Neutral Citation: [2022] UKFTT 00291 (TC)

Case Number: TC08573

FIRST-TIER TRIBUNAL
TAX CHAMBER

[Taylor House]

Appeal reference: TC/2018/07517

VAT – lease rental invoices - whether the requirements of s 24 of the Value Added Tax Act 1994 and reg. 111 of the Value Added Tax Regulations 1995 were met – no - whether the Appellant held a valid VAT invoice which entitled it to claim input tax – no — appeal dismissed

Heard on: 15 June 2022
Judgment date: 22 August 2022

Before

JUDGE NATSAI MANYARARA
DEREK ROBERTSON JP

Between

STAR SERVICES OXFORD LIMITED

Appellant

and

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: No Appearance

For the Respondents: Mr M Uddin, Litigator of HM Revenue and Customs Solicitor's Office

DECISION

INTRODUCTION

1. The Appellant appeals against an assessment of VAT ('the Assessment'), in the sum of £26,250.00, for the periods 06/14 to 12/17. The Assessment relates to input tax claimed on services provided by Oxford City Council ('OCC') to rent the premises known as 6 Gloucester Street ('the Premises'). The Assessment was issued on 25 June 2018, pursuant to s. 73(1) of the Value Added Tax Act 1994 (hereinafter referred to as 'VATA').

BACKGROUND FACTS

2. On 29 August 2013, Mr Latifi (sole proprietor in a property rental business) entered into a lease agreement ('the Agreement') with OCC, in relation to the Premises. OCC raised quarterly rental invoices in the sum of £8,750.00, plus standard-rated VAT, to Mr Latifi.

3. On 27 November 2013, the Appellant was incorporated. The Appellant was registered for VAT with effect from 27 September 2013. The Appellant's business is as a Bed & Breakfast, and the Appellant occupied the Premises.

4. On 20 August 2014, the Appellant sublet a room to Lola Zeng Tea/Coffee Shop ('*Lola Zeng*'). The Appellant raised quarterly invoices to Lola Zeng in the sum of £7,500.00, which flowed through the Appellant's VAT returns. A room was also sublet to Stitch (Tailor) ('*Stitch*') and the sum of £600 per month was paid to Mr Latifi, directly.

5. On 22 May 2017, HMRC visited the Premises to inspect the Appellant's books and records ('the Inspection'). On 12 June 2017, HMRC explained that the VAT claimed by the Appellant as input tax on the rental of the Premises had to be to the taxable person (the Appellant), and not Mr Latifi.

6. On 30 November 2017, the Appellant's agent explained that the sub-letting of the main ground floor space of the Premises to Lola Zeng had already been properly accounted for by the Appellant in its VAT returns. It was further explained that Stitch is a friend of Mr Latifi who looks after the Premises in Mr Latifi's absence.

7. On 1 May 2018, HMRC issued a notice under Schedule 36 of the Finance Act 2008 ('Schedule 36') to provide information and produce documents. HMRC then raised an Assessment on 25 June 2018. On 28 June 2018, the Appellant's agent argued that Mr Latifi is the beneficial owner of the Appellant, by virtue of controlling shares and directorship.

8. HMRC replied, on 4 July 2018, and explained why VAT was assessed and why the charge to Lola Zeng was not claimable. The explanation given was that Mr Latifi and the Appellant are separate legal entities, both of whom are required to register for VAT separately if carrying on taxable business activities. On 5 July 2018, HMRC reiterated this explanation.

9. On 21 August 2018, the Appellant's agent requested a review on the basis that there was a technical error in the lease agreement, and that the Assessment was excessive. The agent added that the lease has since been registered to the Appellant (on 20 June 2018).

10. On 5 October 2018, HMRC issued its review conclusion, upholding the Assessment.

11. On 3 November 2018, the Appellant lodged its appeal with the Tribunal.

THE PARTIES' RESPECTIVE POSITIONS

12. HMRC's written case can be summarised as follows:

(1) The requirements of s. 24 VATA have not been met, and the VAT on the rental invoices is not deductible by the Appellant.

(2) The Appellant does not hold a valid VAT invoice, which entitles it to deduct the input tax. OCC leases the Premises to Mr Latifi, who then sublets rooms to the Appellant, Lola Zeng and Stitch. Accordingly, the supply from OCC is not to the Appellant. VAT was incurred by Mr Latifi and not the Appellant, so it is not claimable by the Appellant and has correctly been disallowed. The incorrect issue of a VAT invoice is a debt to the Crown, under para. 5, Schedule 11 VATA.

(3) It is asserted that the supply is in connection with the Appellant's incorporation, and for the Appellant's benefit. This however relates to the Transfer of a Going Concern ('TOGC'). Furthermore, the disputed VAT includes periods that post-date the Appellant's incorporation.

(4) The rent from Stitch, in the sum of £600.00 per month, was paid to Mr Latifi directly and is not accounted for by the Appellant. It is not taxable under para. (d) and (e) of Item 1, Group 1, Schedule 9 VATA.

