[2015] UKFTT 632 (TC)

TC04765

Appeal number: TC/2013/06417

VAT – INPUT TAX – deduction denied on basis no supply – company formed by owners of property to undertake holiday lettings incurred costs on refurbishment – owners later formed partnership – recharge of refurbishment invoices by company to partnership did not constitute supply of services –knowledge or means of knowledge of fraud not necessary for input tax to be denied – input tax allowed on supply of goods (furniture and other items) from company to partnership – deliberate inaccuracy penalties cancelled – careless inaccuracy penalties upheld – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR E KELLY AND MRS S KELLY T/A LUDBROOK MANOR PARTNERSHIP — **Appellant**

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
REBECCA NEWNS

Sitting in public at the Royal Courts of Justice, London, on 9 November 2015

Timothy Brown, counsel, for the Appellants

Les Bingham, HMRC officer for the Respondents

DECISION

Introduction

1. The appellants run a holiday letting business at Ludbrook Manor in Devon. The appeal relates to the denial of input tax of £93,304.00 on the appellant's 06/13 VAT return in respect of an invoice raised by an associated company Happy Holidays Limited (HHL) to the appellants for upgrading and refurbishment of a property. HMRC argue that the amount is not input tax as no supply had taken place between HHL and the appellants; rather HHL had consumed the building services it had procured. HMRC also denied input tax in the amount of £18,320.16 on various other invoices on the basis that these were made to HHL and not to the appellants.

2. The appellants argue the invoice is prima evidence that there was a supply from HHL to the appellants of project management and that there was such a supply. They further argue that even if there was no supply then the fact remains the appellants were charged VAT on the invoice and that according to the relevant case law they can only be denied input tax if it is established that the appellants knew or ought to have known the transaction was connected with VAT fraud and no such allegation has been pleaded.

3. The appellant also appeals against various penalties for careless and deliberate error totalling £46,238.00.

Evidence and Findings of Fact

4. We received witness statements and heard oral evidence which was cross-examined by the opposing party from Eamonn Kelly and Debbie Franklin, the appellants' tax adviser, on behalf of the appellants, and Raymond Rimes, the HMRC officer who had dealt with the appellants in relation to the matters under appeal on behalf of HMRC. We were also referred to various pieces of correspondence and reports passing between the appellants, their advisors, HMRC and certain invoices. All the witnesses were credible witnesses and from their evidence and the documents before us we were able to make the following findings of fact.

5. The appellants are a partnership which was registered for VAT with effect from 1 April 2013. The partnership's business activity is the letting of part of Ludbrook Manor as holiday accommodation. The appellants have since 8 October 1993 carried out a financial services advisory business (KFM) in partnership with each other.

6. Ludbrook Manor which the appellants had bought in February 2002 consisted of a main manor house and an annex ("the stables"). Having decided to start a holiday-letting business of the stables (the main house being used to accommodate the appellants and their children who were living with them at the time), the appellants, on the advice of their accountant at the time, formed a limited company (HHL), a company of which they were both directors and equal shareholders. The stables were refurbished and consisted of three en-suite bedrooms. By September 2010 the

appellants' children had moved away and the appellants decided to let the entire property (the stables and the manor house which at that time consisted of seven en-suite bedrooms). In order to be let to the target clientèle the manor house had to be extensively refurbished. This included works to increase the capacity from seven to nine en-suite bedrooms. HHL had (Mr and Mrs Kelly maintain on the basis of incorrect advice given to them by HMRC) exercised the option to tax in relation to rent charged by it to KFM which occupied another property adjacent to the house. HMRC disallowed a significant amount of the VAT that had been incurred on the refurbishment and issued an assessment for £45,366 which the appellants say arose out of the implications of the option to tax.

7. HHL was registered for VAT from 1 August 2004 to 14 November 2013. It did not own the property and there was no formal lease or license agreement for HHL to occupy the property. From around 2012 the HMRC officer handling HHL's VAT affairs was Julia Miller.

8. On 4 March 2013 Mr and Mrs Kelly met with Debbie Franklin, a tax partner at Peplows Chartered Accountants. Ms Franklin had carried out work for Blue Chip Holidays, a letting agent with whom Mr and Mrs Kelly were proposing to sign up with and Blue Chip Holidays had referred Ms Franklin on. Ms Franklin reviewed the direct tax implications of the appellant's business structure and advised on the non availability of sideways loss relief against the partnership profits from KFM. In a strategy report sent to the appellants on 12 March 2013 she recommended the formation of a new partnership to undertake the furnished holiday letting. Not being a VAT specialist she informed the appellants in the report that she had consulted with an independent VAT consultant, Dave Brown and asked the appellants if they were content for him to advise the HMRC Officer, Ms Miller of the proposed course of action which was to register the partnership for VAT and "…have [HHL] invoice the new Partnership to recharge all expenditure on Ludbrook Manor (preferably prior to 5 April 2013)".

