[2019] UKFTT 183 (TC)

TC07033

Appeal number: TC/2017/02681

VALUE ADDED TAX - Input Tax - invoice from an associated business to another business - same owner and sole director - whether a supply and a continuous supply - yes- amounts incurred in connection with a residential property - whether de minimus reclaim allowable - yes. Value Added Tax Act 1994, sections 24, 25, 26 and 29 and Part II - Value Added Tax Regulations 1995, regulations 99, 100, 101, 105A, 106, 106 ZA, 106A and 107 - VAT Notice 706, Partial Exemption, section 11 - Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

COMPUTATIONAL STRUCTURAL MECHANICS LIMITED — **Appellant**

- and -

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

TRIBUNAL: JUDGE W RUTHVEN GEMMELL WS
MEMBER SUSAN STOTT FCA

Sitting in public at Edinburgh on 19 February 2019

Philip Simpson QC for the Appellant

Lloyd Ellis, Litigator, for HMRC, for the Respondents

DECISION

1. This is an appeal by Computational Structural Mechanics Limited ("CS") against a decision by HM Revenue & Customs ("HMRC") to disallow a total of £18,683.19, or in the alternative £17,747.14, claimed as input tax on CS's 03/16 VAT return. This comprised of a claim for input VAT relating to goods and services supplied to CS, £12,000.00 of which related to an invoice from an associated company, Linear & Non-linear Structural Dynamics Limited ("LD").

2. HMRC's decision to disallow this claim was based on the belief that when companies with a common director supply services to each other there is not a vatable supply as the other company could have supplied the services itself.

3. The remainder of the disallowed amount related to amounts incurred in connection with two residential properties which CS claims is allowable under the *de minimus* rule for accounting period ended 31 March 2016. HMRC claimed that the accounting period should be shorter, due to the fact there was a change in the VAT period, and as there was no continuous supply, and as they had disallowed the £12,000 payable by LD, the *de minimus* test was not met.

4. Evidence was given by Dr Khaled El-Deeb ("KED"), the sole shareholder in and director of both CS and LD, and by Hugh McCauley ("HM"), a VAT Compliance Officer/Inspector and Officer of HMRC. Both witnesses were credible and gave reliable evidence and were examined and cross-examined.

5. The Tribunal had before it a bundle of documents which included the notice of appeal.

Legislation

Value Added Tax Act 1994 (VATA), Sections 24, 25, 26 and 29 and Part II

Value Added Tax Regulations 1995, Regulations 99, 100, 101 105A, 106, 106 ZA, 106A and 107

VAT Notice 706, Partial Exemption, section 11

Case referred to

The Withies Inn Limited [1996] Lexis Citation 851

The Facts

6. CS was incorporated on 4 October 2001 and was formed to provide "engineering related scientific and technical consulting activities" as defined in Companies House Standard Industrial Classification (SIC) code reference 71122. LD was incorporated on 22 March 1995, commenced trading on 4 April 1995 and was formed to provide "technical testing and analysis" as defined in the Companies House SIC code reference 71200.

7. It was explained to the Tribunal that "verification" is concerned with identifying and removing errors in a theoretical model by "comparing numerical solutions (computational methods) to analytical or highly accurate benchmark solutions" and that "validation" is concerned with "quantifying the accuracy of the theoretical model by comparing numerical solutions to experimental data".

8. It was further explained that the type of work carried out by CS and LD involved ensuring that the software for analysis produced the correct answers and is used in civil engineering, offshore structures and automotive and marine structures and installations. There is a differentiation between testing a physical structure and testing a scaled-down model. As it is not always possible to test a real structure for, say, events such as explosions, then software is developed which provides a numerical model to which can be applied loading events, which are generally stress testing factors.

9. Once the software has been tested or verified and found to provide a good correlation/correct answers then it can be validated and then used on full-scale structures. An example given was underwater storage tanks for storing liquid gas.

10. When LD was created its main activity was verification and it acted as a consultant to QinetiQ between the period April 1995 to September 2001 in relation to the marine industry "in the field of numerical analysis, which included the evaluation (verification and validation) of computational (numerical) methods of software tools for fluid structure applications using physical testing and analytical methods".

11. From the period September 2001 until April 2003, CS provided consulting services to QinetiQ "in the field of 'Numerical Modelling' relating to the structural integrity and performance of real full-scale structures using computational methods and software tools that had been verified and validated".