(5) The re-assigned lease has no bearing on the property rental activities undertaken by Mr Latifi between 29 August 2013 (when the lease was granted) and 20 June 2018 (when the lease was reassigned).

(6) HMRC are empowered, by s. 73 VATA, to raise an assessment in the amount of VAT due to the best of their judgment, where it appears that a return is incomplete, or incorrect. The assessment is required to be made within the time-limit specified in s. 73(6) VATA; namely two years after the prescribed accounting period, or one year after evidence of the fact comes to the knowledge of HMRC. The time-limit to raise an assessment is restricted by s. 77 VATA to no more than four years after the end of the prescribed accounting period.

(7) The Assessment was raised in time as the facts only became known to HMRC when the investigation had progressed, and the Appellant's representative had written to HMRC on 30 November 2017. Therefore, the Assessment has been made within the one-year time-limit specified in s. 73(6)(b) VATA.

13. The Appellant's case can be summarised as follows:

(1) The lease was acquired in Mr Latifi's name because the Appellant did not exist at the time that the lease agreement was entered into. The name on the lease was changed from Mr Latifi's name to the Appellant on 20 June 2018. There was an innocent omission to transfer the lease from Mr Latifi's name to the Appellant's name, and the delay was caused by forgetfulness.

(2) The name on the lease was, therefore, an administrative mistake which has been exploited by HMRC. If the Appellant had known the consequences, the lease would have been changed earlier. The intention was to use the Premises in the Bed & Breakfast business. Replacing the name on the lease is better than setting up another business for taxation purposes.

(3) Since the Appellant's incorporation, all sales income and receipts in respect of the Premises have been put through the Appellant's books, and properly accounted for. All transactions are declared in the Appellant's VAT returns. The Appellant has issued, and accounted for, VAT invoices in respect of the sub-letting of the ground floor to Lola Zeng. No offset has been applied by HMRC in this respect. There was no loss of revenue as the income was declared in good faith.

(4) An earlier assessment issued on 7 December 2017 included rental income relating to the room sublet to Stitch, which was not contested by the Appellant. The Appellant has paid the amount.

(5) The Appellant disagrees with the interpretation that the invoice needs to be addressed to the right legal entity. A company may, under s. 24(6)(c) VATA and if permitted by Regulations, claim input tax on the pre-incorporation supplies for its business, or for appropriation.

(6) The Appellant disagrees with the application of the legislative provisions to its case. HMRC have also misapplied the internal guidance.

(7) Mr Latifi was not a taxable person, but the Appellant was.

THE HEARING

14. Neither the Appellant, nor his representative, attend the hearing. The Appellant's representative requested a hearing in absence. We were satisfied that the Appellant had received notification of the hearing. We were further satisfied that it was fair and just to proceed with the hearing in the Appellant's absence, having regard to the terms of the Procedure Rules.

15. We had the benefit of hearing Mr Uddin's submissions on behalf of the HMRC. In short, he relied on the Statement of Case and the Skeleton Argument filed on behalf of the Respondent (*supra*). He also replied to the Skeleton Argument filed on behalf of the Appellant and

submitted that the Appellant's interpretation of the legislation was wrong. He emphasised the fact that the lease agreement during the relevant period was between OCC and Mr Latifi. He added that Mr Latifi's registration for VAT is an admission that Mr Latifi is a separate legal entity from the Appellant.

16. At the conclusion of the hearing, we reserved our decision, which we now give, with reasons.

APPLICABLE LAW

17. Section 14 VATA provides that:

> *"**14 Contents of VAT invoice***
>
> *(1) Subject to paragraph (2) below and regulation 16 [and save as the Commissioners may otherwise allow], a registered person providing a VAT invoice in accordance with regulation 13 shall state thereon the following particulars-*
>
> *(a) [a sequential number based on one or more series which uniquely identifies the document],*
>
> *(b) the time of the supply,*
>
> *(c) the date of the issue of the document,*
>
> *(d) the name, address and registration number of the supplier,*
>
> *(e) the name and address of the person to whom the goods or services are supplied,*
>
> …
>
> [Emphasis added both above and below]

18. Section 24 VATA deals with input tax and output tax as follows:

> "***24 Input tax and output tax***
>
> *24(1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say-*
>
> *(a)VAT on the supply to him of any goods or services;*
>
> *(b)VAT on the acquisition by him from another member State of any goods; and*
>
> *(c)VAT paid or payable by him on the importation of any goods from a place outside the member States,*
>
> *being (in each case) goods or services used or to be used for the purposes of any business carried on or to be carried on by him.*
>
> *…*
>
> *24(6) Regulations may provide-*
>
> ..

(c) for a taxable person that is a body corporate to count as its input tax, in such circumstances, to such extent and subject to such conditions as may be prescribed, VAT on the supply, acquisition or importation of goods before the company's incorporation for appropriation to the company or its business or on the supply of services before that time for its benefit or in connection with its incorporation.