9. On 28 March 2013 Dave Brown 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…".

10. On 1 June 2013 HHL provided a VAT invoice addressed to Mr and Mrs Kelly t/a Ludbrook Manor Partnership with the heading:

> "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: 1. Obtaining Planning Consent 2. Dealing with and paying the following professional services: Architectural, Structural Engineer, Water Services Consulting Engineer, Planning Consultancy & Building Regulation fees 3. Liaising with Western Power & Distribution 4. Water systems 5. Liaising with, planning and payment to the following providers of electrical renewal and repair work 6. Repair and renewal of the existing floors to the Sitting Room and Drawing room to meet current Building Regs standards 7. Ground maintenance and repairs 8. Pool room 9. Liaising with/design and project management for all the external works to repair and renew the roof structures for all 3 major phases 10. Internal building works 11. Liaising with and payment to suppliers of general sundries necessary to the repairs and renewal work 12. Furniture replacement / supply of linen/ crockery for guests to Ludbrook Manor Partnership Holiday Letting business: liaison with and payment of bills with named suppliers.

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.

13. The figures for completion of the return for the period ended 30 June 2013 were sent to the appellants' representative on 30 June 2013 and then sent to the appellants on 11 July 2013 (the reference in Mr Kelly's witness statement to the date of 11 June 2013 is obviously an error). On 12 July 2013 the appellants filed an electronic VAT return for Ludbrook Manor Partnership for the period 1 April 2013 to 30 June 2013 in which they stated the amount of VAT reclaimed on purchases and other inputs to be £107,861.13. The appellants' claim included a claim for VAT on the invoice referred to above from HHL.

14. On 11 July 2013 HHL was declared insolvent. The output tax for the invoice was not accounted for and the partnership was not mentioned as a creditor in the insolvency report.

15. The VAT return was flagged by HMRC for further checks and on 2 August 2013 Mr Rimes, the HMRC officer assigned to deal with the partnership, visited Ludbrook Manor to meet with the appellants and their representatives Ms Franklin and Mr Brown. Mr Rimes reviewed the partnership's SAGE VAT print-outs dated 10 July 2013 made available to him and was given a tour of the partially renovated manor house. The differences between the amounts on the return and those on the SAGE print outs were explained to Mr Rimes as follows: the input tax on the SAGE

report was £120,196.71; this was due to a private use apportionment being applied to the costs for Ludbrook Manor. Mrs Kelly explained to Mr Rimes that she had erroneously entered an amount for output tax due to a single letting of the incomplete manor which had taken place over Easter 2013 when in fact it had been accounted for prior to Ludbrook Manor Partnership becoming VAT registered on 1 April 2013.

16. In addition to the main invoice above Mr Rimes queried the following:

(1) Input tax of £14,446,67. This related to purchases dated 1 April 2013 on the SAGE print out. Mr Rimes noted two invoices (those in respect of Mr Builder Co. and Signature Pools) in respect of which input tax had already been claimed by HHL. The invoice for Mr Builder Co. was dated 15 October 2012 for work undertaken between 26 September to 25 November of that year and in the amount of £15,000 plus £3000 VAT. The invoice for Signature Pools and Leisure Limited was dated 10 August 2012 for various items relating to problems with a hot tub and was in the amount of £458.07 plus VAT of £91.61. There was one invoice (SJE Building Services) dated 8 March 2013 for nine days work on internal construction of the main house in the amount of £1080 where no VAT had been charged by the supplier.

(2) Input tax of £3783.49 – this related to four sets of invoices which HMRC thought was for work done prior to 1 April 2013 and was proper to HHL:

(a) VAT of £284.90 on an invoice from No 9 Studio UK (M&P Donaldson) dated 27 March 2013 for "2 Celtic Cross Hip End Ridge Finials" and "6 Lozenge Barrel, Castellated (Rain Cap) Chimney Pots was for a total of £4284.00 with VAT of £856.80. It showed a deposit paid already of £3551.40 and balance due (with the addition of an "extra gas surcharge" of £1709.40.

(b) VAT £333.33 on an invoice from Plumbwest dated 14 March 2013 and addressed to Mr and Mrs Kelly, Ludbrook Manor Partnership in respect of labour undertaken on 21, 22, 27 and 28 February and 4-8 March 2013 (£1,670) and materials (pipework, fittings, under floor heating system) amounting to £1,675.52. The total was £3,345.52 plus £669.10 VAT.

(c) VAT £67.26 in relation to a supply from Chris Wright Associates Consulting Engineers – there were two invoices both addressed to Mr and Mrs Kelly and both of which referred to rates charged in accordance with a proposal letter dated 16 June 2011. The first, which was in the amount of £64.00 plus £12.80 VAT was dated 20 February 2013 covered the period 1 October 2012 to 20 February 2013. The second was dated 18 April 2013 and was for £272.30 plus VAT of £54.46.

(d) VAT £3098.00 in relation to supplies from TJZ Building Contractors Ltd. The invoices were dated 22 March 2013 for £8560 plus VAT and 2 April 2013 for £4310 plus VAT and addressed to Mr and Mrs Kelly outlining various amount of days of time for various plasterers, carpenters, general builders and labourers for work carried out at Ludbrook Manor.