12. In October 2005 until March 2010, CS provided consulting services to Atkins in the field of "Advanced numerical modelling". These services included "the prediction of offshore structures to extreme environmental and accidental loading events using advanced computational methods and software tools".

13. From April 2010 until July 2011, LD provided consulting services to Atkins in the field of "computational mechanics". The services included testing Atkins's in-house developed software for numerical model conversions between various structural analysis software tools for offshore structures.

14. From July 2011 until 31 March 2015, CS provided consulting services to Atkins in the field of "development of advanced numerical modelling procedures for offshore structures". These services included the prediction of offshore structures to extreme environmental and accidental loading events using the current state-of-the-art advanced computational methods and software tools that had been identified separately by LD using verification and validation tests.

15. KED confirmed in evidence that the work of CS for Atkins in this period involved structural analysis and that the computational methods and software tools

used was primarily a third party program not belonging to Atkins *called ABAQUS*. This program enables the simulation of offshore structures with extreme environmental conditions.

16. KED gave evidence that the work by LD on ABAQUS was continuous including up to the date of the hearing as this program was released every year with new changes which had to be tested. Evidence was also given of a payment which was made and received of £40,000 in the accounts of both LD and CS for the period ended 31 March 2016 with a note that this was a supply by the former to the latter.

17. KED explained that the reason to set up CS was to provide consulting services to Atkins and a different company was needed primarily because of the different SIC code references that needed to be applied to each company but also, as a consequence of that, the different levels of risk attaching to the different activities, particularly in relation to mortality risks in relation to CS and, accordingly, the different insurance arrangements required in light of that.

18. Consequently, KED had two companies with, in simple terms, LD testing software and CS engineering consultancy. At different times CS did not need LD to carry out work as the industry software was available, or the companies, whom CS was working for, had their own software, which had been tested elsewhere.

19. It was explained that during the July 2011 to March 2015 contract with Atkins, CS had identified some shortcomings and suggested that better tools were used to provide more accurate results. As this involved new software tools each of these had to be tested and this work was contracted to LD.

20. It was further explained that there was a secondary reason which related to the contract between CS and Atkins. This contract provided that the intellectual property rights (IPR) in any work that CS carried out for Atkins would belong to Atkins. Consequently, in addition to the reasons noted above such as the SIC reference codes, the different activities and the different insurance arrangements there was also a logical reason for LD to be used in effect as a contractor to CS so that the IPR in the work subcontracted to LD would not pass to Atkins but instead remain with LD.

21. KED stated that he acquired a Bachelor of Science degree in 1985, a PhD from the University of Edinburgh in 1990 and in December 1996, while working for LD and before CS was incorporated, he was certified as a Professional Simulation Engineer at an advanced level by NAFEMS, (the International Association for the Engineering Modelling, Analysis and Simulation Community), a not-for-profit organisation established to improve the status of all persons engaged in the use of engineering simulation.

22. LD has always carried out and is still performing verification and validation of computational methods and software tools using public domain published test data and analytical results. This process is necessary to keep up to date with the current state-of-the-art computational methods and software tools. Accordingly, the cost of

relevant training courses had been borne by LD, as well as the cost of NAFEMS accreditation.

23. Expertise gained by LD was used by CS to gain work in the area of structural integrity assessment and there had been several transactions over a number of years between LD and CS which had been reflected in the VAT returns of both companies submitted to HMRC, and without enquiry by HMRC until 2016.

24. The accounts for LD and CS for the periods ended 31 March 2014, 31 March 2015 and 31 March 2016 showed corresponding "related party disclosures" noting "the provision of management services or the receipt of management services" and the appropriate amounts charged.

25. In relation to the sum disallowed and the subject of the appeal there was no evidence of any contract between LD and CS and no timesheets evidencing the amount of time expended by KED in his capacity as a director of LD.

26. The only evidence was an invoice dated 1 January 2016 from LD to CS with the following description "To Fee the provision of consultancy services in relation to work done in the period 1 April 2014 to 31st March 2015" in an amount of £60,000 to which VAT at 20% was added making a total of £72,000.

27. KED explained that the nine month gap between the conclusion of the work on 31 March 2015 to the issuing of the invoice on 1 January 2016 was "what was usually done". KED stated that, similarly, in relation to the services provided in the 12 months to 31 March 2013 and 31 March 2014, the relevant invoices would have been dated approximately nine months later. None of these invoices were before the Tribunal. KED said that he dealt with accounting matters towards the end of the year which was when he calculated the amount due in association with his accountant.

