TC05480

Appeal number: TC/2015/04357

VAT – input tax – VAT groups – section 43 Value Added Tax Act 1994 – Article 11 of Council Directive 2006/112/EC

FIRST-TIER TRIBUNAL
TAX CHAMBER

HEATING PLUMBING SUPPLIES LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE Rachel Mainwaring-Taylor

Sitting in public at Fox Court, London on 6th June 2016

Michael Firth, Counsel, for the Appellant

Rita Pavely of HM Revenue and Customs, for the Respondents

DECISION

Background

1. The Appellant was incorporated on 2nd March 2001. Its business is the wholesale distribution of domestic heating and plumbing appliances and supplies to the trade and members of the public.

2. In around November 2010 the Appellant's board of directors decided to look into a management-led buyout.

3. The Appellant engaged EMW Law to provide it with banking and legal advice in relation to the buyout as well as to implement the structure and Grant Thornton to provide it with commercial and tax advice (together 'the Services').

4. The management-led buyout was presented to staff on the basis that it would create an independent company wholly owned by the staff and management. All staff were given the opportunity to invest and approximately 50% took up that opportunity.

5. The structure adopted as the means of giving effect to the buyout was for the Appellant to be acquired by a new holding company, Heating Plumbing Supplies Group Ltd ('HPSGL'), which was owned by the management and staff.

6. HPSGL was incorporated on 28th March 2011.

7. Irrevocable undertakings were given in respect of the transaction on 13th April 2011 and the transaction was completed on 28th April 2011.

8. The Appellant was registered for VAT prior to the management-led buyout, but its registration was cancelled to set up the VAT group registration following the buyout. HPSGL was not registered for VAT separately before joining the group.

9. A group registration for VAT was issued on 19th April 2011, with effect from 1st April 2011. The Appellant is the representative member of that group.

10. Input tax of £12,226.60 was claimed on the Appellant's VAT return for the period ended 06/11, when it was representative of the VAT group.

11. A VAT visit was undertaken on 18th and 19th November 2014. After the visit, HMRC obtained a schedule of the input tax claimed, together with relevant invoices and letters of engagement. HMRC decided that the group member had not made any supplies within or outside the VAT group since registration and disallowed £12,154 of the VAT claimed, stating it was not a cost component of a taxable supply. This sum was later found to have involved an arithmetical error and a further assessment f £72 was issued on 23rd June to bring the total to £12,226.

12. The Appellant appealed HMRC's decision, stating that the VAT was deductible as it related to the taxable supplies made by the VAT group as a whole. HMRC undertook a review and upheld its original decision in a letter dated 7th May 2015.

13. The Appellant appealed to the Tribunal on 16th July 2015.

Evidence

14. The Tribunal heard evidence from Mr Anthony Curneen, director of the Appellant, and from Graham Colcombe of HMRC.

15. The Tribunal was referred to documents evidencing the cancellation of the Appellant's original VAT registration and the VAT registration of the group; engagement letters from EMW Law dated 22nd February 2011 and Grant Thornton LLP dated 7th January 2011; invoices from Grant Thornton LLP dated 27th April 2011 and from EMW Law dated 27th April 2011, 4th May 2011 and 10th May 2011; and a service agreement from EMW Law dated 28th April 2011.

Law

16. The relevant legislation is found in sections 6(3), 24(1), 25(2), 43 and 83(1)(e) of the Value Added Tax Act 1994 (VATA 1994), Regulation 101(2) of the VAT Regulations 1995 (SI 1995/2518) and Article 11 of Council Directive 2006/112/EC ('Article 11').

VATA 1994

17. Section 6(3) provides that "a supply of services shall be treated as taking place at the time when the services are performed".

18. Section 24(1) defines input tax as being "VAT on the supply to [a taxable person] of any goods or services…used or to be used for the purpose of any business carried on or to be carried on by him".

19. Section 25 deals with crediting input tax against output tax and subsection (2) provides that the taxable person "is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him".

20. Section 43 deals with groups and provides that:

> "(1) Where…any bodies corporate are treated as members of a group, any business carried on by a member of the group shall be treated as carried on by the representative member, and –
>
> …(b) any…supply of goods and services by or to a member of the group shall be treated as a supply by or to the representative member…
>
> and all members of the group shall be liable jointly and severally for any VAT due from the representative member."

VAT Regulations 1995 (SI 1995/2518)

21. Regulation 101(2) deals with the attribution of input tax to taxable supplies, requiring the identification of the goods or services supplied to the taxable person, allowing the attribution of input tax on such of those goods and services used by the taxable person exclusively in making taxable supplies and setting out circumstances in which input tax may not be attributed, such as where the goods or services are used by the taxable person in making exempt supplies or in carrying on any activity other than the making of taxable supplies.

