[2012] UKFTT 586 (TC)

TC02263

Appeal number: TC/2011/6689

VAT - let of hotel accommodation by undisclosed agent – deemed supply by and to agent under s47(3) VATA – whether deemed supply to agent necessarily has same VAT status as deemed supply by agent – no – whether Item 1(d) of Group 1 to Schedule 9 VATA only exempts supplies to physical user of accommodation – no – appeal allowed in principle

FIRST-TIER TRIBUNAL
TAX CHAMBER

NATHANIEL DAVID RODEN **Appellants**
AND
REBECCA CATHERINE RODEN

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at Bedford Square, London on 16 August 2012

Mr T Brown, Counsel, instructed by Francis Clark LLP, for the Appellant

Mrs R Paveley, officer of HMRC, for the Respondents

DECISION

1. The appellants appealed against a review decision of HMRC dated 26 July 2011 which denied input tax recovery of £70,000.

The facts

2. The facts were not in dispute. The appellants adopted HMRC's version of events as recorded in its Statement of Case and in the witness statement of Mr Waterfield's who was an HMRC officer). From these I find as follows:

3. St Moritz Developments Limited ("SMDL") developed an hotel complex called the St Moritz Hotel ("the Hotel") which was in Trebetherick near Wadebridge in Cornwall. The rooms were later sold individually to investors to sub-let the rooms to guests wishing to stay in the hotel.

4. On 30 August 2007 SMDL entered into a management agreement with St Moritz Hotel and Garden Villas Limited ("GVL"). Under this agreement, in brief, GVL agreed to manage the hotel complex and in particular maintain the estate and common parts, and to maintain and let the hotel rooms as undisclosed agents for the owners of the rooms.

5. On 6 April 2010 SMDL granted a 999 year lease ("the Lease") of Apartment 104 of the Hotel to the appellants in this case, Mr & Mrs Roden, in return for which they paid £400,000 plus VAT of £70,000. They were duly issued with a VAT invoice by SMDL dated 31 March 2010.

6. The terms of the Lease included terms that the Rodens would not underlet the property other than "through the landlord's letting agency". SMDL also covenanted to undertake services such as marketing the hotel, receiving the hotel guests, servicing the accommodation (such as changing the beds), and making the leisure facilities available. SMDL was entitled to deduct commission from the letting charges it collected. Even though GVL was not a party to the Lease, there was a provision that it would provide the same services to the Rodens that SMDL covenanted to provide, such as making up the rooms and receiving the guests.

7. On 8 July 2010, Mr & Mrs Roden applied for VAT registration and submitted a VAT return covering the period at issue, reclaiming the £70,000 paid on the purchase of Apartment 104. On 20 August 2010 their advisers asked HMRC for a ruling on whether the supply by the appellants was standard rated. The Rodens were registered for VAT by HMRC on 31 March 2011.

8. HMRC by letter of 22 February 2011 ruled that the Rodens' supply of Apartment 104 was exempt and therefore the VAT on its purchase could not be recovered, and by another letter of the same date, adjusted their input tax claim on their return to nil.

9. The appellants requested a review of that decision which was duly carried out. By letter dated 26 July 2011, HMRC upheld their initial decision to disallow the input tax, and the appellants appealed to this Tribunal.

10. At some point after the dispute with HMRC arose the appellants applied to make an option to tax over Apartment 104. It was therefore agreed between the parties that if my decision was in favour of the appellants then that would dispose of the dispute with HMRC entirely; but if I agreed with HMRC that the tax at stake was attributable to an exempt supply by the appellants, then I should only give a decision in principle on this point. This was because the parties would then seek to reach an agreement over whether the application to opt to tax made by the appellants ought to be allowed and to what extent this would permit recovery of the input tax by them.

Apartment 104

11. Apartment 104 comprised 3 bedrooms, a sitting/dining/kitchen room with balcony. It was reached by a common stairway and lift area. It was agreed by the parties at the hearing that each bedroom had an ensuite bathroom. The accommodation was therefore self-contained, although nothing turned on this for the appeal.

12. It was a term of the long lease granted to the appellants that they were unable themselves to reside in the room for more than 8 weeks per year. I assume that the reason for this provision was because SMDL (or its agent GVL) could only earn commission from guests when the appellants were not in residence.

GVL's position

13. The management agreement between SMDL and GVL assumed that GVL would have a direct contract with each owner of each apartment in the hotel block as it said at Recital C:

> "The Managing Agent [GVL] has agreed to provide services to each Owner separately with respect to each room in the Building."

