50.4	55.5	60.4	65.9
Total turnover, £m	25.1	49.0	58.0	62.8	68.6	74.9
Standard method %[8]	17%	13%	14%	12%	13%	12%
HCL Method % (rounded)	53%	51%	53%	50%	48%	47%

[7] King WS para 30 [Supp/63]. Also e.g. at WS 31; 50.
[8] HCL's SMO calculations round up the recovery percentage to the next highest whole percent.

12. As to profitability, neither hospitality nor entertainment businesses were profitable for the entirety of the relevant period. By way of example, for calendar year 2015, gaming made £8.3 million in EBITDA profit; whereas the hospitality and entertainment businesses were all unprofitable, making a combined loss of circa £2.1 million [UT/165].

13. The UT found that the bars, smoking terraces, restaurant and theatre provided important amenities to gaming customers [UT/161-162]. People coming to a casino to game will often want to have a drink or something to eat or have a cigarette on one of the outside terraces (allocated as bar areas) or otherwise take a break away from the gambling areas. The bar, restaurant and entertainment areas provided a strategic competitive advantage over other live casinos and differentiated the experience of coming to the Hippodrome to game rather than play online. It was necessary to the gaming business for regulatory reasons, as well as important for social responsibility reasons, to provide non-gaming areas in the casino. The bars, restaurant and theatre help to increase dwell time of gamers, and therefore increase the length of time they spent gaming. The attractiveness of the bars or restaurants 'in their own right' served to enhance the attractiveness of the same as an amenity for those who are gaming.

14. The UT found that HCL made significant economic use of areas allocated under HCL's SMO Method to hospitality and entertainment for the purposes of its gaming supplies [UT/170]; again at [UT/172]: "*Standing back and having considered the evidence before us holistically, we find that the economic reality is that the floor areas of the Hippodrome allocated for hospitality and entertainment have significant dual use for gaming as well*." There is no appeal against that finding.

15. Finally, the discrete issue that arises in this appeal in respect of the Capital Goods Scheme ('CGS') concerns how the block for business entertainment works in conjunction with the standard method.[9] Under the CGS, there is an initial apportionment of input tax on capital items (essentially on the basis of anticipated use) but then the use of those items is reviewed annually over 10 years, with adjustments being made each year. In this appeal, the annual CGS VAT was £914,690 [UT/207 footnote 18]. HMRC contend that first an amount should be blocked corresponding to business entertainment use, in the ratio of the value of complimentary supplies to all turnover. This is a block of approximately 1.75% for 2016-17[10]. Conversely, HCL contend that the standard method is applied to the whole. In other words, in monetary terms, the difference in deductible VAT under the CGS is between applying the standard method to £898,679 (HMRC) or to £914,690 (HCL) – just £2,081 in 2016-17.

Ground 1

16. HMRC's central case before the FTT was that HCL's SMO Method was fundamentally flawed because it proceeded on the false premise that the areas allocated under that method to 'bars', 'restaurant' and 'entertainment' were only

[9] For the avoidance of doubt, the principle at issue regarding the block for business entertainment is not limited to adjustments under the CGS, but rather is applicable to the calculation of deductible input tax generally. HMRC later made assessments against HCL on the basis that the business entertainment block had not been undertaken in HCL's calculations for various VAT periods. However, these assessments are subject to a separate appeal which has been stayed, hence why it is only in respect of the CGS assessments that the point directly arises in the present appeal.

[10] [Supp/11] SMO calculation for 2016/17, Appendix 2: Total complimentary sales £1,202,548.93; total "sales (box 6)" [Supp/10] across the four periods: £68,702,185 [£15,470,203 + £18,491,827 + £18,199,956 + £16,540,208]

used for the purposes of taxable supplies of hospitality and entertainment.[11] HMRC's case was that these areas were used economically both for the purposes of taxable supplies and as important amenities for HCL's exempt gaming business. This was referred to below as the "Dual Use Issue".

17. Before the UT, HMRC's principal complaint was that while the FTT acknowledged HMRC's Dual Use argument at [FTT/108–110], nowhere in the paragraphs that followed did the FTT give any proper response to it.[12] The UT agreed. Having recorded the submissions made on behalf of HCL [UT/40-54], it set out its discussion and analysis at [UT/56-81]. It concluded that the FTT had materially erred in law. At [UT/79]: "*Nowhere in the Decision did the Tribunal give reasons for rejecting HMRC's contention that the areas allocated to bars, restaurant and theatre were also used in part for the purposes of its gaming business, such that there was dual use of those areas, or why if there was such dual use, the SMO Method (which assumed exclusivity of use) could be more precise than the standard turnover method (or fair, reasonable and precise).*"

18. HCL makes two points in its skeleton in support of its contention on this first ground that the UT erred in law. Neither has any merit.

