Hilary Term
[2013] UKSC 15
On appeal from: [2007] EWCA Civ 938

JUDGMENT

Her Majesty's Revenue and Customs (Appellant) *v* Aimia Coalition Loyalty UK Limited (formerly known as Loyalty Management UK Limited) (Respondent)

before

Lord Hope, Deputy President
Lord Walker
Lord Wilson
Lord Reed
Lord Carnwath

JUDGMENT GIVEN ON

13 March 2013

Heard on 24 and 25 October 2012

Appellant	*Respondent*
Philippa Whipple QC Suzanne Lambert (Instructed by VAT & Duties Litigation Team, Solicitor's Office, HM Revenue and Customs)	David Milne QC Michael Conlon QC (Instructed by Hogan Lovells International LLP)

LORD REED

Introduction

1. This appeal concerns the well-known Nectar scheme. Its essential elements as at the relevant time can be summarised as follows. A member of the scheme has an account with Aimia Coalition Loyalty UK Ltd, formerly called Loyalty Management UK Ltd ("LMUK"), the promoter of the scheme, and is issued with a Nectar card. When a member purchases goods or services from a retailer which has agreed with LMUK to participate in the scheme in relation to the issue of "points", the retailer swipes the Nectar card and the member's account with LMUK is electronically credited with a number of points. The member is then entitled to use the points to receive goods or services, either at no cost or at a reduced cost, from a retailer which has agreed with LMUK to participate in the scheme in relation to the "redemption" of points. When the member receives goods or services from that retailer, the retailer swipes the Nectar card and the member's account with LMUK is electronically debited with the number of points which have been redeemed.

2. The scheme involves four parties: (1) the promoter of the scheme, LMUK; (2) the members of the scheme ("collectors"); (3) retailers of goods and services ("sponsors"), who pay for their customers, if they produce a Nectar card, to have points credited to their accounts with LMUK when they have purchased goods or services and their cards are swiped; and (4) other retailers of goods and services ("redeemers"), from whom collectors receive goods and services, at no cost or at a reduced cost, when their cards are swiped and points are debited to their accounts.

3. The scheme depends upon a network of contracts between LMUK and the three other parties. First, LMUK agrees with the collectors the terms upon which their accounts are operated, including an obligation on the part of LMUK that it will ensure that the collectors can obtain points when they purchase goods or services from sponsors, and that it will make goods and services available to the collectors at no cost, or at a reduced cost, when they redeem their points. LMUK provides the members with information about the identities of sponsors and redeemers, the particular goods and services which can be obtained using the points, and the number of points required in order to receive the goods or services in question.

4. Secondly, LMUK agrees with the sponsors that it will credit collectors' accounts with the points for which the sponsor has agreed to pay and will secure

that goods and services are made available to collectors on their redemption of the points. In return, the sponsors make payments to LMUK based on the number of points credited to collectors' accounts, at an agreed value per point, together with an annual marketing fee. Each sponsor is granted by LMUK the exclusive right to participate in the Nectar scheme in a particular market sector. The contract entered into between LMUK and each sponsor provides that their agreement does not create a relationship of partnership or agency.

5. Thirdly, LMUK agrees with the redeemers that they will provide collectors with specified goods and services upon the redemption of the applicable number of points, and will in addition provide a number of other services to LMUK, in return for the payment of "service charges" by LMUK based on the number of points redeemed, at an agreed value per point. That value is lower than the value agreed with the sponsors. In relation to the other services which redeemers are required to supply, they must for example provide LMUK with information about problems affecting the quality or availability of goods and services, provide customer data and other information which LMUK requires for marketing purposes, grant permission for the use of their names and brands in marketing material, handle complaints by collectors and replace faulty goods. The commercial arrangements between LMUK and each of the redeemers are negotiated individually. The sponsors and collectors are not involved in these negotiations and are not normally in a position to know what arrangements have been made. In particular, since a sponsor or collector does not normally know the agreed redemption value of the points, it is not normally in a position to know the price paid by LMUK to a redeemer for the provision of particular goods and services: a price which will however be less than the amount which the sponsor paid LMUK for the issue of the points in question to the collector.

6. The three contracts involved in the scheme, described in the preceding paragraphs, are separate from, and should not be confused with, the contracts between the sponsors and the collectors, or the contracts between the collectors and the redeemers. In particular, the purchase of goods or services by a collector from a sponsor is a separate transaction, between different parties, from the crediting of points by LMUK to a collector's account, or the payment of LMUK by a sponsor in respect of those points.

7. As is apparent from this summary of the arrangements, which reflects the findings of fact made by the Value Added Tax and Duties Tribunal ("the tribunal"), to refer to "points" being "issued", "purchased" and "redeemed" is to speak metaphorically. The "points" are a means of describing the collectors' contractual rights to receive goods and services at no cost or at a reduced cost. The sponsors pay LMUK for the grant of those rights to collectors. LMUK uses part of its receipts from the sponsors to pay the redeemers to provide collectors with the goods and services in accordance with their rights. LMUK derives its profits from

the difference between its receipts from the sponsors and its payments to the redeemers.

8. In essence, therefore, when sponsors pay LMUK for the points issued to collectors, they are paying LMUK for granting the collectors the right to receive goods and services in exchange for their points. The redeemers provide the collectors with the goods and services to which their points entitle them, and LMUK pays the redeemers the redemption value of the points. It is thus by means of the redeemers' performance of their contractual obligations to LMUK that LMUK fulfils the obligations which it has undertaken to the sponsors and collectors and so carries on its business.

9. Since points are used by collectors to obtain goods or services, they may be regarded as a means of payment for those goods or services. The amount paid for the right to obtain the goods or services is the amount paid to LMUK by the sponsors for the issue of the points which the collector uses. The amount received by the redeemer, following the provision of the goods or services, is the lesser amount which it is paid by LMUK.

10. It is common ground that the provision of points to collectors in return for payment by the sponsors is a taxable supply by LMUK. When LMUK charges VAT on the payments which it receives from the sponsors, it is therefore charging VAT on the amount which it receives as consideration for granting to collectors the right to receive goods and services in exchange for the points. The redeemers in turn charge VAT on the payments which they receive from LMUK. The VAT is charged at the standard rate, regardless of whether the goods and services provided to the collectors are zero-rated or exempt, on the basis that it is charged in respect of a service supplied by the redeemers to LMUK.

11. The facts of this case, as I have described them, are both complex and unusual. In particular, the business operated by LMUK differs in fundamental respects from sales promotion or customer loyalty schemes which are operated by retailers as part of their own business, and under which the issue of points or vouchers does not involve a taxable supply. That being so, LMUK's business cannot be assumed to fall within the scope of decided cases concerned with schemes of the latter kind. Rather than relying upon inexact analogies with other forms of business, it is essential to bear in mind the particular characteristics of the business carried on by LMUK when considering the issue raised in the present appeal.

12. The issue in dispute is whether LMUK is entitled to deduct as input tax the VAT element of the payments which it makes to the redeemers. LMUK contends

that the payments are the consideration for the redeemers' supply to it of the services for which it has contracted with them. Since that supply is made to LMUK for the purpose of its business, it maintains that it is entitled to deduct the VAT as input tax in accordance with article 17 of Council Directive 77/388/EEC of 17 May 1977 ("the Sixth Directive"), as implemented by the Value Added Tax Act 1994. The Commissioners on the other hand decided in 2003 that the payments were third party consideration for the redeemers' supply of goods and services to collectors, and that any VAT charged on such a supply was therefore not deductible by LMUK as input tax. LMUK appealed to the tribunal against that decision.

The relevant legislation

13. The relevant EU legislation is contained in Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes ("the First Directive"), and the Sixth Directive, as amended by Council Directive 95/7/EC of 10 April 1995. These are translated into domestic law by the Value Added Tax Act 1994. It is sufficient to refer to the EU provisions.

14. Article 2 of the First Directive describes the basic system of value added tax:

> "The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.
>
> On each transaction, value added tax, 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 value added tax borne directly by the various cost components.
>
> The common system of value added tax shall be applied up to and including the retail trade stage."

15. Article 2 of the Sixth Directive provides:

> "The following shall be subject to value added tax: (1) the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such . . ."

Articles 5 and 6 define "supply of goods" and "supply of services" respectively. The former means "the transfer of the right to dispose of tangible property as owner". The latter means, generally, "any transaction which does not constitute a supply of goods within the meaning of article 5".

16. Article 11 defines the taxable amount. It provides, so far as relevant:

> "(A) Within the territory of the country 1. The taxable amount shall be: (a) in respect of supplies of goods and services…, everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies…."

Article 17(2) allows a taxable person the right, "in so far as the goods and services are used for the purpose of his taxable transactions", the right to deduct VAT due or paid "in respect of goods or services supplied or to be supplied to him by another taxable person."

The decision of the tribunal

17. The tribunal allowed LMUK's appeal against the Commissioners' decision ([2005] BVC 2628). It considered that the transactions in question could only be understood in the context of the arrangements between LMUK, the sponsors, the redeemers and the collectors viewed as a whole. Assessing the commercial and economic reality of the case on that basis, the tribunal concluded that "the proper analysis of the transaction under which a [redeemer] provides goods to a [collector] in return for points is that the [redeemer] is providing a service to [LMUK] in assisting it to discharge its obligation to [collectors]" (para 60). The tribunal reached the same conclusion in relation to the provision of services to collectors.

18. The tribunal further concluded that LMUK's payments to redeemers were consideration only for the supply of the service which it received from them. In that regard, the tribunal applied the principle, established by the case law of the Court of Justice of the European Union, that the concept of consideration requires a direct link between the goods or services provided and the consideration received. The tribunal considered that LMUK was provided by redeemers with a

composite service, which had other elements besides the provision of goods and services to collectors. It was of the view that the service charge paid by LMUK to a redeemer was in return for all the services which the latter provided, and that the service charge was therefore "directly linked only to the supply to [LMUK] and not to any supply which might be made to the [collector]" (para 63).

19. In the view of the tribunal, the only taxable supply for which LMUK provided consideration was therefore the supply of services to itself. Since that was a supply to a taxable person for the purpose of its business, it followed that the VAT element of the amounts for which the redeemers invoiced LMUK was deductible as input tax.

20. The tribunal declined to make a preliminary reference to the Court of Justice, observing that the real issue in the appeal did not concern the interpretation of the relevant directives but rather concerned the correct analysis of the facts.

The decision of the High Court

21. The Commissioners appealed against the tribunal's decision: it is relevant to recall that an appeal lies on a point of law only. The appeal was allowed by the High Court ([2007] STC 536). Lindsay J noted that, when goods were provided by a redeemer to a collector, that must be a supply of goods to the collector. That followed from the definition of a supply of goods in article 5(1) of the Sixth Directive ("the transfer of the right to dispose of tangible property as owner") as interpreted by the Court of Justice, notably in *Auto Lease Holland BV v Bundesamt für Finanzen* (Case C-185/01) [2003] ECR 1-1317; [2005] STC 598: a case to which it will be necessary to return. Since there were passages in the tribunal's decision where it had said that goods should be regarded as being supplied to LMUK, it followed that the tribunal had in that respect erred in law. Lindsay J considered that this error was material to the tribunal's decision.

22. Lindsay J stated that whether a redeemer's provision of goods or services to a collector was wholly for points or partly for points, what the redeemer received had to include what LMUK became obliged to pay him upon his having supplied the collector. On that basis the service charge paid by LMUK to the redeemer was third party consideration for that supply. It followed that the payments made by LMUK to the redeemers could not also be consideration for the supply of services to LMUK.

23. Ultimately, Lindsay J stated that he preferred the argument of the Commissioners because "it seems to me the more consistent with the requirements,

illustrated in *Auto Lease* and the coupon cases, that one should stand back and look at the characteristics of the provision and payment in issue in a relatively robust and commonsensical way" (para 78). In that regard, emphasis was placed upon the fact that the payments made by LMUK were related to the number of points redeemed, and upon the absence of any separately identifiable fee for the services provided to LMUK other than the provision of goods and services to collectors.

