[2017] UKFTT 334 (TC)

TC05811

Appeal number: TC/2016/00051

VALUE ADDED TAX – special schemes – second-hand goods – whether puppies are second-hand goods – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

LITTLE RASCALS PETS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JANE BAILEY
MR SIMON BIRD

Sitting in public at Centre City Tower, Birmingham on 5 April 2017

Mr Jeremy Dable, of counsel, for the Appellant

Ms Esther Hickey, presenting officer, for the Respondents

DECISION

Introduction

1. The Appellant's appeal is against the Respondents' ruling, dated 16 July 2015, that the Appellant should account for VAT on the full price on the puppies it sells. The Appellant appeals on the basis that some of the puppies are "second-hand goods" and that it should account for VAT only on the margin on its sale of the puppies.

Background

2. At the time that this appeal was filed with the Tribunal, the Appellant shared common directors and engaged in the same trade as Swindells Livestock Limited ("SLL"). SLL had traded for a number of years in the sale of puppies.

3. In March 2014 the Respondents conducted an inspection of SLL's premises and VAT records. This was followed by correspondence between SLL and HMRC in relation to SLL's use of the margin scheme on its sale of certain puppies. On 23 October 2014 the Respondents provided SLL with a ruling on liability. This ruling was upheld in a review decision dated 8 July 2015 and SLL subsequently appealed to this Tribunal.

4. The Appellant was incorporated in August 2014. In November 2014 it also began trading in the sale of puppies. On 16 July 2015 the Respondents notified the Appellant that the review decision on liability dated 8 July 2015 which had been provided to SLL was also to apply to the Appellant. The Appellant appealed to this Tribunal. The precise date on which the Appellant appealed is unclear. The Appellant's Notice of Appeal is dated 5 August 2015 but date-stamped as received by the Tribunal on 23 December 2015. The Respondents do not take any point with regard to any possible delay on the part of the Appellant in submitting the appeal. To the extent that it may be required, we exercise our discretion under Rule 5 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 to extend time to enable the Appellant to submit its appeal out of time.

5. The Appellant's appeal was joined with SLL's appeal. Directions were issued to prepare the two appeals to be heard together on 17 August 2016 but, on 1 August 2016, a director of SLL sought an adjournment of SLL's appeal. The Respondents did not object to this adjournment but drew the Tribunal's attention to the fact that SLL had been wound up on the petition of a creditor on 29 June 2016. The hearing on 17 August was cancelled for both SLL and the Appellant. On 27 July 2016 liquidators had been appointed to manage the affairs of SLL but they did not express an interest in pursuing SLL's appeal to this Tribunal. Eventually SLL's appeal was struck out at the beginning of December 2016.

6. Therefore in this decision we are concerned only with the appeal of the Appellant.

Summary of the parties' position

7. The Appellant accepts that it is correct to account for VAT upon the full sale price of all home-bred puppies, and also upon the full sale price of all bought-in puppies which were purchased from its VAT registered supplier. The Appellant contends that it should operate the margin scheme in respect of its sale of all bought-in puppies purchased from its non-registered supplier on the basis that these puppies constitute second-hand goods.

8. The Respondents take the view that the puppies do not fall within the definition of second-hand goods, and that VAT should be accounted for upon the full sale price of all the puppies, irrespective of the VAT status of the Appellant's supplier.

Evidence heard

9. For the Appellant we heard evidence from Edward Swindell, a director of the Appellant, and Amy Allen, the Appellant's Office Manager. For the Respondents we heard evidence from Joanne Jackson, a Higher Executive Officer of the Respondents.

10. We found all three witnesses to be truthful. However, it was clear that the relationship between Mr Swindell and the Respondents was not a happy one. Mr Swindell obviously feels deeply aggrieved at the Respondents' actions with regard to SLL, and considers them responsible for the chain of events which led to the liquidation of SLL. That emotional sense of grievance coloured Mr Swindell's responses when being cross-examined by the Respondents and when talking about his interactions with Ms Jackson.

11. Much of the evidence we heard concerned SLL and the position around March 2014 when the Respondents visited SLL at the premises at which the Appellant now operates. That visit predates the Appellant's incorporation and trading. We are concerned with the Appellant's position and endeavour to focus on the facts relevant to the Appellant in our findings of fact.

