TC02243

Appeal number: TC/2009/15261

VAT – input tax claim refused – horse trading - is business test satisfied - no

FIRST-TIER TRIBUNAL
TAX CHAMBER

GOODMAN EQUINE LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ALISON MCKENNA
HARVEY ADAMS

Sitting in public at Bedford Square on 27 June 2012

Tim Brown of counsel for the Appellant, instructed by the VAT Consultancy

Michael Jones of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns a decision by HMRC to deny Goodman Equine Limited ("the Appellant") the input tax claimed for the period 10/08. The input tax claimed amounted to £73, 166.76, and related to the company's purchase of one horse ("For Fun" on 30 May 2008 for the VAT inclusive sum of £490,000) and associated costs. The claim was denied by HMRC in a decision dated 9 March 2009, in which it took the view that the Appellant company was not a business for the purposes of VAT. The Appellant requested a Review of that decision, which was completed and issued dated 15 October 2009 and upheld the original decision. The Appellant now appeals to the Tribunal by way of its Notice of Appeal dated 21 October 2009.

2. The Tribunal's jurisdiction in this matter is derived from s. 83 (1) (c) of the Value Added Tax Act 1994, so that the Tribunal may affirm or vary the decision under appeal. Following Mr Jones' closing submissions on behalf of HMRC and the inclusion of suggested alternative bases for refusing the income tax claim, Mr Brown objected on behalf of the Appellant that he had received no prior warning of these alternative arguments. Mr Jones explained that they were in response to the evidence heard by the Tribunal and that he had been unaware of how the Appellant put its case until the hearing itself. The Tribunal confirmed that it was seized of HMRC's decision to refuse the input tax claim, rather than being required to consider the reasons originally given for doing so; however, we expressed the concern that the Appellant should have a fair opportunity to respond to all the arguments and offered to consider further written submissions on the new points raised, so as to give the Appellant more time to consider them.

3. After some discussion it was agreed by both counsel that the Tribunal should now proceed to make its decision on the main issue before it, which is whether the Appellant company meets the "business test". If the answer to that question is no, then the appeal will be dismissed. If the answer to that question is yes, then the Tribunal will at that stage invite further submissions from both counsel before finalising its decision as to whether the decision to refuse the input tax claim should be affirmed or varied.

Background

4. The Appellant is a company limited by shares. It was incorporated on 15 May 2008 with the sole director and sole shareholder being Mrs Jennifer Goodman. It was registered for VAT with effect from 16 May 2008 and described the nature of its business on the VAT 1 registration form as "*show jumping and trading in horses*". The estimated value of taxable supplies for the 12 months following registration was given on the VAT 1 form as £500,000, however the first year's accounts showed the company's turnover as nil.

5. The Appellant's objects as set out in its memorandum of association are to carry on business generally as a commercial enterprise. It was not disputed that the company has its own bank account and credit card; that its accounts for the financial

year May 2008 to May 2009 have been prepared by a firm of chartered accountants and submitted to Companies House (but were not, and were not required to be, audited); that it has since incorporation made certain taxable supplies in relation to stud fees for another horse; that it has acquired a number of horses in the past four years but has not, to date, sold any horses.

6. By the time of the hearing it was no longer argued that prize money from show jumping competitions constituted taxable supplies within the scope of the VAT regime. The Tribunal heard that there were still some unresolved issues between the parties in relation to the correct VAT treatment of the provision of hospitality by the Appellant to sponsors, the appropriate treatment of the sponsorship payments and of the provision of advertising to sponsors (by displaying their corporate insignia on the horses' numnahs during competitions). However, it is not necessary for the Tribunal to reach a concluded view on the tax treatment of those activities in order to decide the issues in this appeal.

7. HMRC's decision to deny the input tax claim was based on its view that the company does not meet the business test set down in case law. The letter of 9 October 2009 made particular reference to the requirement for the Appellant to satisfy HMRC that it had a realistic intention to make taxable supplies on a regular and ongoing basis. It also referred to the absence of a plan of action to increase the value of the horse before selling it on or of one to obtain sponsorship for the horse.

8. The Appellant's grounds of appeal are that the company is entitled to the recovery of input tax as it is acting as a taxable person, carrying out economic activity and having a genuine intention to make taxable supplies. It states that the company purchased For Fun as a show jumping horse with the genuine intention of exploiting this asset for the purposes of obtaining income, and that it has incurred costs which were preparatory to the carrying out of an economic activity.

