TC02812

Appeal number: TC/2009/16911

VALUE ADDED TAX – input tax claimed by a company in relation to a supply of services to it by a subsidiary – the company making only exempt supplies to which the services were attributable – whether input tax deductible – held, no – whether decision to deregister the company ought to be upheld – held, yes – whether refusal of the company's application for backdated VAT group treatment unreasonable – held, no – whether penalties chargeable – held, yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

CHELHAM LIMITED **Appellant**

and

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

TRIBUNAL: JUDGE JOHN WALTERS QC
HENRY RUSSELL OBE

Sitting in public at Bedford Square, London on 2 March 2012 and 4 October 2012 (Further written submissions received from the parties dated 1 November 2012 and 8 November 2012)

Rakesh Rathod, Alton & Co., for the Appellant

Christopher Shea, Officer, HM Revenue & Customs, for the Respondents

DECISION

Introductory

1. The appellant, Chelham Limited ("Chelham") holds 99.8% of the shares in another company, Perrie Limited ("Perrie").

2. Chelham appeals against assessments to VAT for the periods 12/06 (£14,210), 03/07 (£14,000) and 03/08 (£15,085) and penalties in relation to those three periods and for the period 03/09. Chelham also appeals against the decision of the Respondents ("HMRC") to deregister Chelham for VAT purposes with effect from 1 April 2009 and HMRC's decision to refuse an application for backdated VAT group treatment. The application was made on 27 March 2012, after the first hearing of the appeal (on 2 March 2012) and was refused by a letter dated 18 April 2012.

3. We received Witness Statements from Savaravana Sivarajah and Ibrahim Bozkurt for Chelham and Officer Sean Clayton and Officer Reese Berry for HMRC.

4. We also had before us a bundle of documents.

The facts

5. From the evidence, we find the following facts.

6. Chelham leases a commercial property at 245-254 Cambridge Road, London ("the Property"). No VAT is charged on the supplies by Chelham to the tenant of the Property. Chelham acquired the Property in about 1994.

7. Since September 1999, the clothing business, which had until then been carried on by Chelham, has been carried on by Perrie, which is registered for VAT.

8. Perrie additionally carries out certain property management services for Chelham. These include arranging insurance, repairs and maintenance.

9. Chelham paid a management fee of £106,000 in the year ending 31 March 2009 to Perrie. VAT was charged and paid by Perrie in relation to this fee and a repayment claim was made by Chelham asserting that the VAT was deductible by Chelham as input tax.

10. On 17 April 2009, Officer Clayton made a control visit to Chelham to verify the repayment claim. He met Mr Bozkurt (the director) and Mr Sivarajah (the company accountant of Chelham, and also an employee of Perrie). Officer Clayton ascertained at that meeting that the VAT claimed as input tax by Chelham related to services supplied by Perrie to Chelham in relation to the Property and that no VAT was charged by Chelham on rental income from the Property.

11. On 21 April 2009, Officer Clayton wrote to Chelham confirming his decision to disallow the input tax claim for VAT period 03/09 on the basis that it was attributable to the exempt activities of Chelham and his decision to assess VAT that had been

deducted as input tax within the 3 years before the VAT period 3/09. On 23 April 2009 a notice of assessment to VAT charging VAT of £43,295 relating to VAT periods 12/06, 03/07 and 03/08 was issued. On the same date he issued a deregistration letter implementing his decision that Chelham should be compulsorily deregistered with effect from 1 April 2009.

12. Officer Clayton considered whether Chelham had a reasonable excuse for the avoidance of, or claim to mitigation of, penalties imposed under section 63 VAT Act 1994 ("VATA") and decided that Chelham could not demonstrate such a reasonable excuse.

13. Mr Bozkurt claims that it would be unfair for Chelham to be denied credit for the VAT which Perrie has accounted for in respect of management charges made by Perrie to Chelham.

14. At the first hearing of the appeal, the Tribunal enquired why no VAT group election had been made to cover Chelham and its subsidiary Perrie. No reason was advanced, and an adjournment was allowed and a direction made, to enable Chelham to make an application for VAT group treatment and request that it be backdated.