19. The Value Added Tax Regulations 1995 (1995 No 2518) provide that:

*"**111** (1) Subject to paragraphs (2) and (4) below, on a claim made in accordance with paragraph (3) below, the Commissioners may authorise a taxable to treat as if it were input tax-*

(a) VAT on the supply of goods or services to the taxable person before the date with effect from which he was required to be, registered, or paid by him on the importation or acquisition of goods before that date, for the purpose of a business which either was carried on or was to be carried on by him at the time of such supply or payment, and

(b) in the case of a body corporate, VAT on goods obtained before its incorporation, or on the supply of services before that time for its benefit or in connection with its incorporation, provided that the person to whom the supply was made or who paid VAT on the importation or acquisition-

(i) became a member, officer or employee of the body and was reimbursed, or has received an undertaking to be reimbursed, by the body for the whole amount of the price paid for the goods or services

(ii) was not at the time of the importation, acquisition or supply a taxable person, and

(iii) imported, acquired or was supplied with the goods, or received the services, for the purpose of a business to be carried on by the body and has not used them for any purpose other than such a business."

DISCUSSION

20. This is an appeal by the Appellant against an Assessment in the sum of £26.250.00, for the period 06/14 to 12/17. The Assessment relates to input tax claimed by the Appellant in relation to lease charges made to Mr Latifi by OCC, and followed a VAT compliance check by HMRC.

21. The background facts to this appeal are not in issue between the parties, save that the parties differ in view about the outcome as a result of those facts. This much is apparent from the grounds of appeal submitted on the Appellant's behalf, within the notice of appeal dated 3 November 2018, as follows:

"The facts of this case are undisputed…we only disagree with HMRC on the points of law."

Findings of fact

22. On 20 March 2013, the Premises were acquired by Mr Latifi under a lease agreement that was signed between OCC ('the lessor') and Mr Latifi ('the lessee'). Mr Latifi is the sole proprietor of a property rental business. Lease rental invoicing began on 29 August 2013. At the time, Mr Latifi was not registered for VAT. OCC raises quarterly invoices in the amount of £8,750.00 (and standard-rated VAT). Rooms in the Premises were subsequently sublet to Lola Zeng and Stitch. Quarterly invoices in the amount of £7,500.00 (plus standard-rated VAT) were issued to Lola Zeng and the amounts were evidenced in the Appellant's VAT returns. Monthly payments of £600.00 were paid directly to Mr Latifi by Stitch. The Appellant is a Bed & Breakfast (B&B) business. The Appellant was incorporated on 27 November 2013, and VAT registration was effective from 27 September 2013.

23. On 22 May 2017, HMRC visited the Premises to inspect the Appellant's books and records ('the compliance visit'). HMRC then wrote to the Appellant's agent to set out the issues arising from the visit, on 12 June 2017, as follows:

> *"…*there is an issue regarding the lease of the property from Oxford City Council, and the sub-letting of the ground floor areas to both the tailors mentioned above, and to Lola Zeng. From our conversations with Mr Abdul Latifi, it is our understanding that the building of 6 Gloucester Street, Oxford, OX1 2BN is leased from Oxford City Council by Mr Abdul Latifi as an individual, rather than by the company Star Services Oxford Ltd which is the VAT registered entity. The property has then been sublet by Mr Latifi on a formal basis to Lola Zeng, and on an informal basis to the tailors, and in effect on an informal basis to Star Services Oxford Ltd.
>
> To date Star Services Oxford Ltd has been claiming the VAT that has been charged on the rental invoices from Oxford City Council to Mr Abdul Latifi, as its input tax despite the fact that the services under the lease agreement are to Mr Latifi as the lessor, rather than to Star Services Oxford Ltd. In order for VAT to be claimed as input tax, the services i.e. rental of the property must be to the taxable person which in this case is Star Services Oxford Ltd rather than Mr Latifi. Therefore the VAT charged on the invoices by Oxford City Council is not proper to Star Services Oxford Ltd & is not reclaimable as input tax. Our Notice 700 Section 10 provides further guidance on the definition of, & what can be claimed as, input tax.
>
> [Emphasis added both above and below]

24. HMRC subsequently requested further information relating to the VAT that had been claimed by the Appellant on the rental invoices from OCC to Mr Latifi, from 28 March 2013 to 31 March 2017. HMRC were also aware that invoices for the sub-letting to Lola Zeng were being raised by the Appellant. The conclusion reached by HMRC was that since there was no supply of the Premises by the Appellant to Lola Zeng, no tax invoices should have been raised by the Appellant. The further information requested was required from the Appellant by 14 July 2017.

25. On 30 November 2017, the Appellant's agent replied in the following terms:

"**Issue no. 3 - title of premises lease on director's personal name;**

Last point in your letter relates to the issue regarding the title of lease for the premises. The lease was taken on the personal name of the sole-director and shareholder, Mr A W Latifi, just because the company did not exist at that time. Ideally the lease should have been transferred over to the company name after its incorporation in the year 2013. However. Mr Latifi claims that he forgot doing this but has now requested the Lessor, Oxford City Council, to substitute the name of the company in the records instead of his own as an individual...