Article 11

22. Article 11 provides:

> "After consulting the advisory committee on value added tax (hereafter, the 'VAT Committee'), each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links".

Appellant's submissions

23. The Appellant submitted that the input VAT was recoverable because:

> (1) The Services were supplied to a single taxable person; and/or
>
> (2) Within the group, the supplies were made to the Appellant; and/or
>
> (3) HPSGL always intended to make supplies that would have been taxable if it were a separate entity.

First argument

24. The Services were completed on 28th April 2011 and so, applying section 6(3) VATA 1994, that is when they were performed. At that time, the Appellant and HPSGL were part of a VAT group.

25. The Appellant maintained that it and HPSGL, as members of a VAT group, constituted a single taxable person, citing Article 11 and HMRC's letter of 19th April 2011 confirming the VAT group registration. It followed that this should inform any reading of the legislation, which refers to the "taxable person".

26. Treatment as a single taxable person precluded the members of the VAT group from being identified as separate taxable persons. It was therefore inappropriate for HMRC to seek to disallow the input tax deduction on the basis that the supply was not made to the person carrying on the business.

27. The Appellant cited the case of *Skandia America Corporation* C-7/13, para 29:

> "In this connection, treatment as a single taxable person precludes the members of the VAT group from continuing to submit VAT declarations separately and from continuing to be identified, within and outside their group, as individual taxable persons, since the single taxable person alone

> is authorised to submit such declarations (judgment in *Ampliscientifica and Amplifin,* C-162/07, EU:C:2008;301, paragraph 19). It follows that, in such a situation, the supplies of services made by a third party to a member of a VAT group must be considered, for VAT purposes, to have been made not to that member but to the actual VAT group to which that member belongs."

28. In this case, the Services had been provided to HPSGL and the business was carried on by the Appellant, but both entities formed a single taxable person. Therefore the proper analysis was that there was a single taxable person, which carried on an economic activity and made taxable supplies and to which the services in question were supplied.

29. As to whether the input tax on the Services could be deducted, the Appellant maintained that the purpose of the management-led buyout (to which they related) was to promote growth and efficiency in the business by rewarding, incentivising and motivating its management and employees. The Services were supplied for the purpose of the business and the costs of the Services should be viewed as overheads of the business.

30. On the treatment of overheads, the Appellant cited Lord Millett in *CEC v Redrow Group plc* [1999] STC 161 at paragraph 169:

> "These provisions entitle a taxpayer who makes both taxable and exempt supplies in the course of his business to obtain a credit for an appropriate proportion of the input tax on his overheads. These are the costs of goods and services which are properly incurred in the course of his business but which cannot be linked with any goods or services supplied by the taxpayer to his customers. Audit and legal fees and the cost of the office carpet are obvious examples…",

as well as *Mayflower TheatreTrust Ltd v HMRC* [2007] EWCA Civ 116 at paragraphs 27-34.

31. The Services were supplied to and formed part of the overheads of a business carried on by a single taxable person. That taxable person made exclusively taxable supplies and so the input tax was recoverable.

Second argument

32. The Appellant submitted that if, contrary to the above, one did look at the entities within the VAT group and attribute the Services to one of them, the ultimate result would be the same.

33. The Appellant had the contractual right to receive the Services and so was the recipient of the supply. In support of this, the Appellant referred to the professional engagement letters which formed the contract for the services. The contract was entered into by the Appellant in February 2011, at which time HPSGL did not exist.

34. The Appellant cited *Airtours Holidays Transport Ltd v HMRC* [2016] UKSC, where it was held that professional services were supplied to Airtours' banks rather than Airtours because the banks had the contractual entitlement to the services.

Third argument

35. Finally, the Appellant submitted that if (i) one did look through the VAT group to individual entities within in and (ii) in doing so concluded that the supply was made to HPSGL rather than to the Appellant, the result did not change.

36. The Appellant stated that it was always the intention that the directors would be engaged by HPSGL and provided to the Appellant on terms that it paid their remuneration. This would amount to a supply of services which would be taxable if the two companies were not part of the same VAT group.

37. The Appellant argued that *BAA PLC [2013] EWCA Civ 112* was distinguishable on the basis that in that case it was found that the holding company had no intention of making taxable supplies at the relevant time, referring the Tribunal to paragraph 99 of that judgment.

38. The Appellant argued that it would be inconsistent of HMRC to ignore the single taxable person in order to analyse which entity, with the group, received the supplies, but to then rely on the existence of the single taxable person to argue that supplies made by the entity so identified were not taxable supplies.