17. It was not in dispute that all of the above invoices had been paid for.

18. Mr Rimes was told at the meeting with the appellants on 2 August 2013 that the company was in liquidation but not that it was insolvent. He learned later of the insolvency from HMRC's debt management unit at which time he then obtained details of the insolvency report.

19. In a decision letter dated 15 August 2013 Mr Rimes having sought technical advice from HMRC colleagues came to the view that the claim for input tax should be rejected on the basis that the transaction between HHL and the Ludbrook Manor Partnership was a Transfer of a Going Concern and therefore neither a supply of goods nor of services.

20. Following a request for a review of the decision and further consideration from HMRC policy the above decision was withdrawn in relation to the invoice described at [12] and a new decision was given in a letter dated 9 December 2013 rejecting the input tax claim of £86,704.20 and £6,600.

Law

21. As regards the appellants' right to deduct input tax, Article 168 of Directive 2006/112/EC ("VAT Directive") provides:

> "In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled… to deduct the following from the VAT which he is liable to pay:
>
> (a) the VAT due or paid…in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person…"

22. The Directive provision is implemented into UK law by s24(1) Valued Added Tax Act 1994 ("VATA 1994") which provides so far as relevant:

> "(1) … "input tax", in relation to a taxable person, means the following tax, that is to say—
>
> (a) VAT on the supply to him of any goods or services
>
> …"

23. Section 5(2) VATA 1994 states:

> "(a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration;
>
> (b) anything which is not a supply of goods but is done for a consideration … is a supply of services."

24. The provisions relevant to the penalties in this appeal are set out in Schedule 24 of the Finance Act 2007 ("FA 2007"). Paragraph 1 of FA 2007 provides where relevant :

"Error in taxpayer's document

1—

(1) A penalty is payable by a person (P) where—

(a) P gives HMRC a document of a kind listed in the Table below, and

(b) Conditions 1 and 2 are satisfied.

(2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to—

(a) an understatement of a liability to tax,

(b) a false or inflated statement of a loss …, or

(c) a false or inflated claim to repayment of tax.

(3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part."

25. The documents mentioned in the Table as regards VAT include a VAT return under the regulations made under paragraph 2 of Schedule 11 VATA 1994, and a return statement or declaration in connection with a claim. The Table also refers in respect of any of the taxes mentioned in the Table (which include VAT): "Any document which is likely to be relied upon by HMRC to determine without further inquiry a question about – (a) P's liability to tax…or (d) repayments, or any other kind of payment or credit, to P."

26. Paragraph 3 of Schedule 24 deals with degrees of culpability and provides that an inaccuracy in a document given by "P" to HMRC is careless if "the inaccuracy is due to failure by P to take reasonable care".

27. Paragraph 4(2) sets out that the relevant penalty amounts for careless action and deliberate action as respectively 30% and 70% of the "potential lost revenue" which is defined in paragraph 5(1) as "the additional amount due or payable in respect of tax as a result of correcting the inaccuracy…".

28. Paragraph 10 provides for reductions of penalties where a person discloses an inaccuracy. The penalty amount is also dependent on whether the disclosure is "unprompted" or "prompted" with, in the case of 30% penalties, a minimum of 15% for prompted disclosure and a minimum of 0% for unprompted disclosure, and in the case of 70% penalties a minimum of 35% for prompted disclosure and 20% for unprompted disclosure. The terms "prompted" and "unprompted" are defined in Paragraph 9(2) as follows:

"Disclosure—

(a) is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy, the supply of false information or withholding of information, or the under-assessment, and

(b) otherwise, is "prompted"."

29. Paragraph 9(1) provides that a person discloses an inaccuracy by-

> "(a) telling HMRC about it,
>
> (b) giving HMRC reasonable help in quantifying the inaccuracy…, and
>
> (c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy… is fully corrected."

30. Paragraph 10(1) requires that where the person has made a disclosure HMRC must reduce the standard percentage (i.e. in this case the 70% figure or the 30% figure) "to one that reflects the quality of the disclosure". "Quality" in relation to disclosure is defined in paragraph 9(3) as including "timing, nature and extent".

31. Paragraph 11 enables HMRC to reduce a penalty because of special circumstances and paragraph 14 enables it to suspend all or part of a penalty if compliance with a condition of suspension would help the person on whom the penalty is imposed to avoid becoming liable to further penalties for careless inaccuracy. Under paragraph 17 which sets out the Tribunal's powers on a penalty appeal, the Tribunal may affirm or cancel HMRC's decision that a penalty is payable and on an appeal against the amount of the penalty payable the Tribunal may affirm HMRC's decision or substitute for HMRC's decision another decision that HMRC had power to make.

