
Supreme Court judgement clarifies rules on reclaiming VAT

Your inboxes may already be full of alerts from advisory firms who are excited or despondent about a judgement published on 17th December by the Supreme Court in the case of Hotel la Tour (HLT). At the same time, you may be puzzled as to why the case, which involved a sale of shares by a hotel operator, would have anything at all to do with charities. In our view, the judgement issued by the Court confirmed two principles which will be of importance to the charity sector even if only to confirm that what we always thought was the answer is in fact still the answer.

The case and judgement

A quick summary of the case is as follows:

HLT sold shares in a subsidiary company to raise funds to build a new hotel. The sale of shares was exempt from VAT and, in the normal course of events, where a taxpayer has costs which are directly linked to an exempt transaction the VAT on those costs cannot be reclaimed. Nonetheless, HLT reclaimed the VAT on the costs of marketing the shares for sale and certain other advisory costs associated with the deal.

HLT argued that it was entitled to reclaim the VAT because the ultimate purpose of selling the shares was to raise funds for the new hotel which would generate taxable sales. There was therefore a link between the costs of the sale and downstream taxable income. In making this argument HLT said that the Court should allow their reclaim because, although it did not apply in this case, in some circumstances the sale of shares is outside the scope of VAT rather than exempt, and in those cases a VAT reclaim had been allowed by the European Court of Justice. This, they said, had moved things on from an even earlier case (BLP) where in very similar circumstances a reclaim had been refused by the European Court.

In short, the judgement yesterday said that there was a distinction between a transaction which is outside the scope of VAT, because there is no supply, and one where there is a supply, but that supply is exempted from VAT. In the case of an exempt supply, if there is a direct and immediate link between costs incurred and that exempt supply, then the VAT is not recoverable. The taxpayer cannot look through to the ultimate purpose of the supply and argue that the costs support those downstream activities. However, where a transaction is outside the scope of VAT, the taxpayer can look to the purpose of the transaction because there is no supply in the first instance to which any costs would be directly and immediately linked.

Because HLT's supply was exempt from VAT, and its costs were directly linked to that supply, then HLT was not entitled to recover VAT on its costs.

What does this mean for charities?

We can draw two important points from this decision:

First, if you have costs which relate to an exempt supply, then normally the VAT on those costs is not reclaimable. Although HLT's arguments that taxpayers should be able to consider the wider purpose of transactions may have opened up some opportunities for charities, there was also a big downside risk. Often charities sell things, not because they have any interest in selling the individual items, but because the profit on the sale can be invested in their charitable activity which is often a non-business or VAT exempt activity. If HLT had succeeded, then it was possible that HMRC could then start to reduce VAT reclaims by charities and others on the basis that the VAT incurred on their costs, although immediately linked to a taxable supply, was generating income ultimately used for another purpose beyond the immediate sale of items.

Second, the judgement confirms that there is a distinction between activity which is exempt from VAT and that which is outside the scope of VAT, such as grant funded activity. Where a charity has grant funded activity, there is often an assumption that its VAT on costs associated with that activity will be non-reclaimable. However, the judgement confirms the principle that taxpayers are entitled to look to the wider purpose of an activity such as grant funded activity or generating donations through fund raising and if there is a downstream link to taxable activity, then some or all the VAT may be reclaimed. Of course, if there is no link, then the VAT is not reclaimable.

What next?

The judgement has largely confirmed that HMRC's current policy is correct and we do not therefore anticipate that charities will need to change much in what

they already do. However, it is always useful to think about VAT on the costs of delivering grant funded activity and review whether any of that is reclaimable.

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