19. First, at [AS/14-15] HCL contend that the UT erred in law in drawing a false distinction between the approach to an alleged failure to give reasons and that to

[11] Save for an adjustment in respect of free complimentary supplies, see paragraph 9 above.
[12] HMRC UT skeleton para 36 [Supp/240]

an alleged failure to give *adequate* reasons. No such distinction was made by the UT and there was no misdirection of law:

a. The UT cited at length the relevant principles and authorities at [UT/42-46], referred to them again at [UT/60 (*"the authorities Mr Hitchmough refers to"*) and at [UT/62]. The principles on the authorities that HCL make in their present skeleton [AS/13, 15] are recorded by the UT.

b. At [UT/60], the UT listed particular principles relevant to judicial restraint on appeal. HCL do not contend that any of these are wrong.

c. At [UT/61], the UT was reiterating what HMRC's case before it was. Correctly, the UT recorded that HMRC's complaint was the FTT's failure to address a central issue in the appeal and lack of reasons, as it had earlier noted [UT/35-36].

d. The implication at [UT/61] that the principles identified at [UT/60] did not directly pertain to HMRC's central complaint (compared to the principle that followed at [UT/62]) was reasonable. For example, HMRC were not making an attack on a finding of fact by the FTT, so the principle "*The FTT alone is the judge of the facts*", was not directly at issue.

e. At [UT/62], the UT went on to identify the principle that *was* directly applicable, namely that it is an error of law to fail to give reasons for a conclusion which is essential to a decision. Read fairly, this is not making a distinction between failing to give reasons and failing to give sufficient reasons. The UT cites the passage in *Awards Drinks* at [85] starting *"It is*

well established that a failure to give reasons ***or sufficient reasons*** *for a conclusion which is essential to the decision may constitute a free-standing ground of appeal."* (emphasis added). This is indeed the very principle that HCL itself asserts is applicable [AS/15].

f. There is nothing in the analysis that follows at [UT/65-81] to suggest that the UT did anything other than direct itself to the correct principle, which is that there must be sufficient reasons given for a conclusion that is essential to the decision, such that the parties, especially the losing party, are left in no doubt why they have won or lost.

20. HCL's second point, at [AS/16-32], is that the UT erred in its conclusion that the FTT had failed to engage with HMRC's arguments and give sufficient reasons. This second point does not, in substance, identify any error of law at all. It is merely a dispute with the evaluation by the UT of the judgment of the FTT. HCL does not contend that the UT's reading of the FTT's judgment was one which no reasonable tribunal could reach. On the contrary, the UT carefully addressed the FTT's decision from [FTT/111-127]. There is no error of law in that analysis.

21. Further, there is in any case no substance to HCL's complaints. There is an inescapable tension in HCL's position. On the one hand, it seeks to argue that the FTT had found that there was dual use of the bar, restaurant and theatre areas (which to be meaningful, must be *significant* dual use) – despite the absence of any clear finding to that effect. On the other, HCL cannot show where the FTT explained why, if it *did* find significant dual use as alleged, it rejected HMRC's argument that this was a fundamental problem for HCL's SMO Method (which

proceeds on the assumption of *no* dual use). The FTT's decision was defective either way, as the UT rightly identified at [UT/79].

Ground 2

Legal framework

22. As HCL accept at [AS/4], the parameters on apportionment of residual costs under the Principal VAT Directive ('PVD') and CJEU case law are as follows[13]:

    a. The default method of determining the deductible proportion of VAT on residual costs is the standard, turnover-based method, Art 173(1) and Art 174(1).

    b. Article 173(2) makes provision for alternative methods of attribution: Member States may: *"authorise or require the taxable person to make the deduction on the basis of the use made of all or part of the goods and services;"* However, it is well established that the condition for using an alternative method is that it must guarantee a more precise determination of the deductible proportion of the input VAT than that arising from the application of the turnover-based method (for short-hand hereafter, 'the *Baumarkt* threshold'). As the CJEU stated in case C-153/17 *HMRC v Volkswagen Financial Services (UK) Ltd*:

> *51. According to the Court's case-law, Member States may, as a result of that provision, apply, for a given transaction, a method or*

[13] As the appeal concerns periods prior to IP completion day, 31 December 2020, the withdrawal of the UK from the European Union has no impact on the applicable law in this case. VAT in the UK was governed by EU Directives, and those Directives were implemented in the UK by domestic statutes, in particular by the VAT Act 1994, *News Corp UK & Ireland Ltd v HMRC* [2023] UKSC 7, para 7.

