[2017] UKUT 0326 (TCC)

Tribunal ref: UT/2016/0018

VALUE ADDED TAX — input tax — whether supply made — no — input tax credit not available — appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

MR AND MRS E KELLY
trading as LUDBROOK MANOR PARTNERSHIP **Appellants**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

Tribunal: Judge Colin Bishopp

Sitting in public in London on 15 June 2017

Mr Tim Brown, counsel, instructed by Dave Brown VAT Consultancy, for the appellant

Ms Sadiya Choudhury, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the respondents

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DECISION

1. This is an appeal from a decision of the First-tier Tribunal ('the F-tT') (Judge Raghavan and Ms Newns), released on 3 December 2015, by which it allowed some but dismissed other appeals of Mr and Mrs Eamonn Kelly, trading as Ludbrook Manor Partnership ('LMP'), against various refusals by the respondents, Her Majesty's Revenue and Customs ('HMRC'), of credit for input tax and against some related penalties.

2. The relevant facts are not in dispute and are quite straightforward. Mr and Mrs Kelly entered into a business partnership, known as KFM, in October 1993. KFM provided financial advice, an exempt supply, and KFM was not registered for VAT. In February 2002 Mr and Mrs Kelly bought Ludbrook Manor, a substantial house with an annex formerly used as stables. They and their family lived in the house, while a company, Happy Holidays Limited ('HHL'), of which Mr and Mrs Kelly were the only directors and shareholders, carried on the business of letting parts of the former stables to holidaymakers. HHL had no proprietary interest in, or licence over, the former stables, no doubt because it was thought unnecessary to formalise the relationship between it and Mr and Mrs Kelly. HHL became registered for VAT in August 2004, and it is common ground that the supplies it made to holidaymakers were standard-rated.

3. In or about September 2010 Mr and Mrs Kelly decided that the house should also be let to holidaymakers; I understand from the F-tT's decision that by this time their children had left home and they considered the house too big for their own needs. The house was not immediately suitable for holiday letting, and HHL embarked on an extensive programme of alteration and refurbishment, undertaken by arm's-length contractors; it seems that Mr and Mrs Kelly had moved into the stables while the work on the manor house took place, and it may be they were intending to remain there. It is not in dispute that HHL incurred substantial amounts of VAT as the work progressed, and that the contractors' invoices were paid as they fell due. HHL treated the VAT it had incurred as recoverable input tax although, as the F-tT recorded, part of it was disallowed; it is not apparent why that was so but it is not a matter with which I am concerned. There was, again, no licence or lease of the manor in favour of HHL.

4. In March 2013 Mr and Mrs Kelly were advised by accountants to form a new partnership to undertake the holiday letting of the manor. It was not entirely clear when the new partnership, LMP, came into being but it became registered for VAT with effect from 1 April 2013. Because Mr and Mrs Kelly were already in partnership, as KFM, KFM's activities also fell within the scope of the VAT registration despite the fact that KFM continued to make exclusively exempt supplies.

5. The F-tT described the next development as follows:

> '[9] On 28 March 2013 Dave Brown [a VAT consultant advising Mr and Mrs Kelly] e-mailed Ms Miller at HMRC to inform her that while the company (HHL) had incurred expenditure relating to the upgrading of the main house the revised plan was for the holiday letting to be undertaken by Mr and Mrs Kelly in partnership and that therefore the company had to assume the role of "a main contractor" and that the costs incurred by the company would shortly "be recharged to the partnership". Ms Miller's letter to Mr and Mrs Kelly as directors of HHL included a reply to this e-mail as follows:

> "I have to advise you from the outset that the costs incurred in previous years and paid for and claimed by Happy Holidays should not be recharged to the new partnership. Any business costs incurred by Happy Holidays and the holiday income received appear to remain proper to that company..."'

6. Despite that response, HHL and Mr and Mrs Kelly did as Mr Brown had proposed. The F-tT put it in this way:

> '[10] On 1 June 2013 HHL provided a VAT invoice, addressed to Mr and Mrs Kelly t/a Ludbrook Manor Partnership with the heading:
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> > "Description of work in relation to the work done on over the period: 1 August 2009~ the present date on Ludbrook Manor so that you can begin your Holiday Letting Business
> >
> > To:
> >
> > Project management, for all Phases of renewals and repair work associated at Ludbrook Manor over the above period~ being:..."
>
> [11] The invoice went over the course of six pages to describe the following matters giving details in most of the case of the names of the contractors and in some cases details of the nature of the work carried out …
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> [12] The invoice was for a grand total of £559,825.20 made up of £433,521 plus VAT of £86,704 and £33,000 plus VAT of £6,600 for "Fixtures, fittings & equipment (being located in The Stables)". It was settled according to its terms by a reduction in Mr and Mrs Kelly's directors' loan account with HHL.'