Facts found

12. On the basis of the documents in our bundles and the oral evidence we heard we find the following facts:

a) The Appellant was incorporated in August 2014. The Appellant's first period of trade was the three month period ended 31 January 2015. As no return was submitted for this period the Respondents raised an assessment to VAT. The Appellant has filed VAT returns for all subsequent quarters. From a spreadsheet prepared by the Respondents we find that the total VAT paid by the Appellant thus far is just under £90,000 or an average of just under £10,000 each quarter.

b) The Appellant was incorporated, as Mr Swindell told us, to "trade in and sell puppies, principally to members of the public". The Appellant carries out its trade from farm premises in Lincolnshire. The Appellant breeds

puppies on these premises and also buys in puppies from suppliers for onward sale. The Appellant has 14 employees including its directors. Two of these employees are part-time and are employed only to provide cover for other members of staff who are on leave or are unwell.

c) At the farm premises the Appellant currently has 75 adult kennels with approximately 200 breeding dogs: 145 females and 55 males. At the date of the hearing the Appellant also had, in separate kennels on the premises, approximately 55 puppies available for sale and another 20-30 puppies aged six to eight weeks old and so too young to be made available for sale. In the Appellant's bundle is a spreadsheet prepared by the Appellant which documents the puppies as they become available for sale by the Appellant. This spreadsheet shows additional puppies becoming available for sale by the Appellant roughly every one to two weeks (twice in the second half of January 2017, twice in February 2017 and once in early March 2017).

d) The Appellant buys puppies from two suppliers in Northern Ireland, and buys around 15 to 30 puppies each month, depending on the puppies available. The two suppliers breed puppies for sale and almost always sell some puppies from each litter to private individuals before the remaining puppies are available for the Appellant to buy. The puppies are about eight weeks old when they are bought by the Appellant. SLL previously bought puppies from around ten different suppliers in the Republic of Ireland but changes in Irish regulations meant that the Appellant was unable to buy puppies younger than 15 weeks old from suppliers in the Republic of Ireland. This reduction in the supply of puppies has resulted in the Appellant taking steps to increase its breeding stock and so increase the ratio of home-bred to bought-in puppies it sells.

e) Mr Swindell estimated that approximately 60-70% of the puppies now sold by the Appellant are home-bred by the Appellant in Lincolnshire, with the remaining 30-40% of puppies sold by the Appellant being bought-in from its two suppliers. Mr Swindell told us that the Appellant's record showing the puppies which are available is updated on at least a daily basis. The last date noted on the spreadsheet in our bundle is 6 March 2017, and we find that the spreadsheet was created on or about that date. The spreadsheet records events for 105 puppies, of whom 51 are noted as "HB" or home-bred, and the remaining 54 are shown are being purchased from one named supplier. The number of puppies purchased each month is consistent with Mr Swindell's evidence on this point, but the spreadsheet differs slightly from his estimated sales proportions. On the assumption that the Appellant will aim to sell all, or virtually all, of the puppies it buys or breeds, we find that about 50% of the puppies sold by the Appellant are home-bred and the remaining 50% are purchased from suppliers for onward sale.

f) Mr Swindell told us, and we accept, that payment for the bought-in puppies is made partly in cash on the day and partly by bank transfer. This mixed payment ensures that the suppliers are paid some cash on the day of purchase but that the Appellant is able to demonstrate the purchase audit trail as the bank transfer of part of the payment for the puppies is shown in the Appellant's bank records. The price paid for bought-in puppies is shown on the Appellant's spreadsheet. The Appellant paid £250 for each puppy (irrespective of breed) bought in January and February 2017 and £240 for each puppy bought in March 2017.

g) One of the Appellant's two suppliers is VAT registered, and the other supplier is non-registered. Mr Swindell told us, and we accept, that the base cost charged for each puppy is the same for each supplier. The only difference in the price paid by the Appellant to each of the two suppliers is that the VAT registered supplier adds VAT to that base cost price.