The Evidence

9. The Tribunal heard sworn evidence from Mrs Goodman. She had filed two witness statements in the proceedings, dated 8 November 2011 and 31 May 2012, which were taken as her evidence in chief.

10. In her witness statements, Mrs Goodman explained that she has been involved with horses all her life. She has a background in polo, dressage and show jumping and competes in dressage. She described the business model of the company as being for her to use her knowledge of horses to identify horses with potential for improvement and to purchase them, give them expert training, and then sell them at a profit. She said that she enters into contracts with riders who will provide the training and ride the horse in competitions. She travels extensively throughout Europe to attend horse shows where she can identify such horses. In her second statement she explained that the company now owns twelve horses, which she lists. Of these, six were in active competition and ridden by others; one was ridden competitively by herself; the remaining five were retired or injured or intended to be retained for breeding, or to be used as a companion for the other horses.

11. In her evidence to the Tribunal, Mrs Goodman appeared unsure of when and how all of these horses came into the ownership of the company. Some of them had been purchased by the company itself but some had apparently been transferred from her own private ownership to that of the company. She did not explain why this was. She did not think that any valuation had been undertaken before doing so. She said they are shown as assets of the company in its most recent accounts (which we did not see) at what she had paid for them. She accepted in answer to a question from the Tribunal that a retired horse and a companion pony have no re-sale value. She also referred to the transfer of the employment of her own groom to employment by the company, but accepted that this expense had not been shown in the company accounts for the relevant period.

12. In cross examination, Mrs Goodman said that all her horses are always for sale but it depends on getting the right offer. She explained that she had received an offer of £100,000 for the horse Rossini but had decided not to sell him. She had loaned him on terms that the host pays the costs of keeping him but that she could ride him whenever she chose, including in dressage competitions. Mrs Goodman said she does not pay to ride Rossini. In answer to questions she explained that the benfit to the host is that they share any prize money after expenses are paid and that they receive a share of the proceeds of sale when the horse is sold.

13. With regard to the company's activities of sponsorship and hospitality, Mrs Goodman explained that the Horse of the Year Show was televised with the sponsor's name visible on the numnahs. She had taken guests of the sponsoring restaurant to the show, where they had watched For Fun compete. The Tribunal had seen two different invoices in respect of this event. One had VAT included and the other did not. Mrs Goodman said this was because a corrected invoice had to be issued and the corrected one included VAT. She explained that the estimated £500,000 turnover referred to on the VAT 1` form was stated in anticipation of selling For Fun. The intention had been to sell him in 2 -3 years but he had not been sold. He had been unwell the previous year. She told the Tribunal that For Fun is now 14 or 15 years old but that horses still compete at a high level at aged 16 and above and live into their 20s.

14. Mrs Goodman accepted that the first year's accounts for the company showed that its turnover was nil. It listed the cost of sales as £32,000, its administrative expenses as £50,000 and the only income was derived from prize money. The bottom line showed a loss of £73,000 and she accepted that it was technically insolvent at that point. She said she was unsure if the second year's accounts showed higher income, they were in the process of being prepared and had not been produced to the Tribunal. The company's accounts for the year to 2009 showed that it had then received an interest-free loan from Mrs Goodman of over £600,000. In her evidence to the Tribunal she estimated that she was now owed considerably more by the company but said that she hoped and expected that her loan would be re-paid. She accepted that the total output tax in 4 years was £144 and that the total input tax claimed was £87,000. It was accepted that taxable supplies had been made in the sale of semen, however these did not appear on the relevant VAT returns. Mrs Goodman said that she had relied upon her advisers to include the relevant items in the VAT returns.

15. In re-examination Mrs Goodman confirmed that the main activity of the company was buying, improving and selling horses although other activities were also undertaken.

16. The Tribunal also heard sworn evidence from Mr Greenough, the HMRC officer who had taken the review decision in this case. His witness statement was, by agreement, taken as his evidence in chief. He told the Tribunal that he had, subsequent to the review decision, received and considered further evidence and representations from the Appellant's representatives. He had also heard Mrs Goodman's evidence to the Tribunal. Nevertheless he remained of the view that the business test was not met in this case. He was asked in cross examination why he had not de-registered the company for VAT. He said that this was not his area of responsibility.