7. On 11 July 2013 HHL was declared to be insolvent; it did not, then or subsequently, account to HMRC for the output tax included on the invoice. LMP submitted its VAT return for the period to 30 June 2013 on the following day. The return included a claim for repayment of £107,861.13, of which part consisted of the VAT charged by the HHL invoice. LMP's return was selected for verification. HMRC examined not only the claim attributable to the HHL invoice but also some other input tax claims: they related to two invoices in respect of which HHL had already claimed credit, to one where VAT had not been charged by the supplier, and to a number of further invoices which related to work undertaken before 1 April 2013 and which HMRC considered to be proper to HHL.

8. On 15 August 2013 HMRC wrote to LMP to say that they regarded the transaction between HHL and LMP as the transfer of a going concern which, by virtue of art 5 of the Value Added Tax (Special Provisions) Order 1995, is to be treated as neither a supply of goods nor a supply of services; in that case the VAT included in the invoiced amount could not be the subject of an input tax credit, though HHL would also not have to account for it. At the same time HMRC rejected LMP's other claims. In addition HMRC imposed various penalties amounting in all to £46,238 for deliberate and careless errors; the detail is not important for present purposes. LMP appealed against all of those decisions to the F-tT.

9. Shortly thereafter HMRC changed their minds, and withdrew the decision that the transaction was the transfer of a going concern. Instead, they said, there was no supply at all by HHL to LMP; rather, HHL had consumed the supplies it had received from the arm's length contractors in its own business, and could not sell them on to LMP. Moreover, HHL had not declared the VAT as output tax, and its insolvency report did

not reflect the invoice. LMP's position was that the invoice was prima facie evidence of a supply of project management, that there was such a supply, and that even if there was not LMP's claim could be denied only if it could be shown that LMP knew or ought to have known that the transaction was connected to VAT fraud, but because HMRC had not pleaded any such allegation they were precluded from denying credit on that ground.

10. The F-tT allowed the appeal so far as it related to the VAT of £6,600 charged on the fixtures, fittings and equipment; it was persuaded that the various goods had been supplied by HHL to LMP. HMRC do not challenge that conclusion. The F-tT dismissed the appeals against the rejection of the remaining input tax claims. As to the VAT of £86,704 included in the June invoice, the essence of its reasoning was that there was a 'temporal disconnect' between the supposed supply and the payment of the consideration: at the time payment of the June invoice was made the supplies of construction services had already taken place. It dismissed the appeal so far as it related to the remaining input tax credits because there was no partnership in existence at the time the works which were referred to in the invoices took place. It discharged some of the penalties and reduced others, leaving a residual aggregate of £2,834. The only matter in issue now is the refusal of input tax credit for the June invoice; there is no appeal before me in respect of the other disallowed input tax or in respect of the penalties as reduced by the F-tT.

11. LMP's application for permission to appeal was refused by Judge Raghavan and again by Judge Sinfield in this tribunal on paper, but when the application was renewed orally he was persuaded that it should be granted on two of the three grounds advanced. Those grounds, in summary, are, first, that the F-tT incorrectly interpreted the judgment of the Court of Justice of the European Union ('the CJEU') in Case C-283/12 *Serebryannay vek EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' - Varna pri Tsentralno upravlenie na Natsionalna agentsia za prihodite* [2014] STC 427 ('*Serebryannay*') in concluding that LMP had to be in existence when HHL incurred the cost of the building and refurbishment works and, second, that it erred in finding as a fact that there was no partnership in existence at that time. As part of its second ground, though it seems to me that it is in reality a discrete ground, LMP argues that the F-tT wrongly limited itself by assuming that the supply to LMP by HHL could only have been of project management services. Permission was refused, in my view inevitably, in respect of the third ground which related to the argument, rejected by the F-tT, that input tax credit could be refused in respect of a transaction which did not actually take place only if the taxpayer knew or ought to have known of fraud by the issuer of the invoice.