28. The original contract between CS and Atkins was dated 31 July 2011 and was a sub-consultancy agreement. The initial term of the agreement was from 31 July 2011 to 31 December 2012 and involved work on clients, who were all oil operators, specifically, Woodside Energy Ltd, CNR Ltd and Talisman Energy UK.

29. The project was "computational mechanics", the description of professional services was those related to "Advanced computational methods" and the minimum competency levels were described as "BSc Structural Engineering, PhD Dynamic Response of Storage Tanks to Accidental Loading and NAFEMS Advance Registered Analyst". Although the contract was in the name of CS, none of these minimum competency levels could be attained by a company and, accordingly, it was assumed by the Tribunal that these must relate to KED personally.

30. Invoices were to be submitted monthly for services carried out during the period ending on the last day of each month and the initial contract set out relevant hourly rates. This contract was extended repeatedly until 31 March 2015 and the hourly rates were also changed. Examples of these invoices were before the Tribunal.

31. Clause 6.1 of this contract stated "The Sub-Consultant acknowledges and agrees that all Intellectual Property Rights (defined in the contract) and all other rights in the Services (defined in the contract) and any deliverables provided in relation to the Services shall vest in and shall be and remain the sole and exclusive property of Atkins"

32. KED confirmed that he owned Flat 5 at 182 Granton Road, Edinburgh (Flat 5) personally which was his home and that a room there was used as an office from which both LD and CS operated.

33. In addition CS had property investments, Flat 2 (Flat 2) and Flat 4 (Flat 4) both also at 182 Granton Road, Edinburgh. Flat 2 was bought during September 2010 as an investment and underwent a major refurbishment which was completed in early 2012. Afterwards secondary issues required resolution so that the flat was not let for a period of at least 12 months. During May 2014, the shower room of Flat 2 suffered extensive damage from the shower room of the flat immediately above it, being Flat 4. At that time Flat 4 was not owned by CS. The damage to Flat 2 was repaired and insurance claims made over the following 12 months.

34. Flat 4, the source of the damage to the shower room of Flat 2, was bought by CS during October 2015. This also underwent major refurbishment which was completed in September 2016.

35. KED gave evidence that no family members, friends, acquaintances or non-acquaintances had ever occupied Flat 2 or Flat 4 for free or otherwise and that since October 2016 both flats had been on the letting market with Ben Property Agents or were actually let.

36. Flat 4 is the flat for which the VAT reclaim is in dispute. The total cost including zero-rated supplies was £39,440.51 and the input VAT on this amounted to £5,901.97. The VAT was associated with the refurbishment expenses incurred up to the end of March 2016 only and was principally for bathroom and shower room fitters, timber and insulation materials for flooring; gas central heating materials including boiler, water tank, radiators, thermostatic valves, controls and other ancillaries and miscellaneous items required as part of the refurbishment project. The VAT periods were 31 May 2015, 31 August 2015, and 30 November 2015 and 31 March 2016, at which time the VAT period was changed to coincide with the company year-end and quarterly thereafter.

37. The amounts of input tax incurred by CS from the period 1 April 2015 to 31 March 2016 were £12,578.06 taxable supplies; £5901.97 exempt supplies and £727.38 used for both exempt and taxable supplies making a total amount of £19.207.41. These figures relate to the year ended 31 March 2016.

38. Due to the change in the VAT period during the accounting year 2015/16 and if it was accepted that the Longer period should run from 1 June 2015 to 31 March 2016, that is to say 10 months, the above amounts are adjusted to £12,059.60 taxable

supplies; £4963.95 exempt supplies and £723.59 used for both exempt and taxable supplies making a total amount of £17,747.14.

39. Total input tax of £18,683.19 was the amount contained on the original VAT return to 31 March 2016 and covers the period 1 June 2015 to 31 March 2016. This does not, however, account for £936.05 relating to exempt supplies input tax that was either duplicated on the original return or claimed in error as it was the subject of an insurance claim. If this is accepted the amount of £936.05 should not be included in the total amount of £18,683.19 and the revised total input tax becomes £17,747.14

40. HM, who has worked as a VAT Compliance Officer/Inspector since 2001, gave evidence that in the VAT period 03/16, CS submitted a repayment return for £18,683.19. On 7 May 2016, HMRC selected this VAT return for checks as this claim was not what they would have expected for this type of business "which was normally in a HMRC payment return position with their VAT returns".