h) Mr Swindell told us about what happened to the puppies once they reached eight weeks old and were weaned (whether bought-in or bred by the Appellant). The puppies are inspected by a veterinarian (within 24 hours of arrival at the farm for puppies bought-in), and are wormed, microchipped and vaccinated. The puppies live in puppy kennels, away from the other dogs. The puppy kennels have two areas, a back area where the puppies sleep and a front area for play. Puppies under the age of 12 weeks old are not exercised. The puppies are taken, litter by litter, into the farm shop for socialisation training. Two employees are responsible for the socialisation of the puppies. During their socialisation the puppies are given toys to play with, they begin toilet training and they are videoed to be advertised for sale.

i) The Appellant's current business model is to sell the puppies when they are aged between ten weeks and five months old. On the spreadsheet we saw, 26 of the 77 puppies sold were less than ten weeks old at the date of sale, 46 puppies were aged between ten to 12 weeks, and the remaining five puppies were aged 12 to 14 weeks old at the date of sale. 19 puppies remained available for sale when the spreadsheet was printed (6 March 2017), and these ranged in age from ten weeks old (ten puppies) to 15 weeks old (one puppy). We find that the majority of puppies are sold by the time they reach 12 weeks of age and that almost all puppies will have been sold before they reach 14 weeks.

j) The Appellant's aim is to sell puppies principally to private individuals and families although a very small number of puppies could be sold to pet shops. The Appellant would sometimes also keep a few puppies to join its breeding stock. On the spreadsheet we were shown seven of the 105 puppies shown were noted as being kept: three were bought-in puppies and four were home-bred puppies. Mr Swindell told us that a charity which provided guide dogs for blind children might also buy a puppy which was regarded as suitable to be a guide dog but these puppies would

not have been given any greater training than puppies sold to private individuals to be pets.

k) The Appellant's spreadsheet showed the price paid for the 77 puppies which had been sold. These prices ranged between £400 and £1,500 per puppy, with 49 of the 77 puppies being sold for £500 or more. There was limited overlap between the breeds bought-in and the breeds home-bred by the Appellant but where there was some overlap (Cockapoos), we could see that there was no obvious distinction in the price charged for home-bred puppies and bought-in puppies.

l) The Appellant currently charges VAT upon the full price of all puppies sold and all VAT returns submitted have declared VAT on this basis.

Discussion and decision

13. This appeal, made under Section 83(1)(b) Value Added Tax Act 1994 ("VATA 1994") is against the Respondents ruling on the VAT chargeable on the Appellant's supply of goods. In such an appeal the onus of proof lies with the Appellant. The standard of proof is the balance of probabilities.

14. The essence of the Appellant's appeal is that the Respondents are wrong not to regard the puppies as "second-hand goods". On that basis the Appellant argues that the ruling on liability is incorrect. The parties are agreed that, although this is unlikely to be how many puppy-owners would view their animals, puppies are tangible moveable goods. The parties were also agreed that puppies can, in principle be second-hand goods, although both parties also acknowledged that the description "second-hand goods" was not one which would ordinarily be applied to living creatures, particularly not family pets.

<u>The legislative background</u>

15. It is convenient to start our discussion by setting out the EU legislation relevant to the taxation of second-hand goods, and then looking at the domestic legislation which gives effect to that EU law.

16. Article 26a of the Sixth Council Directive (77/388/EEC) ("Article 26a") provides that there shall be special arrangements applicable to certain items including second-hand goods. Definitions are set out in part A and, for the purposes of Article 26a:

> (d) second-hand goods shall mean tangible movable property that is suitable for further use as it is or after repair, other than works of art, collectors' items or antiques and other than precious metals or precious stones as defined by the Member States; and
>
> (e) taxable dealer shall mean a taxable person who, in the course of his economic activity, purchases or acquires for the purpose of his undertaking, or imports with a view to resale, second hand goods … whether the taxable person

is acting for himself or on behalf of another person pursuant to a contract under which commission is payable on purchase or sale.

17. Part B of Article 26a provides:

> 1. In respect of supplies of second-hand goods … effected by taxable dealers, Member States shall apply special arrangements for taxing the profit margin made by the taxable dealer in accordance with the following provisions.
>
> 2. The supplies of goods referred to in paragraph 1 shall be supplies, by a taxable dealer, of second-hand goods … supplied to him within the Community:
>
> - by a non-taxable person,
>
> 3. The taxable amount of the supplies of goods referred to in paragraph 2 shall be the profit margin made by the taxable dealer, less the amount of value added tax relating to the profit margin. That profit margin shall be equal to the difference between the selling price charged by the taxable dealer for the goods and the purchase price.

