Neutral Citation: [2024] UKFTT 00703 (TC)

Case Number: TC09250

FIRST-TIER TRIBUNAL
TAX CHAMBER

Taylor House, London
Appeal reference: TC/2021/02684

VAT – credit for input tax on acquisition of property – appeal dismissed

Heard on: 26 April 2024
Judgment date: 25 July 2024

Before

TRIBUNAL JUDGE MCGREGOR

Between

KENTHOUSE PROPERTIES LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Hari Singh of ASR Solicitors

For the Respondents: Andrew Marshall, litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. This appeal concerned HMRC's disallowance of input VAT incurred on the purchase of a property by Kenthouse Properties Limited ("KPL"). The amount of VAT was £183,601.05 and it related to the period 09/18. The dispute related to whether or not the appellant company could recover input VAT on the purchase of a property.

EVIDENCE

2. I had a hearing bundle of 373 pages and an authorities bundle of 91 pages.

3. I heard sworn witness evidence from:

   (1) Abdul Ghafar ("AG"), director of KPL;

   (2) Mohammed Erfan Gaffar ("EG"), accountant for KPL; and

   (3) Kenneth Rhodes ("KR"), officer of HMRC.

   All were cross-examined.

4. I also had the benefit of skeleton arguments from both parties.

5. At the hearing, the Appellant's representative also handed up a copy of a chronology document listing every date and document in order. It was not subsequently referred to during the hearing. Since it was handed up so late and was not in an agreed form, I have not used it in reaching the factual findings I set out below.

FACTS

6. The following represent the key structural facts for this dispute and are based on the evidence presented. There are further findings of fact set out later in this decision where further discussion of the evidence is required.

7. AG bought the Kenthouse Tavern property (the "Property") in his personal name, completing the transaction on 18 February 2014.

8. At that time, the Property was a pub with residential accommodation upstairs.

9. AG bought the Property for a cost of £645,000 plus VAT of £116,120.

10. AG was registered for VAT at the time of the purchase of the Property.

11. On 13 October 2015, AG obtained planning permission from the London Borough of Bromley to create six one-bedroom flats on the first and second floor of the property.

12. KPL was incorporated on 29 December 2015, with AG as its sole director.

13. A TR1 was completed with a date of 19 March 2016 transferring the Property from AG to KPL. The consideration for the transfer was listed as £915,000.

14. KPL was identified as the proprietor of the Property at the Land Registry with effect from 19 May 2016.

15. AG made an application to register KPL for VAT on 8 December 2016. The form identified that it was an application for compulsory registration on the basis that the company had made supplies exceeding the threshold in the 30 days following 1 May 2016. HMRC registered KPL with effect from 1 May 2016.

16. Building work at the Property had been ongoing and the first residential unit was issued a certificate of completion from the London Borough of Bromley on 16 June 2017.

17. On 19 October 2018, KPL submitted an option to tax form to HMRC in respect of the Property. This was acknowledged by HMRC on 28 November 2018, with the effective date of the option being 18 October 2018.

18. On 26 November 2018, KPL submitted its VAT return for the quarter 09/18. This return made a repayment claim for £183,601.05. This reclaim included £183,000 of VAT incurred on the purchase of the Property (at the standard rate based on the purchase price of £915,000) plus a £601.05 of VAT incurred on the legal fees related to the purchase of the Property.

19. Officer Rhodes conducted a credit validation enquiry including a visit to KPL's agent's premises on 16 January 2019.

20. After further correspondence between the parties, KR issued his decision letter denying the VAT credit on 28 July 2020.

21. On 8 September 2020, KPL requested a review.

22. On 9 July 2021, HMRC issued their decision upholding the decision on review.

23. On 26 July 2021, KPL notified its appeal to this Tribunal.

LAW

24. Section 25 of the Value Added Tax Act 1994 ("VATA 1994") provides for accounting for VAT on a periodic basis, but also provides for credit for input tax suffered. Sub-section (2) provides:

> "Subject to the provisions of this section, he 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."