However, no such agreement was produced at the hearing and I was told that there was no such agreement in existence. As I have already mentioned in paragraph 6, GVL was given obligations in the Lease agreement but was not a party to it, so those obligations can only be interpreted as an obligation on SMDL to ensure that GVL carried out those obligations.

14. Nevertheless, despite these inconsistencies in the documents, it was assumed by all parties that GVL acted as undisclosed agent to the appellants when letting their apartment to hotel guests.

15. I find that the legal position under the Lease was that SMDL was liable to facilitate the letting of Apartment 104 to hotel guests and entitled to use an agent to do so, and was entitled to be paid commission for doing so. In the event SMDL used GVL to facilitate the lettings of Apartment 104.

16. Therefore, although the documents did not create a direct legal relationship between GVL and the appellants, I find that they did allow SMDL, as a disclosed agent, to create an agency relationship between GVL and the appellants. Therefore, I agree with the parties to this appeal that GVL let Apartment 104 as agent for the appellants, and, as its position as agent was unknown to the hotel guests, it was (in the language of English contract law) an undisclosed agent or (in the language of the VAT Act and the EU VAT directives) an agent who acted in his own name.

The law

17. The parties were agreed that s 47(3) of the Value Added Tax Act 1994 ("VATA") applied to the supply of Apartment 104 by the appellants to any guest. This provided as follows:

> "**47 Agents**
>
> …
>
> (3) Where services are supplied through an agent who acts in his own name the Commissioners may, if they think fit, treat the supply both as a supply to the agent and as a supply by the agent."

18. On its face, s 47(3) VATA gives an option to HMRC to treat any particular supply through an agent acting in his own name as a supply both to and by the agent. But Mr Brown's position was that his clients accepted that their supply should be treated as one to an undisclosed agent under s 47(3) and they did not rely on the apparent optional nature of s 47(3).

19. Article 28 of the Principle VAT Directive 2006/112 ("PVD"), which is now the provision which s 47(3) implements, does not allow the taxing authority a discretion. Article 28 of the PVD is mandatory:

> "Where a taxable person acting in his own name but on behalf of another person takes part in a supply of services, he shall be deemed to have received and supplied those services himself."

20. S 47(3) VATA is therefore not entirely in accordance with this provision of the PVD. Nevertheless, s 47(3) must be interpreted to be as consistent with the provision it is intended to implement as possible and for that reason it seems to me to be right I should give a very wide interpretation of the discretion given to HMRC by s 47(3) so as to make the agent-as-principal treatment virtually mandatory. Therefore, I find HMRC's after-the-event treatment in letters of the appellant's supply as caught by s 47(3) an effective exercise of HMRC's discretion under s 47(3). Therefore, I agree that the appellant was right to take no point on the apparent optional nature of s 47(3) and was correct to accept that their supply was deemed to be to GVL.

VAT Trap? - can Art 28 change liability of supply?

21. Were it not for Art 28, the appellants' supply (albeit via an agent) would be a standard rated supply of hotel accommodation to the guest, irrespective of whether

nor not the appellants waived the option to tax over Apartment 104. Item 1(d) of Group 1 to Schedule 9 provides that the following supplies are excluded from exemption:

> "the provision in an hotel, inn, boarding house or similar establishment of sleeping accommodation or of accommodation in rooms which are provided in conjunction with sleeping accommodation or for the purpose of a supply of catering."

22. HMRC's case was Art 28 deemed the appellants instead to make a supply of the same accommodation to their undisclosed agent GVL. And because GVL was not the occupier of the room, ran HMRC's case, the supply could not be within Item 1(d), as to be within Item 1(d) the accommodation had to be supplied to the person who would use the room as sleeping accommodation.

23. HMRC's position is that, although Art 28 does not affect the value or nature of the supply, nevertheless it can affect the VAT status of the supply. It might, say, convert a zero rated supply into a standard rated supply. The example given in HMRC's public notice is of a taxable sale of goods to a customer based outside the UK. If the vendor sold direct, the VAT status of the supply would be zero rated (or in PVD-speak, exempt with recovery of input tax which amounts to the same thing). However, if the vendor sold the goods via an undisclosed agent based in the UK, the effect of Art 28, says HMRC, is that two supplies would be deemed to take place. The first deemed supply would be by the vendor to the agent, and the second deemed supply would be by the agent to the customer. Only the supply by the agent to the customer would be zero rated because only the customer is located outside the UK. The deemed supply to the agent by the principal would be subject to VAT as an ordinary supply of taxable goods.

24. HMRC consider that the same applies to supplies of services under 47(3). Where the identity of the customer affects the VAT status of the supply, the effect of s 47(3), says HMRC, is that the VAT status of the supply by the principal is altered.