18. Therefore the position under EU law is that a taxable person who buys second-hand goods in the course of his economic activity is a taxable dealer. Second-hand goods are those suitable for further use, and – for there to be a further use – there must have been a prior use. So, when a taxable person buys goods which have already been used, for the purpose of his undertaking or for resale, he becomes a taxable dealer. (The taxable dealer does not himself have to use the goods, as they were already second-hand at the point of purchase by him.) When a taxable dealer sells on those second-hand goods, either as they are or after repair, he may opt to be charged VAT upon the profit margin when selling those second-hand goods.

19. In order to give effect to Article 26a, the UK enacted Section 50A VATA 1994 which provides that the Treasury may by order provide that a taxable person may be entitled to opt for VAT to be charged by reference to the profit margin on his supplies of second-hand goods rather than by reference to the value of those goods.

20. The Value Added Tax (Special Provisions) Order 1995 (SI 1995/1268) (the "Special Provisions Order"), made under the power in Section 50A VATA 1994, enables certain suppliers to opt to account for the VAT chargeable on the profit margin on the supply instead of by reference to its value. Article 12(1) of the Special Provisions Order provides:

> (1) Without prejudice to article 13 below and subject to complying with such conditions as the Commissioners may direct in a notice published by them for the purposes of this Order or may otherwise direct and subject to paragraph (4) below, where a person supplies goods of a description in paragraph (2) below, of which he took possession in any of the circumstances set out in paragraph (3) below, he may opt to account for the VAT chargeable on the supply on the profit margin on the supply instead of by reference to its value.

(2) The supplies referred to in paragraph (1) above are supplies of—

(b) second-hand goods.

(3) The circumstances mentioned in paragraph (1) above are—

[(a) that the taxable person took possession of the goods pursuant to—

(i) a supply in respect of which no VAT was chargeable under the Act or under Part I of the Manx Act;

21. Second-hand goods are defined in Article 2 of the Special Provisions Order as follows:

"second-hand goods" means tangible moveable property that is suitable for further use as it is or after repair, other than motor cars, works of art, collectors' items or antiques and other precious metal and precious stones.

22. The Special Provisions Order is supplemented by Public Notice 718, parts of which have force of law. Although this Public Notice may be relevant to the parties if a subsequent issue regarding record-keeping arises, we did not find Public Notice 718 of assistance in determining the central issue between the parties in this appeal.

23. It seems to us that the Special Provisions Order can be construed more widely than Article 26a. It is clear from Article 26a that the option to charge tax on the margin is available only to taxable dealers, and that taxable dealers are taxable person who buy second-hand goods for the purpose of their undertaking or for resale. By contrast, the Special Provisions Order does not specify that the goods purchased must be bought for the economic activity of the taxable person. It seems possible that a VAT registered individual trading in sports goods might purchase a second-hand bicycle from a private individual for his personal enjoyment, subsequently tire of cycling and then add that bicycle to his trading stock. That bicycle would not have been bought for the purposes of the undertaking or as stock but an onward sale appears to meet the criteria of the Special Provisions Order.

24. We should note that the Special Provisions Order is also less clear than Article 26a as to the stage at which goods should be assessed to ascertain whether they are second-hand. It is clear from Article 26a that the goods must be second-hand at the point when they are bought by the taxable person who wishes to operate a margin scheme when the goods are sold on. However, it is possible to read the Special Provisions Order as allowing a taxable person who buys new goods from a non-registered trader and then uses those goods, to sell on those goods as second-hand. We were not addressed on this point by either party, nor on whether we should regard the Special Provisions Order as being ultra vires to the extent that it goes further than Article 26a. While we consider that the better interpretation of the Special Provisions Order is that the goods should be second-hand at the point that the taxable person took possession of them – to follow the intention of Article 26a to which the Special Provisions Order attempts to give effect – we will consider the position under both interpretations.

Are the bought-in puppies second-hand when purchased by the Appellant?

25. It is against that legislative backdrop that we consider first the issue of whether the puppies bought by the Appellant are second-hand goods. The only puppies in question are those bought-in from the Appellant's non-registered supplier. The Appellant accepts that neither the puppies that are purchased from its VAT registered supplier, nor the home-bred puppies, can meet the requirements of the Special Provisions Order.

