



TC04393

Appeal number:TC/2013/09453

VAT – input tax – partial exemption – whether input tax associated with supplies of goods directly attributable to taxable supplies – yes – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

NK MOTORS

Appellant

- and -

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

**TRIBUNAL: JUDGE JONATHAN RICHARDS
 IAN PERRY**

Sitting in public at Priory Courts, Birmingham on 21 April 2015

Alastair McClelland of MGA Associates for the Appellant

Lisa Saxton, Officer of HM Revenue & Customs, for the Respondents

DECISION

1. The appellant partnership appeals against HMRC's decision that input tax it
5 incurred in connection with certain building works was attributable wholly to exempt
supplies with the result that it is not entitled to any credit for that input tax. The
appellant contends that HMRC should have accepted that the input tax was
attributable to both taxable and exempt supplies with the result that a partial credit is
available.

10 **Undisputed facts**

Background

2. The partners in the appellant are Mr and Mrs Kumar (the "Kumars"). The
appellant is registered for VAT.

3. The appellant holds a number of properties. Some of these properties are the
15 subject of an election to waive VAT exemption and some are not. The appellant,
therefore, has to apply VAT provisions relating to "partial exemption" in order to
determine how much input tax it is entitled to recover.

4. One of the appellant's properties is Jesse Farm, a 100 acre farm situated in
Derbyshire, which it acquired in early 2008. Jesse Farm was not being run as a
20 working farm when the appellant acquired it. On 7 April 2008, at or around the time
of the purchase of Jesse Farm, Mr Kumar obtained a report (the "Report") from a
consultant on options for keeping a dairy herd on the farm. The Report outlined
differences that would arise depending on whether Jersey or Holstein cows were kept,
included an estimate of the capital expenditure that would be required and estimated
25 gross margins that could be achieved.

5. However, shortly after the acquisition of Jesse Farm, global economic problems
affected the Kumars' business interests. They had financial worries and were not able
to proceed with the proposals set out in the Report. Mr Kumar decided to obtain
much-needed additional income by establishing a "DIY livery business" under which
30 stabling space at Jesse Farm was made available to local residents.

6. To that end, the Kumars acquired all the shares in a new company, Lime Lane
Livery Limited ("Lime Lane Livery"), which was incorporated on 29 April 2009 and
Mr Kumar became a director on the same day. Lime Lane Livery started the livery
business and used Jesse Farm under the terms of a licence granted by the appellant.
35 We were not shown the terms of that licence. Mr Kumar's business practice, when
dealing with an associated company, is to set prices for services that are affordable in
the light of that company's financial position. It was accepted that, at some point, the
annual licence fee payable was around £60,000 per annum.

7. The appellant has not elected to waive VAT exemption in relation to Jesse Farm
40 and therefore the licensing of Jesse Farm is an exempt supply for VAT purposes.

Works at Jesse Farm

8. Between 2009 and 2013, the appellant carried out certain works at Jesse Farm. We were not provided with a comprehensive description of those works, but the parties agreed with the following general summary of what they involved.

5 (1) The interiors of certain outbuildings (the “Barns”) were converted into stabling for 53 horses and ancillary storage space (“Barn Conversion”).

(2) General repairs to outbuildings, not included in the Barn Conversion, were effected (“Barn Repairs”). Some of the Barn Repairs involved repairing the roof of the Barns.

10 (3) An outdoor ménage was constructed for use by Lime Lane Livery’s customers to exercise their horses.

(4) A car parking and turning area was built (“Car Parking Works”).

(5) The entrance to Jesse Farm was moved from an unsatisfactory location on a bend in the road.

15 (6) Some general fencing work was undertaken in addition to the fencing provided in connection with the ménage.

9. On 4 March 2010, an application for retrospective planning permission was submitted, and duly granted subject to conditions, in relation to:

(1) the Barn Conversion;

20 (2) the movement of the entrance to Jesse Farm; and

(3) the construction of the open air ménage and car parking area.