The penalties imposed on the appellants

32. Five penalties were charged which were notified to the appellants in a letter dated 14 February 2014. Three penalties (in the amount of £39,450.77, £3,003.00 and £231.84) concern behaviour which is considered by HMRC to be deliberate. Two of the penalties (in the amounts of £2,817.10 and £737.78) relate to behaviour which is considered by HMRC to be careless. All penalties were calculated by HMRC on the basis that the disclosure was prompted.

33. The penalties of £39,450.77 and £3,003.00 relate to respectively the services and fixtures amounts recharged on the June 2013 invoice. Both penalties were reduced by the maximum for "helping" (30%) and "giving" (40%) as "full access was given to the records of this registration to establish the quantum of the error". Mr Rimes did not give any reduction for "telling" as according to him the insolvency of HHL was not initially disclosed to him and because there had been no admission of culpability or error on the part of the appellants.

34. The penalty of £231.84 related to the appellant's repayment claim for the period 09/13 which Mr Rimes investigated while the enquiries of the 06/13 claim were ongoing. Mr Rimes' evidence was that a routine request had been made to see the six highest value purchase invoices and the SAGE VAT report for the period on 20 November 2013 and that he received copies of the documents with an e-mail of 26 November 2013. He raised further queries in respect of the relevant business purpose of two of the invoices (Frost-Wilshire and Cutec computers). Despite reminder e-mails he did not get any response to his queries and the repayment claim was reduced

by £737 to cover the queried invoices and the balance repaid on 28 January 2014. Mr Rimes decided to impose a penalty for deliberate behaviour. He considered that the partners were experienced in the preparation of VAT returns and in HMRC's repayment and return verification process and he came to the view that the failure to respond to HMRC could not be considered reasonable behaviour. Nor could the failure to respond be considered as "careless" according to him as two reminders were issued and "a total of 69 days elapsed before a decision to reduce the claim was made". In calculating the penalty he gave a full reduction for helping as HMRC had already quantified the error but no reduction was given for "telling" or "giving" as there had not been any further assistance or communication from the appellants regarding the invoices in question.

35. The penalties for £2,817.00 and £737.78 relate to invoices in respect of construction services which although appearing in the appellants' SAGE records were services which were supplied to HHL rather than the partnership and which should not, in HMRC's view, have been claimed as input tax of the partnership. Mr Rimes' view was that the appellants cannot have taken reasonable care in presenting these invoices as opening liabilities of the partnership as all the costs prior to that date had been incurred by HHL. He reduced the penalty charges in full to take account of giving access to documents and helping because the full quantum of the error was established from the outset of HMRC's enquiries. He did not give any reduction for "telling" as according to him "details of the full extent of the situation" were withheld at the initial meeting and no admission of any culpability had ever been received.

Parties' submissions

36. HMRC argue no supply took place between HHL and the appellants; the building services procured by HHL were consumed by HHL in its business and could not be sold to the appellants. They point to the fact there was no corresponding output tax declared by HHL and that its insolvency report did not reflect the invoice issued.

37. In relation to the other invoices these related to transactions during the period when HHL was still trading and some were for invoices which were claimed already. The appellants say they were invoiced for the supplies which they used or they were going to use for their business purposes and that they had paid for them.

38. The appellants submit activities of an economic nature are subject to VAT and that the terms which define taxable transactions are objective and apply without regard to the purpose or results. HHL supplied services as a taxable person to the appellants for which the appellants gave consideration.

39. As regards the penalties the appellants argue that if the tribunal finds against them on their arguments above then the level of penalty is too high as they dispute that any inaccuracy is deliberate or that their disclosure was prompted as HMRC maintain.

Discussion

Invoice of 1 June 2013 –input tax of £86,704

40. The entitlement of the appellants to repayment of input tax in respect of this invoice turns on whether there was a supply from HHL to the partnership. As pointed out by the appellant (referring to *Apple and Pear Development Council v CCE* (Case 102/86) STC 221 at 237) there must be a taxable supply and a direct link between the taxable supply and the consideration received by HHL. It is not in dispute that HHL received a reduction in the appellants' directors' loan accounts with HHL. However, the difficulty raised by the facts of this case is that of being satisfied as to what exactly it was the payment was in return for. For the reasons explained below we were not persuaded the services of project management and liaison were provided in return for the payment. Nor were we satisfied that the recharge of invoices on the facts of this case could amount to a supply of service.

41. The appellants points to (1) the fact that the ECJ has consistently held that activities of an economic nature carried out by a taxable person are subject to VAT (*MKG* Case C-305/01 at [39]-[42]) (2) that the scope of "economic activities" is very wide, and is objective in that it considered without regard to its purpose or results (*Optigen* Case C-354/03)) 3) The deduction system is meant to relieve the trader entirely of the burden of VAT payable or paid in the course of all his economic activities (*European Community Commission v France* (Case 50/87).