The decision of the Court of Appeal

24. LMUK's appeal against the decision of the High Court was allowed by the Court of Appeal ([2008] STC 59). Chadwick LJ, in a judgment with which the other members of the Court of Appeal agreed, regarded the decision of the House of Lords in *Customs and Excise Commissioners v Redrow Group plc* [1999] 1 WLR 408; [1999] STC 161 as authority for two propositions: first, that a supplier could be treated as making, in the same transaction, both a supply of services to one person and a supply of different services to another person; and secondly, that in addressing a claim for input tax by one of those persons, the relevant questions were (1) whether that person had made a payment to the supplier, (2) whether the payment was consideration for the services supplied to him, and (3) whether the services were used or to be used in the course of a business carried on by that person.

25. Applying the approach adopted by Lord Millett in the case of *Customs and Excise Commissioners v Plantiflor Ltd* [2002] UKHL 33; [2002] 1 WLR 2287; [2002] STC 1132, to which it will be necessary to return, Chadwick LJ observed that it might be said that LMUK made a supply of services to the collectors: it granted them rights which they could exercise to obtain goods and services. When a collector received goods and services from a redeemer, the redeemer made two different supplies. One was the supply of the goods and services to the collector; the other was the supply to LMUK of the services of providing the rewards to the collector and providing the agreed information and other services to LMUK. In relation to the supply by the redeemer to LMUK, the answer to each of the three relevant questions identified in *Redrow* was an affirmative: (1) LMUK made a payment to the redeemer, (2) that payment was consideration for services supplied by the redeemer to LMUK, since LMUK received something of value in return for the payment, and (3) the services supplied by the redeemer to LMUK were used or to be used in the course of LMUK's business of operating the scheme.

26. It followed that there was a supply of services by the redeemer to LMUK and that the supply was made for a consideration. If that was correct, it was not in dispute that LMUK was entitled to input tax credit in respect of the VAT paid on that supply.

27. Chadwick LJ also observed that it was important to keep in mind the tribunal's finding that the collector's right to receive goods and services was a right which he acquired when he was credited with points. The sponsor paid LMUK for the issue of the points, and thus for the grant of that right. LMUK accounted to the tax authorities for the output tax. The tax authorities therefore received VAT at that time on the supply of the right to receive goods and services in exchange for the points. If, when the collector exercised that right, the provision of the goods or services was treated as a taxable supply to him, the tax authorities would receive not only VAT on the amount paid for the right to obtain those goods and services but also VAT on the amount paid to satisfy that right. If, on the other hand, the provision of the goods and services to the collector formed part of a service supplied by the redeemer to LMUK, the tax authorities would still receive from LMUK the VAT chargeable on the amount paid for the collector's right to obtain those goods and services (and on any additional amount paid by the collector when it exercised that right) but account would also be taken of LMUK's entitlement to deduct as input tax the VAT element of the amount which it had to pay in order to satisfy that right.

28. The Court of Appeal declined to make a reference to the Court of Justice. Chadwick LJ observed that the real issue in the appeal was not as to the interpretation of Community legislation, or as to the effect to be given to judgments of the Court of Justice, but as to how principles which were not in doubt should be applied to the particular facts. That was an issue which the Court of Justice would expect the national court to resolve.

The preliminary reference

29. The Commissioners appealed against the decision of the Court of Appeal to the House of Lords. It is that appeal which is now before this court. The House referred the following questions to the Court of Justice for a preliminary ruling:

> "In circumstances where a taxable person ('the promoter') is engaged in the business of running a multi-participant customer loyalty rewards programme (the 'scheme'), pursuant to which the promoter enters into various agreements as follows:
>
> > (a) Agreements with various companies referred to as 'sponsors' under which the sponsors issue 'points' to customers of the sponsors ('collectors') who purchase goods or services from the sponsors and the sponsors make payments to the promoter;

(b) Agreements with the collectors which include provisions such that, when they purchase goods and/or services from the sponsors, they will receive points which they can redeem for goods and/or services; and

(c) Agreements with various companies (known as 'redeemers') under which the redeemers agree, among other things, to provide goods and/or services to collectors at a price which is less than would otherwise be payable or for no cash payment when the collector redeems the points and in return the promoter pays a 'service charge' which is calculated according to the number of points redeemed with that redeemer during the relevant period;

1. How are articles 14, 24 and 73 of the Council Directive 2006/112/EC of 28 November 2006 [the VAT Directive] (formerly Articles 5, 6 and 11(A)(1)(a) of Council Directive 77/388/EEC of 17 May 1977 [the Sixth Directive]) to be interpreted where payments are made by the promoter to the redeemers?

2. In particular, are those provisions to be interpreted such that the payments of the kind made by the promoter to redeemers are to be characterised as:

(a) consideration solely for the supply of services by the redeemers to the promoter; or

(b) consideration solely for the supply of goods and services by the redeemers to the collectors; or

(c) consideration in part for the supply of services by the redeemers to the promoter and in part for the supply of goods and/or services by the redeemers to the collectors?

3. If the answer to question 2 is (c), so that the service charge is consideration for two supplies by the redeemers, one to the promoter and the other to the collectors, what are the criteria laid down by Community law to determine how a charge such as the service charge is to be apportioned between those two supplies?"

30. The House of Lords' reasons for concluding that it was necessary that a preliminary reference should be made are not recorded. Although the case was not straightforward, the view of the tribunal and of the Court of Appeal, that the issue in the case was as to how established principles should be applied to the particular facts, was one for which there was in my view much to be said. More importantly, it is apparent from what followed that the reference did not make sufficiently clear to the Court of Justice what the central issues were, as they emerged from the judgment of the Court of Appeal: issues which had appeared to the highest court in this country to be of such difficulty that a reference was required. Nor did the reference direct the attention of the Court of Justice to the facts found by the tribunal which bore most directly upon those issues.

31. In relation to the facts, for example, the statement that "the sponsors issue 'points' to customers" was a very compressed, and potentially misleading, way of describing the arrangement under which the sponsor's computer communicates electronically with LMUK when a collector's card is swiped, LMUK then credits the collector's account with the rights represented by "points", and the sponsor pays LMUK for the grant of those rights. That compressed description gave no indication of how different the arrangement was from that involved in a typical loyalty rewards scheme, where a retailer issues points to its customers: on the contrary, it tended to suggest that the LMUK scheme was of a similar character. Nor was it explained that, unlike the position in a typical loyalty rewards scheme, where no identifiable consideration is given for the issuing of points (as, for example, in *Kuwait Petroleum (GB) Ltd v Customs and Excise Commissioners* (Case C-48/97) [1999] STC 488, the issuing of points by LMUK was accepted by both parties to be a taxable supply. Nor was it explained that LMUK therefore accounted for VAT on the consideration given for the supply to collectors of the right to receive rewards.

32. In relation to the issues emerging from the judgment of the Court of Appeal, one such was what might be described as the *Redrow* issue: that is to say, whether, considering the transactions in question in the context of the scheme as a whole, the payments made by LMUK to the redeemers were most aptly regarded as the consideration paid for the supply of services to it by the redeemers, which it required for the purposes of its business: services which included the provision of goods and services to collectors. A second issue, closely related to the first, was whether the principle that VAT is neutral in its effect upon taxable persons required that LMUK, having accounted for VAT on its supply of the right to receive the goods and services provided by redeemers, should be able to deduct the VAT element of the costs which it incurred in order to satisfy that right.

33. As a consequence of these aspects of the reference, a situation was created in which, instead of the dialogue between the Court of Justice and national courts

which is the essence of the preliminary reference procedure, there was a danger that the ruling of the Court of Justice would fail to address the issues which lay at the heart of the appeal before the referring court.

34. The Court of Justice joined the reference with another, in the case of *Baxi Group Ltd v Commissioners for Her Majesty's Revenue and Customs* [2008] STC 491, which was concerned with a loyalty scheme of an entirely different character. It appears to have considered that both cases alike involved the straightforward application of established principles, since it determined them without a submission from the Advocate General. In terms of article 20, paragraph 5 of its Statute, it may do so only "where it considers that the case raises no new point of law".

The preliminary ruling

35. In its judgment *Commissioners for Her Majesty's Revenue and Customs v Loyalty Management UK Ltd and Baxi Group Ltd* (Joined Cases C-53/09 and C-55/09) [2010] STC 2651, the Court of Justice reformulated the questions so as to ask the following:

> "whether, in the context of a customer loyalty reward scheme such as those at issue in the main proceedings:
>
> - payments made by the operator of the scheme at issue to redeemers who supply loyalty rewards to customers must be considered, in Case C-53/09, as third-party consideration for a supply of goods to those customers, and/or, as the case may be, for a supply of services made by those redeemers for the benefit of those customers, and/or as the consideration for a supply of services made by those redeemers for the benefit of the operator of that scheme".

36. The court answered the question which it had formulated as follows:

> "Payments made by the operator of the scheme concerned to redeemers who supply loyalty rewards to customers must be regarded, in Case C-53/09, as being the consideration, paid by a third party, for a supply of goods to those customers or, as the case may be, a supply of services to them. It is, however, for the referring court to determine whether those payments also include the

consideration for a supply of services corresponding to a separate service."

The judgment of the Court of Justice

37. In its judgment, the court made a preliminary observation about the limited nature of the reference, and the fact that it did not touch on the relationship between LMUK and the sponsors:

> "It must also be stated, in relation to Case C-53/09, that neither the questions referred by the national court nor the views exchanged before the Court of Justice touched on the relationship between the sponsors and the operator of the loyalty reward scheme, namely LMUK. Consequently, the court will confine its assessment to the questions as referred by the national court." (para 32)

38. It is readily understandable that the Court of Justice should have made that preliminary observation. The case law of the court, including its judgment in the present case, indicates that, when determining the relevant supply in which a taxable person engages, regard must be had to all the circumstances in which the transaction or combination of transactions takes place. In the present case, in particular, it would be impossible to answer the questions on a proper footing without considering as a whole the relationships between LMUK, the sponsors, the collectors and the redeemers. The Court of Justice was not however in a position to consider the matter in that way.

39. This preliminary observation also implied that the assessment by the Court of Justice would leave out of account matters which had been regarded as being of importance in the national proceedings. In particular, the tribunal and the Court of Appeal had, as I have explained, attached significance to the undisputed fact that LMUK made taxable supplies when it granted to collectors, in return for payment by the sponsors, the right to receive goods and services from redeemers.

40. The Court of Justice then carried out an evaluation of the facts of the case on that limited basis. It stated that it was evident from the orders for reference that the loyalty rewards schemes at issue in both the present case and the *Baxi* case were designed to encourage customers to make their purchases from particular traders. To that end, the court said, LMUK, in the present case, and Baxi's sub-contractor, @1, in the *Baxi* case, "provide a number of services linked to the operation of those schemes" (para 41). The court appears therefore to have inferred from the reference that the present case, like the *Baxi* case, concerned a scheme

operated by traders with the assistance of a third party. That approach does not however fully reflect the facts found by the tribunal, by which this court is bound. LMUK did not provide a number of services linked to the operation of the scheme: it operated the scheme. The scheme was established by LMUK. It was designed to earn profits for LMUK, and to provide benefits to its millions of members (according to the evidence, 40% of UK households), as well as to the retailers who took part.

41. The court did not mention that the services provided by LMUK included the supply of the right to receive the rewards. Nor did it mention that the payments made by LMUK to redeemers for the provision of the rewards were met out of the consideration which it received from sponsors for the supply of the right to receive the rewards. As I have explained, these matters had not been focused in the reference. They had however played an important part in the reasoning of the Court of Appeal.