> *allocation key other than the turnover-based method, on condition that the method used guarantees a more precise determination of the deductible proportion of the input VAT than that arising from the application of the turnover-based method (judgment of 8 November 2012, Finanzamt Hildesheim v BLC Baumarkt GmbH & Co KG (Case C-511/10) EU:C:2012:689, [2013] STC 521, para 24."*

23. When it comes to apportionment of residual costs, there is therefore a binary situation: either the standard method is used, or an alternative method which satisfies the *Baumarkt* threshold.

24. Turning then to the provisions of Part XIV of the VAT Regulations 1995:

    a. These are governed by the over-arching EU law position. They can therefore only provide for the use of the standard method, or an alternative method which guarantees a more precise determination.

    b. One way by which the UK authorises or requires deduction on a basis other than the standard turnover method is where there is a Partial Exemption Special Method ('PESM'). Regulation 102 of the VAT Regulations 1995 enables the Commissioners to approve or direct the use of a method other than the standard method, i.e. by way of a PESM.

    c. Another way is by way of the standard method override ('SMO'). Regulation 107B(2) requires that where attribution has been made under the standard method and *"that attribution differs substantially from one which represents the extent to which the goods or services are used by him or are to be used by him"*, the taxable person shall calculate the difference and account for it on his return.

25. There is no relevant distinction therefore in the condition to be satisfied where a taxpayer is seeking to displace the standard method by way of an override under reg 107B(2) (as here), or by way of a PESM. Either way, the *Baumarkt* threshold has to be satisfied, and the taxpayer has the burden of proving that it is.[14]

26. It is critically important to note that there is no way of determining the "use" of a residual cost for taxable supplies other than by way of a method. Costs such as those at issue in this appeal are 'residual' precisely because they are not used exclusively for the purpose of either taxable or exempt supplies. Rather, they are used for both. There will always be some method that is (even implicitly) being adopted in order to quantify the proportion of "use" for taxable supplies. In the present case, HCL's appeal against refusals of claims for additional input tax made under reg 107B(2) inescapably involves a contention for a method (HCL's SMO Method): it is by reference to the very outcome of its SMO Method that HCL asserts that there is substantial difference in use from the attribution under the standard method.

27. Both the FTT [FTT/104-106] and the UT [UT/113-126] found that the focus of the appeal must be on HCL's proposed Method, with HCL bearing the burden of proof to establish that HCL's SMO Method guarantees a more precise determination than the standard method. They were correct to do so.

[14] On the burden of proof, see *Revenue and Customs Commissioners v London Clubs Management Ltd* [2011] EWCA Civ 1323 at [33].

Response to Appellant's contentions on ground 2

28. HCL's basic contention is as set out at [AS/35]. HCL's analysis starts at reg 107B. It submits that "*In answering that question* [i.e. whether attribution under the standard method differs substantially from one which represents the extent to which the goods or services are used in making taxable supplies] *there is no need to consider whether any other (or any other particular) method does represent the extent to which the expenditure in issue is used in making taxable supplies".* This is fundamentally wrong:

    a. It fails to acknowledge the fact that determining the extent of use of residual costs for making taxable supplies will necessarily involve a method. HCL's own case proves this. HCL submitted its claims on a standard method override under reg 107B calculated on the basis of a floor space method. That was the basis on which a substantial difference of over £50,000 under reg 107C was claimed, as the FTT noted [FTT/99].

    b. It therefore fails to recognise that the *Baumarkt* threshold – which it does not dispute [AS/4] – must equally apply to a claim under the standard method override under reg 107B.

    c. That being so, HCL is wrong to contend that the focus should be on the standard method. On the contrary, the governing law is clear that the standard method must apply, unless another method is found to guarantee a more precise determination of the deductible proportion. As this was HCL's appeal in favour of HCL's SMO Method over the standard method, the

burden of proof was on HCL to establish that its Method met the *Baumarkt* threshold. Otherwise, the standard method is not displaced.