HMRC's submissions

39. HMRC submitted that:

> (1) Joining a VAT group does not allow costs that would otherwise be irrecoverable under a single registration to be recoverable as part of the group. In a management buyout situation the direction and purpose of the supplies must be looked at, not just who paid the invoice and to whom it was addressed;
>
> (2) The supplies in question were fully consumed within the management buyout process and could not relate to any taxable supplies to be made by the VAT group;
>
> (3) Where a holding company acquires a subsidiary in order to receive a dividend, this is regarded as an investment activity rather than an economic activity and any VAT incurred is non-deductible;
>
> (4) For input tax to be deductible there must be a direct and immediate link between the costs incurred and the taxable supplies and joining a VAT group does not create such a link unless one can be traced through intra-group supplies;
>
> (5) Although general costs have a direct and immediate link to all of a business' supplies because they are cost components of the business as a

whole, HMRC does not consider that management buyout costs are general costs.

40. HMRC referred to a letter dated 8th January 2015 to Mr Colcombe from Mr Curneen in which he stated: "I confirm that Heating Plumbing Supplies Group has not made any supplies and that management charges have not been made".

41. HMRC cited *EU v Ireland* C-85/11 as authority that being part of a VAT group does not automatically confer on a VAT group member a right to recover VAT charged, specifically the AG's opinion at paragraph 85:

> "When a VAT group acts in accordance with the rules of the VAT regime, the right of the persons belonging to the VAT group to deduct VAT for purchases is not expanded. This right continues to be applicable only to those supplies that are made for the activities subject to VAT by the VAT group. Nor are the members of the VAT group entitled to deduct VAT on supplies made for VAT exempted activities".

42. HMRC argued that the *Airtours* case did not apply here since it was concerned with establishing who the recipient of services was under a tripartite agreement. There was no such question here. HMRC accepted that the Services were received by HPSGL. Their argument was that HPSGL had no entitlement to input tax deduction since it had no economic activity.

43. HMRC cited the *BAA* case, where the Court of Appeal found that the holding company did not make, nor intend to make, taxable supplies of goods or services at the time the VAT was incurred. HMRC stated that *BAA* established the two requirements for the deduction of input tax were that:

> (1) The tax was incurred by a taxable person in the course of an economic activity; and
>
> (2) The goods and services on which tax was incurred must have a direct and immediate link with taxable supplies made by that person.

44. In HMRC's view, in this case the requirements were not satisfied because HPSGL was not engaged in economic activity and the Services had no direct and immediate link with any taxable supplies made.

Findings of fact

45. The Appellant's business is, and at all material times has been, solely the making of taxable supplies.

46. The purpose of the management-led buyout was to motivate and incentivise staff by giving them a stake in the business, with a view to improving the growth and efficiency of the business.

47. The Appellant engaged the services of Grant Thornton and EMW Law LLP in February 2011 to provide it with advice on the structure of the buyout and to

implement the same. The contract for these services was between the service providers and the Appellant.

48. HPSGL was incorporated on 28th March 2011.

49. A group registration for VAT was issued on 19th April 2011, with effect from 1st April 2011.

50. Invoices for the fees for the services provided were addressed to and paid by HPSGL, at a time when it was part of the VAT group.

51. Mr Curneen's service agreement is with HPSGL (dated 28th April 2011) and it is under the terms of this contract that he works for the Appellant. He receives his remuneration from the Appellant.

Discussion

52. The Appellant's first argument was that the VAT group was a single taxable person and that it was inappropriate to look through the group to its individual members and assess them as if they were taxable persons in their own right.

53. HMRC's response to this was that membership of a VAT group could not render recoverable costs that would have been irrecoverable but for membership of the group.

54. *EC v Ireland* is authority for the fact that non-taxable persons may be members of a VAT group. The parties here do not dispute that. HMRC sought to rely on this case to show that supplies to a non-taxable member of a group could not be recovered, citing the opinion of the AG, not the decision of the court. That opinion is not binding on this Tribunal. However, looking at the specific passage cited, the AG does not appear to have been arguing the same point that HMRC seek to make here.

55. The legislation states that where a VAT group exists, supplies made to a member of the group are deemed to have been made to the representative member (section 43(1)(b) VATA 1994).

56. In this case, there is a VAT group and any supplies made to HPSGL (a member of the group) are to be treated as having been made to the Appellant (the representative member).

57. Whether the input tax is recoverable then depends on whether the services to which it relates were used in connection with the making of taxable supplies (SI 1995/2518). HMRC are correct that there must be a direct and immediate link between the services received and the making of taxable supplies. The authorities cited support this and the Appellant did not dispute the point.