26. We started from the position that for any goods to be "suitable for further use", there must have been a prior use. We see no reason for that prior use to be different from the further use. Some goods which are purchased second-hand (for example, a washing machine) have limited scope for being used in any other way than that intended by the original producer, and are highly likely to be used in the same way by the original user and by all subsequent users.

27. Therefore in considering first whether the puppies are second-hand at the point of purchase by the Appellant, we considered whether they had previously been used. In this regard the Appellant submits that the puppies have been used as pets by the non-registered breeder and so each puppy has been used. It followed that at the point of onward sale to a private individual, a puppy will be "suitable for further use". The Respondents disagree, contending that the puppies were not used when bought by the Appellant and that, in any event, under the authority of *Förvaltnings AB Stenholmen v Riksskatteverket* [2004] STC 1041 ("*Stenholmen*"), a decision of the Court of Justice of the European Union ("CJEU"), animals bought from their breeder cannot be second-hand goods.

28. Before looking at *Stenholmen* we remind ourselves of the factual position here. The puppies were eight weeks old and just weaned from their mother when they were bought by the Appellant. When Mr Swindell was asked to what use the breeders put the puppies, he told us that they "bred puppies". He added that the breeders almost always sold some puppies in each litter to individuals before the Appellant bought other puppies from that litter. These answers tend to suggest that the breeders regarded the puppies as stock, and not that they used the puppies as pets. We consider the eight weeks old puppies were too young to have been used for any other purpose.

Stenholmen

29. In *Stenholmen*, the question referred to the CJEU was whether a horse bought by a taxable person from a private individual (rather than a breeder) and then sold on after training was to be regarded as second-hand goods as the time of the sale. The CJEU reached the conclusion that in principle a horse or other animal could be second-hand goods, and concluded (paragraph 29):

> Thus an animal bought from a private individual (other than the breeder) which is sold on after training for a specific use may be considered to be second-hand goods.

30. The Respondents argue that as the CJEU's decision decided that in principle animals could be regarded as second-hand goods, and the CJEU specifically excluded animals bought from their breeder, then the puppies bought by the Appellant from its non-registered supplier (the puppies' breeder) cannot be second-hand goods.

31. The Appellant argues that there is no attempt by the CJEU to explain why a breeder should be considered to be in a different position from other sellers of animals, and that we should look at the economic rationale for *Stenholmen* which suggests that fiscal neutrality rather than the status of the seller is decisive. We consider the economic rationale below. However, it seems to us that some explanation for the distinction between the breeder and other sellers is given in the opinion of Advocate General Stix-Hackl. At paragraph 42 the Advocate General notes the Commission's submission:

> Whilst the value added tax system does not cover newborn animals, which are not subject to any value added tax before their supply to the dealer, it does cover animals which were first supplied to a non-taxable person and then sold to a dealer.

32. Advocate General Stix-Hackl then considers the economic background and the position of a private individual in a supply chain, before she concludes (at paragraph 46):

> It follows … that animals purchased from a private individual, rather than a horse breeder, can be considered to be second-hand goods.

33. The Advocate General discusses the training which the horse has undertaken but concludes that change in function is not a helpful criterion. She returns to the economic rationale (which we discuss below), concludes that the horses can be second-hand goods, and states (at paragraph 61):

> If the horses were not treated as second-hand goods within the meaning of the provision in question, they would – reintroduced into commercial circulation – be fully taxed again.

34. As the Advocate General's conclusion is based upon the economic supply, we conclude that the Commission's submission was relevant to that conclusion and that breeders are distinguished from other owners because they have not paid VAT on the birth of the foal. Horses bought and then sold by private individuals have been in commercial circulation and then re-enter commercial circulation. A horse sold for the first time by its breeder enters commercial circulation for the first time and so there is no prior taxation.

35. The CJEU was brief in its Judgment and did not discuss the position of breeders, except to exclude them. At paragraph 25 the Judgment states:

> To tax the supply by a taxable dealer of an animal such as a horse, bought from a private individual and sold on after training, on the basis of its total price would theoretically amount to double taxation since, however large that part of

the price attributable to training, part of the price would continue to represent the purchase price, including in almost all cases a sum paid in respect of input VAT by the private individual which neither he nor the taxable dealer could deduct.