15. Chelham made an application for VAT group treatment, to include it and Perrie, by completing Forms VAT 50 and 51. These were sent to HMRC with the application on 27 March 2012, with the request that VAT group treatment be back dated to 1 October 2006.

16. The request was refused by a letter from HMRC dated 18 April 2012. This letter was written by Officer Reese Berry, from whom we also received evidence.

17. Officer Berry considered whether HMRC should exercise its power under section 43B(4)(b) VATA to allow group registration from a date before the application was made.

18. Officer Berry's evidence was that, as a matter of policy, HMRC do not allow backdating of group applications to a date more than 30 days prior to the receipt of the application in all but the most exceptional circumstances. Officer Berry explained that 'this is due to the fact that many of the "bodies corporate" applying to join the group are usually VAT registered in their own right' and the policy avoids the need to replace any returns on file and the need to 'rewrite taxpayers' histories'. Exceptional circumstances include cases where the application for retrospective group treatment is being made as a result of an error on the part of HMRC. Officer Berry looked to see if there were any exceptional circumstances in Chelham's case which would justify departure from HMRC's general policy, but could find none. Officer Berry attached paragraph 57.16 to 57.18 of V1-28 Registration Volume 2, Part A (HMRC's policy on group registration) which supported the evidence given.

The submissions

19. Mr Rathod submitted that HMRC taking the benefit of Perrie's payment of output tax and not either allowing a mirror-image claim for deduction of input tax by Chelham or the refund of the output tax paid by Perrie pursuant to VAT group

treatment of Chelham and its subsidiary Perry was unfair. He stressed that Chelham was supporting Perrie in its activities and that there were no third parties involved.

20. There was no dispute over the figures either of the assessments or of the penalties imposed, which had been reduced to 3% (£426 for 12/06; £420 for 03/07; and £452 for 03/08 – as detailed in a document handed up to us by Mr Shea). Mr Rathod did, however, contend that there was, or ought to be, no liability at all, on general fairness grounds. He submitted that not much extra work would be involved on HMRC's part consequent on accepting the application for backdated VAT group treatment.

21. Mr Shea submitted that HMRC's policy as referred to by Officer Berry was reasonable and the decision to apply it in this case and refuse backdated group treatment was also reasonable and one which it had been open to Officer Berry to take. No exceptional circumstances justifying departure from HMRC's general policy had been identified or suggested. A mere assertion of unfairness was insufficient.

22. Mr Shea submitted that it would be unfair to other taxpayers to whom the general policy on backdated group treatment had been applied to depart from that policy in Chelham's case without any exceptional circumstances being shown. Further, the situation giving rise to the application for backdated group treatment had arisen in Chelham's case only once an enquiry into Chelham's VAT affairs had been instituted by HMRC. It would be unfair to other taxpayers (in relation to whom no VAT enquiry had been instituted) to give Chelham advantageous VAT treatment following the opening of an enquiry into their VAT affairs.

23. The Tribunal invited written submissions from the parties on the implications, if any, in this case of the decision of the Court of Appeal in *R v Inland Revenue Commissioners, ex parte Unilever plc* [1996] STC 681, in which that Court decided that the Inland Revenue's reliance on the late submission by Unilever of formal group relief claims to deny Unilever entitlement to group relief for losses sustained.

24. Mr Shea lodged a full written submission on 1 November 2012, and the Tribunal received a letter dated 8 November 2012 in which Alton & Co. (for Chelham) referred to HMRC's submission, made comments on paragraphs 2.17 and 2.18 in it and reiterated their submission that HMRC's action in disallowing relief for the payment of VAT on the supplies by Perrie to Chelham was unfair and inequitable.

25. Alton & Co. point out that HMRC have agreed that 'except for administrative reasons there are no circumstances here which would prevent a group election from being ranted and that this is not part of any tax avoidance scheme'.