42. On the basis of its assessment of the economic reality, the Court of Justice concluded, in the first place, that loyalty rewards were supplied by the redeemers to the collectors. That much was not in dispute between the parties, and had been understood by the Court of Appeal.

43. The court then considered whether the transactions between the collectors and the redeemers constituted supplies of goods or services to the collectors within the meaning of the Sixth Directive. In a case where the transaction involved the provision of goods, the court held that that must constitute a supply of goods within the meaning of article 5(1) of the Sixth Directive, since there was a transfer by the redeemer to the collector of the right to dispose of tangible property as owner. In a case where the transaction did not constitute a supply of goods, it held that it must constitute a supply of services within the meaning of article 6(1) of the Sixth Directive, since the transaction did not constitute a supply of goods, and article 6(1) defines the expression “supply of services” as meaning any transaction which does not constitute a supply of goods. These matters also were not in dispute and had been understood by the national courts.

44. The court next considered whether the supply of goods or services by the redeemer to the collector was a taxable supply. As I have explained, that depended upon whether the supply was effected for consideration. The court noted that it followed from its case law that, in order for that requirement to be satisfied, there must be a direct link between the goods or service provided and the consideration received. These matters had been understood by the national courts.

45. The court then addressed the possibility that collectors might have provided consideration for the supply of the rewards when they purchased goods and services from sponsors. It noted that the price which customers paid to the sponsors was the same whether the customers were collectors or not. The court referred to its earlier judgment in *Kuwait Petroleum (GB) Ltd v Customs and Excise Commissioners* (Case C-48/97) [1999] STC 488. That case had concerned a loyalty rewards scheme operated by a petrol retailer, under which customers received points which they could exchange for goods. Since the customers paid the same price for their petrol regardless of whether they took the points or not, the court held that the price could not be regarded as containing an element representing the value of the points or of the goods for which they were exchanged. The sale of the petrol which gave rise to the award of points, on the one hand, and the supply of goods in exchange for the points, on the other hand, were therefore two separate transactions. In the view of the court, it followed that, in the case at hand, the sale of goods and services giving rise to the award of points, on the one hand, and the supply of goods and services in return for points, on the other hand, were also two separate transactions.

46. So far as it went, that conclusion was uncontentious. What is however significant is that the court did not address the possibility that the sponsors might have provided consideration for the supply of the rewards when they paid LMUK for the points issued to collectors, as the Court of Appeal's judgment had suggested. The court again left out of account the fact (1) that the award of points was a taxable supply by LMUK, separate from the supply of goods or services by the sponsor, (2) that, as a consequence of LMUK's having made that supply, the collectors were entitled to receive goods and services at no cost or at a reduced cost, and LMUK had to make goods and services available to them on that basis, and (3) that it paid redeemers to provide those goods and services on that basis. These features had not been present in the *Kuwait* case.

47. The court continued at para 57:

> "In that regard, it is evident from the order for reference in Case C-53/09 that the exchange of points by the customers with the redeemers gives rise to the making of a payment by LMUK to those redeemers. The amount of that payment is the sum total of the charges, which are of a fixed amount for each point redeemed against all or part of the price of the loyalty reward. In that context, it must be considered that, as maintained by the United Kingdom Government, that payment corresponds to the consideration for the supply of the loyalty rewards."

48. On the basis of the approach to the facts which the court had adopted, its conclusion is unsurprising. As I have explained, however, the terms of the reference resulted in the court's approaching the facts on a different basis from that which the referring court was bound to adopt. It left out of account a number of matters found by the tribunal and relied upon by LMUK before the national courts, including (1) the fact that sponsors pay LMUK for the grant to collectors of the right to receive goods and services, (2) the fact that LMUK meets the cost of the provision of goods and services to collectors out of those payments, (3) the fact that LMUK has, in return for those payments, granted collectors the right to receive goods and services without further payment or at a reduced cost, (4) the fact that collectors obtaining goods and services from redeemers are therefore exercising a right which has already been paid for, (5) the fact that the provision of goods and services by the redeemers is the means by which LMUK discharges its obligations to sponsors and collectors and (6) the fact that the payments made by LMUK to redeemers are therefore an essential cost of its business. More generally, as I have explained, the court does not appear to have assessed the transactions in question in the context of the arrangements considered as a whole, or determined on that basis what they amounted to in terms of economic reality. Nor is it apparent that the court took into account, in reaching its conclusion, the fact that (1) LMUK had agreed to make a taxable supply when it granted to collectors the right to receive goods and services at no cost or at a reduced cost, and (2) collectors receiving goods and services on that basis were therefore exercising a right for which LMUK had already been paid, and the consideration for which had already been subject to VAT.

49. The court is not of course to be criticised for failing to take these matters into account. As I have explained, they were not focused in the reference, and the court understandably confined its assessment to the matters raised in the questions referred.

50. The question whether there was also a supply of services to the promoter of the scheme was considered by the court principally in relation to the scheme with which the *Baxi* case was concerned. That scheme was of a different character from the Nectar scheme. It was an in-house scheme under which Baxi issued points to its own customers, which they could redeem in order to obtain rewards in the form of goods. The operation of the scheme had been subcontracted to an operator, @1, which purchased the rewards and supplied them to customers in return for points. Baxi paid @1 the retail sale price of the rewards. The court held that there was a supply of goods by @1 to the customers.

51. It was against that background that the court considered Baxi's contention that (in the court's words) the consideration for the payment did not correspond to a supply of goods, but to a complex service under which the supply of rewards to customers was one of a number of services. On the facts of the case, the court

concluded that the payments made by Baxi could be divided into two elements, each of which corresponded to a separate service: the supply of the rewards to the customers on the one hand, and the service supplied by @1 to Baxi on the other.

52. In relation to the present case, the court stated at para 64:

> "By contrast, in Case C-53/09, LMUK has, in both its written and oral observations, asserted that the payments which it makes to the redeemers are not the consideration for two or more separate services. It is, however, for the referring court to determine whether that is the case."

The issues now arising

53. The first issue which now arises is how this court should apply the ruling of the Court of Justice.

54. Article 267 TFEU confers on the Court of Justice jurisdiction to give preliminary rulings concerning (a) the interpretation of the Treaties and (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union. In the present case, it is the court's jurisdiction to rule on the interpretation of the VAT directives which is relevant. On the other hand, putting the matter very broadly, the evaluation of the facts of the case, and the application of EU law to those facts, are in general functions of the national courts. The relevant principles were summarised more precisely by the Court of Justice in *AC-ATEL Electronics Vertriebs GmbH v Hauptzollamt München-Mitte* (Case C-30/93) [1994] ECR I-2305, paras 16-18:

> "16. On that point, it should be borne in mind that Article [267] of the Treaty is based on a clear separation of functions between the national courts and the Court of Justice, so that, when ruling on the interpretation or validity of Community provisions, the latter is empowered to do so only on the basis of the facts which the national court puts before it (see the judgment in Case 104/77 *Oehlschläger v Hauptzollamt Emmerich* [1978] ECR 791, point 4).
>
> 17. It is not for the Court of Justice, but for the national court, to ascertain the facts which have given rise to the dispute and to establish the consequences which they have for the judgment which it is required to deliver (see the judgment in Case 17/81 *Pabst & Richarz v Hauptzollamt Oldenburg* [1982] ECR 1331, paragraph 12).

> 18. It is, moreover, solely for the national court before which the dispute has been brought, and which must assume the responsibility for the subsequent judicial decision, to determine in the light of the particular circumstances of each case both the need for a preliminary ruling in order to enable it to deliver judgment and the relevance of the question which it submits to the court (see the judgments in Case 247/86 *Alsatel v Novasam* [1988] ECR 5987, paragraph 8, and in Case C-127/92 *Enderby v Frenchay Health Authority and Secretary of State for Health* [1993] ECR I-5535, paragraph 10)."

55. As I have explained, the Court of Justice recognised that the reference in the present case raised no new point of law. The court however endeavoured to clarify how established principles applied in the circumstances of the case, so far as they emerged from the reference. It is particularly unfortunate in those circumstances that, as I have explained, the reference failed to reflect fully either the facts on the basis of which this court must proceed or the issues at the heart of the dispute, with the consequence that the Court of Justice did not fully address those facts or those issues.

56. The Court of Justice's analysis of the legal issues focused in the reference, on the basis of the facts as it understood them, is not open to question. This court is required by section 3(1) of the European Communities Act 1972 (as amended by section 3 of and the Schedule to the European Union (Amendment) Act 2008) to determine "any question … as to the validity, meaning or effect of any EU instrument" in accordance with "any relevant decision of the European Court". Nevertheless, this court's responsibility for the decision of the present case on the basis of all the relevant factual circumstances, and all the arguments presented, requires it to take into account all the facts found by the tribunal, including those elements left out of account by the Court of Justice, and to consider all those arguments, including those which were not reflected in the questions referred. That responsibility under domestic law is also recognised in EU law, as the Court of Justice explained at paragraphs 17 and 18 of its *AC-ATEL* judgment. In the exceptional circumstances of this case, this court cannot therefore treat the ruling of the Court of Justice as dispositive of its decision, in so far as it was based upon an incomplete evaluation of the facts found by the tribunal or addressed questions which failed fully to reflect those arguments. This court must nevertheless reach its decision in the light of such guidance as to the law as can be derived from the judgment of the Court of Justice. In that regard, important aspects of the judgment include the statement that consideration of economic realities is a fundamental criterion for the application of the common system of VAT (para 39), and the statement that, where a transaction comprises a bundle of features and acts, regard must be had to all the circumstances in which the transaction in question takes place (para 60).

57. Before turning to consider the present case on that basis, it is necessary to say something about the principal authorities which are relied upon by the parties in support of their contentions.

The Redrow line of authority

58. LMUK seeks support for its contentions from the approach adopted by the House of Lords in *Customs and Excise Commissioners v Redrow Group plc* [1999] 1 WLR 408; [1999] STC 161. That case concerned a sales incentive scheme under which Redrow, a firm of housebuilders, promoted the sale of its houses to prospective customers by arranging for estate agents to value and market the customers' existing homes. This was done on the basis that the cost would be borne by Redrow, provided the customer bought a Redrow house. The House concluded that there was a supply of services by the estate agents to the customers, and simultaneously a supply of services by the estate agents to Redrow. Since the latter supply was received by Redrow for the purposes of its business, it followed that Redrow was entitled to deduct the VAT which it had paid as input tax.

59. The critical reasoning appears in the speeches of Lord Hope of Craighead and Lord Millett, with which the other members of the Committee agreed. Lord Hope said at pp 412-413:

> "Questions such as who benefits from the service or who is the consumer of it are not helpful. The answers are likely to differ according to the interest which various people may have in the transaction. The matter has to be looked at from the standpoint of the person who is claiming the deduction by way of input tax. Was something being done for him for which, in the course or furtherance of a business carried on by him, he has had to pay a consideration which has attracted value added tax? The fact that someone else - in this case, the prospective purchaser - also received a service as part of the same transaction does not deprive the person who instructed the service and who has had to pay for it of the benefit of the deduction."

60. Lord Millett's reasoning was similar, at p 418:

> "The fact is that the nature of the services and the identity of the person to whom they are supplied cannot be determined independently of each other, for each defines the other. Where, then, should one begin? … One should start with the taxpayer's claim to

> deduct tax. He must identify the payment of which the tax to be deducted formed part; if the goods or services are to be paid for by someone else he has no claim to deduction. Once the taxpayer has identified the payment the question to be asked is: did he obtain anything - anything at all – used or to be used for the purposes of his business in return for that payment? This will normally consist of the supply of goods or services to the taxpayer. But it may equally well consist of the right to have goods delivered or services rendered to a third party. The grant of such a right is itself a supply of services."

61. Applying this reasoning to the present case, LMUK argues that it is in a similar situation to Redrow. LMUK pays the redeemers and obtains services in return, including the provision of goods and services to the collectors in fulfilment of its contractual obligations towards them, which it uses for the purposes of its business. Following the approach adopted in *Redrow*, it is therefore entitled to deduct input tax.

