Disposal of shares: Is the BLP test dead?

Indirect Tax



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A series of legal judgments have questioned whether VAT relating to the disposal of shares really is irrecoverable, and whether the purpose of the sale could be the deciding factor.

Key Points

What is the issue?

For more than 25 years, the *BLP* 'test' has held sway in the UK, and many businesses and advisors have automatically assumed that input tax relating to the disposal of shares has been irrecoverable.

What does it mean for me?

The European Court of Justice has held that the *purpose* of a sale of shares is fundamental to its VAT analysis.

What can I take away?

Taxpayers and their advisors should no longer fear ‘looking through’ non-economic transactions to their ultimate taxable activity, or assume that selling shares will automatically ‘break the chain’ and prevent them from deducting input tax.

In 1995, the European Court of Justice issued its judgment in *BLP Group plc* (Case C-4/94). In that case, the taxpayer had sold shares in a company to raise funds for the purpose of paying down debts incurred while making taxable transactions. The taxpayer then attempted to recover the input tax associated with the sale of shares on the grounds that the VAT was linked to its taxable transactions.

HMRC rejected the claim on the basis that the sale of shares was an exempt transaction and that this exempt transaction had consumed the disputed VAT: of course, Article 135(1)(f) of the Principal VAT Directive, as it now is, exempts ‘transactions … in shares’.

Upon reference to Europe, the European Court of Justice agreed with HMRC, and the judgment in *BLP* gave rise to what is often known as the prohibition on ‘looking through’. As HMRC puts it at VIT62100 of VAT Input Tax, *BLP* ‘highlighted the idea of a “chain breaking” exempt supply that stops VAT flowing through the chain of one business’s output tax being another business’s input tax’, *regardless* of whether the ‘ultimate purpose’ of the exempt transaction is taxable.

For over 25 years, the *BLP* ‘test’ has held sway in the United Kingdom, and many businesses and advisors have automatically assumed that input tax relating to the disposal of shares has been irrecoverable. But have they been right to do so?

The European Court of Justice moves on

In reality, it is arguable that the judgment in *BLP* is anomalous, even within the jurisprudence of the 1990s. In *Polysar* (Case C-60/90), for example, which was handed down four years before *BLP*, and then in *Sofitam* (Case C-333/91) in 1993, the court was clear that, although transactions in shares were exempt, ‘the mere acquisition of financial holdings in other undertakings’ did not amount to

economic activity.

By the summer of 1996, the European court had concluded by way of its judgment in *Wellcome Trust* (Case C-155/94) that if merely acquiring financial holdings in other companies did not constitute economic activity, ‘the same must be true of activities consisting in the sale of such holdings’. In other words, and in contrast with transactions ‘effected as part of a commercial share-dealing activity’ that were exempt, merely buying or selling shares were for VAT purposes non-economic activity.

The court confirmed this analysis in its judgment in *EDM* (Case C-77/01) in 2004, where it held that in order for transactions concerning shares to be exempt, they had to ‘go beyond the compass of the simple acquisition and sale of securities, such as transactions carried out in the course of a business trading in securities’.

Thus it is the settled case law of the European court that a business whose corporate purpose is *trading securities* is engaged in exempt economic activity, whereas a business which has merely bought or sold securities has engaged in *non-economic* activity. But where does this leave the issue of input tax incurred by selling shares?

***Kretztechnik* and after**

In the case of *Kretztechnik* (Case C-465/03), an Austrian taxpayer had issued shares in order to fund its taxable transactions and sought to deduct the input related to the issuance of those shares. In its judgment of 2005, the European Court of Justice reiterated that the acquisition, holding and selling of shares do not amount to economic activity, before holding that the same analysis applied to the *issuance* of shares.

As for the question of whether taxpayers could deduct input tax that was incurred during non-economic activity but *for the purposes* of taxable activity, the court held that because the share issuance had been undertaken ‘in order to increase its capital for the benefit of its economic activity in general’, there was ‘a direct and immediate link with the whole economic activity of the taxable person’. The input tax was therefore deductible.

The issue of whether non-economic activity could give rise to the right of deduction has appeared before the court several times since *Kretztechnik*. In *Sveda* (Case C-126/14), *Iberdrola* (Case C-132/16) and *Hartstein-Industrie* (Case C-528/19), the

court each time reaffirmed that wherever non-economic activity was undertaken for the purposes of economic activity, this created the link that was necessary to make any such VAT deductible.

