TC02458

Appeal number: TC/2010/89

VAT – assessments to recover VAT reclaimed on invoices in respect of work not supplied to the appellants – appeal dismissed – assessments to recover VAT reclaimed on invoices for work supplied to appellants – appeal dismissed as reclaim made out of time

FIRST-TIER TRIBUNAL
TAX CHAMBER

MOHAMED SAHEID AND SHERIFAN NEISHA SAHEID **Appellants**

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE
MICHAEL SHARP

Sitting in public at Bedford Square, London on 12 June 2012 with written submissions received from both parties up to 3 December 2012

Mr Saheid in person for both Appellants

Mr R Wastell, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The appellants were in partnership running a farming business and residential care home, and at one stage in the past, a post office. A Notice of Appeal was filed on 25 November 2009 against a decision of HMRC taken on 6 March 2009.

2. The appeal was lodged late but HMRC did not take any issue on this and we admitted the appeal out of time.

3. The assessments arose out of a visit by HMRC officer Mrs Jenman to the appellants which took place on 6 March 2008. Mrs Jenman formed the view that certain amounts of input tax claimed by the appellants were unsupported by invoices. She asked for the invoices or alternative evidence to be made available to her and entered into correspondence with the appellants who sent in various documents and promised further documents.

4. On 10 June 2008, Mrs Jenman notified the appellants that she would make a protective assessment of £2,978.72 covering tax reclaimed by the appellants in their return for 06/05 but for which Mrs Jenman was not satisfied they possessed the necessary invoices.

5. Following a further visit on 24 September 2008, Mrs Jenman notified the appellants that she would be making a second protective assessment for £2,977 in respect of VAT period 09/05.

6. On 30 October 2008, due to the lack of provision of any further evidence to justify the input tax claims, Mrs Jenman raised an assessment for the remainder of the queried input tax of £8,128.

7. The input tax claims for which Mrs Jenman was not provided with invoices or what she considered to be satisfactory alternative evidence fell into three main types:

- Three supplies by Livingstone & Co (Solicitors) on which the VAT totalled £8,191.48
- Two supplies by Thomas Eggar (Solicitors) on which the VAT totalled £2,680.86
- One supply by Bond Pearce (Solicitors) on which the VAT was £3,214.05.

Livingstone & Co

8. The appellants had no invoices to support this claim. This is not surprising. It was undisputed that the charges of Livingstone & Co were made to a Mr T Bennett.

9. Mr Bennett was an employee of the appellants. He was dismissed. He instructed Livingstone & Co and successfully sued the appellants for wrongful dismissal. As part of decision of the County Court, the appellants were ordered to pay

Mr Bennett his costs and interest, totalling £70,000. They paid this sum to Mr Bennett in two tranches, the first in 2001 and the second in February 2002.

10. The appellants spent some years in correspondence with Livingstone & Co seeking confirmation that the sum had been paid: in the meantime Livingstone & Co ceased trading and a successor to their business eventually provided this confirmation in 2005. At this point the appellants estimated that some £55,000 of this was Mr Bennett's gross legal costs. They then claimed the VAT part of this estimated sum as input tax in three tranches in periods 06/05, 07/05 and 10/05.

11. HMRC disallowed the claim on the grounds that:

(a) It was not the appellants' input tax as it was not incurred on a supply made to them; and

(b) It was made out of time as it was made more than three years after it was incurred.

Thomas Eggar

12. The appellants contracted with a Mr Batchelor to carry out work for them. Mr Saheid thought that this was in 1996 or 1997. Mr Batchelor was to plant their land, treat and then reap the crops. Mr Saheid's case was that Mr Batchelor sprayed the crops with brackish water and thereby significantly reduced the yield. As the appellants were dissatisfied with the work carried, they refused to pay his invoices.

13. Mr Batchelor sued them and the court ordered the appellants to pay £27,000 to Mr Batchelor which included Mr Batchelor's legal costs. Mr Saheid's evidence was that the majority of this payment reflected Mr Batchelor's claim for work done but he was unable to be precise.

14. The money was to be paid in three tranches over three years

15. Letters from Thomas Eggar to the appellants confirmed payment by the appellant to Mr Batchelor of £9,000 on 19 January 1999 and 5 January 2001. Mr Saheid said he paid the other tranche of £9,000 but he never received a receipt for this and did not reclaim the VAT on it: it is therefore not relevant to the appeal.

16. It is also Mr Saheid's case that he intended to wait until he had three receipts before making the claims as he did not realise there was a time limit: eventually the appellants made the claims in respect of two of the tranches in 2006. They treated the two payments of £9,000 as a gross payments and recovered £1,340 in their return for 09/06 and again the same figure in 12/06.