36. Therefore, although we would agree with the Appellant that the distinction between a breeder and another individual is not clearly explained by the CJEU, we consider that the CJEU's reason for excluding breeders lies in the fact that individuals who have purchased a horse have paid VAT on that purchase, whereas individuals who own horses which they have bred, have not paid VAT on the birth of the foal. The CJEU considered it appropriate to regard the re-entry of a horse into a supply chain as a purchase of second-hand goods because the price of that horse included "a sum paid in respect of input VAT by the private individual which neither he nor the taxable dealer could deduct."

37. That brings us to the Appellant's main argument which lay in the economic rationale for *Stenholmen* and the economic distortion it was said would be suffered in this case if the Appellant was not able to use the margin scheme on the sale of the puppies bought-in from the non-registered supplier.

38. The Appellant's main argument in relation to *Stenholmen* was that what the CJEU was attempting to address was economic distortion and that we should focus upon this aspect. We agree with the Appellant that concerns regarding economic distortion and fiscal neutrality lie at the heart of *Stenholmen*.

39. We also agree with the Appellant that the CJEU's primary concern was that goods which had progressed through an economic chain, with VAT borne by the final consumer, should not carry that original VAT with them when they entered a subsequent economic chain. The rationale for Article 26a is to resolve the problem of double taxation which occurs if goods which have passed through one economic supply chain, with VAT being borne by a final consumer, then subsequently enter another economic supply chain. The price charged for the goods by that final consumer when the goods enter that second supply chain inevitably takes account of the VAT which the final consumer has borne. When a taxable dealer buys those goods, and cannot recover the VAT which is inherent but not explicit on that purchase, Article 26a ensures that VAT will be borne only on the margin in respect of the subsequent sale of those goods. For that taxable dealer to charge VAT on the full sale price would result in the goods carrying the inherent VAT from the first supply chain as well as the VAT in the second supply chain: double taxation.

40. The Appellant's submission was that it was bearing the cost of VAT twice over in paying the VAT borne by its non-registered supplier. (Despite the CJEU's conclusion in *Stenholmen*) the Appellant argued that although the non-registered supplier did not pay to acquire the puppy, it did incur costs in its trade of breeding puppies and in raising the puppy from birth to eight weeks. Those costs (for example, veterinary charges and food once the puppy had been weaned) would (or perhaps more accurately could, as there was no evidence about the breeders' purchasing) include an element of VAT in their price. The Appellant's argument was that similar

purchases made by the VAT registered breeder would cost less as the VAT-registered breeder was able to recover the VAT element included in these costs. The non-registered breeder was not able to recover the VAT element in these costs and so this element was passed on to the Appellant in the price charged for the puppy. The Appellant argued that it was economic distortion for it to be required to account for VAT on its full sales price as it was unable to recover the VAT suffered by its non-registered supplier and which was inherent in that supplier's price. The puppies should be regarded as second-hand goods in order that the Appellant could avoid the economic distortion which the CJEU was anxious to avoid in *Stenholmen*.

41. It is by no means obvious to us that the VAT on costs incurred in increasing the value of an asset should be treated in the same way as VAT incurred on the purchase price. We have discussed above what seems to us to be the reason why "the breeder" (not "a breeder") is excluded from the conclusion in *Stenholmen*, namely that there is no acquisition cost which can carry inherent VAT from previous commercial circulation of the goods. There would be no reason for the CJEU to have excluded breeders if the costs incurred in increasing the value of an asset were to be treated in the same way as the cost of acquisition. But, putting this point to one side, the main difficulty we see with the Appellant's argument on economic distortion is that it is not supported on the facts of this case.

42. Mr Swindell's evidence was that the base cost element of the price charged by the Appellant's two suppliers is the same. We questioned Mr Swindell closely on this point and he was clear that the only difference in price was that one supplier would add VAT to the base cost whereas the other would not. As the Appellant, a VAT registered trader, is able to recover the VAT it has paid upon its purchase of stock, it follows that the cost borne by the Appellant for each puppy it buys is the same, irrespective of whether the supplier is VAT registered.