Moreover, retrospective corrections are being made by lodging a personal VAT registration for Mr A W Latifi in order to account for the VAT on lease invoices on his individual name. His personal VAT registration number is 278 0054 03 and the Effective Date of Registration (EDR) is 01 October 2013. For each invoice that Mr Latifi has received in the past from Oxford City Council he has issued a similar invoice at exactly the same amount(s) to the company. Now the company has received invoices from its actual Lessor, Mr Latifi, for that entire period of time.

These invoices will also replace the previous ones in the company records in conformity with the relevant legal provisions. [sic]

26. The Appellant's agent referred to the request to furnish details of the VAT that has been claimed by the Appellant on the rental invoices from OCC, and the VAT that it has incorrectly charged and accounted for in its books on the sub-letting invoices that it issues to Lola Zeng. The agent further explained that OCC raise quarterly invoices amounting to £8,750.00, plus standard-rated VAT. The agent added that invoices have already been accounted for in the company's vat computations.

27. In the letter dated 30 November 2017, the Appellant's agent also dealt with two further issues that had been raised by HMRC in their letter of 12 June 2017. There, HMRC had highlighted that the majority of the Appellant's B&B customers come via booking.com from whom the Appellant is charged monthly fees based on a percentage of the value of the bookings. As had been explained on the compliance visit, booking.com are based & VAT registered in The Netherlands, and because the Appellant is VAT registered in the United Kingdom, they do not charge the Appellant any Dutch (or UK) VAT. HMRC added that the "Notice 741 Place of Supply of Services" explains that when supplies of services are made between two EC VAT registered businesses, the place of supply is where the recipient is based. HMRC further added that s. 5 of the Notice goes on to explain the reverse charge that this is a simplification measure to avoid the need for suppliers to register in the Member State where they supply their services.

28. HMRC also raised the issue of wages claimed in the financial accounts, in the amount of £28,783.00, of which £20,840.00 were paid from the business bank account, leaving an amount of £7,943.00 presumably paid in cash. Allowing for £1000.00 cash B&B income being used as cash wages, HMRC were of the view that this left a shortfall of £6,943.00.

29. HMRC added that Mr Latifi had stated that he personally introduced capital into the company, and the source of this capital were the rents he received from sub-letting the shop on the ground floor. However, HMRC could find no entry for "Capital Introduced" in the accounts for the year ended 30 November 2015, nor was it obvious to HMRC that the subletting of the room occupied by Stitch on the ground floor by Mr Latifi was generating sufficient income for

him to have introduced £6,943.00 into the company. HMRC had therefore asked the Appellant's agent to provide details of where in the company's financial accounts the capital introduced was reflected. In relation to the small sum of cash-sales that HMRC had seen on the hard-copy spreadsheets in the various binders, HMRC sought to understand what records these amounts were based upon.

30. The Appellant's agent acknowledged that there was an apparent error in relation to the VAT treatment of reverse charge on booking.com. The agent stated that the Appellant has been advised that this amount must be paid on the VAT account, when the Assessment is made. The Appellant's agent added that the correct reverse charge treatment was being applied in all quarterly VAT computations from the date of the compliance visit, including the open quarter 06/17.

31. In relation to the second point raised by HMRC in respect of the question as to how the wages amounting to £28,840.00 were paid, and whether there was a capital introduction in that financial year to pay such wages in cash, the Appellant's agent explained that the financial year in question was the year ended 30 November 2015. The Appellant's agent added that they had reviewed the business bank account statements, and other accounting records and did not find any evidence of capital introduced, or any other receipt in cash in that year to pay the wages in full. The agent further added that total cash sales in this accounting year amounted to only £1,325.00. Therefore, the agent concurred with HMRC's findings on this point.

32. On 1 May 2018, HMRC issued an Information Notice to provide information and produce documents, under Schedule 36 of the Finance Act 2008 ('Schedule 36').

33. On 5 June 2018, HMRC wrote to the Appellant, as follows:

> "Since my letter of 7 December 2017, I am aware that VAT registration has been obtained by Mr Abdul Latifi as a sole proprietor & that an application for a belated option to tax has been made on that sole proprietor registration. However in order for that belated option to tax to be approved (or otherwise), specific information was requested by our Option to Tax Unit in a letter dated 11 April 2018 that was issued to your agent Sortax Accountants. There has been no response to that letter and therefore currently there is no valid belated option to tax in place. With no option to tax in place, no taxable supply has therefore been made by Mr Latifi to Star Services Oxford Ltd, and there is no VAT on any charges between these entities to be claimed as input tax at present.
>
> Based on your accountant's letter of 30 November 2017, my understanding is that a total of £29750.00 has been claimed as input tax by Star Services Oxford Ltd on the invoices from Oxford City Council since October 2013 at a quarterly rental of £8750 plus VAT. I will therefore be raising a further assessment in this sum."

34. The lease with OCC was changed from Mr Latifi's name to the Appellant, on 20 June 2018, and an option to tax has been applied for on the sole proprietor registration.

