TC01519

Appeal number TC/2010/03611

VAT – Whether a direct and immediate link between professional fees incurred and exempt disposal of a farm – Yes – Appeal dismissed

FIRST-TIER TRIBUNAL

TAX

LINDA ANNE PARKHOUSE **Appellant**

- and -

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

TRIBUNAL: JOHN BROOKS (TRIBUNAL JUDGE)
WILLIAM HAARER (MEMBER)

Sitting in public at Keble House, Southernhay Gardens, Exeter EX1 1NT on 12 October 2011

Mr R L C Bibby of West Tax Taxation Consultants for the Appellant

Mrs G Orimoloye of HM Revenue and Customs, for the Respondents

DECISION

1. Mrs Linda Parkhouse appeals against an assessment by HM Revenue and Customs ("HMRC") which disallowed input tax of £11,122 incurred in respect of Estate Agent's commission and professional fees in relation to sale of her farm (the Farm") at Walson Barton, Bow Crediton in Devon

Facts

2. Although we were not provided with a statement of agreed facts and did not hear any formal oral evidence the following facts were not disputed.

3. The farm business, which was registered for VAT from 1 April 1973, was originally run as a partnership by Mr and Mrs Parkhouse. However, following the death of her husband, the business was transferred to Mrs Parkhouse as a going concern on 17 March 2003 to enable her to continue as sole proprietor. In addition to arable farming, resulting in taxable supplies for VAT purposes, Mrs Parkhouse's business activities included the letting of three residential cottages, a VAT exempt supply.

4. Following the cessation of trade the sale of the Farm (an exempt supply), but not the three residential cottages, was completed on 30 December 2008. The business was subsequently deregistered for VAT with effect from 1 August 2009.

5. A VAT visit was undertaken by Mr Monty Bagwell, a Higher Officer of HMRC, on 1 October 2009 at the premises of Mrs Parkhouse's accountants. On examination of the records Mr Bagwell identified £198.98 as input tax directly attributable to the letting of the residential cottages and £847.98 as input tax directly attributable to the Farm. However, input tax amounting to £11,122.16, shown on three invoices (the Invoices"), was treated as residual input tax. These Invoices comprised of one from Savills, in respect of commission for sale of the Farm which and showed input tax of £6,825.00, and two from Michelmores solicitors in respect of professional fees, again incurred in relation to the sale of the Farm. The Michelmores invoices included input tax of £3,922.16 and £375.00 respectively.

6. Mr Bagwell, who was not aware at the time that Mrs Parkhouse had retained the residential cottages and that these were not included in the sale of the Farm, was of the view that the Farm business was partially exempt for VAT purposes and concluded that £8,081.95 input tax claimed by Mrs Parkhouse should be disallowed. Following correspondence between Mr Bagwell and Mrs Parkhouse's accountants an assessment was issued on 5 January 2010. Unhappy with the assessment, on 4 February 2010 Mrs Parkhouse accepted HMRC's offer of a review.

7. During the review process HMRC came to the conclusion that all of the £11,122.16 input tax shown on the Invoices was wholly attributable to an exempt supply, the sale of the Farm. The assessment was consequently amended to include all of that input tax.

8. The amended assessment, in the sum of £11,122, was issued to Mrs Parkhouse on 26 March 2010 and this was further confirmed in HMRC's letter to Mrs Parkhouse's accountants of 19 April 2010. On 12 April 2010 Mrs Parkhouse appealed to the Tribunal.

Law

9. The right to deduct input tax is derived from Title X of the Principal VAT Directive (2006/112/EC). Article 173 of the Directive provides for an apportionment where input tax relates both to supplies which carry the right to deduct and supplies in respect of which VAT is not deductible. Under Article 173(2)(c) a Member State may "*authorise or require the taxable person to make the deduction* [of input tax] *on the basis of the use made of all or part of the goods and service*". This has been enacted into domestic legislation by the United Kingdom in the Value Added Tax Act 1994 ("VATA").

10. Section 25 VATA provides that a person is "*entitled to credit for so much of his input tax as is allowable under section 26* [VATA]."

11. Insofar as it is relevant to the present case s 26 VATA provides:

> *(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.*
>
> *(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business–*
>
> *(a) taxable supplies;*
>
> *(b) …*
>
> *(c) …*
>
> *(3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above …*
>
> *(4) Regulations under subsection (3) above may make different provision for different circumstances and, in particular (but without prejudice to the generality of that subsection) for different descriptions of goods or services; and may contain such incidental and supplementary provisions as appear to the Commissioners necessary or expedient.*

12. Section 4(2) VATA defines a "taxable supply" as "*a supply of goods and services made in the United Kingdom other than an exempt supply*".

13. An "exempt supply" is, according to s 31(1) VATA, a supply of goods or services if it is of a description specified in schedule 9 VATA. This includes the "*grant of any interest in or a right over land*" (see Item 1 Group 1 schedule 9 VATA).

14. Regulations 99 – 107 of the VAT Regulations 1995 (SI 1995/2518) (the "Regulations") provide for the attribution of input tax when there is partial exemption, ie where goods and services are provided to a taxable person who makes both taxable and exempt supplies. Regulation 101 sets out the detailed rules for attribution of input tax to taxable supplies and is the "Standard Method" for partial exemption which apples in the absence of the approval by HMRC of any alternative "special" partial exemption method.

15. In the case of *BLP Group plc v Customs and Excise Commissioners* [1995] STC 424 ("*BLP*") the Court of Justice of the European Union (the "ECJ") was asked whether input tax is deductible on services provided by one taxable person (A) to another taxable person (B) when those services are used by B for an exempt transaction (in that case the sale of shares). Having stated, at [19], that use of the words "for transactions" in the provisions that give the right to deduct show that the "goods or services in question must have a direct and immediate link with the taxable transactions" the answer of the ECJ at [28] of its judgment was:

> "… where a taxable person supplies services to another taxable person who uses them for an exempt transaction, the latter person is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction."