41. On 2, 17 and 20 June 2016, HMRC attempted to make contact with CS or their agent Neil Nisbet ("NN") by letter and telephone and, on 21 June 2016, a letter was received from NN dated 17 June 2016 which contained copies of the company's VAT records, including workings and supplier invoices. Although bank statements were said to be included, they were missing.

42. On 21 June 2016, HMRC emailed NN asking for an explanation as to why input tax been claimed on the supply and installation of a new bathroom/shower room in the property at 182/5 Granton Road, Edinburgh which was listed as the principal place of business of the company. At this time HMRC noted that the company had bought an investment property and so requested details of the address on the current use of that property.

43. HMRC also asked NN to refer CS to guidance on VAT Public Notice 700/34 Staff and asked what consultancy services were being supplied by LD that KED could not have supplied himself as a director of CS.

44. On 5 July 2016, NN emailed HMRC to say that the supply and installation of the bathroom suite was at Flat 4 owned by CS, and not Flat 5. NN claimed that supplies in relation to Flat 4 would fall under exempt input tax but would be *de minimus* in the period for partial exemption purposes and claimable in full.

45. HMRC, on 5 July 2016, requested copies of bank statements for the company that had been previously requested but not submitted and a copy of the property missives for the new flat purchase.

46. HMRC further enquired what investment property was included in the annual accounts for 2014/15, details of its current use, who had been living in that property, with a list of tenants and what rent had been paid since it was purchased and whether that rent was included in turnover of the VAT return as exempt income?

47. HMRC queried why the supplier invoices for the bathroom goods and services were not addressed to the company, although HMRC also stated that they could accept alternative evidence for input tax deduction at their discretion.

48. HMRC stated that the partial exemption *de minimus* threshold for the period 03/16 would be breached for the amount of exempt input tax being claimed in that period if HMRC adjusted and disallow the input tax being claimed on the associated LD invoice dated 1 January 2016. It was explained that as there was no taxable or exempt income in that period, the exempt input tax would not be recoverable and HMRC asked NN to provide completed partial exemption calculations for the longer period, partial exemption annual adjustment as well as copies of the company's period 05/15 workings.

49. On 25 August 2016, NN sent HMRC additional records and stated that some input tax should not have been claimed. In reviewing the return with his client, he advised that the insurance claim actually covered an additional amount and they had adjusted this in the calculations.

50. NN also stated that the CS's investment property at Flat 2 was, as a result of being flooded due to a leak from the flat above, unable to be let out and was part of the reason to acquire the property at Flat 4. No rent had been received on either of those properties up to the period 03/16.

51. On 30 August 2016 HMRC emailed NN stating that they could find no trace of any payment being made by CS to LD for the invoice issued by the latter for "management services/consultancy services" on the bank statements provided and asked for confirmation of payment.

52. An intra-company invoice stated that the management consultancy services covered a 12 month period from 1 April 2014 to 31 March 2015. HMRC stated that as the receiving company CS was partially exempt and if evidence of genuine supplies of intercompany services took place, then the invoice should only have been raised by 30 September 2015 or payment received before that date. Otherwise, a basic tax point was created which becomes the date the 12 month period ends, which in this case would be 31 March 2015.

53. HMRC asked NN if there was a legal agreement or contract signed between the associated companies for the management services described on the intercompany sales invoice, which had been issued, whether there were timesheets kept and how the amount shown on the invoice was calculated. In addition clarity on the addresses and number of flats owned by CS was requested.

54. Having received no response to the issues raised on 30 August 2016, a decision letter was issued dated 24 October 2016 notifying CS that HMRC were disallowing the input tax on the supplier invoices claimed in the period 03/16.

55. HMRC disallowed the input tax of £12,000 on the associated management charge from LD on the basis that no clear evidence of a contract existed for the supply

of management services between both LD and CS and none had been provided to HMRC.

56. HMRC gave evidence that as KED held the relevant qualifications, and not LD, he could use them for CS in implementation of the contract with Atkins. HMRC did not believe a genuine supply of services had been made as there was no contract, no timesheets and as KED had a skill set that Atkins required in implementation of the contract. Evidence was given that LD had paid output VAT on the supply to CS in terms of the invoice dated 1 January 2016 and HMRC confirmed that he had not checked the VAT returns of LD, nor had it been suggested that he do so, and confirmed that LD would have paid tax to HMRC if they had correctly made a VAT return for such a supply.