Matters in dispute

10. At the hearing, the appellant and HMRC were agreed that input tax incurred in connection with Barn Conversion and the construction of the ménage was directly
25 attributable to the appellant’s making of a VAT exempt supply, namely the licensing of Jesse Farm to Lime Lane Livery.

11. The appellant and HMRC also agreed that input tax incurred in connection with the movement of the entrance to Jesse Farm and general fencing works was recoverable as “residual input tax” that was attributable to the making of both taxable
30 and exempt supplies.

12. The parties were not agreed on the treatment of input tax associated with Barn Repairs. HMRC considered that this should be treated in the same way as input tax associated with Barn Conversion.

13. The appellant accepted that the input tax associated with Barn Repairs was
35 attributable to the exempt supply of licensing Jesse Farm. However, it argued that the input tax was also attributable to taxable supplies. It made the following three arguments in support of this contention.

(1) Firstly, the appellant argued that at all material times it had the intention of making taxable supplies by bringing Jesse Farm back into use as a working farm.

5 (2) Secondly, it argued that it carried on a business of selling eggs at Jesse Farm and that there was the requisite connection between the input tax incurred and zero-rated supplies (in the form of sales of eggs).

10 (3) Thirdly, it maintained that prior to conversion into stables, the Barns had been used to store motor vehicles owned by a separate motor business of the Kumars. The appellant argued that it made taxable supplies in connection with the provision of the storage space and that also provided the requisite connection between the input tax incurred and taxable supplies.

14. The parties did not seem sure whether there was a disagreement as to the treatment of input tax associated with Car Parking Works. We have assumed for the purposes of this decision that there is a disagreement with HMRC arguing that the input tax associated with Car Parking Works is directly attributable to exempt supplies and the appellant arguing that it should be treated as “residual input tax”. We therefore refer to the Car Parking Works and the Barn Repairs together as “Disputed Works” in this decision.

Evidence and procedural matters

20 15. The appellant produced short statements of the following witnesses:

- (1) Mr Kumar,
- (2) Mr Poultney, Mr Kumar’s accountant; and
- (3) Ms Croft, the stable manager of the livery business.

25 16. However, none of these witnesses attended the hearing. Mrs Saxton explained that she would have wanted to cross-examine all of these witnesses. However, she confirmed that the assertions made in the witness statements tended to repeat assertions that had already been made in correspondence. In addition, she confirmed that her cross-examination would in all likelihood be no more searching than simply putting HMRC’s opposing view of the facts to the witness. In the circumstances, therefore, she stated that she would not object to admission of those statements as hearsay evidence. We decided to admit the witness statements as evidence. However, we have taken into account that they are hearsay evidence when assessing their weight.

35 17. For HMRC, we had a witness statement of Officer Atkinson who had made the assessments giving rise to this appeal. He was cross-examined by Mr McClelland and we found him to be a straightforward and reliable witness.

18. Mrs Saxton prepared a helpful bundle of documents (including documents that the appellant had requested be included), a bundle of authorities and a skeleton argument.

Relevant law

19. The right to deduct input tax is set out in Article 167 and Article 168 of Directive 2006/112/EEC (the “VAT Directive”). Article 168 provides that a taxable person is entitled to deduct VAT due or paid in respect of supplies of goods or services to him from the VAT which he is liable to pay in so far as the goods and services are used for the purposes of taxed transactions of the taxable person. There is, however, no right to deduct VAT due or paid in respect of supplies of goods or services which are used by the taxable person for the purposes of exempt transactions. Article 167 makes it clear that that any right of deduction arises at the time that the input tax in question becomes chargeable.

20. Article 173 of the VAT Directive deals with the situation where goods or services are used by a taxable person both for transactions in respect of which VAT is deductible and for transactions in respect of which it is not. In that case, Article 173 provides for a proportion of the VAT incurred to be deductible.