62. LMUK seeks to draw further support from the decision of the House of Lords in *Customs and Excise Commissioners v Plantiflor Ltd* [2002] UKHL 33; [2002] 1 WLR 2287; [2002] STC 1132. Plantiflor sold horticultural goods by mail order, and contracted with its customers to arrange for the delivery of the goods by Parcelforce and to meet the cost of that delivery, in return for the payment by its customers of a charge for postage. It contracted with Parcelforce for the delivery of the goods in return for payment of the postage charge. Plantiflor argued that it was not accountable for output tax on the postage charges paid by its customers, since it received those payments merely as the agent of its customers rather than as consideration for any service provided by itself: it maintained that the charges were the consideration for a service supplied to the customers by Parcelforce. The majority of the House however rejected that analysis, holding that Plantiflor was acting as a principal and received consideration from its customers for providing them with the service of arranging the delivery of the plants. Parcelforce made two supplies: it supplied to the customers the service of delivering the plants they had ordered, and it supplied to Plantiflor the service of delivering the goods which it had sold.

63. These authorities were followed by the Court of Appeal in *WHA Ltd v Customs and Excise Commissioners* [2004] STC 1081. WHA was an insurance claims handler which acted on behalf of motor breakdown insurers. It entered into agreements with garages under which it authorised and paid for repairs to policyholders' cars. The issue was whether it could deduct the VAT element of the repair bills as input tax. The Court of Appeal held that it could. It received a service from the garages, namely the carrying out of the repairs, and it did so for the purposes of its business, since it was discharging its obligations to the insurers. Although there were other beneficiaries of the repairs, namely the car owners, that

did not prevent the repairs being a supply of services to WHA. That decision is currently under appeal to this court.

64. The Commissioners contend that the decision of the Court of Justice in the present case is incompatible with that line of authority, and in particular with both the reasoning and the conclusion reached in *Redrow*, which should therefore not be followed. I cannot however find anything in the court's judgment which directly engaged with the issues considered in those cases. That indeed is part of the problem with which this court is faced, since the decision of the Court of Appeal in this case was based upon the application of the principles established in *Redrow*.

65. I see no reason to question the correctness of the conclusions reached on the facts of *Redrow* and *Plantiflor* (it would not be appropriate to express any view in relation to *WHA,* since it is under appeal). Nor do I question the reasoning. On the contrary, the passages which I have cited from the speeches of Lord Hope and Lord Millett appear to me to provide valuable guidance.

66. I would at the same time stress that the speeches in *Redrow* should not be interpreted in a manner which would conflict with the principle, stated by the Court of Justice in the present case, that consideration of economic realities is a fundamental criterion for the application of VAT. Previous House of Lords authority had emphasised the importance of recognising the substance and reality of the matter (*Customs and Excise Commissioners v Professional Footballers' Association (Enterprises) Ltd* [1993] 1 WLR 153, 157; [1993] STC 86, 90), and the judgments in *Redrow* cannot have been intended to suggest otherwise. On the contrary, the emphasis placed upon the fact that the estate agents were instructed and paid by Redrow, and had no authority to go beyond Redrow's instructions, and upon the fact that the object of the scheme was to promote Redrow's sales, indicates that the House had the economic reality of the scheme clearly in mind. When, therefore, Lord Hope posed the question, "Was something being done for him for which, in the course or furtherance of a business carried on by him, he has had to pay a consideration …?", and Lord Millett asked, "Did he obtain anything – anything at all – used or to be used for the purposes of his business in return for that payment?", those questions should be understood as being concerned with a realistic appreciation of the transactions in question.

67. Reflecting the point just made, it is also necessary to bear in mind that consideration paid in respect of the provision of a supply of goods or services to a third party may sometimes constitute third party consideration for that supply, either in whole or in part. The speeches in *Redrow* should not be understood as excluding that possibility. Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods

or services to a third party), but that possibility cannot be excluded *a priori*. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation, the correct analysis is likely to be that the payment constitutes third party consideration for the supply.

68. It is also important to bear in mind that decisions about the application of the VAT system are highly dependent upon the factual situations involved. A small modification of the facts can render the legal solution in one case inapplicable to another. I would therefore hesitate to treat the judgments in *Redrow* as laying down a universal rule which will necessarily determine the identity of the recipient of the supply in all cases. Given the diversity of commercial operations, it may not be possible to give exhaustive guidance on how to approach the problem correctly in all cases.

Auto Lease Holland

69. The Commissioners on the other hand rely upon the decision of the Court of Justice in *Auto Lease Holland BV v Bundesamt für Finanzen* (Case C-185/01) [2003] ECR 1-1317; [2005] STC 598. That case was concerned with "fuel management agreements" between Auto Lease, a vehicle leasing company, and its lessees, under which a lessee could fill up his vehicle in the name and at the expense of Auto Lease, using a credit card issued by a credit card company, DKV. The lessee paid a monthly sum to Auto Lease based on his likely consumption of fuel, with a balancing sum being paid at the end of the year. Auto Lease contended that it was entitled to deduct the VAT paid on the fuel as input tax, on the basis that it was the recipient of the supply of the fuel.

70. The Court of Justice rejected the contention. It noted in the first place that the expression "supply of goods" was defined by article 5(1) of the Sixth Directive as meaning "the transfer of the right to dispose of tangible property as owner". The court continued:

> "34. It is common ground that the lessee is empowered to dispose of the fuel as if he were the owner of that property. He obtains the fuel directly at filling stations and Auto Lease does not at any time have the right to decide in what way the fuel must be used or to what end.
>
> 35. The argument to the effect that the fuel is supplied to Auto Lease, since the lessee purchases the fuel in the name and at the expense of that company, which advances the cost of that property,

> cannot be accepted. As the Commission rightly contends, the supplies were effected at Auto Lease's expense only ostensibly. The monthly payments made to Auto Lease constitute only an advance. The actual consumption, established at the end of the year, is the financial responsibility of the lessee who, consequently, wholly bears the costs of the supply of fuel.
>
> 36. Accordingly, the fuel management agreement is not a contract for the supply of fuel, but rather a contract to finance its purchase."

71. This decision does not appear to me to assist the Commissioners in the present case. Although the Court of Justice referred to it in its judgment, it did so in the context of identifying the recipient of a supply of goods in a situation where redemption goods are provided by a redeemer to a collector. As the court held, the recipient of that supply is the collector. That conclusion is not in dispute in this appeal: indeed, it was not in dispute before the Court of Justice.

The present case

72. The only issue which this court has to determine is whether LMUK is entitled to deduct as input tax the VAT element of the payments which it makes to the redeemers.

73. As the Court of Justice has explained many times, VAT is chargeable on each transaction in the production and distribution process only after deduction of the amount of VAT borne directly by the costs of the various price components. The court has consistently stressed that the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities, and that the VAT system consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are subject in principle to VAT (see for example the statement of the Grand Chamber to that effect in *Halifax plc & Others v Customs and Excise Commissioners* (Case C-255/02) [2006] Ch 387 para 78).

74. The right to deduct VAT, as an integral part of the VAT scheme, has been described by the court as a fundamental principle underlying the common system of VAT, which in principle may not be limited (see, for a recent statement to that effect, *Commissioners for Her Majesty's Revenue and Customs v RBS Deutschland Holdings GmbH* (Case C-277/09) [2010] ECR I-13805, paras 38-39).

75. The consequence of the deduction of input VAT is that the tax is charged, at each stage in the production and distribution process, only on the added value and is ultimately borne only by the final consumer (see, for a recent statement to that effect, *Lebara Ltd v Revenue and Customs Commissioners* (Case C-520/10) [2012] STC 1536, paras 24-25).

76. In the present case, the Court of Justice focused upon the relationship between redeemers and collectors. Since collectors are usually final consumers of the goods and services provided by redeemers, the principle described in paragraph 75 would suggest, at first sight, that final taxation should take place at the stage of that supply. Since no monetary consideration is paid by the collector in so far as the goods or services are exchanged for points, but a payment is subsequently made by LMUK which is based on the value of the points as agreed with the redeemer, it would be possible, if these aspects of the present case were considered in isolation, to conclude that that payment should be regarded as third party consideration for that supply, and taxed accordingly.

77. As I have explained, however, there is another dimension to the case, which the Court of Justice was not requested to consider, and which it therefore left out of account. The appeal before this court is concerned with the claim of LMUK, a taxable person, to deduct input tax. LMUK's business is of an unusual character. Through the Nectar scheme, it provides collectors with a contractual right to obtain goods and services from redeemers in exchange for points. It is common ground before this court that that is a taxable supply, and that the taxable amount is the whole of the consideration which is received by LMUK. The counterpart of the right supplied to collectors is an obligation on the part of LMUK to procure that redeemers provide goods and services in exchange for points. The payments made to redeemers constitute the cost of fulfilling that obligation, and are therefore a cost of LMUK's business.

78. Applying the principles summarised in paragraphs 73 and 74 above, VAT should be chargeable on LMUK's taxable supplies only after deduction of the VAT borne by LMUK's necessary costs. The most obvious of those costs, as I have explained, is the cost of securing that goods and services are provided to collectors in exchange for their points: that is to say, the payments made by LMUK to the redeemers. The principles summarised in paragraphs 73 and 74 therefore indicate that LMUK should be authorised to deduct from the VAT for which it is accountable the VAT charged by the redeemers, so that it accounts for VAT only on the added value for which it is responsible. Only in that way will VAT be completely neutral as regards LMUK.

79. It is implicit in that approach that the transaction between a redeemer and LMUK involves a taxable supply by the former to the latter. That analysis appears

to me to be consistent with economic reality. LMUK carries on a genuine business for its own benefit. It issues the points in its own name and on its own behalf: it is not a mere cipher for the sponsors. As a matter of economic reality, the payments which it makes to redeemers are an essential cost of its business. Its business model is to sell the right to receive goods and services, pay redeemers to provide the goods and services, and derive a profit from the difference between its income from the sponsors and its expenditure on the redeemers.

80. There is a legal relationship between the redeemer and LMUK pursuant to which there is reciprocal performance. In accepting points, which have no inherent value, in exchange for goods or services, the redeemer is acting in a manner which is only explicable because of its agreement with LMUK, under which LMUK will pay it for doing so. LMUK pays it for doing so because its business is dependent on redeemers accepting points in exchange for the provision of goods and services. The only economically realistic explanation of LMUK's behaviour is the value to LMUK itself of the redeemers' acceptance of points in exchange for the provision of goods and services.

81. In these circumstances, it can in my view be said that the remuneration received by the redeemer represents the value to LMUK of the service which the redeemer provides (cf *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509, para 14; *First National Bank of Chicago v Customs and Excise Commissioners* (Case C-172/96) [1999] QB 570; [1998] STC 850, paras 26 to 29).

82. The approach described in the foregoing paragraphs is consistent with the fundamental principle, as the Court of Justice has described it, that a taxable person is entitled to deduct the VAT payable in the course of his economic activities. The alternative approach described in paragraph 76 is not.

83. This approach is also consistent with the application of the guidance given in *Redrow*. If one asks whether, when the redeemer accepts points in exchange for the provision of goods or services to a collector, something is being done for LMUK for which, in the course or furtherance of its business, it has to pay a consideration, the answer seems to me to be in the affirmative, for the reasons given in paragraph 80.

84. If one asks, what about taxation of the supply to the final consumer, the answer is that the Commissioners have decided to treat the issue of the points to the collectors – that is to say, the award of the right to obtain goods and services from redeemers – as a taxable supply. The taxable amount is agreed to be the whole of the consideration received by LMUK for the grant of those rights: an

amount which exceeds the value received by the redeemers from LMUK when the rights are exercised. No question arises in this appeal as to whether that tax treatment is correct. Because of the principle of tax neutrality, however, that tax treatment has implications for the question in issue.