12. The relevant facts of *Serebryannay* are that two individuals, Mr and Mrs Bodzuliak, bought two apartments and subsequently entered into contracts whereby they granted the taxpayer, a company of which Mr Bodzuliak was the sole director, the right to use the apartments for an extendable period of five years. The taxpayer was not required to pay any rent, but agreed to carry out refurbishment work in the apartments in its own name and at its own expense. It was expected that the taxpayer would subsequently let the apartments to third parties. The Bulgarian tax authority decided that the taxpayer had supplied services to Mr and Mrs Bodzuliak which were subject to VAT, and assessed it for output tax on the basis that the taxable amount of the supply corresponded to the expenditure incurred by the taxpayer on the refurbishment. The

CJEU came to the conclusion that there was a direct link between the supply of the refurbishment services and the consideration received in exchange by the taxpayer, consisting of the right to use the apartments for its business activity of letting them to third parties during the term of the contract. The fact that the supply of services in question benefited Mr and Mrs Bodzuliak only after the contract had expired was immaterial: what mattered was the reciprocity of obligation imposed by the contract between them and the taxpayer.

13. Mr Tim Brown, appearing before me for LMP, began with the proposition that the F-tT had misunderstood the judgment in *Serebryannay*. He focussed on a short passage in the decision at [48], but I think it necessary to place that passage in its context. After setting out what the court decided in *Serebryannay* the F-tT said this:

> '[47] The concept of supply of services is undoubtedly broad (as can be seen from the scope of s 5 VATA 1994) and *Serebryannay* does show that it is possible for construction services paid for by one party in order that they may use it for their own business purposes is capable of being a supply to an owner who takes back the property with the benefit of the refurbishments. The reduction in the appellants' directors' loan account at HHL had the potential to be consideration for a supply. However, we are not satisfied that there was such a supply of services for consideration between HHL and the partnership.
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> [48] This is because there was, as we think was intimated by HMRC's arguments, no direct link between such supply and the consideration in essence because of a temporal disconnect between the two elements. As at April 2009, being the time the invoices in respect of refurbishment works started to be incurred, there could not be any supply of services to the partnership because there was no partnership in existence at that point. As at the time the payment of the recharge invoice was made (by way of reduction in the appellants' directors' loan account with HHL) the supplies of construction services had … already taken place. The argument that HHL was providing project management services for the partnership is therefore unsustainable in relation to invoices charged in respect of goods and services supplied before the partnership was in existence and when it therefore was not capable of being in any kind of relationship with HHL.
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> [49] This position contrasts with the situation in *Serebryannay* where as at the time the construction services were being received by the tenant (and supplied by way of refurbishment by the property owner who would benefit from the improvements), the tenant at that time received something in exchange.'

14. What the F-tT said in the second and third sentences of [48] was wrong, Mr Brown said, because the CJEU had not dealt with the time of the supply in *Serebryannay*. What mattered was not the date on which the construction services were undertaken, but the date of supply to the appellants, which was when the invoice was rendered, in June 2013, and LMP was clearly in existence at that time. For that argument he relied on the time of supply rules found in s 6 of the Value Added Tax Act 1994 ('VATA'), and in particular sub-ss (3) and (4):

> '(3) Subject to subsections (4) to (14) below, a supply of services shall be treated as taking place at the time when the services are performed.
>
> (4) If, before the time applicable under subsection … (3) above, the person making the supply issues a VAT invoice in respect of it or if, before the time applicable under subsection … (3) above, he receives a payment in respect of it, the

> supply shall, to the extent covered by the invoice or payment, be treated as taking place at the time the invoice is issued or the payment is received.'

15. If the time of supply was at the date of the invoice it was plain that LMP existed and, indeed, was VAT-registered then. But even if the time of supply pre-dated the adoption by LMP of its trading name the F-tT was wrong to find, said Mr Brown, that there was no partnership in existence in the period between 2009, when the work began, and 2013, when the invoice was rendered. It was enough that Mr and Mrs Kelly had been in partnership since 1993: even though the partnership formed then used one trading name, KFM, and it adopted another, LMP, later, and even though KFM and LMP carried on different trades, there was nevertheless only one partnership, a fact recognised by HMRC's requirement that the VAT registration effected in April 2013 must include KFM's exempt activities. The F-tT had therefore erred, as a matter of law, in treating KFM and LMP as separate entities, an error which led it to the incorrect conclusion that there had been no partnership in existence at the material time.