43. In this case, even if we were to disregard the conclusion of the CJEU that animals bought from their breeder cannot be second-hand, and we were instead to treat the non-registered puppy breeder as a final consumer with regard to the puppies, it is clear that none of the presumed original VAT suffered by that breeder is included in the price paid by the Appellant for those puppies. There is no inherent VAT distorting the purchase price paid by the Appellant: the base cost of each puppy is the same irrespective of whether the breeder is VAT registered. If there was inherent VAT in the base cost then the price charged by the non-registered breeder would be higher than the base cost charged by the VAT registered breeder. As the base cost is the same then any VAT borne by the non-registered breeder is clearly not passed on to the Appellant in the price charged for the puppy. Therefore we do not agree that there is economic distortion in this case.

44. We are bound by the decision of the CJEU in *Stenholmen*, and so we conclude that, as a matter of principle, animals cannot be second-hand goods at the time they are bought from their breeder. We agree with the Appellant that the focus of the CJEU in *Stenholmen* was to avoid economic distortion but (even disregarding the CJEU's primary conclusion), on the facts of this case there is no economic distortion. Finally, even if we were not bound by *Stenholmen*, on the evidence we heard the

Appellant did not satisfy us that the breeders used the puppies as pets in their first eight weeks of life.

45. We conclude that the puppies are not second-hand goods at the time they are bought by the Appellant from its non-registered supplier.

Are the bought-in puppies second-hand when they are sold by the Appellant?

46. Above we set out our conclusion that the better interpretation of the Special Provisions Order is that the goods should be second-hand at the time of purchase by the taxable person who wishes to operate the margin scheme when those goods are subsequently resold. This interpretation would reflect the wording of Article 26a.

47. However, if we are wrong in that regard then under the alternative interpretation it could be possible for goods bought new and then used by the taxable person, to be second-hand when they are sold by that taxable person. If that is the case then, although the puppies are not second-hand when bought by the Appellant (either on the facts or under the principle in *Stenholmen*), it might be that they are second-hand for the purposes of the Special Provisions Order when sold by the Appellant.

48. In this regard the Appellant contended that the puppies were used during its period of ownership; the Respondents contended that the puppies were not used during this time.

49. We have found that the puppies were about eight weeks old when purchased. The Appellant's business model was to sell puppies between the ages of ten weeks old and five months old, though we found that the majority of puppies were sold by the age of 12 weeks. We heard evidence about the house training and socialisation provided to the puppies during the two or more weeks in which they were owned by the Appellant. We do not consider that this training is strictly relevant to the issue of whether the puppies were used in any capacity. It is true that in *Stenholmen* the horses purchased were trained so that they could be used in a different way by a subsequent purchaser. But the horses were not second-hand because they had been trained but because they had already been in commercial circulation.

50. Given their age when sold by the Appellant, we do not consider it credible that the puppies could have be used for any purpose other than as a pet. The puppies would still be too young to be working dogs of any kind. In considering whether the Appellant used the puppies as pets, we had regard to the language used by Mr Swindell in talking about the puppies. He described the puppies as stock, and told us that the Appellant's purpose is to trade in puppies. When Mr Swindell was asked to what use he put the puppies, he said that he "prepared them for sale, for new homes". When he was asked if the puppies were held out for sale as "second-hand", Mr Swindell did not directly answer the question, instead telling us that it was made clear to the Appellant's customers that some of the puppies had been imported. Looking at how the puppies were treated, the evidence was that the puppies were housed in pens on the farm, rather than kept in the Appellant's directors' homes, and (on the basis of the spreadsheet) the puppies were given numbers rather than names. The socialisation

and house-training process was described as being undertaken litter by litter rather than on a puppy by puppy basis. One puppy with a heart murmur, which could not be sold on, was given away to "Angie", a pet shop owner, to be rehoused. None of this suggests that the Appellant or its directors regarded the puppies as their pets or used them as pets. By contrast it is illuminating to recall how Mr Swindell described the Appellant's customers' response: they regarded their puppy "like a new baby".

51. The Appellant argued that the mere patting of a puppy's head, or even the admiration of a puppy from afar, would be petting and so would constitute usage of the puppy as a pet. We do not agree that this amounts to using the puppies as pets. A horse in a field might be admired from afar or even patted on the head by a countryside ambler. That would not mean that the ambler had used the horse as a pet.