85. As the Court of Appeal pointed out, if the provision of goods or services by redeemers were treated as a taxable supply to the collector (other than to the extent to which any monetary consideration might be paid by the collector), the tax authorities would receive not only VAT on the amount received by LMUK for supplying the right to receive those goods and services, but also VAT on the amount which LMUK must pay to satisfy that right. If, on the other hand, the consideration paid by LMUK to the redeemers is regarded as the consideration for the supply of a service to LMUK (a service which encompasses the provision of goods and services to collectors), the tax authorities will still receive VAT from LMUK on the difference between the value of the supplies which it makes in the course of its business (ie its receipts from the supply of the right to receive such goods and services) and the value of the supplies which it receives for the purposes of that business (ie the cost to LMUK of satisfying that right). The tax authorities will thus recover VAT on the value added by the taxable transactions entered into by LMUK, taking the issue and redemption of points as a whole. That conclusion is in accordance with the basic principle of VAT.

Conclusion

86. For these reasons, I would be inclined to uphold the decision of the Court of Appeal and dismiss the appeal. The parties should however be afforded an opportunity to make written submissions on the form of order to be made.

LORD HOPE

87. I think that it was a pity that a preliminary ruling was sought in this case. I agree with Chadwick LJ's observation in the Court of Appeal that the real issue is not one as to the interpretation of Community legislation or as to the effect to be given to judgments of the Court of Justice, but rather as to how principles that are not themselves in doubt should be applied to particular facts: *Loyalty Management UK Limited v Commissioners for HM Revenue and Customs* [2007] EWCA Civ 938, [2008] STC 59, para 66. The CJEU seems to have taken a similar view. It did not seek an opinion from the Advocate General before it proceeded to judgment, indicating that in its view the case raised no new point of law. This places the reader at a disadvantage, as its judgment lacks the depth of reasoning which a judgment informed by an opinion would have provided. It is quite rare for the

domestic court to find itself in this position. The recent case of *O'Brien v Ministry of Justice* (Case C-393/10) [2012] 2 CMLR 25 is an excellent example of the guidance that the CJEU normally gives on issues of EU law and there are, of course, many more.

88. I also think that the questions that were referred, although agreed to by the parties and approved by the House of Lords, tended to obscure what became the real issue when the case was argued in Luxembourg. For this reason the CJEU can hardly be blamed for not addressing that issue directly when it was conducting its analysis. The situation was also complicated by the fact that in the case of *Baxi Group Ltd* (Case C-55/09), which was referred by the House to the CJEU at the same time, there was a separate set of questions designed to fit the facts of that case. The CJEU analysed the *Baxi Group Ltd* case separately in the same judgment. Its analysis of the facts of that case may have influenced its analysis of the present case to the disadvantage of its treatment of the case for LMUK.

The issue

89. Chadwick LJ said that the issue in the present case was whether there was a supply of redemption services by the redeemer to LMUK for the purposes of VAT: para 33. This is how LMUK put its case in paragraph 29 of its written observations to the CJEU:

> "LMUK's analysis is that the redeemers made supplies to *both* LMUK (redemption services) and the collectors (rewards) and that the recipient *in either case* can deduct VAT which it pays, subject to the normal rules. Only LMUK's analysis results in the VAT being deductible (subject to the normal rules) by the person who has actually paid the VAT and ensures that the UK Government collects VAT on the amount of the consideration actually paid by the final consumer." [emphasis added]

The words "both" and "in either case" in this analysis are important. They directed attention to the fact that LMUK's argument was that the redeemers were making supplies in both directions.

90. The Revenue's argument, on the other hand, was encapsulated in question (2)(b) of the reference (see para 29, above). It asked whether the provisions of articles 14, 24 and 73 of Council Directive 2006/112/EC of 28 November 2006 were to be interpreted, where payments were made by the promoter to the redeemers, such that those payments were to be characterised as consideration

"solely" for the supply of goods and/or services by the redeemers to the customers. In paragraph 9 of its written observations the Revenue said that the correct analysis was that the relevant supplies were made by the redeemers to the collectors, and that the consideration given by LMUK to the redeemers was third party consideration for those supplies.

91. The questions in paragraphs (2) (c) and (3) of the reference then asked whether the consideration was "in part" for the supply of services by the redeemers to LMUK and "in part" for supplies by the redeemers to the customers and, if so, what the criteria are for an apportionment. Their inclusion in the reference was unfortunate, as they tended to divert attention from the way the case was presented when it reached the CJEU. This was not, in the event, an analysis which was argued for by either party. It was not LMUK's case by that stage that the consideration that it paid to the redeemers was "in part" for the supply of services by the redeemers to it and "in part" for the supply of goods and services to the customers, and that the consideration could or should be apportioned accordingly. A question which directed attention to the argument that the redeemers made supplies "both" to LMUK and the collectors, and that the recipient "in either case" could deduct the VAT which it paid on the consideration for the supply, was not included in the reference.

92. In his submissions to this court Mr Milne QC renewed the case which he had presented to the CJEU. He said that apportionment was not what his clients wanted, and emphasised that it had not been a live issue before the tribunal. LMUK's case, looked at from its point of view (see *Customs and Execise Commissioners v Redrow Group plc* [1999] 1 WLR 408, 412; [1999] STC 161, 166), was that services were supplied to it by the redeemers for which it paid consideration and, that as the payment it made to the redeemers attracted VAT, it was entitled to deduct input tax on that amount. The scheme required the co-operation of both the sponsors and the redeemers. The redeemers were accountable for the VAT payable on the consideration which they received both for their supplies to the customers and for the services provided by them to LMUK. The customers, assuming that they were traders (as some of them were), and LMUK were both entitled to the benefit of the doctrine of fiscal neutrality.

93. In para 33 of its judgment the Court said that the essence of the questions that were put to it in LMUK's case was whether payments made by LMUK to the redeemers must be considered as third party consideration for supplies to or for the benefit of customers (which was the Revenue's case), or as the consideration for the supply of services made by the redeemers for the benefit of LMUK. This was an incomplete appreciation of the alternative analyses on which the Court's interpretation of the EU legislation was sought. The argument for the Revenue was that LMUK's ability to deduct the input tax on the consideration which it paid to the redeemers for the services that they provided for its benefit was excluded by

the fact that the payments that it made to the redeemers were third party consideration for the goods or services provided by the redeemers to the customers. LMUK's argument was that the treatment of the consideration passing between it and the redeemers should be considered separately from that passing between the redeemers and the customers.

94. A summary of the observations submitted to the CJEU is set out in paras 34 to 37 of the judgment. The Revenue's case is appropriately summarised in para 36, that the payments made by LMUK to the redeemers must be regarded as third party consideration for supplies of goods and services to the customers. LMUK's case is summarised in para 34. The summary is in these terms:

> "In Case C-53/09, LMUK argues that the payments which it made to the redeemers constitute the consideration for services supplied to it by the redeemers. Those services, it submits, consist of various contractually agreed services, including the redeemers' undertaking to supply goods or services to customers without charge or at a reduced price."

This formulation takes the point made by LMUK in paragraph 29 of its written observations. But it does not recognise the argument that the redeemers made supplies both to the collectors and to LMUK, and that the recipient in either case could deduct the VAT which it paid.

The judgment

95. The Court's reply to these observations begins in para 38. The obvious point is made in that paragraph that the system of VAT involves the application of a general tax on consumption which is exactly proportional to the price of the goods and services. In para 39 of the judgment reference is then made to economic realities as a fundamental consideration for the application of the system. Two examples are given: first, the meaning of place of business and, secondly, the identification of the person to whom goods are supplied. The second example is said to be illustrated by *Auto Lease Holland BV v Bundesamt für Finanzen* (Case C-185/01) [2003] ECR I-1317.

96. Having asked itself what the nature was of the transactions under the schemes at issue, the Court said in para 42 that the economic reality was that loyalty rewards were supplied by the redeemers to the customers. So far as it goes, this point was not in dispute. But no mention is made of the effect of applying the economic reality test to the argument that there was also a supply of services by

the redeemers to LMUK. Here again the significance of the way LMUK put its case in paragraph 29 of its written observations, where the word "both" was used, appears to have been overlooked.

97. In para 43 of its judgment the Court asks itself whether the supply of the rewards constituted a supply of goods or services effected for consideration by a taxable person. The conclusion is then drawn in para 49 that the redeemers were supplying goods and services to the customers within the meaning of articles 5(1) and 6(1) of the Sixth Directive. This is unsurprising. But it does not advance the argument, as it was already common ground between the parties. In para 50 the Court asks itself the question whether these supplies were carried out for consideration. In para 56 the point is made that article 11.A(1)(a) of the Sixth Directive provides that the consideration may be obtained from a third party.

98. There then follows para 57, which is in these terms:

> "In that regard, it is evident from the order for reference in Case C-53/09 that the exchange of points by the customers with the redeemers gives rise to the making of a payment by LMUK to those redeemers. The amount of that payment is the sum total of the charges, which are of a fixed amount for each point redeemed against all or part of the price of the loyalty reward. *In that context, it must be considered that, as maintained by the United Kingdom Government, that payment corresponds to the consideration for the supply of the loyalty rewards*." [emphasis added]

99. At first sight the sentence which I have emphasised determines this appeal in favour of the Revenue. But the proposition which I have emphasised does not include the word "solely". Nor is any mention made of the point that LMUK made in paragraph 29 of its observations, where the word "both" was used: that the redeemers were supplying services to LMUK too, and that the payments which LMUK made to the redeemers could also be seen as consideration for services supplied to it by the redeemers. If that proposition was being rejected at this stage on the ground that it was not in accordance with the economic reality, this is not clearly stated. Nor is any reason given here for its rejection.

100. In paras 58 to 63 of the judgment there is an analysis of the issues raised by *Baxi Group Ltd* (Case C-55/09), where it was contended by Baxi that the consideration for the payment by it to the redeemer did not correspond to a supply of goods but to a complex advertising service under which the supply of loyalty rewards to customers was one of a number of services. The conclusion that the Court drew from its analysis of the facts of that case, assisted by a question

directed to this issue, was that the payment could be divided into two elements, each of which corresponded to a separate service. This was because it was possible to identify a profit margin consisting of the difference between the retail sale price of the loyalty rewards to the customer paid by Baxi and the price at which those rewards were purchased by the redeemer. Its conclusion was that the payment was the consideration for two separate supplies. It was in part consideration, paid by the third party Baxi, for a supply of goods to the customers and in part consideration for the supply of services to Baxi. The answer to the question how, in view of that conclusion, the payment was to be apportioned between these two supplies was given in para 63.

101. The judgment then sets out the conclusion that, in contrast to its conclusion in *Baxi*, the Court reached in LMUK's case. It is set out in para 64 as follows :

> "By contrast, in Case C-53/09, LMUK has, in both its written and oral observations, asserted that the payments which it makes to the redeemers are not the consideration for two or more separate [supplies]. It is, however, for the referring court to determine whether that is the case."

The first sentence is a correct statement as far as it goes. It distinguished LMUK's case from that of Baxi. But, for the reasons already mentioned, it does not address the question that needed to be answered. Here again, as in para 57 of its judgment, the Court seems to have overlooked the point that LMUK made in paragraph 29 of its observations that services were also supplied to LMUK by the redeemers in return for consideration paid by LMUK. If that proposition was being rejected, once again this is not clearly stated. The question which is then sent back to the referring court is not in point. LMUK was not asserting, and did not seek to argue before us, that the payments made to the redeemers were the consideration for two or more separate supplies.

102. Lastly, there are the answers that the Court gives in para 65 to the questions referred in each case. The answer to the questions referred in LMUK's case is as follows:

> "[P]ayments made by the operator of the scheme concerned to redeemers who supply loyalty rewards to customers must be regarded … as being the consideration, paid by a third party, for a supply of goods to those customers or, as the case may be, a supply of services to them. It is, however, for the referring court to determine whether those payments also include the consideration for a supply of services corresponding to a separate [supply]."