The Law

17. The right to deduct VAT falls sunder Article 168 of Council Directive 2006/112/EC and requires the taxpayer to use the goods or services "for the purposes of the taxed transactions of a taxable person". A "taxable person" is defined under Article 9 of the Directive as "any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity".

18. The Directive is effected into UK law by s 24 of the VAT Act 1994, which requires the goods and services to be used "for the purpose of any business carried on or to be carried on by him". "Business" is defined in s 94(1) of the 1994 Act as including "any trade, profession or vocation".

19. The business test has frequently been discussed by the Courts with reference to the "badges of trading" which are the generally recognised indicia of economic activity, most recently stated in the High Court's decision in *CEC v Lord Fisher* [1981] STC 238. These may be summarised as:

(1) whether the activity is a serious undertaking earnestly pursued;

(2) whether the activity is an occupation or function actively pursued with reasonable or recognisable continuity;

(3) whether the activity has a certain measure of substance as measured by quarterly or annual value of taxable supplies made;

(4) whether the activity is conducted in a regular manner on sound and recognised business principles;

(5) whether the activity is predominantly concerned with the making of taxable supplies to consumers for a consideration; and

(6) whether the taxable supplies are of a kind which, subject to differences of detail, are commonly made by those who seek to profit by them.

20. The case law makes clear that the badges of trade are indicative only. Further, that it is important to look at the whole picture, rather than considering each "badge" in isolation as no one factor is decisive.

21. Counsel referred the Tribunal to the authorities with regard to an intention to commence business activity, and it is clear that preparatory activity is a relevant consideration for the Tribunal. We were assisted in particular by the European Court of Justice's decision in *Rompelman v Minister van Financien* (case 268/83) [1985] ECR 655 in which the Court found that the stated intention to trade should be supported by objective evidence in each case.

Submissions

22. The Appellant's submission was that the Tribunal has a duty to interpret national legislation implementing an EU Directive so as to give effect to that Directive. Mr Brown referred us to the ECJ's decision in *Wellcome Trust v CCE* (Case C-155/94) [1996] STC 945, in which the meaning of "economic activity" had been given a wide interpretation. He submitted that the question of whether the goods were used immediately for taxable transactions is irrelevant and that neither the scale nor the profitability of the activity were relevant considerations in assessing whether the company meets the test.

23. The Appellant relied on this wide interpretation of "economic activity" in submitting that the company was engaged in relevant activities. Mr Brown pointed in particular to the activities of its director Mrs Goodman in searching for and sourcing horses to improve and sell on.

24. HMRC's contention was that the issue of what constitutes a business or economic activity is a question of law, but the question whether a business exists or not is one of fact. Mr Jones submitted that the domestic legislation and the European Directive establish the same test by a different route. He accepted that there is no exhaustive definition of what constitutes a business, but submitted that as Parliament had not opted to define the term it was a matter for the Tribunal to apply the case law to the facts. The facts here did not support the Appellant's case that it was engaged in economic activity and, in particular, the evidence heard by the Tribunal did not meet the "badges of trading" test. Mr Jones characterised the Appellant's activities as furthering the "hobby" of Mrs Goodman and lacking in the necessary commercial character. He submitted that the only taxable supplies to have been made by the company to date were in respect of stud fees in August and October 2011. He accepted that there had been one isolated example of sponsorship (in respect of which there had been confusion over the VAT treatment) but submitted that this was not an activity that fell within the stated business activity of horse trading on the form VAT 1, and that For Fun could not be used in that line of business in any event as he was a gelding. Mr Jones submitted that the company was not conducted in a business-like way: it could not continue without the financial support of Mrs Goodman.

25. With regard to preparatory activity, HMRC's submission was that it was insufficient for the Appellant merely to state an intention to trade without objective

evidence to support this assertion. He submitted that, on the facts of this case, if the Appellant states that its intention is to trade in horses then the burden rests with the company to show that the relevant conditions of the business test are met. Further, that in circumstances where there has been no sale of a horse but there has been a stated intention to sell horses, HMRC is entitled to seek objective evidence to support the stated intention. Mr Jones conceded that there is no set time frame for the sale of a horse (obviously, it might take longer to prepare for sale a foal than an older horse) but there must be evidence of actions which are preparatory to sale, rather than merely stated intentions.