16. The F-tT had also been wrong, Mr Brown added, to focus on the description of the supply, as it was set out in the invoice, as 'project management'. HMRC had not taken the point that the invoice might have mis-described the nature of what was supplied, and it was too late for them to do so now. The F-tT should instead have followed the guidance of Lord Reed in *Revenue and Customs Commissioners v Loyalty Management UK Ltd* [2013] UKSC 15, [2013] STC 784 at [38] to the effect that when assessing what has been supplied by A to B 'regard must be had to all the circumstances in which the transaction or combination of transactions takes place'. Had it done so, he said, the F-tT would have come to the conclusion that a supply of services similar to those considered in *Serebryannay* had taken place, and that LMP was entitled to recover as input tax the VAT charged on that supply.

17. The response of Ms Sadiya Choudhury, for HMRC, was that the F-tT was right, and for the reasons it gave, and that the appellants' attack on the decision was based on a misunderstanding of the F-tT's reasoning. The finding that there was a 'temporal disconnect' between the supply and the consideration was unassailable: there was no partnership in existence to which HHL could have made supplies of management services when those supplies were supposedly being made, and it is not possible to create a supply, by issuing an invoice, when none existed.

18. The proposition that the F-tT had misinterpreted *Serebryannay* disregarded what else the CJEU said by way of preliminary observation:

> '[37] … it should be borne in mind, first, that the possibility of classifying a transaction as a transaction for consideration requires only that there be a direct link between the supply of goods or the provision of services and the consideration actually received by the taxable person (see *Hotel Scandic Gåsabäck AB v Riksskatteverket* (Case C-412/03) [2005] STC 1311, [2005] ECR I-743, para 22, and *Campsa Estaciones de Servicio SA v Administración del Estado* (Case C-285/10) [2011] STC 1603, [2011] ECR I-5059, para 25). Such a direct link is established if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient (see, inter alia, *RCI Europe v Revenue and Customs Commissioners* (Case C-37/08) [2009] STC 2407, [2009]

> ECR I-7533, para 24, and *Lebara Ltd v Revenue and Customs Comrs* (Case C-520/10) [2012] STC 1536, para 27) …
>
> [40] It follows that if, under a contract concluded with the owner of an apartment, a supplier of services to fit out and furnish that apartment, first, undertakes to carry out that supply of services at its own expense and, secondly, obtains the right to have that apartment at its disposal in order to use it for its business activities during the term of that contract, without being required to pay rent, whereas the owner recovers the improved apartment at the end of that contract, that supply of fitting-out and furnishing services falls within the category of a supply of services for consideration within the meaning of art 2(1)(c) of the VAT Directive. There is thus a direct link between that supply and the consideration actually received in exchange by the supplier thereof, namely the right to use the apartment in question for its business activities during the term of the contract.
>
> [41] The fact that the supply of services in question will benefit the owner of the apartment at issue only after the contract has expired does not alter anything in that regard, seeing that, as from the conclusion of that contract, the parties to such a bilateral contract undertake to perform reciprocal services for each other (see, by analogy, *Kennemer Golf & Country Club v Staatssecretaris van Financiën* (Case C-174/00) [2002] STC 502, [2002] ECR I-3293, para 40, and *RCI Europe*, paras 31 and 33).'

19. The appellants were correct in saying that the court had not concerned itself with the time of supply, but that, said Ms Choudhury, was not the issue. The question to ask is whether there was a direct link between the supply and the consideration, the answer to which will be 'yes' only if there is a legal relationship between supplier and recipient giving rise to reciprocity of obligation. The F-tT was right to find no reciprocity here, because none could be identified; the reciprocity which the F-tT said might, in other circumstances, have existed was negated by the temporal disconnect. It was correct to say, at [51], that

> '… it is not possible in our view to regard the act of simply stating HHL's invoices to be recharged to amount to a supply of services where none existed otherwise. (HMRC's argument that the services were consumed by HHL while correct is not determinative, as the fact services were consumed by HHL does not preclude the services also being provided to another party). The point is rather that (putting to one side the hoped for ability to reclaim input tax) there is nothing that the appellants obtained by way of the provision of the recharge. While the appellant refers to case law which sets out that only activities of an economic nature carried out by a taxable person acting as such are subject to VAT such a test does not supplant the need for there to be some thing which is supplied.'

20. It is evident from what else it said, Ms Choudhury continued, that the F-tT did not consider it determinative that LMP did not exist before 2013; rather, it was a factor leading to its conclusion that there was a temporal disconnect between the supply and the consideration. But in any event its conclusion that LMP did not exist was correct; even though Mr and Mrs Kelly traded in partnership as KFM they were not registered for VAT and were thus not a taxable person. They could not now argue that the supply was made to them as KFM because the invoice was clearly addressed to them trading as Ludbrook Manor Partnership, and not in some other guise.