35. HMRC then raised an Assessment on 25 June 2018, as follows:

> "I believe that you have not declared the correct amount of VAT due for the periods shown on the enclosed schedule. I explained this in my letter dated 5 June 2018… As explained in previous correspondence input tax has been incorrectly claimed on services provided by Oxford City Council i.e. rent of 6 Gloucester Street, to Mr Abdul Latifi as a sole proprietor & not to Star Services Oxford Ltd. I am aware that a belated OTT has been applied for on the sole proprietor registration, & if that is granted in the future following provision of information requested, then any appropriate claim to input tax on the rent that may then be charged by the sole proprietor registration, can be made on a future return as appropriate.
>
> I have made assessments of VAT due under section 73 of the VAT Act 1994.
>
> …
>
> As a result of these assessments, the total VAT due is £26,250.00."

36. On 28 June 2018, the Appellant's agent wrote to HMRC, as follows:

> "Mr Latifi is beneficial owner of both "the company" (by virtue of controlling shares and directorship) and "the property" leased and located at;
>
> 6 Gloucester Street, Oxford, OX1 2BN
>
> Land Registry Title No: ON308889
>
> He took the property on lease for business purposes and later on formed a micro/ (close) company, incorporation date 27/09/2013. Soon after the incorporation of this company he obtained a VAT registration for it, effective date 27/09/2013.

37. The Appellant's agent repeated that since incorporation all sales income and receipts went through the Appellant's books, and were accounted for. The agent added that all costs and expenditures, which also include the lease payments to the lessor, are made through and accounted for in the same company books; and further added that the Appellant has since charged and accounted for output tax on all sales and claimed input tax in accordance with the rules.

38. HMRC replied, on 4 July 2018, repeating that in relation to the relevant period, Mr Latifi and the Appellant are separate legal entities, both of whom are required to register for VAT separately if carrying on taxable business activities.

Consideration

39. HMRC have raised an Assessment under s. 73 VATA. The power given to HMRC under statute is to make an assessment to their best judgment on such information as is available. An assessment requires to be made to best judgment in the sense that it has to be prepared in good faith. This must be balanced against the well-established rule that the primary obligation is on

the taxpayer to make a return himself, and HMRC are not required to do the work for the taxpayer.

40. The burden is, therefore, on the taxpayer to establish the correct amount of tax due. This is evident from *Commissioners of Customs and Excise v Pegasus Birds Ltd* [2004] STC 1509; [2004] EWCA Civ 1015 (‘*Pegasus Birds*’), where Carnwath LJ said this:

> “[14] Generally, the burden lies on the taxpayer to establish the correct amount of tax due:
>
> ‘The element of guess-work and the almost unavoidable inaccuracy in a properly made best of judgment assessment, as the cases have established, do not serve to displace the validity of the assessments, which are prima facie right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessments right or more nearly right.’

41. The meaning of the phrase “to the best of their judgment” has been the subject of some adjudication. The starting point to the sphere of litigation that has arisen are the principles enunciated in the case of *Van Boeckel v Customs and Excise Commissioners* [1981] STC 290 (‘*Van Boeckel*’), where the classic test was laid down by Woolf J (as he then was), at p. 292, as follows:

> "…What the words 'best of their judgment' envisage, in my view, is that the Commissioners will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due. As long as there is some material on which the Commissioners can reasonably act then they are not required to carry out investigations which may or may not result in further material being placed before them."

42. He added this, at p. 296:

> “If they do make investigations then they have got to take into account material disclosed by those investigations.

43. Woolf J drew three conclusions in relation to the obligation that is upon HMRC. Firstly, there must be some material before HMRC on which they can base their judgment. Secondly, HMRC are not required to do the work for the taxpayer in order to form a conclusion as to the amount of tax due. Thirdly, HMRC are required to exercise their powers in such a way that they make a value judgment on the material which is before them.

44. The test to be applied in interpreting s. 73(1) VATA is now adequately set out in *Pegasus Birds*, at [38] (Carnwath LJ). The threshold for making a “best judgment” assessment is a low one. The correct test is whether there has been an honest and genuine attempt to make a

reasoned assessment: *Pegasus Birds*, at [22]. This does not translate to meaning that whether an assessment could be said to be "wholly unreasonable" is irrelevant to determining that question: *Pegasus Birds*, at [77] (per Chadwick LJ). HMRC only need to consider the information before them in a fair way and come to a decision which is reasonable (and not arbitrary) as to the amount of tax due.

45. It is not disputed that the lease agreement entered into in 2013 was between OCC and Mr Latifi. It is further not in dispute that the name on the lease was only changed in 2018. The rental invoices were to Mr Latifi and not the Appellant, albeit that VAT was accounted for in the Appellant's accounts. HMRC have disallowed the input tax claimed by the Appellant, following a compliance visit and requests for information, and this formed the basis for the Assessment raised. These matters are, therefore, not in issue between the parties.

46. There is, in truth, one live issue in the appeal before us. That is whether HMRC correctly disallowed input tax claimed by the Appellant on lease charges from OCC, in relation to the Premises.