This answer brings together the points that the Court made in paras 57 and 64. Here again, it respectfully seems to me, the point that is really in issue in this case is not answered. The question sent back to the referring court must be taken to be the same as that which the Court set out in para 64. An affirmative answer to it would lead to the making of an apportionment of the consideration between the two separate services. But LMUK is not contending that there should be an apportionment. The CJEU then sets out a proposition for which LMUK was not contending and did not contend when the case came back to this court.

The response

103. We are, of course, obliged to treat any question as to the meaning or effect of any EU instrument as a question of law which must be determined as such in accordance with the principles laid down by and any relevant decision of the CJEU: section 3 of the European Communities Act 1972, as substituted by the European Union (Amendment) Act 2008, section 3 and the Schedule, Part 1. And where a question is referred to the CJEU for a preliminary ruling, it is our duty to give effect to the Court's ruling as to how the instrument must be interpreted according to the principles of EU law. We must be loyal to our Treaty obligations. But I do not read the ruling contained in this judgment as determining how the principles that it sets out are to be applied to the facts of this case. That is our responsibility. The problem that we face in looking to the judgment for guidance is that it does not say that the payments made by the promoters to the redeemers are to be characterised *solely* as consideration for the supplies by the redeemers to the customers. Nor does it say that the proposition that the redeemers made supplies in both directions and that the recipients of those supplies could deduct VAT on the payments they made must be rejected. That, as I understand the competing arguments which were advanced before us, is what is really at issue. In this situation it must be treated as an issue of fact for us to decide.

104. It is worth recalling that in para 38 of his judgment in the Court of Appeal Chadwick LJ said that the passages which he had quoted from the speeches in *Customs and Excise Commissioners v Redrow Group Plc* provided clear authority for the propositions (a) that there is no reason why, in a VAT context, a supplier (S) may not be treated as making, in the same transaction, both a supply of services to one person (P1) and a supply of different services to another person (P2); and (b) that, in addressing a claim for input tax credit by P2, to whom services have been supplied in these circumstances, the relevant question are (i) did P2 make a payment to S, (ii) was that payment consideration for services supplied to P2 and (iii) were those services used or to be used in the course of a business carried on by P2.

105. Having considered the speeches in *Customs and Excise Commissioners v Plantiflor Ltd* [2002] 1 WLR 2287; [2002] STC 1132 and the judgment of Neuberger LJ in *WHA Ltd and another v Customs and Excise Commissioners* [2004] STC 1081, Chadwick LJ observed in para 51 that the argument that found favour with Lindsay J in the present case – which was that, in a case where it was possible to identify different supplies to different recipients in the same transaction, only one could be the relevant supply for VAT purposes – was not self-evident. His own conclusion was to the contrary. Mr Milne invited us to endorse that conclusion. As he put it, the fact that there was a supply to the customers did not eliminate the possibility of their having also been the supply of a service to LMUK. The ruling that has been obtained from the CJEU does not, as I have sought to show, address this issue.

106. The question then is whether the judgment lays down any principles which are determinative of this issue. Mrs Whipple QC for the Revenue said that the question in this case all the way up has been: to whom was the supply made? She submitted that it must be taken from what the Court said in para 39 of its judgment that this question must be answered by considering the economic realities, as this was a fundamental criterion for the application of the system of VAT: *Customs and Excise Commissioners v DFDS A/S* (Case C-260/95) [1997] 1 WLR 1037, para 23 and *Planzer Luxembourg Sàrl v Bundeszentralamt für Steuern (*Case C-73/06) [2007] ECR I-5655, para 43. The judgment in *Auto Lease Holland* [2003] ECR I-1317, paras 35 and 36 showed how this test was to be applied to identify the person to whom the goods are supplied. The case of *Redrow* was wrongly decided. The economic realities of the case could show that the supply was to a third party, not to the person who paid the consideration. That was the position in this case.

107. The problem with this approach is that it does not exclude the possibility that there may, as a matter of economic reality, be two or more supplies within the same transaction. Mrs Whipple said that one must start with the economic reality, and I have no difficulty in accepting that. But what the economic reality is in a given case must surely be a question of fact for the domestic court. The statement that the Court makes in para 42 of its judgment that the economic reality is that the loyalty rewards are supplied by the redeemers to the customers is only part of the story. This is shown by the fact that the Court said in para 64 that it was for the referring court to determine whether the payments that LMUK makes to the redeemers were the consideration for two or more separate services. Presumably the test which it would have to apply, if it were to address this question, would be to consider the economic realities. If that is a question which it is proper to send back to the referring court, why is it not open to it to examine the question that the Court itself did not answer – whether it is possible, upon consideration of the economic realities, to identify two different supplies by the redeemers to two different recipients in the same transaction?

108. If, as the Court of Appeal held, it is possible to identify different supplies by the redeemers to different recipients in the transaction by which LMUK pays consideration to the redeemers, what then? It is not easy to see why the economic realities test should exclude the possibility there can be more than one relevant supply for VAT purposes. It seems to me that the judgment leaves it open to this court to determine whether, in fact and as a matter of economic reality, the redeemers may not be treated as having made, in the same transaction, both a supply of services to the customers and a supply of different services to LMUK or, as LMUK put its case in paragraph 29 of its written observations, the redeemers made supplies both to LMUK (redemption services) and to the customer (rewards). For the reasons the Court of Appeal gave, I would answer that question in the affirmative.

109. Mrs Whipple argued strongly to the contrary. She submitted that it followed from the CJEU's judgment that *Customs and Excise Commissioners v Redrow Group plc*, which the Court of Appeal applied to the facts of this case, was wrongly decided. But I am unable to find anything in the CJEU's judgment that drives us to that conclusion. The only statement of principle which it contains is that consideration of economic realities is a fundamental criterion for the application of VAT: para 39. I do not see this as undermining the way the questions of fact were determined in *Redrow* or the conclusion by the appellate committee that, as the services in respect of which Redrow claimed input tax deductions were supplied for a consideration paid to it in return, it was entitled to the benefit of the deduction. I am not persuaded that *Redrow* was wrongly decided.

110. I acknowledge, however, that some of the reasoning in *Redrow* needs to be adjusted in the light of later authority. I would not wish to alter what I said at [1999] 1 WLR 408, 412H-413A: was something being done for the person claiming the deduction for which, in the course or furtherance of a business carried on by him, he has had to pay a consideration which has attracted value added tax? But I think that Lord Millett went too far at p 418 G when he said that the question to be asked is whether the taxpayer obtained "anything – anything at all" used or to be used for the purposes of his business in return for that payment. Payment for the mere discharge of an obligation owed to a third party will not, as he may be taken to have suggested, give rise to the right to claim a deduction. A case where the taxpayer pays for a service which consists of the supply of goods or services to a third party requires a more careful and sensitive analysis, having regard to the economic realities of the transaction when looked at as a whole. It may lead to the conclusion that it was solely third party consideration, or it may not.

Conclusion

111. For the reasons I have given, do I not see the CJEU's judgment as precluding a finding in LMUK's favour that the redeemers should be treated as having made, in the same transaction and as a matter of economic reality, both a supply of goods and services to the customers and a supply of different services to LMUK, and that LMUK is entitled to input tax credit on the consideration in return for which those different services were supplied to it. In my opinion the only conclusion that can properly and fairly be reached in this case is that the Court of Appeal's decision should be affirmed. For these reasons, and for the further reasons given by Lord Reed, I would make the order that he proposes.

LORD WALKER

112. I am doubtful whether I can usefully add anything to the thorough and closely-reasoned judgments of Lord Hope and Lord Reed, with which I am in full agreement. But as this Court is divided I think it right to restate, as briefly as I can, what I see as the essential reasons for dismissing this appeal.

113. Anyone with even a passing acquaintance with value-added tax is familiar with the basic concept of the fiscal neutrality of a chain of transactions which, however short or long, leaves the burden of the tax on the ultimate consumer. In *BLP Group Plc v Customs & Excise Commissioners* (Case C-4/94) [1996] 1 WLR 174, 190, [1995] ECR I-983, 993, [1995] STC 424, 430, para 30, the Advocate General (Lenz) referred to

> ". . . an ideal image of 'chains of transactions' . . . intended to attach to each transaction only so much VAT liability as corresponds to the added value accruing in that transaction, so that there is to be deducted from the total amount the tax which has been occasioned by the preceding 'link in the chain'".

In a simple chain (a wholly linear series of transactions) each transaction in the chain must be considered separately to determine what output tax is payable and what credit is available for input tax.

114. But in developed economies wholly linear series of transactions are relatively unusual. Increasingly, businesses are organised so as to rely on subcontracting and outsourcing. Consumers are increasingly encouraged to obtain packages of goods and services put together by entrepreneurs. Many marketing

schemes (such as that run by LMUK during the period now under consideration) operate through a construct of contractual relationships of some sophistication. It is a construct that is more like a web than a chain.

115. In cases of that sort it is still necessary, in determining the proper amounts of output tax and input tax, to look separately at different parts of the web of transactions. But in determining the economic reality it is also necessary to look at the matter as a whole. This Court was not shown any authority establishing that a payment by A to B cannot be both consideration for a service supplied to A by B, and (as third-party consideration) an element of the consideration paid for a supply by B to C (in this case, the collector, who is usually, but not always, also the final consumer).

116. That negative proposition was adopted by Lindsay J in the Chancery Division in his "once and one way only" theory: [2007] STC 536, paras 58 and 76 to 80. In support of it he relied on *EC Commission v Germany* (Case C-427/98), [2002] ECR I-8315, [2003] STC 301. That was a case about a simpler promotional scheme for reduction of the retailer's price for goods on presentation of a coupon distributed by the manufacturer to potential retail customers. But the Court of Justice's decision related to the amount of tax on the supply by the retailer to the customer. It did not rule that the manufacturer must suffer a loss of input tax credit when it reimbursed the retailer, and it would have been inconsistent to have made such a ruling.

117. Like Lord Hope and Lord Reed I consider that *Customs & Excise Commissioners v Redrow Group Plc* [1999] 1 WLR 408 and *Customs & Excise Commissioners v Plantiflor Ltd* [2002] 1 WLR 2287 were correctly decided, and are still good law. Lord Millett's unqualified language ("anything – anything at all") at p 418 may be capable of being misunderstood, but in context (including his explanation at p 417 of *BLP Group Plc v Customs & Excise Commissioners*) it must be understood as referring to anything that can properly be regarded as a taxable supply. Mrs Whipple QC suggested in her oral submissions that *Plantiflor* was an exception of a relatively small and insignificant category of cases of "delivery". But if that expression is taken, in the common modern usage, to cover the delivery of a variety of packages of outsourced services, it can be seen as more than a small or insignificant category.

118. The Court of Justice did not discern any significant issue of EU law arising on this case. The issue of economic reality is for the national court. I was one of the Law Lords who, five years ago, directed a reference to the Court of Justice, but with hindsight I recognise that it was unnecessary, and that it would have been better not to have made a reference.

119. For these reasons, and for the much fuller reasons stated by Lord Hope and Lord Reed, I would make the order proposed by Lord Reed.

LORD CARNWATH (with whom Lord Wilson agrees) (dissenting)

Luxembourg has spoken…

120. In the light of the CJEU judgment, I would have regarded the appeal as bound to succeed. With respect to my colleagues, I find it difficult to see how their contrary view can be compatible with our responsibilities under the European Communities Act 1972.