25. Section 26 then sets out what input tax is allowable. Specifically, for the purposes of this appeal, it allows so much input tax as is attributable to, among other things, "taxable supplies" (section 26(2)(a)).

26. Section 30 provides for the zero-rating. It sets out that goods or services will be zero-rated if they fall within Schedule 8 to VATA 1994 and, if they are, no VAT shall be charged on the supply, but shall in all other respects be treated as a taxable supply.

27. Item 1(b) in Group 5 of Sch 8 to VATA 1994 specifies:

> "1 The first grant by a person–
>
> (a) constructing a building–
>
> (b) converting a non-residential building or a non-residential part of a building into a building designed as a dwelling or number of dwellings or a building intended for use solely for a relevant residential purpose
>
> of a major interest in, or in any part of, the building, dwelling or its site…"

28. Section 95 of VATA 1994 defines a major interest in relation to land as "… the fee simple or a tenancy for a term certain exceeding 21 years…".

PARTIES ARGUMENTS

Taxpayer's arguments

29. AG bought the Property in 2014 with the intention of converting it to residential flats upstairs with a commercial unit on the ground floor and then either renting those units out or selling as units or as a whole. This is what AG does with the properties he buys.

30. The intentions of KPL were exactly the same as AG's intentions.

31. The intentions of KPL with regards to the downstairs of the Property changed over time because KPL was unable to fund a tenant for the commercial unit and it was instead converted into further residential units.

32. However, the relevant case law makes it clear that it is the intention at the time of transfer that needs to be the same.

33. AG transferred the Property into a company, KPL, because he was advised to do so by his accountant.

34. When AG transferred the Property to KPL, he did not charge VAT on the transfer because he thought it was a TOGC (transfer of a going concern).

35. Fairness dictates that AG and KPL should not be out of pocket just by transferring the Property from an individual to a company. It doesn't make sense to suffer VAT on the wholesale transfer of a business.

36. The transfer from AG to KPL should have been treated as a TOGC and that is what the Tribunal should look at.

37. KPL did later claim input VAT on the transfer but only because the TOGC treatment had been denied by HMRC and HMRC had advised KPL that it could recover its input tax.

38. The transaction should never have been captured by the VAT legislation at all and it would unjustly enrich HMRC for them to be able to keep the VAT amount charged on the transaction.

HMRC's arguments

39. The decision to disallow the VAT credit was both legally and technically correct.

40. The VAT credit has been disallowed because KPL made wholly exempt supplies of short-term rentals of the flats at the Property and not zero-rated supplies.

41. HMRC believes that KPL did not have an intention make zero-rated supplies but had an initial intention to rent out the residential flats, making exempt supplies.

42. HMRC relies on:

(1) The form VAT5L submitted by KPL alongside its VAT registration form on which the following answers were given:

(a) Are you selling, or planning to sell, all or part of the land or property (including any property you build or intend to build on the land? – No

(b) Are you renting or leasing, or planning to rent or lease, all or part of the land or property (including any property you build or intend to build on the land? – Yes, after which the following boxes were ticked as current plans:

(i) To develop new commercial property for rental or lease;

(ii) To develop new residential property for short lease or short term rental;

(iii) To develop new residential property for long lease;

(c) Will you be providing residential property to an unconnected third party at open market value? – Yes

(d) Are you making or intending to make supplies of the land or property that would be exempt without an option to tax? – Yes

(e) Do you want to opt to tax those supplies – Yes

(f) Have you made any exempt supplies of the land or property you want to opt within the 10 year period ending with the date from which you want your option to be effective – No

(2) These answers are wholly contrary to the information and responses given subsequently.

43. If the Property was purchased with the intention of making zero-rated supplies on the basis that KPL would sell leasehold flats as the grant of a first major interest of the flats after a conversion, then an application for option to tax would have been unnecessary.

44. To the extent that any of the Property was previously residential, some of the supplies of the converted property would be exempt, but there is insufficient information to determine the apportionment.