42. In *MKG* the issue (as interpreted by the court at [37]) was whether factoring transactions whereby a factoring company purchased debt and assumed the risk of the debtor defaulting fell within the application of Council Directive 77/388/EEC ("the Sixth Directive") so that the factoring company had an entitlement to deduct input tax. At [39] by reference to Articles 2 and 4 of the Sixth Directive the court noted, as highlighted by the appellant, that "only activities of an economic nature, carried out within the territory of the Member State by a taxable person acting as such are subject to VAT". At [41] it noted the concept of "economic activities" as defined encompassed " "all" activities of producers, traders and persons supplying services…" and at [42] "that in accordance with the Court's settled case-law, Article 4 of the Sixth Directive confers a very wide scope on VAT, comprising all stages of production, distribution and the provision of services."

43. The appellants also argue their case is analogous to *Serebryannay vek EOOD* (Case C-283/12) where a supply of fitting out and furnishing of a property by a tenant which was returned to the owner at the end of the contract amounted to a supply of services for consideration by the tenant. The appellants argue this case shows that construction works paid for by a third party can be supplied onward to the landlord if there is consideration because the landlord takes the benefit of the property ultimately. The CJEU's decision establishes that supply of fitting out and furnishing falls within a supply of services for consideration: – the appellants there received a supply of construction services from a supplier which had itself been supplied with the services and which it had intended to be used in the course and furtherance of its own business.

44. HMRC argue the case can be distinguished on the basis that all the relevant parties were in existence at the same time whereas in this appeal the partnership did not exist when the construction works were supplied.

45. The reference in *Serebryannay* as interpreted by the CJEU concerned (as set out at [36]) whether Article 2 (1) of the VAT Directive (which lists "the supply of services for consideration…by a taxable person acting as such" as a transaction which is subject to VAT):

> "…is to be interpreted as meaning that a supply of services to fit out and furnish an apartment must be regarded as having been carried out for consideration if, under a contract concluded with the owner of that apartment, the supplier of those services, 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."

46. The court answered the question in the affirmative having noted at [37] to [39] :(1) the requirement for a direct link between the supply and consideration and that 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, (2) that a supply of services in exchange for another supply of services could constitute the taxable amount provided the value could be expressed in monetary terms and (3) that barter contracts and transactions where the consideration was in money were the same economically the same.

47. The concept of supply of services is undoubtedly broad (as can be seen from the scope of s5 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.

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 (putting aside the particular time period discussed below) 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.

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.

50. While there is some dispute as to when the partnership came into existence HMRC accept it existed from 1 April 2013 so on any view there is a period during which both the partnership and HHL were in existence. We find below that in fact the partnership started earlier. However, although the invoice states that it relates to the work done over the period 1 August 2009 to the present date (being at that time 1 June 2013) we were not referred to any particular invoices in this period which were incurred in the name of HHL in respect of which HHL was providing project management services. It may be surprising if that was the case because the advice from the appellants' tax advisers was for future invoices to be raised in the name of the partnership. There is accordingly no factual basis upon which we can find that recharges of invoices in this period comprised a supply from HHL to the partnership upon which input tax could be reclaimed.

51. As regards the so called recharge of invoices, even taking account of the broad way in which supplies are defined 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. Indeed in *MKG* referred to above the ECJ went to the trouble of articulating what exactly the service consisted of, identifying at [49] of its decision, that the factor who purchased debts owed to his client without enjoying a right of recourse against the client if the debtors defaulted "indisputably supplies a service to the client, consisting essentially in relieving [the client] of the debt-recovery operations and of the risk of the debts not being paid."

52. Mr Brown, for the appellants, drew attention to the fact HMRC must initially have been satisfied that there was a supply in order for the Transfer of Going Concern argument to be relevant. This does not assist the appellant's case. The fact HMRC thought at one point there was a supply does not mean there was a supply.

53. Given the arguments made by HMRC, we should point out that our reasoning does not rely on the absence of output tax in the insolvency report or on any VAT return of HHL. While those factors are consistent with there not having been a supply they are not conclusive as if there was a supply output tax would nevertheless be due even if the VAT return of HHL omitted it and even if there was no mention of it in the insolvency report.

Entitlement to deduct input tax even if no taxable transaction as no pleading of knowledge / means of knowledge of fraud

54. The appellants argue that even if there is no taxable supply then unless HMRC can show the appellant knew or should have known that the transaction was connected to VAT fraud (which HMRC cannot do as they have not suggested or pleaded their case in that way) the input tax cannot be denied. For this proposition the appellant relies on the CJEU case of *Stroy Trans EOOD* (Case C-642/11).

55. The context of the referral in that case was a refusal of input tax deduction on invoices for the supply of diesel fuel where the tax authority took the view there was no actual supply of fuel and in circumstances where the VAT declared by the issuer of the invoice had not been adjusted by the tax authority. As set out at [30] the referral as interpreted by the court concerned:

> "whether the principles of fiscal neutrality, proportionality and the protection of legitimate expectations must be interpreted as precluding the recipient of an invoice from being refused the right to deduct input VAT even though, in the tax adjustment notice addressed to the issuer of that invoice, the VAT declared by the latter was not adjusted."