121. Criticism is made in the majority judgments of the form of the questions referred to the court, and even of the fact that a reference was made at all. I find this very surprising. The decision to refer was made by a panel of the House of Lords (Lords Hoffmann, Walker, and Mance, one of whom is a member of the present panel), following an oral hearing on 3 April 2008. Although there is no formal record of the reasons, they can be inferred from the Commissioners' request, which pointed to an apparent conflict between the decision of the House in *Redrow* and the CJEU judgment in *Auto Lease*.

122. The questions were then agreed by the parties in the normal way, submitted to the House on 30 June 2008, and adopted for the purpose of the reference. They were substantially in the form of the draft appended to in the Commissioners' petition of appeal. LMUK's notice of objection, dated 16 November 2007, and signed by the counsel for LMUK (who had appeared successfully in the Court of Appeal), challenged the need for a reference; but LMUK did not take material issue with the form of questions proposed, then or later. We must assume that they were thought by all, including the members of the House and LMUK, to be the questions which needed answers in order to determine the appeal.

123. I do not see how we can, properly or responsibly, go behind either the decision of the House to make the reference, or the questions which were then approved with LMUK's consent. Nor, still less (with respect to Lord Reed), do I believe that it is appropriate or fair for us now to decide that there were other relevant facts , necessary for the determination, but which, through oversight of ourselves and the parties, were not drawn to the attention of the court; and, further, that the true issues were not questions of law at all, so that we are free to redetermine them for ourselves as questions of fact, without regard to the CJEU's conclusions on them. Those are to me entirely novel and controversial

propositions, on which at the very least I would have wished to hear submissions from the parties.

124. As it happened, there was a significant delay between the agreement of the questions in June 2008 and the formal order making the reference on 15 December 2008, which was registered by the CJEU on 6 February 2009. This delay, as I understand it, was caused principally by the decision to link this case with the *Baxi* case. The history is summarised in a letter to the judicial office dated 19 February 2009 from LMUK's solicitors. In that letter, they complained of the delay and of the handling of the case by the office, but they made no criticism of the form of the questions. At some point, certainly before May 2009, new counsel (Mr Milne QC) was instructed. The hearing in the CJEU took place in January 2010. If at any time during that period LMUK's representatives had formed the view that the questions were defective in some way, they had plenty of time to seek to amend or supplement them.

The "real issue" - two supplies or one

125. Lord Hope (para 89 above) defines what he calls "the real issue" by reference to a paragraph in LMUK's written observations to the CJEU:

> "LMUK's analysis is that the redeemers made supplies to *both* LMUK (redemption services) and the collectors (rewards) and that the recipient in *either* case can deduct VAT which it pays, subject to the normal rules. Only LMUK's analysis results in the VAT being deductible (subject to the normal rules) by the person who has actually paid the VAT and ensures that the UK Government collects VAT on the amount of the consideration actually paid by the final consumer." (para 29, Lord Hope's emphasis)

Lord Hope attaches importance to the words "both "and "in either case", as showing the nature of LMUK's case. It was not that the consideration was to be apportioned between the two forms of supply; rather that, following *Redrow*, and looking at the matter solely from LMUK's own point of view (regardless of the collectors' position), the whole consideration was paid for services supplied to LMUK, which was accordingly entitled to deduct input tax on the whole amount.

126. If this was seen by LMUK as "the real issue", it is strange that they took no steps to ensure that it was adequately reflected in the submitted questions. In LMUK's notice of objection to HMRC's petition, the "sole issue" was said to be whether the supplies were made to LMUK "notwithstanding that third parties,

namely the Collectors, also benefited *de facto* from the making of such supplies". The Commissioners' suggested alternative of apportionment was said to "have no merit in it". Against that background, I can only infer that the omission of a question directed specifically to Chadwick LJ's formulation was a matter of deliberate choice, presumably because it was thought unlikely to succeed in Europe. As Lord Hope recognises, it is hard to criticise the CJEU for failing to answer an issue which had not been raised in the questions referred to it, even if mentioned in some of the subsequent observations.

127. I note in passing Mr Milne's separate complaint about the lack of any specific reference, either in the questions, or in the Court's response, to the issue of deduction of input tax as such. I found this difficult to understand. Since deduction of input tax was what the case had been about from the outset, it is fanciful to suggest that there was any doubt in anyone's mind of the context in which the questions were asked. It was referred to in terms in the European Commission's observations (see below), and the Court began its judgment by accurately summarising the course of proceedings below, beginning with LMUK's claim to "deduct… input VAT" on its payments of service charges to the redeemers (para 13).

Absence of an Advocate-General's Opinion

128. In agreement with Lord Hope, I think it was unfortunate that there was no Advocate-General's Opinion in this case. This is by no means unusual. Published figures show that it happens in more than 40% of the cases decided by the court. But those figures say nothing about the relative importance of the various cases, or the level of the court from which they have been referred.

129. Article 20, paragraph 5, of the CJEU Statute provides:

> "Where it considers that the case raises no new point of law, the Court may decide, after hearing the Advocate-General, that the case shall be determined without a submission from the Advocate-General."

I can understand that this case was thought to raise no "new" point of law, as such. The underlying principles had been discussed in many previous judgments. However, it was a reference by the highest court in this country. It should have been clear from the judgments below, and the submissions, that it had raised serious differences as to the correct application of those principles, including

questions as to the authority of the leading House of Lords decision in the light of subsequent European authority.

130. The court itself does not as a matter of practice comment directly on domestic cases, but the Advocate-General may have more flexibility in that respect, and more opportunity to look at the issues in a wider context. Experience shows that the Advocate-General's Opinion can often provide a fuller discussion of the principles and their practical application, against which the sometimes sparse reasoning of the judgment can be easier to understand and apply. In this case, at least in retrospect, as the present controversy demonstrates, it was an unfortunate omission.

131. On the other hand, it is important to note that United Kingdom interpretation was supported by the European Commission in written observations. They provide some useful background information, and to that extent did something to fill the gap left by the absence of an Advocate General's opinion. In particular they addressed the possibility of a more comprehensive view, not dissimilar to that adopted by the Lord Reed:

> "21. One possible approach to such schemes would be to say that there is no such thing as a 'free gift'. Loyal customers pay for those 'gifts' as part of the price of goods they buy; customers who are not loyal, moreover, pay for the 'gifts' enjoyed by those who are loyal. The cost of operating a loyalty scheme is a cost of business for the trader, and at any given level of profit there is no difference between lowering the price for all customers and selectively lowering the price for loyal customers by giving them more products for the same price. Nor is there any difference between giving loyal customers additional quantities of the products normally supplied by the trader and giving them other goods or services. Again, this is a form of price discrimination in favour of loyal customers: it is no different from granting them a quantity discount or for that matter a cash rebate. Over time, the customer has paid a certain amount for the whole of goods received by him, including those presented as being 'free'. Accordingly, he should bear the VAT on that amount, which is the total of his consumption. There is no reason to charge additional VAT in respect of the 'free' goods, because in reality he (together with the customers who are not loyal) has already paid for them."

132. They rejected this approach as inconsistent with *Kuwait Petroleum*. They then considered whether the inclusion of the "services" made any difference to the analysis:

> "26. The circumstances of the present cases appear at first sight to fall within that analysis. However, in an apparent attempt to evade its consequences, the creators of the loyalty schemes concerned have introduced a nuance: the payments made to the 'redeemers', that is to say the persons supplying the goods to the customers, are described as payments for services. Those services are said to be 'redemption services' (compendiously described in point 8 of the order for reference in Case C-53/09) or 'marketing services' (in Case C-55/09)."

133. In the Commission's view the inclusion of the services did not make a material difference. The "economic reality" of the situation was that the redeemer was being paid -

> "… to provide goods to the customers, and nothing more. Even if there can be said to be a service element, it is purely ancillary, and the core of the transaction is the supply of goods." (para 27)

Accordingly, the payments were to be regarded as third-party consideration for the supply of the goods, and "no input VAT is deductible in respect of those payments". Such payments could be considered as including payment for services to promoters "only in so far as it is possible to identify a service separate from the provision of the goods and to determine the price of that service".

The court's reasoning

134. In spite of the criticisms which can be made of some aspects of the judgment, I do not myself find any serious uncertainty about what the court has decided and why. In substance the court adopted the Commission's reasoning. It is important to read the judgment in the light of the words of the directive, and the previous European case-law, and without any preconceptions derived from domestic case-law, or from an independent view as to how the tax should operate.

135. There are as I see it three crucial points underlying the court's decision. First, the supply of loyalty rewards by the redeemers to the collectors was to be treated as a distinct transaction, separate from the other elements of the rewards scheme (para 55). As the court noted (para 32), this approach accorded with the form of the questions and the submissions of the parties, and also with previous case-law (*Kuwait Petroleum* [1999] ECR I-2323, para 28). That being so, it is unsurprising (as Lord Reed acknowledges – paras 36-38 above) that the court did not undertake a broader analysis of the relationships between LMUK and the other

parties involved. While I acknowledge the apparent attractions of Lord Reed's analysis and the elegance with which it is presented, the decision of the court is to my mind clear on this point and binding on us. Nor did I understand LMUK to argue otherwise.

136. Secondly, the taxable event under the directive (article 2.1) is a *supply* of goods or services for consideration. In relation to any transaction, it is therefore necessary to start by identifying the relevant supply in respect of which tax is said to be chargeable or deductible.

137. Thirdly, the amount of the charge to tax on the one hand, and the right to deduct on the other, are governed by two provisions of the Directive respectively:

i) Article 11, which defines the "taxable amount" as –

> "… everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies…."

ii) Article 17(2), which allows a taxable person the right, in so far goods and services are used for the purpose of his taxable transactions, to deduct –

> "… value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person."

138. It is noteworthy that these two provisions are not directly matched. From the point of view of the person making the supply, and accounting for the tax, the taxable amount is not limited to consideration from the recipient of the goods, but includes consideration from third parties. Conversely, the person seeking to deduct tax has to show, not merely that he gave consideration and paid tax in connection with his own taxable transactions. He must show also that the tax was paid in respect of goods or services supplied *to him*. Consideration given by a third party is taken into account in assessing the taxable amount, but there is no corresponding provision giving the person paying third-party consideration the right to deduct.

139. Applied to the facts of this case, if one ignores for the moment the incidental information and other support services given to LMUK by the redeemers, the CJEU's interpretation of those provisions is readily understandable. As is now common ground, the goods were supplied by the redeemers to the collectors, not to LMUK, who merely paid third-party consideration for them.

Article 17(2) gives LMUK no right to deduct, even though the consideration was paid in respect of their taxable transactions, because it was not paid in respect of supplies received by them. It is true that the redeemers had a contractual obligation to LMUK to make the supplies to the collectors. But there is nothing in the words of the directive to suggest that the mere fulfilment of a contractual obligation of this kind is to be equated with the supply of a service.

140. This approach can be seen as a natural extension of the court's reasoning in *Auto Lease Holland BV v Bundesant für Finanzen* (Case C-185/01) [2003] ECR I-1317. Under the "fuel management agreement" between Auto Lease and its lessees, the cost of petrol supplied to lessees was paid for by Auto Lease (through a credit card arrangement) and reimbursed by lessees by monthly payments and an annual balancing charge. It was held that there was no relevant supply to Auto Lease. The fuel management agreement was "not a contract for the supply of fuel, but rather a contract to finance its purchase". The fuel was purchased not by Auto Lease, but by the lessee "having a free choice as to its quality and quantity, as well as the time of purchase." (para 36). So here, the agreement between LMUK and the redeemers, so far as relates to the supply of goods, is no more than a contract to finance their purchase, the choice of goods and the time of purchase being left entirely to the collectors.