17. HMRC disallowed these claims on the grounds:

(a) Either the payment was in respect of Mr Batchelor's costs and did not relate to a supply to the appellants, or the payments were in relation to Mr Batchelor's services and the appellants had failed to show that they did not reclaim the VAT at the time the services were first invoiced;

(b) In any event both claims were out of time.

Bond Pearce

18. The appellants had run a post office. They were involved in litigation with Post Office Counters Limited ("PO") which they lost and in respect of which they were ordered to pay the costs of the PO. Bond Pearce were the solicitors to the PO and therefore the payments made to Bond Pearce were payments of costs under the court order.

19. Mr Saheid' case is that the PO through its advisers had told him that the PO could not reclaim the VAT and that he would be entitled to reclaim it.

20. HMRC disallowed the claim on the ground that the supplies by Bond Pearce were not made to the appellants but to the PO.

Review decision of 6 March 2009

21. This letter notified the appellants that HMRC would withdraw the first two assessments on the grounds they had not been properly notified to the appellants.

22. These assessments related to the first two tranches of "input tax" arising out of the Livingstone & Co matter. They are therefore not an issue in this appeal and the appellants are not liable to pay them.

23. The main assessment for £8,128 remained in issue and that covered the last tranche of the Livingstone & Co matter, the Thomas Eggar claims and the Bond Pearce claim.

The Law

24. Taxpayers are entitled to reclaim input tax which is attributable to taxable supplies made by them. There is no dispute that the appellants were a taxable person and that they made taxable supplies.

25. The dispute is whether the amounts claimed as their input tax was the appellants' input tax as a matter of law.

26. Input tax is defined in s24(1) of the Value Added Tax Act 1994 ("VATA"). This provides that:

> "… "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;
>
> (b) VAT on the acquisition by him from another member State of any goods; and
>
> (c) VAT paid or payable by him on the importation of any goods from a place outside the Member States,

> being (in each case) goods or services used or to be used for the purpose of any business carried on by him."

27. Therefore, to be "input tax" of the appellant, the VAT charged in respect of the "Livingstone", "Thomas Eggar" and "Bond Pearce" supplies had to be on supplies "to" the appellant: (s 24(a)).

28. Claims to recover input tax should be supported by invoices: Regulation 29(2) of the VAT Regulations 1995 no 2518. None of the claims for input tax in this appeal were supported by invoices. Nevertheless, HMRC are entitled to accept alternative evidence of the supply. However, HMRC did not deny the VAT because they refused to accept alternative evidence but because they did not accept that VAT recovered related to any supply made to the appellant.

29. Claims for input tax also have to be made within the appropriate time limit.

Decision

"Livingstone & Co" – third tranche

30. To reclaim VAT on the sums paid to Livingstone & Co, the appellants must demonstrate that it was VAT incurred on a supply made to them by Livingstone & Co.

31. The question of to whom a supply is made is determined by who is liable to provide the consideration in respect of it. This is a fundamental principle of the VAT system: supplies must be for consideration. Another fundamental principle is the requirement for the supply to be directly linked to the consideration and this requires mutuality: an agreement to provide the supply in return for the consideration.

32. Therefore, the question of to whom a supply is made is answered by determining who was liable to provide the consideration in respect of it.

33. We note that this analysis is supported by the House of Lords' decision in *Redrow*. See Lord Hope's comments:

> "The matter has to be looked at from the standpoint of the person who is claiming the deduction by way of input tax. Was something being done for him for which, in the course or furtherance of a business carried on by him, he has had to pay a consideration which has attracted Value Added Tax? The fact that someone else--in this case, the prospective purchaser--also received a service as part of the same transaction does not deprive the person who instructed the service and who has had to pay for it of the benefit of the deduction."

34. And Lord Millett said:

> "It is sufficient that the taxpayer obtained something of value in return for the payment of the agents' fees in those cases where it became liable to pay them…."

35. In the case of legal advice, the person who is liable to pay the lawyer is his client.

36. Where a litigant is ordered to by a court, or agrees as part of an out of court settlement to pay the legal costs of the other party to the proceedings, that litigant becomes liable to pay the sum determined to the other party. But as between two litigants, in so far as the settlement or court order could be seen as a "supply" for "consideration" it is well established that it is outside the scope of VAT. As no VAT is chargeable on the "supply" it can generate no input tax.

37. The appellants' case is that because the other party in legal proceedings is the recipient of a supply of legal advice from its lawyer, but yet the result of the court order or settlement is that the losing party must pay it, that somehow that changes the direction of the supply. So it is in effect the appellants' case that, to the extent that the losing party was liable to pay the costs of the lawyers, instead of the legal advice of the lawyers being supplied to their client, it was supplied to the losing party.

38. But that is confusing the issue. The lawyers supplied their services to the person who was liable *to them* to pay for their advice. So far as the lawyers were concerned, the only person who would be liable to pay them was their client.