45. The intention of KPL to make taxable supplies of the Property has not been proven because:

(1) The planning application was made by AG before KPL bought the Property and is therefore not evidence of KPL's intentions;

(2) The Board resolution of KPL, which asserts KPL's intention to sell the flats either individually or as a whole unit, is dated before the submission of the VAT 5L form and contradicts what is stated on that form;

(3) The estate agent's letter dated 17 December 2018, which presents a valuation of the 9 flats at that time and advises that the values may be 15-25% higher after Brexit, is dated after KPL had already started to rent out the flats;

(4) The sales leaflets, showing the flats available for sale are undated but show photographs of the flats with personal possessions in them and therefore must have been dated after the initial rentals were commenced;

(5) No supplies or costs have been declared on KPL's VAT returns since registration.

DISCUSSION

Scope of the appeal

46. At the hearing it became apparent that Mr Singh was making submissions on the basis that the transfer of the Property from AG to KPL should have been treated as a TOGC. He argued that this was very clear in the notice of appeal and in the skeleton argument provided in advance.

47. The notice of appeal contained no details at all regarding the technical basis of the appeal – it stated simply "There is a dispute on point of law. We will submit the details 14 days before hearing.".

48. I also do not accept that it was clear from the skeleton argument that the appellant was proceeding on the basis that the transaction should have been treated as a TOGC. The earlier failed attempt to treat the transaction as a TOGC in the hands of the seller was referenced in the skeleton, but the basis of the appeal was not stated to be that the transfer from AG to KPL should be treated as a TOGC.

49. Even if this had been articulated clearly in the skeleton argument, it could still not have formed the basis of this appeal. As a matter of fact, recorded at paragraph 18 and not in dispute between the parties, KPL submitted a VAT return to HMRC in which it claimed it had suffered input tax on the purchase of the Property and that this was repayable to it.

50. When HMRC refused to make that repayment, KPL ultimately brought an appeal to this Tribunal against the decision to refuse the input tax credit on that VAT return. It is that appeal that is being decided. If KPL considered that the transaction was a TOGC, it would not have made a VAT return claiming input VAT as no input VAT would have arisen.

51. Put simply, the decision under appeal, being the denial of input VAT, does not allow for an argument that KPL should never have claimed the input VAT in the first place. Under section 83(1)(c) of VATA 1994, an appeal lies to this Tribunal with respect to the "amount of any input tax which may be credited to a person". KPL, by claiming it on the VAT return, claims that the amount to be credited should be £183,601.05. HMRC disagrees and says that amount should be zero. When KPL brought an appeal to this Tribunal, it was challenging HMRC's decision. The decision I therefore have to make is whether to allow KPL's appeal, concluding that it was entitled to input tax, or uphold HMRC's decision that KPL was not entitled to that input tax. Therefore, there is no basis on which I can consider whether the transaction should have been treated as a TOGC at the time of the transfer of the Property in May 2016, which would have resulted in no claim for input tax being made on KPL's VAT return.

The requirements for input tax recovery on this transaction

52. In accordance with VATA 1994, s 26, in order for KPL to be able to recover the input tax incurred on the purchase of the Property, KPL would need to show that the input tax was directly attributable to taxable supplies that are made by KPL.

53. KPL argues that its consistent intention has always been to make taxable supplies, being zero-rated supplies under item 1 of group 5 of Schedule 8 to VATA 1994, being supplies of the first grant of a major interest in the building by KPL, who was the person converting a non-residential building into a building designed as a number of dwellings.

54. It is clear, and I did not take HMRC to dispute, that KPL had converted a partially non-residential building into a building designed as a number of dwellings. There is clear evidence that the Property had been a pub prior to KPL's ownership and had been converted into, eventually, 9 residential flats. There is the potential complication of the fact that a small proportion of the Property was residential to start with, but given the decision made, it is not necessary to deal with that issue.

55. KPL argues that its intention was always to make zero-rated sales of these flats. This would require KPL to make a first grant of a major interest. It was accepted by both parties that this had not happened, because KPL had in fact made exempt supplies of 1 year tenancies of the flats instead. However, the question of intention remained a matter of dispute.

56. HMRC focussed on the contradictory responses between the forms submitted to HMRC by KPL and the responses provided to Officer Rhodes during his enquiries. HMRC also questioned AG on intentions during his witness evidence.