47. HMRC's case is that OCC leased the Premises to Mr Latifi and that, therefore, the supply was made to him and VAT was incurred by him. In further amplification of this submission, HMRC submit that in order to be able to claim input tax, the Appellant must hold a VAT invoice and be able to evidence that the supply is being made to the Appellant.

48. The Appellant's case is that HMRC have not acted in accordance with the law as the lease was granted before the Appellant was incorporated. In further amplification of this submission, it is argued that Mr Latifi was not a taxable person, and that the Appellant has accounted for the VAT (therefore there was no loss of tax). It is further argued on the Appellant's behalf that the failure to change the name on the lease was an innocent mistake which has been exploited by HMRC.

Q. Have the requirements for claiming back input tax been met?

49. The right of taxpayers to deduct VAT due, or paid, on goods and services received as inputs (i.e., input tax) from the VAT they are liable to pay on their supplies of the goods and services (i.e., output tax) is a fundamental system of VAT established by the Principal VAT Directive ('PVD'). The right to deduct is an integral part of the VAT scheme. The deduction system is intended to relieve the trader, entirely, of the burden of the VAT payable, or paid, in the course of all of their economic activities. The common system of VAT consequently ensures the neutrality of taxation of all economic activities, provided they are themselves subject in principle to VAT.

50. The right to deduct is subject to compliance with both substantive and formal requirements, or conditions. The substantive requirements for the right to arise are:

(1) that the "interested party" is a "taxable person";

(2) that the goods or services relied on to give entitlement to the right to deduct must be used by the taxable person for the purposes of their own taxed output transactions; and

(3) that as inputs, those goods or services must be supplied by another taxable person.

51. In relation to the use of the supply for the purposes of the taxable person's business, it is trite law that the correct test is that a supply will be treated as being used for the purpose of the business of a taxable person if there is "*a direct and immediate link*" between the supply and one or more output transactions, or between the supply and the taxable person's economic activity as a whole. The provisions of law relating to supplies by a business are set out at s. 14 and s. 24 VATA (*supra*) and reg. 13 and reg. 14 of VAT Regulations.

52. Regulation 13 of the VAT Regulations requires a taxable person to provide an invoice when supplying goods or services to another taxable person. Regulation 14 specifies that the invoice has to show the name and address of the supplier and the customer. It must also contain a description of the goods or services provided. Section 24 VATA is however the starting point. As is evident from s 24(1) VATA, in order to recover input tax as a credit against output tax, it is necessary for a taxable person to firstly show that the VAT was paid on the supply to him of goods or services and, secondly, that the goods or services are used or to be used for the purpose of his business. Regulation 29 enables HMRC to consider alternative evidence, other than VAT invoices.

53. It is, therefore, trite law that in order to be able to reclaim input tax, the Appellant must hold a valid VAT invoice to evidence that the supply is being received by the Appellant. This means that the invoice needs to be addressed to the right legal entity, and the supply needs to be made to that entity. VAT cannot be recovered on invoices in the name of third parties. This is the starting point.

54. In *Tower Bridge GP Ltd v HMRC* [2022] EWCA Civ 998, the Court of Appeal ruled that absent a valid VAT invoice showing the supplier's VAT number and the customer's name, the right to deduct input tax on that invoice could not be exercised. The case is important as it reconciles different Court of Justice of the European Union ('CJEU') authorities that formed the basis of the argument that once the substantive conditions for the right to deduct were met, the formal invoicing conditions were irrelevant. The decision confirmed the Court of Appeal's earlier decision in *Zipvit Ltd v HMRC* (Case C-156/20) that input tax recovery requires possession of an invoice documenting the VAT. The Court of Appeal analysed retained EU case law, starting with the case of *Jorion née Jeunehomme v Belgian State* (joined cases C-123/87 and C-330/87) where a valid VAT invoice was said to be the *"ticket of admission"* to the right to deduct.

55. The Court of Appeal identified a golden thread through the cases, showing that there were substantive and formal conditions that exist in relation the right to deduct. The fact that the substantive conditions had been met (i.e., the right to deduct was being exercised by a

taxable person, and the goods or services were supplied to the taxable person for the purposes of his own taxable transactions) did not mean the right to deduct was automatic. Something more was required. Accordingly, the Court of Appeal found that the absence of a valid VAT number and the absence of the customer's name had the effect that the formal requirements had not been met, and the right to deduct could not be exercised.

56. In relation to the exercise of discretion, the Court of Appeal found that there were two exercises of discretion within reg. 29 of the VAT Regulations. The first is whether to entertain an application to establish the right to deduct otherwise than by a compliant invoice. The second (if the first discretion is exercised in the taxpayer's favour) is the discretion to specify the documentary evidence that HMRC require in order to prove that the input tax had been incurred.

57. It is not disputed that the invoices from OCC were addressed to Mr Latifi, as sole proprietor, and not the Appellant. As Mr Latifi was a sole proprietor, he was a separate legal entity. We are fortified in our view by the fact that Mr Latifi has registered for VAT as a separate legal person, and a belated option to tax has been applied for.