57. After removing the input tax of £12,000 from the VAT return, HMRC then disallowed the exempt input tax claimed on the purchase and installation of the bathroom suite and other items/services claimed in the period. As the partial exemption conditions had not been met, the exempt input tax was not deductible by CS. HMRC also stated that there was no evidence provided of the intended business use of the flats for leasing.

58. This correspondence continued and on 6 January 2017, NN explained that CS had not said the services were completed by 31 March 2015 but instead were on-going services. Accordingly, NN stated that the tax point was not 1 April 2015 but "when agreement is reached as to the value provided for that period." As a sales invoice was raised within 14 days of that date the sales invoice dated 1 January 2016 is treated as the tax point." NN also stated that the invoice was sufficient evidence of the services provided.

59. NN stated they did not agree with HMRC's comments in relation to "a tax year". NN stated that the tax year related to the 12 months ending on 31 March 2016 and accordingly started on 1 April 2015 and so his partial exemption calculations were correct.

60. HMRC replied on 12 January 2017 and repeated their view that if the supply of services did take place between both companies then under VAT regulation 94 the tax point should be as follows:-

> "If LD raised charges for a supply of continuous services covering a 12 month period from 01/04/14 to 31/03/15, then by law they would need to raise a VAT invoice by 30/09/15 or receive payment before that date. Otherwise a basic tax point is created which becomes the date the 12 month period ends, which in this case is 31/03/15. With regard to the Partial Exemption, our VAT Public Notice 708 specifies what is a tax year for completing a longer period adjustment. The tax year is a period of 12 calendar months. It normally ends on 31st March, 30 April, or 31 May depending on your tax period you (that is, the periods covered by your VAT returns). If you make monthly returns, your tax year ends on 31st March. You have confirmed that your client bought Flat 2 since 2010 therefore the longer period annual adjustment would require to be made from the period ending in May each year. Your client changed their VAT *stagger* to end on March, June, September and December from 07/10/15. The partial exemption longer period annual adjustment of the previous year would therefore have been carried from 01/06/14 through to 31/05/15 whether or not any exempt input tax was claimed in this period.

> From 2015 to 2016, the tax period would run for 10 months only as you cannot use previous months which falls [sic] into an earlier longer period annual adjustment."

61. NN then advised that they were seeking the help of a VAT specialist and on 23 February 2018 HMRC received an email from Scott Craig of Scott Moncrieff (SC). Further correspondence ensued setting out the reasons why LD had made a supply and reiterated that LD provides technical testing and analysis activities whereas CS provides engineering related scientific and technical consulting activities.

62. On 23 February 2018, SC wrote to HMRC setting out that LD believed it had provided a genuine management service, had charged VAT and accounted for this in an amount of £12,000 as output tax and that if the input tax for CS was refused than the output tax would be repayable to LD. Furthermore that the same adjustment and repayment would be required for the preceding four years when such charges had been made.

63. SC referred to Section 172 of the Companies Act 2006 which limits a director's role in a company to "the management of individual companies and the promotion of that companies (sic) successes". SC also referred to regulation 29(2) of SI 1995/2518 which states that a person is only required to hold a document or invoice to support the supply and recovery VAT.

64. SC stated that it would have been inappropriate and incorrect if LD and CS had not recognised the supply and receipt of services between them and the value of the charges.

65. HMRC responded on 21 March 2018 reiterating their view that there was no written agreement and that there was no evidence of a continuous supply of services. As for this, they would need to have been an agreement for LD to continue supplying services to CS after 1 April 2015. Otherwise the services would have been completed when CS issued their last sales invoice once the contract with Atkins was finished on 31 March 2015.

66. SC replied on 27 April 2018, once again stating that, CS benefited from the knowledge held by LD and had to pay for it as any other third party would do when accessing such knowledge; that the activities and purposes of the companies were entirely different and that they were separate legal entities who had incurred costs to develop the skills in areas that were suitable for their respective businesses.

67. SC stated that the supplies by LD to CS were continuous by nature whereby CS effectively paid a royalty or set fee for the right to access information that KED provides to CS in his capacity as a director of LD. "It follows that if the tax point was adjudged to be the tax year end instead of the date of the invoice, all tax points on the invoices issued will be moved to the previous or later year and the final VAT calculation would not be upset. The partial exemption calculations would continue to result in the partial exemption *de minimus* limits being satisfied".