56. The court ruled that the above principles did not preclude the refusal of input tax deduction in such circumstances. It went on to state in its ruling:

> "However, if, in the light of fraud or irregularities, committed by the issuer of the invoice or upstream of the transaction relied upon as the basis for the right of deduction, that transaction is considered not to have been actually carried out, it must be established, on the basis of objective factors and without requiring of the recipient of the invoice checks which are not his responsibility, that he knew or should have known that that transaction was connected with VAT fraud, a matter which it is for the referring court to determine."

57. HMRC seek to distinguish the situation in *Stroy Trans* on the basis that it applies where the parties are not connected whereas in this case the appellants were on both sides of the transaction. There is nothing in the court's reasoning however to suggest that the fact of connection between the issuer of the invoice and the recipient would of itself have made a difference to the court's conclusion. (The fact a recipient and issuer are connected might of course be relevant to the question of knowledge of fraud or means of knowledge.)

58. Having said that, we reject the appellants' argument that their input tax reclaim must be accepted on the basis of this case. The court's ruling in *Stroy Trans* which refers to a transaction relied upon for the input tax claim not being considered to have been "actually carried out" applies to situations of "fraud or irregularities, committed by the issuer of the invoice or upstream of the transaction". The decision refers to situations where *because of* fraud or irregularities so committed a taxable transaction purporting to have taken place has not taken place. In that context it can well be seen, given the familiar case-law of the CJEU (referred to at [48] of it decision i.e *Optigen* and *Kittel* (Cases C-439/04 and C-440/04) that the question of knowledge or means of knowledge of fraud become relevant. What the court's ruling in *Stroy Trans* does not

extend to in our view are situations such as the current one where a transaction is carried out but the question is the proper characterisation of the transaction for VAT purposes. In such a case there is no fraud or irregularity which has been committed by reference to which the question of knowledge or means of knowledge may be applied. The fact HMRC have not pleaded knowledge of fraud or means of knowledge is therefore irrelevant; it does not mean the appellants are entitled to a deduction of input tax despite the conclusion we have reached above that there was no taxable supply of services.

59. We note in passing that this conclusion is consistent with that reached in the FTT (Judge Brannan and Shameem Akhtar) in *Global Cellular Limited v HMRC* [2015] UKFTT 226(TC) (see [331]-[348]). That case considered a statement at [34] of the CJEU's decision in *LVK-56 EOOD* Case C-643/11 in identical terms to the ruling described above by the CJEU in *Stroy Trans* and came to view, after performing a detailed analysis of the CJEU's case law, that the application of the *Kittel* test as applied in *LKV* was limited to circumstances where the only evidence which leads the national authorities to deny the deduction for input tax on the basis that the supply did not take place is that of fraud or irregularities of the supplier.

Invoice for "fixtures and fittings"- VAT claim of £6,600 on amount of £33,000

60. In relation to the part of the invoice for "fixtures, fittings and equipment" while HMRC say that Mr Rimes did not see the goods and the detail of them was not provided, we are satisfied from Mr Kelly's evidence that purchases of such goods were made by HHL. While HMRC's case appears to be that no goods were supplied from HHL to the partnership we are satisfied that a variety of goods were supplied (such as replacement furniture including settees, bedding, crockery, knives). (Mr Rimes' tour of the premises had not included the Stables annex where the items were stored according to the appellants). As the appellant has pointed out HMRC have not argued the invoice does not meet the criteria of Regulation 14(1)(g) VAT Regulations 1995 (that the invoice's particulars should include "a description sufficient to identify the goods or services supplied").

Other invoices

61. The parties disagree as to when the partnership came into existence and whether this was 1 April 2013 or earlier on from 12 March 2013 following the recommendation of Ms Franklin to form a partnership due to the fact that invoices dated in March were addressed to the partnership and because the error in relation to output tax as explained at the meeting with Mr Rimes had stemmed from the partnership not being VAT registered at the time of the Easter letting in March, not because the partnership did not exist. On the other hand Mr Kelly agreed in cross-examination that the partnership was formed on 1 April 2013.

62. As the appellant points out pre-registration input tax may still be claimed as input tax under Regulation 111 of the VAT Regulations 1995. However as we explain below little turns on dispute on the relevant date as on either view performance of the supplies took place at times which pre-date the existence of the partnership.

Rejection of £14,446.67

63. It is clear that at least in relation to one invoice input tax had already been claimed, and that in relation to others that they referred to performance which had taken place at a time when the partnership not in existence. The invoices referred to comprise a large proportion of this amount. We were not referred to the supporting invoices which suggest the work was done at the time the partnership was in existence and for the partnership. There is insufficient evidence to be satisfied the invoices were incurred for the partnership.

Rejection of £3,783.49

64. While an invoice addressed to the appellant is prima facie evidence by definition that means it can be displaced. If at the time the goods were delivered/ the service performed the partnership was not in existence then the partnership cannot be the recipient of the supply even if the invoice is addressed to the partnership. The question is not about the appropriate time of supply but whether a supply was made to the partnership in the first place. There is insufficient evidence before us upon which to make a finding that the services / goods referred to at [16(2)] above were supplied after the earliest date the partnership was formed (12 March 2013).