58. It was initially submitted on behalf of the Appellant, by a letter dated 28 June 2018, that although the lease agreement with OCC had been with Mr Latifi, Mr Latifi was the beneficial owner of the Appellant by virtue of controlling shares and directorship (and that the Appellant did not exist at the time that the lease agreement was entered into). The Appellant prays in aid the case of *Praesto Consulting UK Limited v HMRC* [2019] EWCA Civ 353 (Hamblen and Haddon-Cave LJJ) ('*Praesto*'), in support of the submission that although lease agreement was between OCC and Mr Latifi, the Appellant was entitled to claim input tax because the business had not been set up at the time that the lease agreement was initially entered into.

59. The case of *Praesto* concerned whether a company which pays the legal fees relating to the defence of civil proceedings brought against its sole director was entitled to credit for input tax charged in relation to those fees. The Court of Appeal held, at [23] – [24], that in order to recover input tax as a credit against output tax, it is necessary for a taxable person to show (i) that the VAT was paid on the supply to him of goods or services; and (ii) that the goods or services are used, or to be used, for the purpose of his business. Materially, the court further held that there must be a legal relationship between the provider of the service and the recipient: *Tolsma v Inspecteur der Omzetgelasting Leeuwarden* (Case C-16/93) [1994] STC 509, at [14].

60. We find that the legal relationship was between OCC and Mr Latifi. This is because the lease agreement was between OCC and Mr Latifi, from 2013 (when invoicing commenced) and 2018, when the name on the lease was changed. We will return to consider the issue of pre-incorporation supplies (as raised on the Appellant's behalf) later.

61. On the issue of the actual supplies made at the material time, and the 'economic reality', in the Supreme Court case of *R & C Comrs v Airtours Holidays Transport Ltd* [2016] 4 WLR

87 ('*Airtours*'), the issue on appeal was whether the appellant, Airtours Holidays Transport Ltd (formerly MyTravel Group plc), was entitled to recover, by way of input tax, VAT charged by PricewaterhouseCoopers LLP ('PwC') in respect of services provided by PwC and paid for by Airtours. At [44], Lord Neuberger considered the speech of Lord Millett in *Customs & Excise Comrs v Redrow Group Plc* [1999] 1 WLR 408, 418G, where he said this:

> "[o]nce the taxpayer has identified the payment the question to be asked is: did he obtain anything - anything at all - used or to be used for the purposes of his business in return for that payment?".

62. Lord Neuberger added that if one takes that question at face value, then it can be said with some force that Airtours obtained a substantial benefit from paying PwC's invoices, namely the potential (and, as it turned out, the eventual actual) financial support of the Institutions for its restructuring. Lord Neuberger considered, however, that Lord Millett's observation cannot be taken at face value. He proceeded to refer to Lord Reed's explanation in *R & C Comrs v Loyalty Management UK Ltd* [2013] STC 784, at [66]- [67] ('*Loyal Management*'), where Lord Reed said this:

> "66. [T]he speeches in *Redrow* should not be interpreted in a manner which would conflict with the principle, stated by the Court of Justice in the present case, that consideration of economic realities is a fundamental criterion for the application of VAT. … [T]he judgments in *Redrow* cannot have been intended to suggest otherwise. On the contrary, the emphasis placed upon the fact that the estate agents were instructed and paid by Redrow, and had no authority to go beyond Redrow's instructions, and upon the fact that the object of the scheme was to promote Redrow's sales, indicates that the House had the economic reality of the scheme clearly in mind. When, therefore, … Lord Millett asked, 'Did he obtain anything - anything at all - used or to be used for the purposes of his business in return for that payment?', [that question] should be understood as being concerned with a realistic appreciation of the transactions in question.
>
> 67. Reflecting the point just made, it is also necessary to bear in mind that consideration paid in respect of the provision of a supply of goods or services to a third party may sometimes constitute third party consideration for that supply, either in whole or in part. The speeches in *Redrow* should not be understood as excluding that possibility. Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded *a priori*. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation, the correct analysis is likely to be that the payment constitutes third party consideration for the supply."

63. Lord Hope made the same point in *Loyalty Management,* at [110]:

> "I think that Lord Millett went too far [at p 418G] when he said that the question to be asked is whether the taxpayer obtained 'anything - anything at all' used or to be used

> for the purposes of his business in return for that payment. Payment for the mere discharge of an obligation owed to a third party will not, as he may be taken to have suggested, give rise to the right to claim a deduction. A case where the taxpayer pays for a service which consists of the supply of goods or services to a third party requires a more careful and sensitive analysis, having regard to the economic realities of the transaction when looked at as a whole."

64. This approach also reflects the approach of the Supreme Court in *WHA Ltd v R & C Comrs* [2013] STC 943 where, at [27], Lord Reed said this:

> "[t]he contractual position is not conclusive of the taxable supplies being made as between the various participants in these arrangements, but it is the most useful starting point".