25. If HMRC are right, this is a very nasty VAT trap for an unwary taxpayer. An unwary taxpayer in the position of the appellants who failed to waive the option to tax would find that their supply was exempt, so any attributable input tax was irrecoverable, while nevertheless the charge for the hotel room was still subject to VAT as the deemed supply by their agent would remain taxable. Such an unwary taxpayer, if HMRC were right, would in effect be charging VAT to their guests (because their receipts would be minus the VAT accounted for by their agent to HMRC) but unable to recover VAT on supplies made to them.

Primary case – Art 28 cannot affect taxable nature of supply?

26. The appellant disagrees with HMRC's case. Its primary case is that, even if HMRC are right about the interpretation of Item 1(d), nevertheless s 47(3) and Art 28 cannot as a matter of law affect the taxable nature of the supply: they merely affect the recipient of the supply. In other words, the appellants' case is that the supply *to* the agent by the principal must have the same VAT liability as the supply *by* the agent

to the customer. The appellants' position is that the supply by the principal to the agent should be a mirror of the supply that would have taken place principal to customer had were it not for the deeming effect of Art 28.

27. For this proposition, the appellant relies on the CJEU case of *Henfling* C-464/10.

Henfling

28. The question referred in that case was whether "services supplied by a commission agent acting in its own name, but on behalf of a principle who organises supply of services referred to in Article 13(B)(f)[the exemption for betting]" were precluded from exemption because of Art 6(4) and 13(B)(f) of the Sixth VAT directive.

29. What was Art 6(4) of the Sixth VAT Directive is now Art 28 of the PVD and what was then Art 13(B)(f) is now Art 135(1)(i) of the PVD.

30. The case appears to concern the VAT status of the commission charged by the agent to its principal. From the perspective of English law, it is a rather opaque decision. It does not make clear why the *principal* was assessed for VAT by the Belgian tax authorities on agency services rendered to it by its agent (located in the same member state). The CJEU also does not make a distinction between the actual agency services provided by the agent to its principal and the deemed supply of a betting service provided by the principal to its agent under Article 6(4). For instance, in paragraph [36] the CJEW refers to the "legal relationship between the principal and the commission agent" but fails to state to which of these two legal relationships it is referring. The CJEU considered its own decision in the *United Utilities* case in which intermediary services provided an agent acting in the name of its principal were found to be taxable as the exemption for betting services did not extend to intermediary services. Yet in *Henfling* the CJEU does not make clear why the intermediary services of an agent acting in its own name should be treated any differently to the intermediary services of an agent acting in the name of its principal, although this is the conclusion the CJEU reached at paragraph [38].

31. However, the difficulties which this decision gives to an English lawyer are explained if I assume what is not explicit in the decision which is that under civil law systems undisclosed agents are treated as principals as a matter of *contract* law as well as VAT law. In civil contract law, it seems, there is no supply of the undisclosed agent's services to its principal: the *only* supply between agent and principal is the deemed supply by the principal to the undisclosed agent. This is deemed to be at the sale price to the customer *less* the agent's commission.

32. If this is the underlying but unexplained assumption behind the CJEU's decision, then all the above difficulties which an English lawyer may have with the decision are explained: the *principal* (and not agent) was assessed for not accounting for VAT on supplies between them as the only supply was the deemed supply principal to agent. The CJEU did not make clear to which of the two legal

relationships between agent and principal it was referring because as a matter of civil law there was only one such legal relationship. And the reason the CJEU did not make clear the distinction between *Henfling* and *United Utilities* is because to a civil lawyer it would be obvious: an agent acting in the principal's name makes supplies to the principal while an agent acting in his own name does not; therefore the agent in *Henfling* is in contract law treated as a principal and supplies to and by him fall within the betting exemption, while supplies by the agent in *United Utilities* were supplies of intermediary services which are not exempt under the betting exemption.

33. What is not clear is how the same factual position in the UK would be taxable. Under the contract law of England and Wales (& I presume Scotland), the agent acting in his own name *does* make a supply for commission of services to the principal. Would such services be exempt under *Henfling* or taxable under *United Utilities?*

34. But while this may be a difficult question to resolve, it is not one at issue in this case. What is clear from *Henfling* is that in the context of the betting exemption, the deemed supply from the principal to the agent has the same VAT exempt status as the deemed supply from the agent to the customer:

> "[36] Since Article 6(4) of the Sixth Directive comes under Title V of that directive, headed 'Taxable transactions', and is couched in general terms, without containing restrictions as to its scope or its extent, the fiction created by that provision also concerns the application of VAT exemptions under the Sixth Directive. It follows that, if the supply of services in which the commission agent takes part is exempt from VAT, that exemption applies likewise to the legal relationship between the principal and the commission agent."