29. This was the core of the legal reasoning of the UT, as set out at [UT/125] and [UT/126]. HCL's skeleton notably fails to engage with this fundamental point. Rather, HCL seek to attack the UT's decision on essentially secondary matters.

30. The first is as regards the UT's comments in respect of *HMRC v Temple Finance Limited* [2017] STC 1781 at [UT/124], where the UT drew from *Temple Finance* that the FTT was not required to make its own enquiry as to whether there might be another method that was preferable. There is no error of law here:

    a. HCL's complaint is [AS/40]: "*Temple Finance simply does not deal with the approach to be adopted by the Tribunal where one or other party has identified flaws with the standard method (engaging regulation 107B) which still require an answer even if that party's proposed answer is itself not satisfactory*". But that argument proceeds on the incorrect premise that the focus is on the standard method and its purported flaws. This is incorrect. As just set out, the focus must be on the proposed method and whether it meets the *Baumarkt* test.

    b. What *Temple Finance* did was to address the situation where only two methods were before the FTT, the taxpayer's and HMRC's. That is precisely the case in the present appeal. The UT was therefore entitled to observe that the dispute was as between those two methods, and the FTT was not

required to make its own enquiry as to whether there might be some other, third, method that was preferable.

c. For the avoidance of doubt, HCL's suggestion that there are significant flaws in the standard method as applied to its business is in any case unwarranted (addressed further in response to ground 3 below).

31. Likewise, there is no problem with the UT's reference to the approach of Warren J in *St Helen's School Northwood Ltd* [2006] UEWHC 3306 (Ch), contrary to HCL's complaint at [AS/46]. The point being made by the UT in citing that case was that Warren J had likewise considered that the jurisdiction of the Tribunal did not extend to putting forward its own version of a special method. Rather, the Tribunal was to rule on the binary question before it, namely for the method proposed by the taxpayer, or that of HMRC.

32. It is also denied that there was any error of law in the UT observing at [UT/121] that it gained little assistance from *Vision Express (UK) Ltd* [2009] EWHC 3245 (Ch) or *St John's College* [2010] UKFTT 113 (TC). In particular, in *Vision Express* there was only consideration of the PESM at issue in that case. There was no determination of any other method to be adopted in its place and at [54] it seems to have been envisaged that if the parties could not agree, then there would have to be a further hearing (presumably to determine between the rival contentions of the parties). It is also to be noted that both those decisions are in any case not binding on this court, and pre-dated *Baumarkt*.

33. Finally, HMRC reject the suggestion [AS/1] that the UT was finding that the jurisdiction of the tribunal was radically different in an appeal relating to the standard method override compared to one relating to the PESM override. All the UT was (correctly) observing was that in the present appeal, it had to determine whether HCL's SMO Method guaranteed a more precise determination of the deductible proportion of input VAT than that arising from the turnover-based method [UT/122]. HCL's skeleton does not explain why that approach was wrong.

34. In addition to the points above, it would in any case be procedurally inappropriate were the Tribunal to have jurisdiction to direct a third method, as HCL seek to argue [UT/110 at (e)]. It would be unfair for a Tribunal to impose its own method, which had not been contended for by either party, and in respect of which no preparations ahead of the hearing can have been made:

    a. The parties would not have any, or any sufficient, opportunity to consider the potential problems with such a third method;

    b. The parties would not have had an opportunity to bring or challenge any evidence that might be relevant to the operation or accuracy of such a method;

    c. The parties would not have any, or any sufficient, opportunity to make submissions in respect of that third method;

    d. The situation in the hearing would be the anomalous one that a party (or potentially both) would be litigating the reasonableness of the third

method against the Tribunal, rather than the Tribunal reaching a determination as between the respective methods proposed by the parties.

Ground 3

35. The third ground seeks to attack the UT's finding in [UT/195]: "*We have found that a third of customers do not gamble* [a reference back to UT/155(d)] *and that is a physical proxy for the economic use but it is not a good proxy for economic use when gambling customers are spending considerably more – floorspace or customer numbers do not more fairly reflect economic use."*

36. This is a finding of fact that the UT was fully entitled to reach. There is nothing unreasonable in the inference that customer numbers into the Hippodrome building did not more fairly reflect economic use than the standard method. HCL's contentions are no more than an assertion of physical use, despite acknowledging that *economic* use is the test [AS/6].