68. HMRC continued to disagree and the matter came before the Tribunal.

CS's Submissions

69. CS say that they have provided credible and reliable witness evidence; that HMRC have drawn incorrect inferences from facts and that the issue over the importance of Intellectual Property Rights ("IPR") was neither considered at the time nor acknowledged as relevant at the hearing by HMRC?.

70. It is clear that IPR are valuable assets and it was perfectly plausible and reasonable why the services that were not necessary for CS in completion of the contract with Atkins were subcontracted and kept outside.

71. The contract between CS and Atkins from July 2011 to March 2015 referred to testing the structure only and it was up to CS to work out what software to use or to use existing software. Nevertheless, to perform the contract better it was both plausible and compelling that the work should be split up. CS say this is compatible with the general structure of the two companies whereby LD was set up first to verify software but as the activities of KED increased CS was incorporated in 2001 to provide engineering related scientific and technical consulting activities. There were good reasons to set up such a company which had notably the different SIC reference codes, different natures of the work, different levels of liabilities attaching to that work and different risks to the companies if something went wrong which, in turn, resulted in different insurance arrangements. CS say even if this is not logical, it is a perfectly reasonable basis to differentiate between CS and LD activities and operate them through distinct entities, albeit that they are solely owned by and controlled by the same person.

72. They distinguish the case of *The Withies Inn Ltd* and say this is not the simple division between a husband and wife whereby one deals with delivering drinks and the other with food. They say the activities in this case were carefully divided up and for good reasons.

73. The type of work alternated between the different objects and activities of each company. Between 2003 and 2005, CS type work was required by Atkins but as soon as the requirement changed in 2010 then LD became the more appropriate provider and relevant company to provide the services required.

74. This then changed again to the CS type of work. Consequently CS say that the distribution of work being applied between the different companies and was in existence long before any HMRC dispute arose.

75. The continual extension of the contract with Atkins was evidence of a continual supply of services by CS to Atkins and as is evidenced by the accounts and, with the need to continually assess the changes to known software and new software, it was necessary that LD provided continuing services to CS to enable CS to meet its contractual obligations or to be in a position to do so. The continuing relationship between CS and Atkins is evidenced by the invoices which was submitted each month.

76. CS agree that there was no written contract nor timesheets which might have been helpful but that there is no particular need for two companies in the same ownership to have written terms between them. They say that a written agreement is not necessary in VAT law and all that is needed is something done for a consideration. In addition, they say there is sufficient circumstantial evidence that LD did provide services to CS and it was clear what was done.

77. The only conclusion was that there was a continuous supply by LD to CS during the Atkins contract period which came to an end on 31 March 2015, but also beyond that as LD continued to provide services to CS, evidenced by the accounts to the period 31 March 2016 for both companies and by the statement by KED that it continues to this day.

78. CS say the actual amount charged by LD was reached in discussions with NN and LD and that in terms of regulation 90 of the VAT Regulations 1995 a continual supply is at the earlier of the payment date made, or when an invoice is issued. If that is correct, the input tax is within the *de minimus* level.

79. CS say that the work carried out by LD during the period 2010 to 2011 was for different software from the structural analysis software used by CS in the period 05/10. In relation to the contract from 2011 to 2015, CS were dealing with a third party program which did not belong to Atkins, known as ABAQUS.

80. CS say the issue before the Tribunal is one of credibility and if KED is credible then the appeal should be allowed.

81. CS's contract with Atkins could have been completed without LD's input and that input could have been obtained from an independent third party of a type of company like LD but it was not. KED has explained why he took the approach he did which was primarily for a number of reasons most particularly to protect IPR.

82. CS say that it is quite clear that the supply by LD to CS was continuous, and indeed is on-going, as stated in KED' s evidence and the published accounts up to and including 31 March 2016. Accordingly, the *de minimus* reclaim is allowable.

HMRC's submissions

83. HMRC agreed that both witnesses provided credible testimony and that it did not appear that the facts were in dispute. The question that needed to be answered was whether a supply actually took place.

84. HMRC say that CS could have used the experience of its own director to fulfil the contract with Atkins without any supply from LD.

85. No written agreement, timesheets or any other evidence apart from the one invoice is available to confirm the supply by LD to CS. HMRC say that when two companies are making supplies to each other, where they are owned by the same individuals and with the same directors, then the need for written evidence is much clearer.

