

Partial exemption – Queens Club case

(Lecture B1070 – 12.02 minutes)

Partial exemption will always be one of the most difficult aspects of the VAT system. It is intended to be a black and white subject with logical outcomes but the reality is that there are many shades of grey to confuse the issues. These shades of grey can sometimes involve hundreds of thousands of pounds of VAT and put immense pressure on advisers and business owners to make correct decisions regarding input tax allocations.

And this fact was highlighted in the recent FTT case of London's international tennis club Queens Club Ltd (TC6119), about whether input tax could be fully reclaimed on the renovation costs of its restaurant. HMRC said 'no'.....the taxpayer said 'yes'.....and the court agreed with the taxpayer. My main concern is that an important FTT case a couple of years asked the same question in relation to bar expenditure at a golf club Bedale Golf Club Ltd (TC4619). HMRC said 'no'.....the taxpayer said 'yes'and the court agreed with HMRC.

Principles of partial exemption

If a business has some income that is exempt from VAT and some that is taxable, then it is a partially exempt trader and needs to apportion its input tax into three categories. Don't forget that there is a big difference between zero-rated and exempt sales. A zero-rated sale is a 'taxable' sale with VAT being charged at 0% whereas an exempt sale does not charge VAT.

The three categories of input tax are: taxable, exempt and residual. Taxable input tax is relevant to an expense that wholly relates to taxable sales and can be fully claimed; exempt input tax wholly relates to exempt activities and is input tax blocked; residual input tax relates to 'mixed costs' ie relevant to both taxable and exempt activities or general overheads of the business such as accountancy fees and telephone bills.

A proportion of residual input tax can be claimed, usually based on the standard method of calculation based on income splits for the period in question. The percentage claimed is as follows: Taxable sales divided by Taxable plus exempt sales (all figures exclude VAT).

The percentage figure is rounded up to the nearest whole number as long as the total residual input tax figure is less than £400,000 per month on average (VAT Notice 706, para 4.7). The end result is that a business that has most of its sales as taxable will claim more residual input tax than a business with a high proportion of exempt income. That is the intention of the legislation.

So to give an easy example, if Queens Club purchase beer and wine for their bar, the input tax can be fully claimed. This is because the expense is directly related to taxable sales ie the onward sale of the stock to club members and guests enjoying a drink after a hard fought game of tennis. The relevant phrase that has stood the test of time is "direct

and immediate link". But if the Club spend money on grass and fertiliser for the courts, then no input tax can be claimed if all of the income from the courts relates to exempt playing fees (exempt by VATA1994, Sch 9, Group 10).

Queens Club facts

The Club is internationally recognised as a top tennis facility (the phrase "world class" was used in the case report on more than one occasion). Members pay an annual fee of £1,820 to join and play tennis and there is a ten-year waiting list for new members. The Club argued that members were only interested in the tennis playing facilities when they joined, and not the quality of the catering and bar facilities. So the upgrading of the café to a restaurant was wholly relevant to taxable supplies argued the Club ie sales of food and drink to members and guests using the facility. HMRC concluded that the costs were "residual" for input tax purposes, ie partly relevant to the exempt membership fees of tennis players because the restaurant is a benefit of membership. But the court disagreed.

Bedale Golf Club facts

The input tax in this case related to repair costs for the lift at the clubhouse, new curtains for the bar and lounge area and repair of bar furniture as well. The taxpayer claimed that all items of expenditure were wholly linked to the taxable bar and dining areas which were exclusive to the first floor ie the same argument successfully put forward by Queens Club. HMRC ruled that the costs were also linked to 'exempt' golf club membership because the bar was a benefit of membership.

The assessing officer's view was that the first floor bar area was "part and parcel of the running and benefit of the club as a whole." All parties were agreed that there was no specific exempt income generated by the first floor, which was wholly relevant to the bar and dining area. So surely the fact that no income was generated from the first floor must mean that input tax can be fully claimed and that the link with the playing membership is an indirect link?

Our challenge is to compare the thinking of the judges in both cases.

Court findings

In the Bedale case, a significant factor in the judge's thinking was that the bar was also used for non-eating and drinking purposes eg team meetings, AGMs etc.

"Crucially, it is at least in part a meeting place for golfers to manage, coordinate and enhance their golfing activities. The same is true of the annual general meeting and, albeit to a lesser degree, trophy presentations and entertaining other teams. From an economic perspective, the availability of the bar and lounge area is an incidence of membership of the golf club as well as a place to buy food and drink."

A further comment was that the bar facilities "are part of an overall supply of exempt golf club membership, the consideration for which is the membership subscription."

So what was the thinking in the Queens case? The key question was whether there is a "direct and immediate link" between the restaurant and the decision of players to either become members or to renew their membership. The tribunal did not think this was the case and that members were only attracted to the 'world class' playing facilities of the

club when they applied to join. The report even noted that the waiting list for potential members actually increased when the restaurant was closed while it was being upgraded.

In short, viewed objectively, what members obtain when they join the Club is a right of access to world-class sporting facilities together with such additional facilities as the Club decides, in its discretion, to offer. The focus is on the sporting facilities” (para 41).

Conclusions

The reality is that the courts returned different verdicts because Bedale Golf Club and Queens Tennis Club are two very different organisations. The bar was an attraction for members joining Bedale Golf Club but not for those joining Queens Club, who were only interested in the tennis. So if there was no link or use between the exempt tennis playing facilities and the restaurant, so the whole of the input tax on restaurant expenditure could be claimed as being relevant to taxable food and drink sales.

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