37. Consider a retailer which leases at great cost a prestigious central London building, from which it sells a) luxury cars at £100,000 each, and b) toy replica cars at £10 each. A customer survey finds that a third of visitors to the shop come only to buy the toy cars. It would plainly not follow that 1/3 of the economic use of the building is for the purpose of selling the toy cars.

38. Likewise in the present case. In 2017-18 for example, only 12% of HCL's turnover came from taxable supplies (and *none* of its profit). Having found that there was significant dual use of the bar, restaurant and theatre areas for the Gaming business [UT/186], the UT was fully entitled to conclude at [UT/195] that

customer numbers do not more fairly reflect the proportion of economic use of the residual costs than turnover. Even adopting HCL's assumption (for the purposes of the argument) that all customers spent the same on food, drink and entertainment whether or not the customer gambles [AS/56], in 2017-18 that would mean that 1/3 of the customers who did not gamble brought in £3.0m in turnover (1/3 of taxable income of £9.0m), whereas the other 2/3 of the customers brought in £71.9 m (£65.9m gaming turnover plus the remaining 2/3 of the taxable income, £6.0m). In other words, 1/3 of the customers, on HCL's own logic, brought in just 4.0% of the income.[15] This aptly demonstrates why there is nothing unreasonable in a finding that the economic use of the residual costs did not follow customer numbers: to suggest otherwise would mean that 33% of the residual costs were being used, economically, to generate just 4.0% of the income.

39. Further, HCL's complaint that the UT was somehow finding that in *all* circumstances the standard method would more fairly reflect economic use than any other method [AS/52 and AS/1] is (with respect) obviously unjustified. The UT was not in any way implying that the standard method would never be displaced. It was merely finding that it was not on the facts of the present case – facts into which it went into very considerable detail at [UT/140] to [UT/173]. The complaint at [AS/123] in respect of [UT/123] is likewise unjustified. The only point the UT is making at [UT/123] is that the standard method is the default method under the legislation, and so up until another method has been proved to meet the *Baumarkt* threshold (i.e. guaranteeing a more precise apportionment), it is in effect deemed by statute to be a fair method. The UT was not saying the

[15] £3.0m out of a total of £71.9m.

standard method could never be displaced: on the contrary, [UT/123] finishes: "*It is therefore for the taxpayer to displace the standard method".*

40. As regards the points at [AS/54-55]:

a. The starting assumption, *"in circumstances where the standard method has been found to be an unreliable proxy for the use by a taxpayer of its VAT-bearing overhead costs",* is unwarranted. The standard method is not, and was not found to be, an unreliable proxy in this case (see further below).

b. HCL was not contending for a method based on customer numbers before the Tribunal. HCL's pleaded case in this appeal was in favour of its floor space SMO Method. The UT rejected the argument that HCL'S SMO Method was more accurate than the standard method, and HCL does not bring any legal challenge to that conclusion.

c. Although before the UT, HCL did submit that the 1/3 figure of customer numbers was "a baseline" of economic use [UT/179], the UT was entitled to reject that for the reasons already given above. The logic of a customer-number method is that the economic use of the residual costs is the same for each customer, whether he comes in to buy a single drink or is a high value gamer. On HCL's own argument, 1/3 of the customers brought in just 4.0% of the revenue (and none of the profit).

d. It is too late for HCL now – or indeed before the UT – to propose a completely different override calculation – for the reasons already noted in ground 2 above. (HMRC also note that HCL asks this court to set aside the

UT's decision, i.e. to re-instate the FTT's order, and HCL does not ask this court to vary the order.[16])

e. In any event, the new alternative method proposed at [AS/55] is wholly without merit. The assumption that at least 1/3 of the economic use of residual costs is for taxable supplies, because 1/3 of the customers do not game, is fundamentally flawed as already explained, as is the assumption that this proportion is immutable. Further, the resultant recovery percentage is in any case much higher than 33%, between 41%-42% for the years 2013/14 to 2017/18.

41. Finally, as already noted, HMRC do not accept that the standard method is an unreliable proxy for the use by HCL of its residual costs.