52. We note that a small number of puppies were retained by the Appellant to join the Appellant's breeding stock. We consider that this small number of puppies is (in due course) used by the Appellant for the purpose of breeding. However, we do not consider that the remainder of the puppies were used as pets (or in any other way) by the Appellant. We conclude that the socialisation and veterinary care described by Mr Swindell was to increase the puppies' market value. Any head patting was an incidental part of the puppies' socialisation and preparation for onward sale, and was not usage as a pet. The puppies were bought with the intention of being sold for profit. The puppies were regarded as valuable stock and looked after accordingly but their treatment lacks the individual care and attention, and mutual relationship of trust and affection, which would normally characterise a relationship between an owner and a pet.

53. We conclude that the puppies are not used during the period they are owned by the Appellant, and so are not second-hand goods at the time they are sold by the Appellant to its customers.

Global accounting

54. We have concluded that the bought-in puppies are not second-hand goods either when bought by the Appellant or when sold by the Appellant. If we had concluded that the puppies were second-hand goods then the Appellant would (provided it met all the criteria of the margin scheme) have been able to account for VAT on the margin on the sale of the puppies bought-in from its non-registered supplier. As the decision under appeal is a decision on liability, we did not hear argument on the Appellant's record-keeping or see any records. However, as we were briefly addressed on Article 13 of the Special Provisions Order, we will respond on two points which arose out of the construction of that Article.

55. Article 13 of the Special Provisions Order provides:

> (1) Subject to complying with such conditions as the Commissioners may direct in a notice published by them for the purposes of this Order or may otherwise direct, and subject to paragraph (2) below, a taxable person who has opted under article 12(1) above may account for VAT on the total profit margin

on goods supplied by him during a prescribed accounting period, calculated in accordance with paragraph (3) below, instead of the profit margin on each supply.

(2) Paragraph (1) above does not apply to supplies of—

(a) motor vehicles;

(b) aircraft;

(c) boats and outboard motors;

(d) caravans and motor caravans;

(e) horses and ponies;

(f) any other individual items whose value calculated in accordance with article 12(5)(a) above, exceeds £500.

56. The Respondents submitted that, on the basis that they applied their guidance on horses and ponies to the Appellant, a similar view approach should be adopted in relation to Article 13(2)(e) and so "horses and ponies" should be interpreted as including dogs. The Appellant pointed out that Paragraph (2) was not an inclusive list and that any goods not specified in that list should be taken as not being on that list. We agree with the Appellant. We do not consider that "horses and ponies" can be interpreted as including a non-equine animal such as a dog, and it is clear that dogs are not separately listed.

57. The second point which arose on the construction of Article 13 was whether the puppies might be excluded as being individual items whose value exceeded £500, and so within Article 13(2)(f). Having had the benefit of looking at Article 12(5)(a) subsequent to the hearing, it is clear that it is the purchase price, rather than the selling price, which determines the value of the goods for the purposes of Article 13. On the evidence we have seen, the purchase price paid by the Appellant for each puppy was less than £500. Therefore the puppies did not fall within Article 13(2)(f).

Legitimate expectation

58. One final matter which we need to touch upon is the Appellant's argument that it had a legitimate expectation that the Respondents would allow it to use the margin scheme. That expectation is said to rest upon a 2008 letter sent to SLL by the Respondents. That authority to use the scheme was then said to have been withdrawn abruptly by the Respondents by a letter to SLL dated 2 September 2014. Although the Appellant did not begin trading until November 2014, it is said that the Appellant was set up in expectation that the 2008 position of SLL would continue and would be applied to the Appellant.

59. As we explained when this argument was raised before us, this Tribunal does not have jurisdiction to consider arguments relating to legitimate expectation, see *HMRC v Abdul Noor* [2013] UKUT 71 (TCC). The Appellant must proceed elsewhere if it wishes to pursue arguments in relation to this point.

Conclusion

60. For the reasons set out above we conclude that the puppies bought-in by the Appellant are not second-hand goods within the meaning of Article 26a, and (in case it is different) the puppies sold by the Appellant are not second-hand goods within the meaning of the Special Provisions Order. The Appellant has not satisfied us that the Respondents' ruling on liability is incorrect, and so its appeal against that ruling is dismissed.

61. 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.

JANE BAILEY
TRIBUNAL JUDGE

RELEASE DATE: 20 APRIL 2017