39. While a court order or settlement may create a liability on the unsuccessful party to pay the costs of the successful party, that is a liability as between the two litigants and only enforceable by the successful party. The lawyers of the successful party, acting for themselves, could not enforce it. The lawyers have no legal right to demand that the unsuccessful party pay their costs. Only the successful party has this right. The fact that in claiming and receiving payment of the costs from him, the lawyers would have been acting on behalf of their client and not themselves, is a distinction that may have been lost on Mr Saheid. But it is nevertheless the true legal position and the effect is that the supply of their legal services was made to their client and not to Mr Saheid and his wife. VAT on those supplies could therefore not be "input tax" of the appellants as it was not VAT on the supply "to him" of services, as required by s 24.

40. It makes no difference to this position whether or not the person to whom the supply was actually made by the lawyers reclaimed or could reclaim the VAT.

41. For much the same reasons, Mr Justice Potts in the case of *Turner* [1992] STC 621 came to the same conclusion that the VAT on the costs of the successful litigant was not input tax of the losing party who was ordered to pay it. This decision is not only clearly right but binding on this Tribunal.

42. Therefore, we dismiss the appellant's appeal in respect of the third tranche payment made by the appellants in respect of the legal costs charged by Livingstone & Co to Mr T Bennett.

"Bond Pearce"

43. For exactly the same reasons we dismiss the appellants' appeal in relation to the payment of the amounts to Bond Pearce.

44. Whatever the PO or its advisers said to Mr Saheid does not alter the legal position. If they did incorrectly advise him that he was entitled to reclaim this VAT, that is a matter he could take up with them, but it is of no relevance to this Tribunal.

"Thomas Eggar"

45. The payment to Mr Batchelor was of a round sum in settlement of Mr Batchelor's claim against the appellants for his unpaid invoices for work carried out for the appellants. If Mr Batchelor was a taxable person, then the original invoices should have carried VAT.

46. As already mentioned above, court orders and settlements are outside the scope of VAT. A court order clearly lacks mutuality necessary for *Tolsma*. A settlement necessarily involves one party agreeing not to pursue the litigation in return for payment and this, it might be thought, amounts to a supply for consideration. But it is well established that even if this is a supply for consideration, it is not a supply within the scope of VAT.

47. As we have said, a supply for consideration requires mutuality: there is a supply where a person agrees to do something in return for the other party agreeing to pay. Where the recipient of the supply fails to pay the agreed consideration, this might well lead to litigation. An order to pay, or a settlement under which payment is agreed, by itself, is outside the scope of VAT: but the underlying supply remains as much subject to VAT as it always was.

48. So if Mr Batchelor's unpaid invoices for services rightly included VAT then the appellants would (subject to invoices) be entitled to reclaim the VAT to the extent that they paid the invoices. Whether the claims they made in 2006 in their VAT returns were valid therefore depends on whether:

(a) VAT was chargeable by Mr Batchelor;

(b) The VAT was not already reclaimed by the appellants at the time they received the invoices;

(c) The claims made in 2006 being within the relevant time limit.

49. At the hearing we pointed out that it was not necessarily the case that the claim was, as HMRC said, time barred. That would depend on the dates of the invoices: the three year cap on input tax was introduced on 1 May 1997 and to the extent its introduction was retrospective, it was ruled unlawful by the House of Lords in their decision in *Fleming (t/a Bodycraft) v HMRC* and *Conde Nast Publications Ltd v HMRC* [2008] 1 WLR 195.

50. It is for the appellants to justify their right to make the input tax claim they made in respect of the "Thomas Eggar" amounts and to do so they needed to show the

dates of the original invoices and whether or not VAT was charged on those invoices and whether or not it had already been reclaimed by the appellant.

51. At the hearing Mr Saheid said that he thought he could obtain copies of Mr Batchelor's original invoices and wanted to time to do so. As HMRC raised no objection to this, we adjourned the case part heard to allow him time to do this.

52. At the same time we made it clear that he would also need to produce evidence that the VAT had not been reclaimed at the time: it would not assist his case if he could prove the invoices pre-dated 1 May 1997 but could not prove that he did not enter the VAT in his returns at the time he received the invoices.

53. Mr Saheid's oral evidence was that he did not recover VAT on invoices until they were paid and therefore he would not have reclaimed the VAT on Mr Batchelor's invoices as he did not pay them.

54. Our directions were that the hearing was adjourned to allow the appellants to provide to the Tribunal and HMRC no later than 31 August 2012 further evidence to support their claim in respect of the "Thomas Eggar" payments, and in particular:

- Mr Batchelor's invoices;
- VAT records from the time of the invoices (to show whether or not the VAT was reclaimed);
- The terms of the settlement with Mr Batchelor.