Penalties

65. In relation to penalties imposed on the basis that the inaccuracy was deliberate it is for HMRC to show that the appellants claimed input tax knowing that they were not entitled to do so.

66. In relation to behaviour which is careless (due to failure by the person to take reasonable care) we were referred by the appellant to the test in *David Collis v HMRC* [2011] UKFTT 588 (TC) where at [29] it was considered that the standard by which reasonable care is to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question.

67. The relevant legislation stipulates that a disclosure is unprompted "if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy…and otherwise is prompted". This test is an objective one according to *United European Gastroenterology Federation* [2013] UKFTT 292 (TC).

68. Given our conclusion above that the appellants were entitled to input tax in respect of the VAT of £6,600 on the invoice of 1 June 2013 referring to goods, there was no inaccuracy in respect of that amount of reclaim and the related penalty of £3,003.00 falls to be cancelled. We discuss the remainder of the penalties in the following section.

Penalty of £39,450.77 - 1 June 2013 invoice

69. In furtherance of their submission that the inaccuracy was deliberate, HMRC maintain the appellants claimed input tax knowing that output tax had not been

declared and would not be paid on the invoice. However whether or not that was the case is irrelevant in our view; the inaccuracy stemmed from a claim in the return for input tax when no entitlement to input tax was due. Knowledge of the fact that output tax was not declared by the supplier would not necessarily mean input tax was not due (in that there could still be a liability to output tax even if it was not declared, and even if it was declared but not paid). The deliberate behaviour which is relevant is whether when claiming input tax the appellants knew they were not entitled to claim it because there had been no supply. We are unable to find that was the case. Having received the advice they did from Mr Dave Brown as part of the package of advice received from Ms Franklin we find the appellants made the claim on the understanding (wrongly it turns out given our conclusions above) that they were entitled to make it on the basis of the June 2013 recharge invoice. We do not accordingly find the inaccuracy was deliberate. Although HMRC, (Ms Mills) had indicated they disagreed the appellants thought the advice they received was correct.

70. While the Tribunal is able to substitute a decision which HMRC had power to make and we have therefore considered whether the penalty could be sustained on the basis that the inaccuracy was careless, in our judgment a penalty decision on this basis should not be made. It was reasonable in our view for the appellants to follow the advice of a chartered accountant who had been referred to them as a specialist in the area and who had acknowledged her inability to give indirect tax advice and who had therefore engaged a VAT consultant. It should also be noted that underpinning Ms Mills' disagreement with the appellant's proposed recharge was a concern that the amounts sought to claimed for had already been claimed by HHL. However there was insufficient evidence before us to find as a matter of fact that that was indeed the case in relation to the amounts comprised within the recharge invoice. Further, it was we think open for the appellants to follow the advice of their advisers even though the HMRC officer had indicated she had disagreed with it. In choosing to go down the path recommended by their advisers we cannot find that the care the appellants took fell below that of a reasonable and prudent taxpayer in the position of the appellants. (The provisions in Paragraph 3(2) of Schedule 24 FA 2007 which treats the inaccuracy as careless do not apply as the relevant specified circumstances are not made out in that the appellants did not discover the inaccuracy at some later time.)

Penalties based on careless behaviour (£2,817.10 and £737.78)

71. In relation to the penalties for £2,817.10 and £737.78 we are satisfied the relevant errors did arise from a failure on the part of the appellants to take the reasonable care that a prudent and reasonable taxpayer in the position of the appellants would have taken. This is clearly apparent in relation to making a claim in respect of invoices where input tax had already been claimed before by HHL. In relation to invoices where the services had been performed for HHL at a time when the partnership was not in existence and which were not the subject of the recharge invoice in relation to which the appellants had received specific advice it would we think have been apparent to a reasonably prudent taxpayer that there would be doubts as to the basis upon which such amounts could be claimed. There is no evidence as to the appellants having sought advice on these invoices.

72. The appellants take issue with HMRC's conclusion that the disclosure was prompted. HMRC's case is based on the fact that the appellants were aware in advance that Mr Rimes was going to visit them so any error that was found was found once the visit was arranged. The appellants argue however that the disclosure took place earlier in 28 March 2013, that HMRC knew the appellants were going to put it on their return and therefore a penalty calculated on the basis that disclosure was prompted was not appropriate.

73. We agree with HMRC however that the disclosure was prompted and reject the argument that Dave Brown's e-mail of 28 March 2013 amounted to disclosure in that in order for there to be a disclosure of an inaccuracy there must first have been an inaccuracy. The disclosure that took place did so at the meeting on 2 August 2013. The appellants knew in advance that meeting was going to take place and also that it would cover the subject of the input tax claim. At the time the disclosure took place we find that the appellants had reason to believe that HMRC were about to discover the inaccuracy.