35. And it is on this paragraph that the appellant relies to make its case that, whether or not HMRC are right on the limitation of Item 1(d) to supplies to the physical users of hotel rooms, deemed supplies under Article 6(4) (now Article 28) by principal to agent will have the same VAT status as supplies by agent to customer.

36. But I am not able to accept that *Henfling* is authority for this proposition. This is because, in the next paragraph, the CJEU indicate that their reasoning in paragraph [36] is not necessarily of general application:

> "[37] That conclusion applies also to the exemption under Article 13(B)(f) of the Sixth Directive, relating to the business of taking bets. Indeed, that exemption does not present – as compared with other exemptions – specific features which would justify limiting the scope of Article 6(4) of that directive and excluding bets from it. Furthermore, in the context of the application of Article 6(4), it is irrelevant that Article 13(B)(f) does not provide for exempting supplies by intermediaries or negotiation, whereas such an exemption is expressly provided for in Article 13(B)(a) and (d) of the Sixth Directive."

37. From the first half of this paragraph, it is apparent that the CJEU's decision was limited to the betting exemption and that the CJEU thought that other exemptions

might have "specific features" which would mean Article 6(4) (now Art 28) would not have the effect of treating the two deemed supplies as being identical.

38. In so limiting their decision, the CJEU may have had in mind exemptions such as the financial exemptions which in some cases depend on the supply being made to and by the same person as another supply. For instance, a supply of the "management of credit" must be made by the same person as the person who granted the credit to the consumer: see what is now Article 135(1)(b). So a supply of the management of credit via an undisclosed agent may result in a change of VAT status of the supply: but I am not called to decide this.

39. My opinion, in conclusion, is that the effect of paragraphs [36] and [37] is that the CJEU's interpretation of the Directive is that, where Art 28 creates deemed supplies, a deemed supply principal to agent would normally but not necessarily, depending on the wording of the exemption or zero rating provision, have the same taxable status as the other deemed supply, agent to customer.

40. Therefore, I reject the appellant's case that the VAT status of the supply principal to agent must necessarily in all cases be the same as the status agent to customer. On the contrary, it seems to me likely that the example relating to cross border sales given in HMRC's notice is correct.

41. But in my opinion, following *Henfling,* it is the case that the normal rule is that the two deemed supplies under Art 28 will have the same VAT status, unless there are "specific features" relating to the supply which mean that the normal rule should not apply. HMRC's opinion is that a supply can only be within Item 1(d) if made to the physical user of the service supplied: so that only the deemed supply agent to customer could fall within Item 1(d) as it is only the customer who physically uses the room. Whereas it is the appellant's secondary case that HMRC are wrong to treat the exclusion from exemption in Item 1(d) as limited to supplies direct to the physical user of the room and I go on to consider this.

Appellant's secondary case - does identity of recipient matter?

42. HMRC's case is that Item 1(d) excludes from exemption the "provision <u>in</u> a hotel <u>of</u> sleeping accommodation" and they say it follows from this that the supply is only within 1(d) if the recipient actually uses the room as sleeping accommodation. They say Art 135(2)(a) of the PVD (which is the authority for Item 1(d)) should have exactly the same interpretation.

43. I agree with the appellants' case on this for a number of reasons.

44. Firstly, there is nothing on the face of Item 1(d) that requires the supply to be to the person who actually uses the accommodation. If HMRC were right, it would mean that where an employer pays for hotel accommodation for its employees to stay in, say for the duration of a conference, that supply would not be taxable under Item 1(d), as the recipient of the supply (the employer) was not the physical user of the sleeping accommodation. It would mean that wherever a company or other non-

natural legal person bought hotel accommodation, the supply would not be taxable under Item 1(d) as the customer could never physically use the room. It would also make wedding receptions exempt as the person buying the services would not be the person physically using most of the services (the services are mostly physically used by the guests). There is no logic in such a distinction and, therefore, I should not interpret the Principle VAT Directive or the VAT Act as requiring such an illogical distinction to be made without express words to that effect. And there are none. I conclude that the application of Item 1(d) does not depend on the customer being able to, and actually, physically using the services provided.

45. Secondly, Item 1(d) should be interpreted in so far as possible to be consistent with the provision of the PVD which it enacts. The relevant provision is Article 135(2)(a):

> (a) the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in sectors with a similar function, including the provision of accommodation in holiday camps or on sites developed for use as camping sites."