21. These articles are given effect in the UK by the Value Added Tax Regulations 1995 (the “VAT Regulations”). Regulation 101(2) provides that

a) ...

b) There shall be attributed to taxable supplies the whole of the input tax on such of those goods or services as are used or to be used by him exclusively in making taxable supplies.

c) No part of the input tax on such of those goods or services as are used or to be used by him exclusively in making exempt supplies shall be attributed to taxable supplies.

d) ... [T]here shall be attributed to taxable supplies such proportion of the residual input tax on such of those goods or services as are used or to be used by him in making both taxable and exempt supplies as bear the same ratio to the total of such input tax as the value of the taxable supplies made by him bears to the value of all supplies made by him in the period.

22. Regulation 101(2)(b) and Regulation 101(2)(c) are phrased in terms of the “attribution” of input tax to supplies. The meaning of this concept was considered in detail in *HM Revenue & Customs v Mayflower Theatre Trust Limited* [2006] EWCA Civ 116 which also reviewed a number of decisions of the Court of Justice of the European Union (“CJEU”). The relevant question is whether there is a “direct and immediate link” between the input and the output or, to put the same test somewhat differently, whether the input is a “cost component” of the output.

23. The *Mayflower* case also noted that there is a category of input tax that can be regarded as attributable to neither taxable nor exempt supplies (in the sense set out above), but which may nevertheless be recoverable as an “overhead” or “general cost” of a business.

24. We have concluded that the questions relevant to this appeal are:

(1) Can the costs of the Disputed Works be regarded as an “overhead” or “general cost” of the appellant’s business?

(2) Is there only a “direct and immediate link” between the Disputed Works and the exempt licensing of the Barns to Lime Lane Livery?

5 (3) Is there a “direct and immediate link” between the Disputed Works and both (i) the exempt licensing of the Barns and (ii) all or any of the taxable supplies made, or to be made, involving the sale of eggs, the storage of motor vehicles or the intended operation of Jesse Farm as a working farm.

10 As noted at [22] above, the concept of a “direct and immediate link” can also be understood by considering whether one supply is a “cost component” of another.

25. We have also taken note of the decision of the High Court in *Customs and Excise Commissioners v Briararch Ltd* [1992] STC 732. In that case, a company incurred input VAT on building works at a time when it intended to make taxable supplies of the land, in the form of a long lease. However, its attempts to grant a long
15 lease were unsuccessful and, in order to obtain short-term income, the company granted short leases of the land which were exempt supplies for VAT purposes. The High Court held that the input tax could not be said to have been wholly used in making exempt supplies since the constant intention to make taxable supplies still subsisted. Accordingly, the apportionment methodology set out in what is now
20 Regulation 101(2)(d) of the VAT Regulations fell to be applied.

26. As a consequence of the decision in *Briararch*, when approaching the question set out at [24(3)] we have determined that it is relevant to consider the extent to which the appellant had the intention to make future taxable supplies even if the Disputed Works were only actually being used for the purposes of making exempt supplies (in
25 the form of licensing the Barns to Lime Lane Livery).

27. Finally, we have noted that the burden of proof is on the appellant to establish that the requisite “direct and immediate link” is present. We have not accepted the contention, advanced by the appellant in its statement of case, though not repeated at the hearing itself, that “the onus of proof is on [HMRC] to prove that Mr and Mrs
30 Kumar had no intention of operating [Jesse Farm] as a mixed dairy and arable farm in 2008”.

Dates of the Disputed Works

28. The assessments against which the appellant is appealing go back to its VAT period 11/09 and the last assessment under appeal is that relating to 02/13. We were
35 not given precise dates on when the Disputed Works took place, nor were we shown a full set of invoices relating to either the Disputed Works, or the works generally.

29. We have noted that the application for planning permission dealt with the Car Parking Works and was described as “retrospective” when it was made on 4 March 2010. We have therefore concluded that the Car Parking Works took place some time
40 between 1 September 2009 (the first day of the appellant’s VAT period 11/09 which is the first period under appeal) and 4 March 2010.