74. In relation to a reduction for "telling" Mr Rimes took issue because he says Mr and Mrs Kelly were not open about the state of HHL and the payment of output tax. He did not give a reduction because he says the "full extent of the situation was withheld at the initial meeting and no admission of any culpability has ever been received."

75. Mr Brown, for the appellants, submits there is nothing in the legislation's reference to "timing, nature and extent" of quality of disclosure which requires a person to accept they had made an error (thereby foregoing the ability to argue that there was no error). The appellant says it should get the maximum amount of mitigation – they went along to meeting, they discussed the fact HHL went into liquidation, they assisted the officer and provided documents.

76. While we agree HMRC may require too much if, without regard to the particular circumstances of the error, they require an admission of liability in order for there to be "telling", we are not satisfied that the disclosure of the fact HHL had gone into liquidation amounted to telling HMRC of the inaccuracy. As indicated above we query whether those matters are relevant to the error which gives rise to these particular penalties. The inaccuracy stems from filling out the claim for input tax when this was not due because the input tax was claimed before by HHL or because the supply was to HHL rather than to the appellants. Mr Rimes' reluctance to give a full reduction seems to us to speak to the disclosure around the insolvency of HHL which is not relevant to the inaccuracies which form the subject of the penalty. As set out above we do not see that non admission of culpability can of itself necessarily be a bar to being able to access a full reduction for disclosure. Having regard to the circumstances of the error the appellants provided all the information they reasonably could. Our decision therefore is that there is no reason why the maximum reduction should not be applied.

77. HMRC considered whether a special reduction should be applied but reached the view it should not. In relation to suspension they considered this was a one off

event and therefore not appropriate for suspension. We received no submissions from the appellant on these points and we see no reason to interfere with those conclusions.

78. Recalculating the penalty therefore at the minimum of 15% the penalty amounts are respectively £2,167.00 and £567.52.

The 09/13 deliberate behaviour penalty

79. HMRC stated the relevant behaviour as follows in their penalty explanation:

> "You claimed two items as input tax but, when asked to provide evidence to verify the claim failed to do so within a reasonable time, despite several reminders.
>
> When eventually received, the documents showed the claim was incorrect in respect of items not relevant to this business; since you had been subject to a number of such validation checks previously and are well aware of the rules for claiming input tax, we can only conclude that there was a deliberate attempt to claim input tax incorrectly."

80. Mr Kelly's evidence was that one invoice was claimed in the mistaken belief the services provided related to his accounting function and the other arose from a failure to allocate for partial exemption purposes and as the appellant points out he was not challenged by HMRC on the point.

81. In our view a penalty imposed on the basis the inaccuracy was deliberate cannot be upheld. We had insufficient evidence before us to make findings as to the previous validation checks or the appellant's level of knowledge as to the making of input tax claims in the context of partial exemption allocations. We are not satisfied from the evidence that HMRC has brought forward that it has shown that the appellants knew when they were claiming input tax in respect of the invoices that they were not entitled to do so. We therefore reject HMRC conclusion the inaccuracy arose from the appellants' deliberate behaviour. However in our view the behaviour was careless in that the appellants did not we think take the care that reasonably prudent taxpayers would in the appellants' position by checking the accuracy of their figures. There is no evidence for instance that advice was sought or relied upon in making this claim.

82. As set out above the penalty range for careless penalties is 15% to 30%. Although HMRC may have expected too much in requiring admission of liability in order to be satisfied as to "telling" there is no evidence the appellant told HMRC about the inaccuracy and no reason in our view to depart from the percentage of 40% that HMRC have applied. No explanation was given for the failure to respond to the further queries that Mr Rimes raised and in view of that there is no reason for further reducing the percentage. Applying the reduction of 40% to the difference of 15% (between the range 15-30%) gives 24% which results in a reduced penalty in the amount of £99.36.

83. We did not receive any submissions in relation to any of the penalties as to reductions for special circumstances or HMRC's decision not to suspend the

penalties. There is nothing in the circumstances of this case which would cause us to question the conclusions reached.

Conclusion

84. HMRC's decision to refuse input tax is upheld to the extent it relates to VAT of £104,934.16 (the total of the VAT amounts of £86,704.20, £14,446.67 and £3,783.49 considered above) on the basis that there was no supply of services between HHL and the appellants. Input tax of £6,600 is however allowed in respect of the supply of goods that took place. The penalty of £3,003.00 in relation to that element of claim is cancelled. The penalty of £39,450.77 for 06/13 is cancelled as we are not satisfied the inaccuracy which gave rise to it was deliberate or indeed careless.

85. As regards the penalties charged for careless inaccuracy for 06/13 the penalty of £2,817.10 is reduced to £2,167.00 and the penalty of £737.78 is reduced to £567.52. The deliberate inaccuracy penalty in relation to 09/13 of £231.84 is reduced to £99.36 on the basis the inaccuracy was careless rather than deliberate.

86. 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.

SWAMI RAGHAVAN

TRIBUNAL JUDGE
RELEASE DATE: 3 December 2015