46. There is nothing in Article 135(2)(a) to limit the exclusion of exemption to grants to the end user of the accommodation. I am aware that Article 135(2)(a) gives Member States some discretion in the implementation of it as it says "as defined in the laws of the Member States" but I read this as meaning that Member States have some discretion in the definition of accommodation and not as giving them a discretion to limit the exclusion to supplies to certain recipients. And, in any event, as I have said, the UK's implementation of this article does not limit the exclusion from exemption to supplies to certain recipients.

47. Thirdly, I agree with the appellant that exclusions from exemption should be interpreted widely (*Blasi C-346/95)* at paragraph [19] where, in respect of what is now Article 135(1)(a) but with general application, the CJEU said exclusions from exemptions should not be interpreted strictly as their effect is to bring transactions back into the general rule of being subject to VAT. Exemptions *are* interpreted strictly: exclusions from exemption are *not* interpreted strictly. For this reason, too, I do not interpret Article 135(2)(a) as permitting Member States to limit the exclusion from exemption to supplies to certain recipients, particularly where there appears no logic to such an exclusion.

48. In conclusion, I find there is nothing in Article 135(2)(a) nor Item 1(d) of Group 1 of Schedule 9 which implements it which means the exclusion from exemption is limited to supplies to the person who physically uses the accommodation as sleeping accommodation. The exclusion from exemption applies to the supply of sleeping accommodation to any person, natural or corporate, and whether or not they physically use it, or allow another person to use or, or on-supply it to another person.

49. Therefore, there are no "special features" of a supply within Art 135(2)(a) which would mean that the general rule in *Henfling* would not apply. In other words, where the supply is within Art 135(2)(a) and Art 28, the deemed supply principal to agent has the same VAT status as the deemed supply agent to customer

50. Therefore, in the case of a deemed supply of sleeping accommodation in an hotel under Article 28, as with a supply of betting in *Henfling*, the supply by the principal to the agent has the same VAT status as the supply by agent to customer. In the case of the hotel accommodation in these proceedings, the deemed supply by the appellants to GVL of Apartment 104 was standard rated under Item 1(d), as well as the deemed supply by GVL of Apartment 104 to the guests. Input tax attributable to that taxable supply to the appellants is therefore recoverable.

51. This appeal therefore succeeds in principle subject to one matter raised below.

VAT status of long lease

52. It was accepted by both parties that the grant of the long lease of Apartment 104 was properly standard rated although at the hearing neither party was certain of the reason for this. However, the point is significant because if the VAT was not properly chargeable by SMDL, it could not be input tax for the appellants.

53. I suggested at the hearing that the lease was not zero rated because of Note (13) to Group 5 of Schedule 8 which provides:

> "The grant of an interest in, or in any part of –
>
> (a) a building designed as a dwelling or number of dwellings; or
>
> (b) ….
>
> is not within item 1 if –
>
> (i) the interest granted is such that the grantee is not entitled to reside in the building or part throughout the year; or
>
> (ii) residence there throughout the year, or the use of the building or part as the grantee's principle private residence, is prevented by the terms of a covenant, statutory planning consent or similar permission."

54. As it was a term of the long lease that the owners were not entitled to reside in the room for more than 8 weeks in any one year, I find that, by virtue of either (i) or (ii) of Note (13), the long lease was excluded from Item 1. The grant of the long lease to the appellants was therefore not zero rated.

55. But was it exempt? It is of course possible, and perhaps likely, that SMDL had made an election to waive any exemption but at the hearing neither party was able to give evidence on this.

56. HMRC, consistent with their case that the supply the appellants to the agent could not be of sleeping accommodation, did not suggest that the grant of the long lease by SMDL to the appellants was excluded from exemption as the grant of a lease over sleeping accommodation.

57. I have, of course, rejected their case that a supply otherwise within Art 135(2)(a) would not be within it if not made to the physical user of the accomodation. Nevertheless, it is clear from *Blasi* (cited above) that grants of long leases are not

within Article 135(2)(a). This was on the basis that leases allowing long term occupation could not be seen as similar to short-term lets of the type made in the hotel sector. Therefore, I find sales or long leases of hotels are not within the exclusion from exemption of Article 135(2)(a).

58. Therefore, whether the supply of Apartment 104 by SMDL to the appellants was correctly standard rated depends on whether an option to tax had been validly made by SMDL. The parties will need to resolve this issue themselves or revert to the tribunal for a decision. As I have said, assuming that the parties agree that the invoice issued by SMDL to the appellants validly charged VAT, I have found that the appellants were entitled to recover the VAT as attributable to their onward standard rated deemed supplies to GVL (and of course their deemed "self" supplies under the *Lennartz* mechanism whenever they physically use the accommodation themselves and for which they have to account for VAT).

59. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 13 September 2012