42. First, it is only by reference to other methodologies that a 'flaw' in the standard method is asserted – and those are themselves unsound. So, for example, the suggestion that the standard method is unfair because 1/3 of customers do not gamble is premised on a customer-numbers based methodology which is mistaken for reasons addressed above. Likewise, the suggestion that it is unfair because of the proportion of space occupied by the bars, restaurant and theatre – that is HCL's SMO Method which the UT rightly rejected. Similarly, the discrete example HCL sought to rely on before the FTT and UT, namely the turnover generated by an electronic roulette terminal against that from a table in the restaurant [UT/178]. This is another form of floor-space argument that is again

[16] Appellant's Notice section 9.

misconceived, because the turnover from that roulette terminal is not, on proper analysis, being generated by the terminal in isolation: the table is able to generate that revenue because of facilities and amenities of the building as a whole, including but not limited to the general areas (so as to access the table, WCs, and similar) [see UT/162 and 195]. In short, HMRC respectfully submit that there is no good evidence that in any of the years in question, the economic use of the residual costs was significantly different from that determined by the standard method. So even if, contrary to ground 2, the Tribunal were to focus on the standard method, HCL still could not satisfy the burden of proving that there was a significant difference in the degree of economic use to that calculated by the standard method.

43. Second, there are positive merits to the standard turnover method (which the fact that it is the statutory default under EU and domestic law doubtless reflects). It is, for example, able to respond to fluctuations in the business [as the UT noted at UT/195]: so, in the present case, in 2018/19 when, the level of taxable turnover increased, the recovery rate was 22%. More fundamentally, the basic premise that the degree of economic use of a residual cost for taxable vs exempt supplies is broadly reflected by the turnover generated by taxable vs exempt supplies is a reasonable one both as a matter of generality and specifically in HCL's case. As noted at paragraph 10 above, the primary performance indicator considered by HCL's board in the period was the *revenue* produced by each area of its businesses. As HCL was using these residual costs to drive the revenue of both taxable and exempt operations, there is nothing that is prima facie unreasonable about apportioning those costs by reference to the revenue thereby generated.

Ground four

44. HCL contend that the UT erred in its conclusion that the VAT on an item of cost is first subject to a restriction for any use of that cost to provide business entertainment, and this is an error of law.

45. The inability to deduct such input tax as was used for the purposes of business entertainment was a matter of both EU and domestic law. As EU law under the PVD had primacy, this is the starting point. Article 176 provided (as Art 17(6) of the Sixth Directive had) that VAT expended on entertainment shall in no circumstances be deductible:

> *VAT shall in no circumstances be deductible in respect of expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.*

46. Therefore, whatever the technical arguments which HCL raises in respect of the domestic legislation, because they result in VAT being recovered in respect of business entertainment, they must be wrong as a matter of EU law.

47. In any case, the UT was correct to find as a matter of domestic law alone that VAT on input costs is first subject to a restriction for any use for the purposes of business entertainment under Article 5(1) of the VAT (Input Tax) Order 1992, for the reasons it gave at [UT/201-210]. HMRC rely on those same reasons here.

48. In particular, it is to be noted that HCL have no proper response to the example cited by the UT at [UT/209-210]. If a cost of £30,000 is found to be used 33% for business entertainment worth £1,000, for taxable supplies worth £1,000 and for exempt supplies of £1,000, then HMRC's analysis (correctly) results in a

deductible amount of £10,000 (1/3 of the cost of £30,000, reflecting 1/3 use for taxable supplies). In contrast, HCL's analysis goes straight to the standard method apportionment (50%), and then says there is nothing for the block under Article 5 to bite on – because the £15,000 is purportedly in respect of taxable supplies. Hence HCL calculate a 50% recovery rate on a cost that has been only 33% used for taxable supplies.

49. HCL's only response to this point is to *look through* the immediate use for business expenditure, to the purpose to which the business expenditure is being used: "*expenditure on business expenditure is… incurred with a clear business purpose in mind*" [AS/63]; likewise in [AS/65], the argument that using a cost for business entertainment is not distinct from use for taxable and exempt supplies. But collapsing the proximate use for business entertainment into the purpose which that business entertainment in turn serves is wrong. If the legislation worked that way, then there would be no need for Article 5 at all. On HCL's analysis, insofar as a cost is used for business entertainment for taxable business, it would be used for taxable business and so deductible (and Article 5 would not apply); conversely insofar as the cost is used for business entertainment for exempt business, it would not be deductible anyway (so Article 5 is unnecessary). The UT was right to dismiss HCL's contentions on this point.

Conclusion

50. For these reasons, HMRC respectfully invite the court to dismiss HCL's appeal.

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