30. It is not clear whether planning permission was needed for Barn Repairs (as distinct from Barn Conversion) and, therefore, the date of the planning permission application offers less of a guide to the date on which Barn Repairs were carried out. Mr McClelland showed the Tribunal some invoices that he submitted related to Barn Repairs, all of which were issued some time in 2010. We have also noted that HMRC's assessments after that for 02/11 are much lower than those for previous periods, which suggests that most of the disputed input VAT was incurred before the end of the 02/11 VAT period. We have therefore inferred that the majority of the Barn Repairs took place in 2010.

31. Since any right of deduction of input VAT arises at the time the input VAT becomes chargeable, we have approached questions of attribution in the light of facts and circumstances in existence when the appellant incurred the VAT on the Disputed Works.

Link between the Disputed Works and the licensing of Jesse Farm to Lime Lane Livery

32. We did not understand the appellant to disagree that there was a "direct and immediate link" between the Disputed Works and the exempt licensing of Jesse Farm to Lime Lane Livery. In any event, we find that there clearly was such a link.

33. The stables used by the livery business were located in the Barns. We find that as a result of the Barn Repairs (viewed together with the Barn Conversion), the Barns were in a state in which they could be licensed to Lime Lane Livery and used for the purposes of the livery business. We also find that Lime Lane Livery benefited from the Car Parking Works as customers of the livery business could be expected to use the car park.

34. We would expect Mr Kumar to factor in the cost of all the Disputed Works when deciding what level of licence fee Lime Lane Livery should pay the appellant. We have therefore found that all these factors establish that there was a "direct and immediate link" between the Disputed Works and the exempt supply consisting of the licensing of Jesse Farm and indeed that the cost of the Disputed Works was a "cost component" of that licensing.

Egg sales

Did the appellant conduct a business of selling eggs at the relevant time?

35. The witness statement of Ms Sarah Croft included the following paragraphs:

"I can confirm that I sell eggs on behalf of one of Mr and Mrs Kumar's other businesses while carrying out my role as Stable Manager.

I can also confirm that depending on space available the sales take place from the two main barns and that the two main barns are used to store chicken feed and other items and equipment needed to support the egg sales."

36. Ms Croft's evidence is not just hearsay, it is also extremely sketchy. It does not state when the egg sales commenced which is highly relevant since, as noted at [19] above, the ability to credit input VAT on the Disputed Works needs to be considered at the time that VAT was incurred. Nor does it state whether she performs egg sales on behalf of the appellant itself or a company owned by the Kumars.

37. In cross-examination, Officer Atkinson admitted that on his visits to Jesse Farm (which took place in 2013) he had seen hens. However, as he noted, it does not necessarily follow that the appellant was conducting a business of selling eggs when the Disputed Works were carried out.

38. We were shown some photographs of signs, adjacent to what look like stables, advertising "eggs for sale". However, we had no evidence as to when, or indeed where, those photographs were taken. We are prepared to accept that they were taken at Jesse Farm, but have not accepted that they shed any light on the state of affairs at or around the time of the Disputed Works.

39. We noted that on 13 March 2014, Erewash District Council granted planning permission for works described as "Extension to existing chicken shed and chicken run and provision of new chicken run on the west side of the extended chicken shed". We were not referred to any mention of chickens or egg production in the grant of planning permission in 2010. From that we have concluded that planning permission of some kind was needed in order for eggs to be sold at Jesse Farm in the manner, or in the scale, that the Kumars intended, but that the requisite planning permission was granted only in 2014.

40. In the light of the sketchiness of the evidence before us, we have only been able to conclude that the appellant currently carries on a business of selling eggs at Jesse Farm. We have not been able to conclude that the appellant was carrying on that business, or that it had the intention of carrying on that business, when it incurred input VAT on the Disputed Works.

"Direct and immediate link" with egg business

41. Even if we had been satisfied that the appellant carried on, or intended to carry on, a business of selling eggs at the relevant time, we had no evidence as to the nature of any link between the Disputed Works and that business.