57. KPL submit that the intentions at the time of the transfer remained exactly as they had been for AG when he bought the Property – to convert into 6 residential flats to sell and then rent out the downstairs as a commercial unit, whether as a pub, shop or other use. The intentions only changed later due to market conditions – KPL couldn't find a tenant for the commercial unit downstairs and could not sell the flats. This led to two changes – the further conversion of the commercial unit into residential flats and the decision to rent out the residential flats on short tenancies.

58. I agree with HMRC that there have been inconsistencies in the message coming from KPL and AG. I would summarise them as follows:

(1) KPL's special resolution dated 4 February 2016 which records the company's decision to purchase the Property, to develop it and "within a reasonable and favourable time after the completion, Market the individual flats and or as a complete unit for sale" (sic);

(2) KPL's original application for VAT registration in December 2016 suggests that KPL will make £20,000 of zero-rated supplies over a 12-month period, amongst turnover of £100,000. It also states that VAT repayment is not expected;

(3) The VAT5L form, which accompanied the VAT registration, contained a series of statements or boxes ticked that indicate that:

(a) There was no intention to sell any of the Property;

(b) There was an intention to rent or lease out the Property on either long or short term basis;

(c) There was an intention to make supplies of land that would, absent an option to tax, be exempt supplies;

(4) An option to tax form dated 19 October 2018 which ticked a box stating that no exempt supplies of the land had been made in the 10 years ending with the effective date (being 18 October 2018);

(5) A series of tenancy agreements, all assured shorthold tenancies, relating to the flats, the earliest of which commenced in May 2017;

(6) A letter from Property World estate agents dated 17 December 2018 which proposes a market valuation for the flats at that time but also expresses that Brexit is causing downward pressure on the valuations and predicting that after Brexit, the value of the flats will increase by 15-25% and will be easier to sell;

(7) AG's witness statement, dated October 2022, includes the following statements:

(a) "I am a property developer and it was my intention to develop this Property into flats and/or commercial units and either rent or sell the units individually or as a whole so that I could make a profit on this development."

(b) "The individual units were either let on rent or leased as and when it was deemed to be in the best interest of the company."

(c) "the business and property were always intended to be developed and then let or sold as recommended by property experts at the time."; and

(8) AG's oral evidence, which was that his original intention, and the intention of the company, was to develop the flats and then sell them, but when he got no takers for the commercial unit and couldn't sell the flats, the intention changed, because KPL couldn't leave the property empty and needed the money to service the debt incurred. He stated that KPL had attempted to sell the properties, but no one wanted to buy leasehold flats with service charges. He said that he couldn't remember when KPL tried to sell the flats, but that it was both before and after they were rented out.

59. The declaration made on the option to tax form that no exempt supplies of the land had been made in the prior 10 years was not true because most of the flats had already been let on exempt short term rentals at the time that declaration was made.

60. The impression given by AG in his witness evidence was of someone who did not understand the VAT consequences of the declarations that were made in the various forms.

61. I heard evidence from EG, but it became clear at the hearing that none of the evidence he was able to give was first hand evidence from his own experience, but rather information gleaned from the papers held by his firm. I did not find his evidence to be of any probative value regarding the intentions of KPL.

62. Considering all of these separate pieces of evidence, I find that KPL's intentions on acquiring the Property were to convert it into a mixture of flats and a commercial unit with a view to making a commercial return on the outlay and that this commercial return would be in whatever format was viable and most profitable to KPL at the time, whether that was renting out or selling long leases. I accept the evidence that the intention with regards to the commercial unit changed as a result of market conditions – the original intention having been to rent out on a commercial basis, but then later converting to additional residential flats. I found no evidence that KPL made any attempt to sell the flats individually or as a whole as long leasehold or freehold sales prior to very late 2018 when KPL discussed the matter with Property World estate agents. AG's assertion in witness evidence that there had been a failed attempt to do so prior to the letting out was vague at best and did not align with the evidence in the tenancy agreements that the flats were rented out prior to the receipt of certificates of completion regarding building regulations.