21. There was, Ms Choudhury added, nothing in the point that the F-tT failed to take into account all of the circumstances. Conspicuously, the appellants did not identify

what those other circumstances might be. In their revised grounds of appeal to the F-tT they had themselves described HHL as akin to a building contractor or project manager and it was difficult to see how the F-tT could be criticised for adopting the appellants' own description. In any event the F-tT had not treated the nature of the supply as the determinative factor; the core of the reasoning was that there was no supply at all.

22. I agree with Mr Brown that one must follow Lord Reed in examining 'all the circumstances in which the transaction or combination of transactions takes place', but I do not think that process helps him. Here, as the F-tT's findings of fact (which Mr Brown did not challenge in this respect) show, HHL procured and paid for supplies of goods and services which, at the time they were received, it intended to use for its own business of holiday letting. It consumed those supplies in putting itself in a position to start letting the manor house to holidaymakers. Before March 2013, when the plan changed, there was no reciprocity of obligation between HHL and Mr and Mrs Kelly, whether one regards them as individuals or as partners in KFM or LMP: it was not in contemplation that HHL would make a supply to them and equally not in contemplation that Mr and Mrs Kelly would pay HHL consideration for any supply. Against that background I do not see how it can sensibly be said, after the change of plan, that HHL had, historically, been making supplies of project management services to Mr and Mrs Kelly, as the June 2013 invoice claims. The judgment in *Serebryannay* makes it clear that the requisite reciprocity of obligation must exist at the time the supplies are made; it cannot be introduced later. That is, I think, what the F-tT meant by its reference to temporal disconnect and, if so, I agree with it.

23. Can it be said, despite the description in the invoice of the supplies which were supposedly made, that HHL in fact made some different taxable supply to Mr and Mrs Kelly which gives rise to an input tax deduction in their hands? Mr and Mrs Kelly undoubtedly benefited from what was done: the manor house was refurbished in a manner which would enable them, as LMP, to embark on a holiday letting business. But the same difficulty presents itself. Unlike in *Serebryannay*, where there was an arrangement by which the taxpayer would pay no rent but refurbish the apartments instead, there was no arrangement, or even understanding, in this case at the time it undertook the work that HHL would refurbish the manor house in exchange for, or instead of, anything; it undertook the work for its own benefit, and it would have used the improvements for the purposes of its own business had there been no change of plan. It cannot be said that it supplied an improved house to Mr and Mrs Kelly, because the house was already theirs, and it cannot be said that it supplied the improvements to them because, so far as Mr and Mrs Kelly were concerned, the improvements had already been carried out gratuitously. No other relevant supply suggests itself. Accordingly there was no supply to Mr and Mrs Kelly which gives rise to an input tax deduction.

24. I do not see how s 6(3) and (4) of VATA assists the appellants. Subsection (3) provides that a supply of services is to be treated as taking place when the services were performed. However one characterises what HHL did, it is quite clear that it was done before April 2013. Mr Brown attempts to overcome that difficulty by pinning the date of supply to the provision of an invoice, as (he says) sub-s (4) requires. That argument is, if I may say so, plainly wrong: by its own terms sub-s (4) applies only if an invoice is issued, or a payment is made, *before* what would otherwise be the time of supply dictated by sub-s (3).

25. I should also address some residual points. It will be observed that I have referred to HHL's relationship with Mr and Mrs Kelly, rather than with either of the partnership names, and that I have not dealt with the question whether it matters that LMP did not exist before March or April 2013. I do not think it does matter. As Ms Choudhury herself pointed out, in English law a partnership is not a person; it has no identity of its own. The fact that Mr and Mrs Kelly may have used this trading name or that is immaterial; the question is whether there was reciprocity of obligation between HHL and Mr and Mrs Kelly, rather than with KFM or LMP. However, the fact that KFM's business had nothing to do with holiday letting and that LMP, as a trading name, came to be used only in March or April 2013, when it was decided for the first time that Mr and Mrs Kelly rather than HHL would carry on the holiday letting business, lends support to the F-tT's and my own conclusion that the refurbishment works were undertaken for the benefit of, and consumed by, HHL.

26. For those reasons the appeal is dismissed.

Colin Bishopp
Upper Tribunal Judge

Release date: 10 August 2017