42. For example, we have been unable to conclude from the evidence before us that the Barn Repairs related in any way to any part of the Barns used to sell or store eggs. We have therefore concluded that, even if, at the relevant time, eggs were being sold, or there was an intention to sell eggs, there was no "direct and immediate link" between Barn Repairs and taxable supplies made as part of the egg business.

43. However, if we had been satisfied as to the existence of the egg business, or the intention to commence the egg business at the relevant times, we would have accepted that there was a "direct and immediate" link between the Car Parking Works and that

egg business as customers who buy eggs could be expected to park their cars in the car park.

Overall conclusion on egg business

44. We have concluded that there was no “direct and immediate link” between the
5 input tax associated with the Disputed Works and any taxable supplies of eggs either made, or intended to be made.

Car storage

Were cars stored in the Barns?

45. Ms Croft’s witness statement contains the following paragraph:

10 “I can also confirm that during my time as stable manager the barns have been used in the past for the storage of motor vehicles; before the stabling business meant that there was no longer space to do so”.

46. Mr Kumar stated in his own witness statement:

15 “[The weather proofing to the Barns] also meant not only were they ready for future farming use but also current use which has included storage for my associated motor business – cars were temporarily stored there and some minor works were also carried out on them there.”

47. Some photographic evidence was also produced that showed a car parked
20 outside a barn. However, that did not demonstrate whether the interior of the Barns was used for car storage at any point.

48. The evidence of Mr Kumar and Mr Poultney was sketchy: it did not, for
example, confirm when the Barns were used to store cars. That evidence was also not
25 tested in cross-examination. However, Mrs Saxton did not suggest that Mr Kumar or Ms Croft were wrong in saying that the Barns have been used for storing cars. We have therefore found that the Barns were used in this way at or around the time of the Disputed Works.

“Direct and immediate link” between Disputed Works and taxable supplies made in the course of car storage activities.

30 49. We had no evidence before us that suggested that use of the Barns for car storage resulted in the appellant making taxable supplies. Firstly, there was no evidence that the appellant made any charge for use of the Barns. Secondly, even if charges had been made, it seems to us more likely than not that the appellant would be making exempt supplies of a licence to occupy land rather than taxable supplies.

35 50. In addition, we had no evidence before us suggesting a close link between the Disputed Works and the activity of storing cars. Mr Kumar’s statement suggests that the Barn Repairs made the barns “ready” for their “current use” of storing cars.

5 However, he does not explain what benefit precisely the Barn Repairs brought to the activity of storing cars and in fact his statement seems to suggest that the Barns were capable of being used to store cars even before the Barn Repairs were carried out. We did not, therefore, accept his statement as evidence that there was any link between the Barn Repairs and the activity of storing cars.

10 51. Ms Croft’s witness statement suggests that, once the Barns had been converted into stables, the activity of storing cars there ceased. Since the Disputed Works were part of the wider project to renovate the Barns and convert them into stables, that suggested to us that, far from enhancing the ability of the Barns to be used as storage for cars, the result of the Disputed Works was that the Barns ceased to be used for this purpose.

52. We have therefore concluded that there was no “direct and immediate” link between the Disputed Works and any taxable supplies made in connection with the storage of vehicles.

15 **Returning Jesse Farm to use as a working farm**

Did the Kumars intend to return the farm to use as a working farm?

20 53. Mr Kumar stated in his witness statement that “farming is something close to my heart” and we accept this. We also accept that when the appellant bought Jesse Farm in 2008, Mr Kumar had an intention to bring it into use as a working farm at some point. The fact that he commissioned the Report is evidence of this.

25 54. Mrs Saxton suggested that, even if this was Mr Kumar’s original intention, that intention subsequently changed. In support of this she argued that Mr Kumar had failed to maintain milking equipment at Jesse Farm. She also argued that the Barn Conversion works were “permanent alterations” that were inconsistent with Jesse Farm being used as a working farm.