141. Does the addition of the information and other services make any difference? The court's answer (para 58-64) was "no", unless the services can be separately identified, and part of the consideration properly apportioned to them. That was possible in respect of *Baxi* but not LMUK. There is nothing surprising about that conclusion. Once it is accepted that the contractual obligation to supply the goods does not in itself amount to the taxable supply of a service to LMUK, there is no reason why the provision of such incidental services should fundamentally alter the position in relation to the goods element of the transaction, as opposed to any value properly attributable to the services as such. Other interpretations might have been possible. Arguably, a broader, more purposive interpretation might have led the court to an approach similar to that proposed by Lord Reed, and in line with that of the Court of Appeal in this case. That might also have had the attraction of avoiding what appears to be an element of double taxation if the scheme is looked at as a whole (as Lord Reed suggests - para 84 above). However, that is (or should be) water under the bridge. Interpretation of the directive is ultimately a matter for the CJEU, not the domestic courts. We are bound to follow their lead.

LMUK's submissions

142. Mr Milne QC, for LMUK, submitted that, properly understood, the judgment is not inconsistent with the reasoning of the Court of Appeal. The

finding that the payments were third party consideration for supply of rewards to customers did not exclude the possibility of their being at the same time consideration for redemption services supplied to LMUK. On the contrary, the judgment acknowledged that possibility in paragraph 64, by leaving it to the referring court to determine "whether those payments also include the consideration for the supply of services corresponding to a separate supply". Accordingly there is nothing in the judgment to undermine the reasoning of Chadwick LJ, or the decisions in *Redrow* and *Plantiflor* on which it was based.

143. In his oral submissions, Mr Milne relied strongly on the decision of the CJEU in Case C-165/86 *Leesportefeuille "Intiem" CV v Staatssecretaris van Financiën* [1989] 2 CMLR 856 ("*Intiem*"), and the comments of the Advocate-General in Case C-338/98 *EC Commission v Netherlands* [2004] 1 WLR 35; [2003] STC 1506. They showed that there could be a taxable supply of goods to one person, notwithstanding that delivery was to a third party. He also relied on a table, showing hypothetical payments and their tax consequences, as indicating that LMUK's argument alone was consistent with the underlying principle of "fiscal neutrality".

144. As a fall-back position, Mr Milne argued for an apportionment on the basis that the service charge should be split between the cost incurred by the redeemer in providing the rewards, and the difference between such cost and the total service charge; alternatively on the basis of the market value of the services provided to LMUK less the cost of the rewards. He suggested that the issue might be remitted to a new tribunal for determination.

Discussion

145. Fairly read, it is impossible in my view to read the judgment as leaving open the possibility that the whole consideration might be taken as in respect of supplies both to LMUK and to the collectors. Even if that possibility was not addressed in terms, the judgment as a whole, particularly the reasoning in the *Baxi* case, leaves no serious doubt what the answer would have been. The court considered the argument that the payments should be treated, not as payment for supply of goods, but rather for "a complex advertising service under which the supply of loyalty rewards to customers is one of a number of services" (para 59). That argument was clearly rejected. The element of the payments, representing the price of the rewards and the cost of packaging and delivery, was treated solely as consideration for the supply of goods to collectors, only the profit margin being allocated to the services to Baxi (paras 61-63). That reasoning is inconsistent with the proposition that, other than by apportionment, the consideration could be treated at the same time as being in respect of supplies to both parties.

146. Paragraph 64 of the judgment must be seen in that context. It cannot be read as leaving open the issue of whether the whole consideration could be treated as in respect of two different supplies. Although the issue of apportionment had not previously been raised in the LMUK case, and had been rejected by LMUK itself as without merit, it was included in the questions before the court, and therefore required an answer. Paragraph 64 follows the treatment of the same issue in the *Baxi* case, where it did arise. As I read paragraph 64, it is simply covering the same issue for the sake of completion in the *LMUK* case, indicating that, in the absence of any relevant findings before the court, it must be left to the domestic courts to determine.

Intiem

147. I turn to the argument based on *Intiem*. The company operated a business involving the distribution by its employees of a catalogue to customers at their homes. The employees used their own cars for deliveries. At the end of each working day, they were able to refuel at the company's expense at a filling station near the company's office, under a contractual arrangement between the company and the station. The filling station then invoiced Intiem for the petrol so supplied to employees. The issue referred to the CJEU was whether the company could deduct the full amount of tax on the petrol so supplied, notwithstanding that it was supplied in fact to the employees. That question was answered in the affirmative. Having noted that the right to deduct applied to goods and services connected with the pursuit of the taxable person's business, the Court said:

> "14 It must accordingly be concluded that this deduction system must be applied in such a way that its scope corresponds as far as possible to the sphere of the taxable person's business activity. Where, in such circumstances, article 17 (2) of the Sixth Directive restricts the taxable person's right of deduction, as regards the value-added tax on supplied goods, to the tax due or paid 'in respect of goods ... supplied to him', the purpose of that provision cannot be to exclude from the right of deduction the value-added tax paid on goods which, although sold to the taxable person in order to be used exclusively in his business, were physically delivered to his employees."

As the Advocate-General had said:

> "The fact that the petrol is pumped directly into the tank of the employee's car and is used on account of the undertaking in no way affects the legal and economic reality of the transaction… In

> economic terms, the petrol with which Intiem is invoiced and for which it has to pay constitutes one of its production cost components which bears the value added tax charged on it at the previous stage… " ([1989] 2 CMLR at p 861)

148. That judgment was distinguished in Case C-338/98 *EC Commission v Netherlands* [2004] 1 WLR 35; [2003] STC 1506, where, under Dutch legislation, an employer was able to pay employees allowances for use of their cars in the employer's business and a standard 12% deduction was allowed by way of input VAT. That arrangement was held to be incompatible with the relevant EU legislation for a number of reasons. The Court noted (para 37), and implicitly accepted, the Commission's identification of three significant differences from the facts of *Intiem*: first, there was no agreement between the employer and the supplier; secondly, the goods were not used exclusively for the employer's business; and thirdly, the taxable employer was not invoiced by the taxable supplier. The Court arrived at its conclusion on the true interpretation of the Sixth Directive, while accepting that it might not appear fully consistent with certain objectives pursued by that Directive "such as fiscal neutrality and the avoidance of double taxation" (para 55).

149. Mr Milne submits that this case is analogous to *Intiem*, rather than the *Netherlands* case, in that, while the goods are physically supplied to the customers, that is in pursuance of contracts between LMUK and the Redeemers, and invoiced accordingly, and it is done wholly for the purposes of LMUK's business.

150. Attractively though the argument was put, the short answer is that it is irreconcilable with the CJEU's decision in this case. The Court has clearly decided that, on the facts of this case, and notwithstanding the contractual position, economic reality lies in treating the rewards as goods supplied to the collectors and not, directly or indirectly, as part of services supplied to LMUK.

Previous House of Lords authorities

151. It remains to consider how the judgment in this case affects the reasoning and conclusions of the House of Lords in the *Redrow* and *Plantifor*. The relevant facts and the essential reasoning of the House of Lords in each case have been described by Lord Reed. Like him, I see no reason to doubt the correctness of the decision in either case, but hesitate to regard either as laying down a universal rule.

152. The Commissioners' position on the correctness of the decision in *Redrow* has fluctuated. Lindsay J recorded, and in effect adopted, their submission

(presented at that time by Mr Vajda QC) that *Redrow* was distinguishable on the facts:

> "Mr Vajda draws attention to the very different facts of Redrow. There it was Redrow not the prospective house purchaser who chose the estate agents and gave instructions to them. Redrow obtained a contractual right as against the estate agents and could even prevent or override changes in the agents' instruction which the house purchasers might otherwise have been minded to make…
>
> By contrast, says Mr Vajda, it was not LMUK that selected the particular goods or services enjoyed by way of reward by Collectors, nor, (in the sense that no Collector was bound to use points in all his acquisitions but could deal with retailers who were not Suppliers) was it LMUK that selected who it was that was to supply them. LMUK had no role in determining whether goods or services should be acquired by Collectors only by the use of points or wholly by cash or partly for one and partly for the other or in what proportions between the two forms of satisfaction. Nor is it the case that such provision as is made to Collectors is exclusively at LMUK's expense; in all cases where points alone did not suffice the Collectors, too, would bear some expense. In Redrow it was easy enough to see the legal and financial characteristics that were there being examined as pointing to a supply to Redrow but the overriding characteristics of the Programme suggest a provision to Collectors, says Mr Vajda, with third party consideration for that provision coming from LMUK…" (para 72-73)

Similar submissions were made in the Commissioners' written observations to the CJEU, when it was asserted that the House of Lords "reached the correct result in the *Redrow* case, but for the wrong reasons".

153. By contrast, before us Mrs Whipple for the Commissioners submitted that neither the reasoning nor the conclusion in *Redrow* was compatible with the CJEU decision in the present case. The House of Lords had been wrong to focus on the position from the point of view of the taxpayer, rather than determining the "economic reality" of the transaction. On that view, the estate agency services were supplied to the householders, albeit subject to a measure of control by Redrow. Lord Hope was right to acknowledge that reality ("clearly the estate agents were supplying services to prospective purchasers…"), but wrong to think that it could stand with a finding that tax was deductible by "the person who instructed the service and who has had to pay for it of the benefit of the deduction" ([1999] 1 WLR 408, 412).

154. I prefer the Commissioners' earlier view. The facts of *Redrow* differed markedly from those of the present case, for the reasons Mr Vajda gave. Although the prospective purchasers benefited, Redrow did not merely pay for the services, but exercised a high degree of control and received benefits for purposes directly related to its own business objectives. By contrast, in the present case LMUK had no direct or indirect interest in the reward goods themselves; their interest was only in the fulfilment of obligations previously undertaken as part of the rewards scheme as a whole.

155. As Lord Reed has noted, *Redrow* was followed and applied in *Plantiflor*, though the outcome in the latter case was victory for the Commissioners. It is unnecessary to repeat his description of the case.

156. Mrs Whipple submitted that the decision in *Plantifor* is compatible with the reasoning of the CJEU in the present case. As she put it in her printed submissions, in terms with which I readily agree:

> "There plainly are cases which fall properly within the 'delivery model' referred to by Lord Millett as being cases where the arrangements 'consist of the right to have goods delivered or services rendered to a third party'. A typical example is where A contracts with B to have flowers delivered to C. The economic reality of those arrangements is that A and B contract, on terms that A's payment is to B, for services provided to A, those services consisting of delivery to C. In *CEC v Plantifor*, Plantifor contracted with Parcelforce to have flowers delivered to its customers. The supply was by Parcelforce to P of the service of delivering P's goods (plants and garden products) to P's customers pursuant to a contract for delivery made between Parcelforce and P, and for a consideration payable by P. The House of Lords correctly identified the VAT supply as being, on these facts, by Parcelforce to P, and not to P's customer."

157. I do not find it necessary or useful to consider in detail the other cases to which we have been referred. They merely serve to illustrate, as Lord Reed has said, how difficult and fact-sensitive the issues may be in individual cases.

Other issues

158. I have noted that the CJEU left open the possibility of an apportionment of the service charge, and LMUK has proposed that the issue should be referred back to the Tribunal. I agree with Mrs Whipple that this point is not open to them at this

stage, having clearly and repeatedly declined hitherto to make it a part of their case. It would be contrary to well-established principles to remit the case to the Tribunal for findings on factual issues which could have been but were not raised when the matter was originally before them.

159. Both parties have claimed that the principles of "fiscal neutrality" support their respective cases. I have found this a somewhat elusive concept on the facts of this case. It must be assumed that so far as appropriate this aspect has been taken into account by the CJEU in their decision. We were told by Mr Milne that they were shown the tables which are before us, and which appear to show an element of double taxation looking at the scheme as a whole. However, as I have indicated, where third-party consideration is involved, a potential for imbalance is inherent in the definitions respectively of the taxable amount and of the right to deduct. It is clear from the CJEU case-law that the "principle of neutrality" is not to be treated as an overriding principle of interpretation such as to justify a departure from the words of the directive (see for example *EC Commission v Netherlands* cited above).

Conclusion

160. For these reasons, I would have allowed the appeal, and restored the order of Lindsay J.