26. Mr Shea, in his written submissions, draws attention to the fact that the nature of the VAT system, being a self-assessment regime, puts a heavy onus on the taxpayer to make an assessment at the right time and on the correct amount. Whereas in *Unilever*, there had been an agreement, or course of conduct accepted, as between Unilever and the Inland Revenue as to when group relief would be claimed, there was here no such understanding between HMRC and Chelham or Perrie and it would be wrong therefore to describe a VAT charge caused by the incidence of the VAT

legislation on the circumstances of Chelham and Perrie as an 'adventitious windfall' arising for the benefit of HMRC, of the type which the Court had identified in *Unilever*.

27. HMRC accept that if Chelham had made an application for VAT group treatment before period 12/06 the aggregate liability to VAT would be likely to be different from the amounts claimed by HMRC but Mr Shea stresses that HMRC played no part in any failure to make an application for VAT group treatment in time.

28. Mr Shea also points out that it is not inevitable that Chelham would have made an application for VAT group treatment if Chelham and Perrie had been aware of all the consequences – for instance, joint and several liability for the VAT liability of the representative member. If Chelham, being a company owning a valuable investment property (the Property), had been grouped for VAT purposes with Perrie (a trading company) and Perrie had failed owing a significant VAT debt, HMRC could have looked to the Property for the payment of the VAT liability arising from Perrie's trading. On the other hand, in the absence of VAT group treatment, the Property would be protected from being available to meet Perrie's VAT liability.

29. Mr Shea justifies HMRC's policy of not normally allowing backdating of VAT group treatment in the absence of exceptional circumstances, on the basis that a 'rewriting' of VAT history is involved and this may have unforeseen and unfortunate consequences. For example, the costs of refurbishing the Property in this case, being costs of Perrie attributable to its taxable property management services would become costs of the exempt rents collected by Chelham. Therefore, although the charge on the supplies of services made by Perrie to Chelham would disappear, the VAT on materials and subcontractors' charges used in the refurbishment would become exempt input tax for the putative group and therefore irrecoverable.

30. Mr Shea submits that this reworking would cause any reduction in overall VAT liability to be 'marginal'. Alton & Co. (for Chelham) dispute this.

31. Mr Shea points out also that Unilever was a compliant taxpayer, but the same cannot be said for Chelham, which had been making incorrect VAT returns for some years.

Our decision

32. It is clear that Chelham has claimed as input tax VAT which is attributable to exempt property supplies (rents etc. charged to the tenant of the Property).

33. Accordingly the input tax is not deductible. Since there is no dispute as to the figures, we uphold the assessments for the periods 12/06, 03/07 and 03/08 and the decision not to allow deduction of input tax in the period 03/09.

34. Also we uphold the decision to deregister Chelham. As Chelham makes only exempt supplies it ought not to be registered for VAT.

35. We accept HMRC's submissions justifying their refusal to accept Chelham's application for backdated VAT group treatment. On this matter, our jurisdiction is

supervisory – that is, the question for us is whether HMRC's refusal was a decision which a reasonable body of Commissioners could take. We are persuaded that the refusal was such a decision, for the reasons given by Mr Shea and that *Unilever* can and should be distinguished on its facts. This is a simple case of Chelham not making an application for VAT group treatment in time, a fact for which it must bear the entire responsibility. As Mr Shea submitted, HMRC bear no responsibility for the fact that no application was made in time. The consequent VAT liability is one which follows from a straightforward application of VAT law and does not give rise to an adventitious windfall for HMRC and is not unfair to Chelham. Chelham and Perrie are different legal entities – for presumably good commercial reasons – and this gives rise to commercial advantages and disadvantages. Liability to non-refundable VAT is one of the disadvantages.

36. We therefore uphold HMRC's decision not to accept Chelham's application for backdated VAT group treatment. We also uphold the penalties assessed which, in their revised figures, are not disputed, once liability is established as it has been by this Decision.

37. Accordingly, for the reasons given above, we dismiss the appeal.

Applications for permission to appeal this Decision

38. 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.

JOHN WALTERS QC
TRIBUNAL JUDGE

RELEASE DATE: 31 July 2013