86. HMRC referred to The Withies Inn Limited case and in particular to the statement by Tribunal Chairman, Theodore Wallace, who stated that "where directors act in a dual capacity an assertion that one company is supplying their services to the other must be viewed with circumspection. It is however quite incorrect to say there cannot be a supply in such circumstances."

87. HMRC say the Tribunal should approach this matter with circumspection and consider the lack of written evidence other than the invoice. They say the contract with Atkins required NAFEMS qualification which was purely with KED and not with CS.

88. HMRC referred to KED's witness statement which says in relation to the July 2011 to March 2015 CS-Atkins contract that "the services included the prediction of offshore structures to extreme environmental and accidental loading events using the current state-of-the-art advanced computational methods and software tools that have been identified separately by LD using verification and validation tests". HMRC emphasise the involvement and identification of LD in relation to these services in relation to the contractual obligations of CS.

89. Consequently, HMRC say that LD had already completed work for Atkins in the period April 2010 to 2 July 2011 and this was provided by KED so that he was already in possession of that knowledge when performing the contract for CS from the period 2011 to 2015.

90. HMRC say, therefore, that it was the same "current state-of-the-art advanced computational methods and software tools" that LD had completed when performing the contract and the period 2010-2011 so there was not, consequently, a supply between LD and CS.

91. HMRC say that CS provided the services and do not agree that the information needed by KED to perform the Atkins contract was owned by LD. Consequently they say there is a supply by KED to CS and not LD, in that he used his own knowledge to fulfil that contract. Consequently the £12,000 does not meet the definition of input tax as there was no supply.

92. As regards the claim for the works carried out to Flat 4, HMRC say that as there was no supply between LD and CS, CS's exempt input tax exceeds 60% of all input tax incurred to the extent that input tax cannot be claimed under the *de minimus* rule.

93. HMRC say that even if LD did supply CS, the remaining input tax cannot be claimed in 15/16 because there has not been a continuous supply of services between LD and CS. The contract between CS and Atkins ended in March 2015 and so any supply between LD and CS ended then and HMRC say they had not been provided with any evidence that LD provided CS with any supply beyond March 2015.

94. HMRC say that the supply between LD and CS was not continuous so that the tax point is 1 April 2015 and in terms of section 6(3) of the VAT Act 1994 the amount of £12,000 should be excluded from the partial exemption computation. The relevant

year in 15/16 was 1 June 2015 to 31 March 2016 and because the tax point was 1 April 2015 it does not fall within this period.

Decision

95. As referred to in the correspondence with HMRC, a director of a company has obligations towards each company of which she or he is a director in terms of the Companies Act 2006 and must act in good faith to promote the success of the company, and exercise reasonable care, skill and diligence in doing so.

96. These duties involve avoiding conflicts of interest and applying a duty of confidentiality. Clearly this raises issues of the attribution of these duties and obligations when a company with a sole director and sole shareholder is supplying or receiving goods or services to or from a company with the same director and shareholder.

97. Consequently, the Tribunal agreed with HMRC that where a director acts in a dual capacity, an assertion that one company is supplying the service to the other must be viewed with circumspection. Nevertheless, the Tribunal accepted that such a supply could be made between, what are referred to here as, "dual capacity companies".

98. The initial matter before the Tribunal relates to the credibility of the proposition that it was necessary, if not essential, for the services provided by LD to CS to be provided in that way (and not as HMRC, contended, by the director providing the services as a director of, and for, CS) and consequently constitutes a supply for VAT purposes.

99. The Tribunal found that there was a supply by LD to CS and that KED was entitled to act and carry out his functions as a director for LD and for those services to be purchased by KED as a director in CS and to accordingly make a claim for VAT.

100. The Tribunal agreed with CS's accountants that it would have been wrong and inappropriate for the companies not to have declared the supply and receipt of the services and their values in their respective VAT returns.

101. The Tribunal took into account that KED's career had progressed over a period of time. It had commenced with the establishment of LD as a company providing technical testing and analysis and had then developed to also include providing engineering related scientific and technical consulting services.

102. It was clear to the Tribunal that the differentiation of the services of, respectively, LD and CS is by no means straightforward to comprehend but good and clear evidence was given by KED at the Tribunal hearing, and in his witness statement, of what this involved, which was not as clearly available to HMRC in their correspondence with CS's accountants.

103. The Tribunal considered a number of criteria that seemed relevant in assessing their level of circumspection and acceptance that supplies can be made between dual capacity companies.