65. Lord Reed assessed the VAT consequences by reference to the reality. As Lord Neuberger said in *Secret Hotels2 Ltd v Revenue and Customs Comrs* [2014] STC 937, at [35],

> "when assessing the VAT consequences of a particular contractual arrangement, the court should, at least normally, characterise the relationships by reference to the contracts and then consider whether that characterisation is vitiated by [any relevant] facts."

66. The aim of the enquiry is to determine whether there is a supply of services effected for a consideration. This will only be the case if there is a legal relationship between the provider of the service and the recipient, pursuant to which there is reciprocal performance; the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient. From the case law cited above, it appears clear that where the person who pays the supplier is not entitled under the contractual documentation to receive any services from the supplier, then, unless the documentation does not reflect the economic reality, the payer has no right to reclaim, by way of input tax, the VAT in respect of the payment to the supplier.

67. In the Court of Justice of the European Union ('CJEU') case of *Finanzamt Koln-Nord v Becker* (Case C-104/12), the company made an unsuccessful claim for recovery of input tax on legal fees incurred in defending criminal proceedings brought against its managing director. The court held, at [19]-[23], that the existence of a direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct is necessary before the taxable person is entitled to deduct input tax. This is because the right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them is part of the cost components of the taxable output transactions giving the right to deduct.

68. The court continued by saying that it is also accepted that a taxable person has a right to deduct even where there is no direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct, where the costs of the

services in question are part of his general costs and are components of the price of the goods or services which he supplies. With regard to the direct and immediate link which must exist between an input and an output transaction, the court held that it would not be realistic to attempt to be more specific. The court concluded by saying that it is apparent from the case law that, in the context of the direct-link test, all of the circumstances surrounding the transaction must be considered.

69. Returning to the issue of pre-incorporation supplies, we have found that Mr Latifi, as sole proprietor, and the Appellant are separate legal entities, requiring separate VAT registration. Mr Latifi did not register for VAT even though he was operating a property rental business by virtue of being OCC's lessee. The Appellant is occupying the Premises to carry on its taxable activities (B&B business). Mr Latifi has made the Premises available to the Appellant for its use, free of charge. That grant was not subject to the option to tax therefore it was an exempt grant so that even if the supply of the Premises could be treated as made to it, some of the input tax incurred would relate to the exempt lease. The fact that the Appellant is occupying the Premises for taxable purposes does not take the Appellant's case any further. Rooms have also been made available in the Premises available to Lola Zeng and Stitch (for rent).

70. Whilst it is argued on the Appellant's behalf that there was always an intention to set up a business when the lease was signed, and whilst it is further argued that the error in failing to change the name on the lease was a genuine mistake (and a technical issue), we have found that the legal relationship in the appeal before us was between OCC and Mr Latifi, not the Appellant. This is in addition to the fact that the invoices were addressed to Mr Latifi, and the fact that the Appellant is carrying on a separate business.

71. A business may, generally, claim the VAT incurred on services it has purchased for its taxable business purposes during the six months prior to VAT registration. VAT cannot, however, be claimed on goods and services purchased before registration which are used to make exempt supplies for non-business activities. Furthermore, the change in the name of lease in the circumstances of the appeal before us occurred many years after the Appellant had registered for VAT, and the invoices were not in the Appellant's name until the change occurred.

72. Whilst the Appellant's agent has attempted to invoke the provisions of s. 24(6) (c) VATA and reg. 111 of the VAT Regulations, the Appellant is not entitled to recover the VAT incurred on the supply by OCC to Mr Latifi as a sole proprietor, for the reasons given above.

73. The Appellant's argument that all income was declared to HMRC does not change the incontrovertible facts in this appeal. In accordance with the legislation, an amount charged on an invoice as VAT will be recovered under para. 5, Schedule 11 VATA, as a debt to the Crown. No offset is made against tax incorrectly charged. In relation to claims when a business is not registered, the person making the claim for input tax must also be the recipient of the supply on which the tax was charged, and a taxable person at the time that the supply was made.

74. We find that significant concessions have been made in the Appellant's agent's letter of 30 November 2017, where the agent unequivocally states that retrospective corrections are being made by lodging a personal VAT registration for Mr A W Latifi in order to account for the VAT on lease invoices on his individual name. The agent further added that for each invoice that Mr Latifi received in the past from OCC, he has issued a similar invoice at exactly the same amount(s) to the Appellant, and that the Appellant has received invoices from its actual Lessor, Mr Latifi, for that entire period of time. The invoices were said to be replacing the previous ones in the Appellant's records, in conformity with the relevant legal provisions.

75. The Appellant's agent was required to provide further information in relation to the option to tax on the sole proprietor registration. HMRC advised that a claim to input tax on the rent charged by the sole proprietor registration could be made in a future return. This matter is not, however, part of the decision under appeal before us.

76. Having considered all of the evidence, cumulatively, we are satisfied that the Appellant was not entitled to claim input tax on the invoices and HMRC were correct to disallow input tax.

77. Accordingly, therefore, we dismiss the appeal and uphold the Assessment.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

78. 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.

NATSAI MANYARARA
TRIBUNAL JUDGE

Release date: 22 AUGUST 2022