30 55. Despite Mrs Saxton’s submissions, we have concluded that while the works, including the Disputed Works, were being undertaken, Mr Kumar did retain the intention of operating Jesse Farm as a working farm. There was no challenge to the evidence that the Kumars were facing financial difficulties. In those circumstances, we accepted that the establishment of the livery business was the action of a businessman who needed to raise additional income from his assets and did not signal a complete change of intention in relation to Jesse Farm. Moreover, Jesse Farm is a 100 acre site and the use of two barns to stable horses did not strike us as inconsistent with the farm as a whole being used as a working farm. However, while we accept
35 that Mr Kumar retained his intention to operate Jesse Farm as a working farm at some point in the future, we have concluded that the Barn Conversions changed the character and function of the Barns significantly and we discuss the relevance of this in more detail at [58] to [59] below.

56. The submissions regarding the milking equipment did not alter our conclusion. Rather, they seemed to us to demonstrate only that, if Mr Kumar was able to realise his ambition, he would need to repair or replace the milking equipment.

The link between the Disputed Works and the intention to operate Jesse Farm as a working farm

57. Mr Kumar stated in his witness statement that:

“...[T]here were some works required to the buildings which would benefit both the short-term use of the buildings for stabling and the long-term use as dairy barns. The farm and the outbuildings were in some disrepair and needed remedial works just to prevent them from decaying further.”

He also stated that weather-proofing of the Barns meant that they were ready for “future farming use”.

58. However, these statements were vague and did not specify how exactly the Barns would be used for “future farming use”. Following the Conversion Works, the Barns were split into 53 stables. We heard no evidence that suggested that the Barns could be used for “farming use” at the same time as they were licensed to Lime Lane Livery and being used for the livery business. For example, it was not suggested that dairy cows could be kept in the Barns as well as horses. Therefore, we concluded that in order for the Barns to be used for the farming purpose that the Kumars had in mind when Mr Kumar commissioned the Report, the livery business would need either to be shut down or moved to a different part of Jesse Farm and work done to reverse the effect of the Barn Conversions.

59. Mr McClelland submitted that reversing the effect of the works was possible and we accepted this, although we found that it would put the Kumars to some expense as well as loss of revenue if the livery business was shut down. However, we were not satisfied on the evidence before us that the Kumars had an intention to reverse the effect of Barn Conversion if and when they resumed farming at Jesse Farm rather than, for example, using other outbuildings or building new ones.

60. We also noted that the Report made no reference to the need for work to the car parking area. That Report made provision for just £1,200 of expenses under the category of “property repairs”. However, the invoices that Mr McClelland presented at the hearing added up to much more than £1,200 which suggested to us that those invoices were not all in respect of works that had a “direct and immediate link” with future taxable supplies of the farming business. It was not at all clear, even to Mr Perry, the member of the Tribunal, who has years of experience as a surveyor, what goods were represented by these invoices. Therefore, we were unable to find a subset of the invoices in relation to which a “direct and immediate link” with future taxable farming supplies did exist.

61. We have, therefore, concluded that, the appellant has not discharged the burden of proving that there was a “direct and immediate link” between any of the Disputed

Works and the intention to make future taxable supplies in consequence of Jesse Farm being operated as a working farm.

Treatment as an overhead

5 62. In consequence of the findings we make at [34] above, the costs of the Disputed Works are attributable to a particular supply (being the exempt licensing of Jesse Farm). Since those costs are directly attributable to specific supplies, we do not consider they can be regarded as “overheads”.

Decision and conclusion

10 63. In conclusion, we have found that all of the input tax associated with the Disputed Works was directly attributable to making of exempt supplies in the form of the licensing of Jesse Farm to Lime Lane Livery.

15 64. We suspect that this is enough to dispose of the appeal. However, since we were not referred in detail to the calculation of the assessments or invoices relating to the Disputed Works, we are not certain that this is the case. We therefore invite the parties to agree between themselves the effect of our decision on the assessments. If they cannot do so, either party has liberty to apply to the Tribunal within 28 days after release of this decision for further directions.

20 65. 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.

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**JONATHAN RICHARDS
TRIBUNAL JUDGE**

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RELEASE DATE: 8 May 2015