104. The first was to assess whether it is reasonable that the supply should be made in the way that it is, so that both companies are acting according to reason. As was well rehearsed during the period of correspondence and at the hearing, the two companies, LD and CS, had (1) different SIC codes, (2) carried out different activities, (3) which activities carry different levels of risk, (4) which required different insurance arrangements and (5) had different costs and obligations in relation to qualification, attribution and assessment of professional qualifications.

105. The second was to assess whether it was plausible that dual capacity companies acted in the way they did and, specifically, that LD supplied CS in this way. The Tribunal considered that it was convincingly plausible particularly in relation to the contract between 2011 and 2015 between CS and Atkins (the CS/Atkins contract) particularly in relation to the issue of IPR.

106. The Tribunal noted that the issue of IPR was not one emphasised as the reason for the creation of the two different companies in 1995 and 2001 but it was, in the Tribunal's view, extremely significant given the terms of the CS/Atkins contract and covering the issue under appeal.

107. The Tribunal considered it unlikely that KED should use his skills, which he gave in evidence that he provided for LD, to CS, as HMRC suggested, as (1) wearing his respective company "hats" there was clear evidence that work had passed from LD to CS as was appropriate for the tasks in hand in the past, but (2), even more significantly, any IPR in that work would have passed to Atkins and not been retained by LD.

108. In the knowledge of this, it would have been detrimental to LD, to the extent that it would not retain the IPR and furthermore detrimental to CS as for any future work that CS may have where it wished to rely on that intellectual property, then CS would be under an obligation, and possibly a financial one, to Atkins a company KED did not own or control.

109. The Tribunal noted that the issue of IPR had not been raised throughout the correspondence with HMRC and it appeared to be only with the delivery of all KED's witness statement a few weeks before the Tribunal hearing that this point was made to HMRC.

110. The third was to consider whether the circumstances appeared logical or correctly reasoned and based on the conclusions the Tribunal reached in relation to the first and second criteria, the Tribunal concluded that the creation of a second and separate company was logical for the different purposes for which it was required. In particular, in relation to the acquisition and retention of IPR it was again logical that a second company should be used that was not under an obligation to assign such IPR

to a third party over which neither LD nor CS had any ownership or control, if this could be avoided.

111. The Tribunal also consider that the issue would have been much more clear-cut if there had been a contract between LD and CS and also some documentary evidence as to the calculation of the charge but accepted, on the balance of probabilities, that in light of the evidence before it, most of which derived from the credible statement of KED and circumstantial evidence, these were not necessary but may have prevented the need for a Tribunal hearing.

112. The Tribunal considered that the case of *The Withies Inn Ltd* involved a supply by a parent to a subsidiary company, rather than two companies. None of the directors of the companies gave evidence and one company appeared not to be actively trading. The case was largely concerned with what was seen as an incorrect proposition of the law by HMRC and whether or not the assessments were to best judgement.

113. Accordingly, although the Tribunal accepted the proposition about treating transactions between dual capacity companies with circumspection, it could find little else of assistance for the matter under appeal.

114. The Tribunal were not persuaded by HMRC's contention in KED's witness statement that the alleged supply by LD to CS for the CS/Atkins contract was in fact the same supply as provided by LD to Atkins in the period 2010 to 2011. There was insufficient evidence to accept this proposition and it was refuted by KED who was recalled as a witness in order to address this issue and whose evidence the Tribunal accepted.

115. Accordingly the Tribunal considered that there was a supply by LD to CS and, in view of the evidence before the Tribunal, this supply was a continuous supply for the reasons put forward by CS in their correspondence with HMRC and in terms of their submissions. The Tribunal noted that it was only latterly in the correspondence between CS's accountants, primarily SC, and HMRC that reference was made to the respective accounts of LD and CS for the year to 31 March 2016 but these, plus the witness evidence of KED were sufficient for the Tribunal to reach its conclusion. The Tribunal also noted that there had been similar supplies or receipt of supplies between the two companies in previous years and that if the claim by CS was refused then repayment would be due to LD by HMRC.

116. Having concluded that there was a supply by LD to CS in the relevant period and that it was a continuous supply the Tribunal then considered the second part of the refused claim in relation to the amounts incurred in connection with the residential property.

117. The Tribunal, in light of these findings, agree with CS's accountants and their submission that the *de minimus* exemption should apply.

118. Accordingly, the appeal is allowed.

119. 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.

W RUTHVEN GEMMELL WS
TRIBUNAL JUDGE

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