Yet in *SKF* (C-29/08), the court went even further. Here, it was common ground that the taxpayer's selling of shares was 'more than a mere sale of securities'. In other words, it amounted to exempt transactions concerning shares. Nevertheless, the court concluded that on account of the principle of fiscal neutrality such a taxpayer still had the right to deduct input tax incurred during exempt sales of shares:

> '[I]f the consultancy costs relating to disposals of shareholding are considered to form part of the taxable person's general costs in cases where the disposal itself it outside the scope of VAT, *the same tax treatment must be allowed if the disposal is classified as an exempted transaction*.'

The EU jurisprudence has therefore made it clear that, wherever a taxpayer sells shares in order to raise funds for its overall taxable activity, the material input tax is properly deductible *regardless* of whether the sales of shares are treated as exempt economic activity or outside-the-scope non-economic activity.

Perhaps more importantly, the court has also held that the *purpose* of a sale of shares is fundamental to its VAT analysis. In contrast with the earlier conclusion in *BLP* that 'the ultimate purpose' of a transaction was irrelevant to VAT analysis, the court recently concluded in *C&D Foods Acquisition* (Case C-502/17) that the taxpayer would have been entitled to deduct input tax incurred on a share disposal if 'the *direct and exclusive reason* [for it had been its] taxable economic activity'.

Far from forbidding taxpayers, advisers and tax authorities from 'looking through' to the ultimate purpose of a transaction as in *BLP*, the European Court has performed what appears to be a *volte face*, the result of which is that 'the direct and exclusive reason' for undertaking non-economic activity is in fact determinative of whether the material input tax is deductible.

Applying EU case law in the UK courts

The UK courts' development of these principles is entirely consistent with the European jurisprudence and throws further doubt on *BLP's* future application. In *Frank A Smart & Son Ltd* [2019] UKSC 39, the Supreme Court considered the taxpayer's acquisitions of units under the single farm payment (SFP) scheme. HMRC

had denied recovery of the VAT incurred on the acquisition of SFP units on the ground that such activity was non-economic, which merely enabled the taxpayer to claim subsidies. However, the taxpayer claimed that the SFP units related to its holding of land which, in turn, bettered and improved its overall (taxable) farming business; in other words, the taxpayer's inputs had a direct and immediate link to its overall taxable activity.

The Supreme Court dismissed HMRC's appeal and upheld the decision of the Court of Session. Indeed, in consideration of *BLP*, Lord Hodge noted that 'more recently, the European court has called into question its ruling in *BLP* in the light of its developing jurisprudence'; and so he founded his judgment on the European judgments handed down only after *BLP*.

By doing so, the Supreme Court alighted on the principle that any material input tax remains deductible where:

- there is a direct and immediate link between non-economic activity and downstream taxable activity; and
- the VAT incurred by way of that non-economic activity forms a cost component of downstream taxable supplies.

Bringing us right up to date is the First-tier Tribunal's decision in *Hotel la Tour* [2021] UKFTT 451 TC. Helpfully, this case aligns closely to the facts in *BLP.* Here, the taxpayer sold shares in a subsidiary in order to raise funds for the development of its hotel business, and subsequently sought to deduct as input tax thus incurred. HMRC refused recovery on the basis that the disputed VAT related to the exempt sale of shares. However, relying heavily on the Supreme Court in *Frank A Smart*, the FTT held that because the VAT had been incurred for the purpose of downstream taxable activity, it was properly deductible.

Lessons and opportunities

Hotel La Tour is the first occasion on which the tribunal has applied the European court's reasoning, by way of *Frank A Smart*, to the sale of shares; and the first time the UK courts have been willing to depart from the 'chain-breaking' analysis laid down in *BLP*. (HMRC, it must be noted, has sought leave to appeal to the Upper Tribunal.)

So while *BLP* may not be ‘dead’, does the Supreme Court precedent in *Frank A Smart* , mean that it is no longer ‘good law’? This remains a point for debate, but what is clear is that taxpayers and their advisors should no longer fear ‘looking through’ non-economic transactions to their ultimate taxable activity, nor assume that selling shares will automatically ‘break the chain’ and prevent them from deducting input tax.