63. As noted above, section 26 of VATA 1994 requires that input VAT incurred is attributable to taxable supplies. KPL cannot point to any actual taxable supplies made of the Property and therefore relies on its intention to make zero-rated supplies. However, I find that there was no clear intention to make zero-rated supplies either at the time of the transaction or later. In circumstances where only exempt supplies have been made, no zero-rated supplies have been made and there is an absence of a clear intention to make such zero-rated supplies, I find that the input tax is not available for credit.

64. Mr Singh made a number of additional submissions regarding fairness and estoppel. None of these arguments were made out in detailed form, but in summary, Mr Singh was arguing that it was unfair for HMRC to receive the output tax from AG on the transfer of the property to KPL but not to allow it as a credit for KPL.

65. He pointed in particular to a statement made in an email from HMRC to KPL's agents which stated "This would mean that although VAT is payable by the sole trader the company is able to claim the VAT back as input VAT." The context for this statement was regarding HMRC's challenge to AG's treatment of the transfer of the Property as a TOGC. HMRC had decided that the transfer of the Property did not meet the conditions to be treated as a TOGC, in particular because KPL was not VAT registered at the time of the transaction and had not made an option to tax at that time. The email invites the agents to provide additional information that might change their conclusion, in particular any evidence that the VAT registration and option to tax letters were submitted in May 2016 and/or that the property transaction had a different date. It then goes on to say "If you can not provide this information I have stated earlier that you could issue an invoice from the sole trader to the limited company. This would mean that although VAT is payable by the sole trader the company is able to claim the VAT back as input VAT."

66. Mr Singh suggests that this statement can be relied upon by KPL to explain why it made the claim that it did and that HMRC should not be able to go back on it. He also argues that this was not a generic statement but one made in an email to a specific taxpayer by an officer who had full knowledge of the situation.

67. He relied upon the Privy Council decision of *Kok Hoong v Leong Cheong Kweng Mines Ltd* [1964] AC 993 as the basis for stating that HMRC is estopped from denying the input VAT by virtue of its previous conduct, being the statement set out in the email.

68. HMRC by contrast argues that this was a general statement of the way that VAT works, rather than a specific commitment regarding KPL's ability to claim input tax.

69. Mr Singh also argued that KPL should be in the same position as AG and should not be treated differently just because AG decided to set up a company to run the development through, and that HMRC should be able to collect the VAT on one side of a transaction and disallow it on another.

70. I considered the decision in *Kok Hoong*, but did not find it to support KPL's position. The Privy Council was considering issue estoppel or *res judicata* and decided that although a default judgment could give rise to estoppel, it would only do so for what the default judgment has necessarily and with complete precision determined. Secondly the case found that an estoppel based on a default judgment could not prevent another party from applying statute.

71. In this case there has not been a default judgment that has determined the question of the ability to credit input tax for KPL. There was no further expansion as to why this case was particularly relevant to KPL. I therefore distinguish it from this case.

72. Mr Singh raised estoppel in the skeleton argument and in oral submissions but did not expand on the nature of the estoppel or attempt to adduce evidence supporting the application of estoppel. I therefore do not consider that KPL has established that estoppel applies in its case. I would note that, while I agree that the statement set out in the officer's email was not a generalised statement from a leaflet, I do not find that it was intended to be an unequivocal statement that KPL would be able to recover input VAT. The officer in question was considering AG's VAT return and not KPL's and that was the context for the statement.

73. I also do not accept Mr Singh's assertion that HMRC are somehow taking advantage of a simple business transaction. It is quite regularly the case that a transaction gives rise to output tax that must be accounted for to HMRC on the side of the supplier, but does not give rise to recoverable input tax in the hands of the recipient. While the nature of the supply is the same, the recipient's ability to recover input tax is affected by a great many factors, including the extent to which it is making taxable supplies, as was the case here.

74. On the basis of my conclusions set out above, I dismiss KPL's appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

75. 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.

ABIGAIL MCGREGOR
TRIBUNAL JUDGE

Release date: 25 July 2024