16. The issue a "a direct and immediate link with the taxable transactions" was further considered by the ECJ in *Midland Bank plc* v *Customs and Excise Commissioners* [2000] EUECJ C-98/98 ("*Midland*"). In that case the ECJ was asked (1) whether a direct and immediate link between a particular input transaction and a particular output transaction or transaction giving rise to entitlement to deduct is necessary before a taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement; and (2) what is the nature of the direct and immediate link.

17. In answer to the first question the ECJ said at [22 – 24]:

> [22] "… as the Court has also held, entitlement to deduct, once it has arisen, is retained even if the economic activity envisaged does not give rise to taxed transactions or the taxable person has been unable to use the goods or services which gave rise to a deduction in the context of taxable transactions by reason of circumstances beyond his control (Case C-110/94 *INZO* v *Belgian State* [1996] ECR I-857, paragraphs 20 and 21; *Ghent Coal Terminal*, cited above, paragraph 20, and C-396/98 *Schloßstraße* [2000] ECR I-0000, paragraph 42).
>
> [23] It is clear from that case-law that, as an exception and in specific circumstances, the right to deduct exists even if a direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct cannot be established.
>
> [24] The answer to the first question must therefore be that Article 2 of the First Directive and Article 17(2), (3) and (5) of the Sixth Council Directive must be interpreted as meaning that, in principle, the existence of a direct and immediate link between a particular input

> transaction and a particular output transaction or transactions giving rise to entitlement to deduct is necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement.

18. In relation to the second question the ECJ said at [25]:

> "In so far as the national court seeks, in the first part of the second question, clarification of the nature of the 'direct and immediate link, the Midland, the United Kingdom Government and the Commission rightly agree that it would not be realistic to attempt to be more specific in that regard. In view of the diversity of commercial and professional transactions, it is impossible to give a more appropriate reply as to the method of determining in every case the necessary relationship which must exist between the input and output transactions in order for input VAT to become deductible. It is for the national courts to apply the 'direct and immediate link test to the facts of each case before them and to take account of all the circumstances surrounding the transactions at issue."

Submissions

19. Mr Bibby, who appeared on behalf of Mrs Parkhouse, relies on paragraph 23 of *Midland* contending that the sale of the Farm, a fundamental asset of the business which was inextricably linked to past taxable supplies, was an exceptional and specific circumstance from which the right to deduct input tax shown in the Invoices arises irrespective of any direct and immediate link between the sale of the Farm and a taxable supply.

20. Alternatively, he submits, that the link between Mrs Parkhouse's supplies over many years (and of her husband before her) to the disposal of the capital asset constitutes a sufficient nexus to give rise to the right to deduct the input tax shown on the Invoices. In the further alternative, Mr Bibby argues that if it is decided that the input tax shown on the Invoices cannot be attributed to the making of taxable supplies a special method of attribution of the input tax should be applied which would give approximately the same result.

21. For HMRC, Mrs Orimoloye submits that as the sale of the Farm was an exempt supply the input tax shown on the Invoices relating to and attributable to that sale are wholly non-deductible. In the circumstances she asks us to dismiss the appeal.

Discussion and Conclusion

22. It was common ground between the parties that at the time of the sale of the Farm Mrs Parkhouse was a taxable person (see s 2 VATA) and that the sale of the Farm was an exempt supply and not subject to VAT (see s 31 and 8 schedule 9 Group 1 VATA). Mr Bibby also accepted that the input tax shown on the Invoices in respect of the professional fees of Savills and Michelmores was incurred by Mrs Parkhouse in relation to the sale of the Farm.

23. Taking account of the facts of this case and the circumstances of the transactions, as we are required to do by paragraph 25 of *Midland*, in particular that had she not sold the Farm Mrs Parkhouse would not have incurred the professional fees of Savills and Michelmores, we find that there is a direct and immediate link between the services supplied to Mrs Parkhouse by Savills and Michelmores and that the sale of the Farm, an exempt supply. As the input tax shown on the Invoices is attributable to an exempt supply we find that Mrs Parkhouse was not entitled to deduct that input tax.

24. We do not accept Mr Bibby's argument, in reliance on paragraph 23 of *Midland*, that it is not necessary for there to be a direct and immediate link between a particular input transaction and a taxable output transaction. Although paragraph 23 of the judgment in *Midland* does, as Mr Bibby contends, say that the right to deduct input tax exists as an "exception and in specific circumstances" even if a direct and immediate link between a particular input transaction and a particular output transaction cannot be established it is apparent from the opening words of that paragraph, "*it is clear from that case-law*", that the ECJ was referring to the cases that had been cited in the previous paragraph, paragraph 22, namely *INZO* v *Belgian State*; *Ghent Coal Terminal*; and *Schloßstraße*. These cases, unlike the present, concerned situations where an entitlement to deduct had already been acquired but could not be linked to a taxable supply due to, eg circumstances beyond the control of registered person. However, in the present case, as the input tax shown on the Invoices was attributable to the exempt sale of Farm Mrs Parkhouse never acquired any entitlement to deduct input tax.

25. With regard to Mr Bibby's argument regarding a special partial exemption method, Reg 102(4) of the Regulations provides that such a method shall take effect from the date directed by HMRC "*or from such later date*" as HMRC specify. HMRC have not given any partial exemption direction to Mrs Parkhouse and, as such, it is not possible for such a method to be applied retrospectively in the present case.

26. We therefore dismiss the appeal.

27. 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.

JOHN BROOKS

TRIBUNAL JUDGE
RELEASE DATE: 21 October 2011