58. The Appellant argued that it was solely engaged in the making of taxable supplies and that the Services should be regarded as general overheads of its business, citing the *Redrow* case. In that case, Lord Millett found that general overheads of a business

could be attributed to the goods and services provided by that business and that a taxable person who made both taxable and exempt supplies could recover an appropriate proportion of the input tax on general overheads as was attributable to his taxable supplies. Professional fees were given as a specific example of what might constitute overheads. The Appellant argued that since it only made taxable supplies, all of the input tax on the Services, being overheads of the business, should be recoverable.

59. HMRC did not dispute that general overheads could be linked with taxable supplies, but they contended that the Services were not general overheads of the business. HMRC cited the *BAA* case as authority that costs associated with the takeover, by a holding company, of the shares in a company that itself made taxable supplies, were not costs of that underlying business.

60. The facts of the *BAA* case are different from those before this Tribunal. In *BAA*, a third party company, ADIL, sought to purchase the shares in BAA. ADIL undertook no economic activity: it only sought to acquire the shares in BAA. Further, at the time services were supplied to ADIL it was not part of a VAT group with BAA and there did not appear to be an intention for it to become part of one.

61. HMRC are correct in their assertion that the mere acquisition of shares with a view to receiving a dividend is not an economic activity and appears to preclude a link between services received for this purpose and any taxable supplies made by the underlying entity. However, in this particular case, it does not seem to me that there was a mere acquisition of shares with a view to receiving a dividend.

62. It is perhaps debatable whether the Services were supplied to the Appellant or to HPSGL. The contract for services was entered into by the Appellant. The invoices were addressed to and payments made by HPSGL. At least part of the advice given appears to have related to the consideration of and appropriate structure for a management-led buyout and was necessarily provided before HPSGL, the vehicle ultimately created to implement the advice, was created. The purpose of the Services was to facilitate a management-led buyout to enable employees of the Appellant to acquire a stake in the business with a view to developing and enhancing that business.

63. The parties' starting point was that the Services were provided to HPSGL, although the Appellant raised the argument that they were provided to it directly as an alternative. In this case, as will be seen below, I do not find it necessary to consider the Appellant's alternative argument. I do not believe it is material to my decision. However, the background to and motivation for the provision of the Services is relevant.

64. In a third party takeover such as that in *BAA*, in the absence of an intention to provide management or similar services that in their own right might constitute economic activity, professional costs associated with the takeover/acquisition of shares may not be linked with the underlying business activities. This principle was confirmed in the decision in *Larentia & Minerva (Case C-108/14 and C-109/14)* to which the parties also referred. The facts were different, but the conclusion reached

was that it was possible to draw a link between the costs of the acquisition of shares in a subsidiary where the holding company was involved in the management of the subsidiary.

65. Although the facts in *BAA* were different, the principles identified by the Court of Appeal in that case remain relevant. To be recoverable, input tax must be incurred by a taxable person in the course of an economic activity and there must be a direct and immediate link between the goods or services supplied (to which the tax relates) and the taxable supplies made by the taxable person.

66. In the *BAA* case the court held that the holding company, ADIL, was not engaged in any economic activity because its sole purpose was the acquisition of the shares and it neither engaged nor intended to engage in economic activity. That is not the case here. HPSGL was formed for the purpose of furthering the Appellant's business by motivating staff and the intention was…

67. Had the Services been provided solely to facilitate the acquisition of shares with a view to receiving a dividend (as in *BAA*) there would have been no direct and immediate link with taxable supplies made by the Appellant. However, in this case, the Services were provided for the direct benefit of the Appellant's business and as such can be viewed as overheads of it.

68. Taking the test in *BAA*, as set out in HMRC's submissions at paragraph 43 above:

> (1) The input tax was incurred by a taxable person (the VAT group, or, within it, the Appellant as the representative member) in the course of an economic activity (the furtherance of the Appellant's business); and
>
> (2) The Services have a direct and immediate link to the taxable supplies made by the taxable person (the VAT group, or, within it, the Appellant as the representative member), specifically to the Appellant's business since they were sought for its benefit.

69. The interests of the underlying business were at the heart of the restructure. The advice was sought and the restructure conceived for the purpose of developing the business, at the instigation of the Appellant itself. There is a direct and immediate link between the Services and the Appellant's business. The Services were provided for the purpose of furthering that business. Since the Appellant's business consists wholly of the making of taxable supplies the input tax in question is recoverable by the Appellant.

Conclusions

70. The appeal is allowed.

71. 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.

RACHEL MAINWARING-TAYLOR
TRIBUNAL JUDGE

RELEASE DATE: 10 NOVEMBER 2016