55. We also directed that HMRC would have time to make submissions in response but that unless either party requested an oral hearing we would proceed to decide the matters on the papers.

56. Mr Saheid wrote to the Tribunal in accordance with these directions on 26 August 2012. He said he was unable to find any evidence other than spreadsheets relating to his business. These spreadsheets were not enclosed.

57. HMRC chased copies of the spreadsheets so that they could comply with the Directions to make a submission on the evidence produced. The spreadsheets, which cover 1997-1999, were eventually provided with a letter from the appellant dated 5 October 2012.

58. HMRC's submissions were received on 7 November 2012. On 21 November 2012 the Tribunal informed the appellants they had 14 days to reply to HMRC's submissions and/or apply for an oral hearing.

59. On 3 December Mr Saheid replied saying that (a) he had sent the spreadsheets with his letter of August and did not know why they were not received; (b) when he returns again to the UK he will ask his advisors to supply the dates the £27,000 was paid and "details of the input tax".

60. There was no request for an oral hearing from either party and we decided to determine the matter without a further hearing. We also decided to do it immediately

as, even if Mr Saheid's letter was taken as a request for an extension of time to submit further evidence, we would refuse it. This is because:

- Mr Saheid asked for and was originally given two months to locate the information on the basis that he was often out of the country. This was a generous time limit in the first place. We are now in December and it is Mr Saheid's position that he still needs more time. We think he has had more than enough time and none of the enquiries he now suggests making are ones he could not have initiated back in the summer immediately after the hearing;

- The further enquiries he suggests making would not, even if successful, provide further evidence to support his case. We need the dates of the original invoices and evidence whether VAT was charged and paid at the time. The dates of payment of the tranches following the settlement, and the details of the settlement, are of no help in the absence of the original invoices.

Date of Mr Batchelor's invoices

61. The date of the invoices is critical. As we observed at the hearing, if they pre-date 1 May 1997 they are not time barred. Mr Saheid has not produced the invoices and cannot remember the date of them, although he considered it likely they were dated from 1996 or 1997. This does not help us determine if they were dated before or after 1 May 1997.

62. Does the Schedule help? The first relates to 1997. Mr Saheid informs us that records prior to that date have been destroyed.

63. All that can be said of the spreadsheets is that they show no entry for any invoice from Mr Batchelor. There could be, we find, only three reasons for this.

64. The first reason why the Batchelor invoices do not show on the spreadsheets might be that the invoices were dated in 1997 but they are not on the spreadsheet because they were not paid. However, if true, that does not help the appellants because it leaves us unable to determine whether the invoices were dated before or after the critical date of 1 May 1997. It is for the appellants to show that they were dated before that date: not for HMRC to show that they were not.

65. The second possible reason for the absence of the invoices is that the spreadsheets are incomplete. We agree with HMRC's point and find that the spreadsheets are not a complete record of the appellants' farming business as the payment of £9,000 on 19 January 1999 to Mr Batchelor is not recorded.

66. The last possible reason for the absence of the invoices may be that the invoices were dated 1996; but if that is true, there is no evidence whether VAT was charged on them or that that VAT was not reclaimed.

67. We say this because it is not clear what the spreadsheets do show: they appear to be a list of purchases and expenses (although the consecutive VAT numbers against

what appear to be purchases would suggest they were sales). Invoices carrying VAT are listed as well as those not carrying VAT (eg zero rated seeds and exempt bank charges). Only one date is listed against each item and it is not clear if this is the date of the invoice or the date of payment. Either way it fails to demonstrate that VAT was only claimed when payment was made.

68. We note that it was Mr Saheid's evidence at the hearing that he only claimed VAT when an invoice was paid. The spreadsheet neither supports nor negates his position. It tells us nothing in this regard. So we have to decide whether to accept Mr Saheid's oral evidence on this.

69. And our decision is that we reject it. Firstly, it is lawful to reclaim VAT on invoices when received even if they are not immediately paid and it makes good business sense to do so. Secondly, it is unsupported. Mr Saheid has not, for instance, produced records from any year showing that habitually invoices received were not entered into the VAT records until paid. (We note that with respect to the three types of claim in this case, it is clear that Mr Saheid was reluctant to reclaim the "input tax" without some documentary evidence in the absence of an invoice, but that does not tell us whether he would reclaim VAT on an invoice when received or paid).

70. In any event, we do not need to decide which of the three possible reasons why the invoices do not appear on the spreadsheet is the right reason. What is clear is that the appellants have failed to prove their case that the invoices pre-dated 1 May 1997. By itself that is enough for their claim to fail.

71. Therefore we reject the appellants' claim for the "Thomas Eggar" VAT as time barred.

72. Therefore we dismiss the entirety of the appellants' appeal.

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

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 27 December 2012