26. Mr Jones directed the Tribunal's attention to the *Lord Fisher* decision, in particular with regard to the question of whether pleasure and social enjoyment in an activity can preclude it from being a business. He submitted that the hurdle for the Appellant must be higher where an activity is ambiguous as to business or social enjoyment.

27. With regard to the indicia, Mr Jones submitted that this was not a serious undertaking earnestly pursued – the undertaking should in truth be regarded as the maintenance of horses for competition as there had been no trading. Further, that there was no reasonable continuity as the only business activities of the stud fees and the sponsorship were both isolated examples; that there were negligible taxable supplies over a 4 year period; that the company could not be said to be conducted in accordance with sound and recognised business principles in view of the fact that it was trading at a loss and could not continue without Mrs Goodman's loan. Further that the records show it cost the company some £7,000 per year to enter competitions in which it won £9,000 in prize money. Its predominant activity was not that of making taxable supplies, and its activities were not (absent the stud fees) of a kind undertaken with a view to profit.

28. Mr Brown submitted on behalf of the Appellant that there is evidence of economic activity in the company because if the business model involves buying and training a horse then it is being used for the purpose of a taxable transaction prior to onward sale. He accepted that a statement of intent without more was insufficient to indicate a business, however he argued that the Tribunal should take into account the specific market place in which the company operated. In relation to the indicia he argued that there was a serious undertaking here, involving substantial investment. The horses are in training and competition all the time so demonstrating continuity. The business is run in a regular manner with accountants and so forth (the mistakes in the accounts were irrelevant). The predominant activity of the company is concerned with making taxable supplies, and this should not be interpreted with reference to the volume of those supplies. He reiterated that the horses were always for sale but awaited the right offer. A wide interpretation of "economic activity" should be given so that the time within which a sale should be made is irrelevant.

Conclusion

29. We have considered all the evidence in this appeal very carefully but have concluded that the Appellant company is not engaged in economic activity for the

purposes of the VAT regime, even giving that term the widest interpretation as argued for by Mr Brown. We have had regard to the badges of trade in reaching our conclusion and in doing so we accept that neither the scale nor the profitability of the company's activities are relevant considerations in deciding this appeal.

30. We were not satisfied that this company constituted a serious undertaking earnestly pursued, not simply because there had been no horse sales to date, but because there had been no horse sales even in the face of a good offer for Rossini having been made and where it would be reasonable to expect the company to have accepted in view of its financial instability. The alternative arrangement which was reached, of a horse loan allowing Mrs Goodman to continue to ride the horse, did not give us the impression of a serious undertaking but rather of an undertaking conducted principally to further the competitive career and enjoyment of the company's director.

31. We were also not satisfied that there was reasonable continuity of activity here as the only business activities we heard about (the stud fees and the sponsorship income) were both isolated examples so that there had been negligible taxable supplies even in relation to these activities (and none in relation to the stated intention of trading in horses) over a 4 year period. We did not accept Mr Brown's argument that the continuous activities of the director in relation to the horses, absent any identifiable business outcome derived from those activities, were sufficient to meet the test.

32. We did not conclude that the company was conducted in accordance with sound and recognised business principles. This was in view of the evidence that the company was not only trading at a loss, but clearly that it could not continue to trade at all without reliance upon Mrs Goodman's financial support. We found it difficult to understand why, if the company's business model was one of "all the horses are always for sale," the director had transferred the ownership of a number of horses without any re-sale value to the company balance sheet. This seemed to us to run counter to recognised business principles.

33. We were not satisfied that the predominant activity of the company was that of making taxable supplies, or that its activities were of a kind undertaken with a view to profit, given that it had not made any horse sales over the relevant period and did not take advantage of offers to buy horses when made. We consider that the predominant activity of the company is, in these circumstances, more closely connected to the pleasure and social enjoyment of equestrian activities by Mrs Goodman than it is to a business and that the Appellant has not satisfied us to the contrary.

34. We considered whether the company's activities might be described as preparatory to trade or undertaken with the intention of trading. Having found that the company had failed to make taxable supplies in circumstances where it might have done so and that it had acted to transfer assets with no re-sale value to its balance sheet, we conclude that the objective evidence does not support the stated intention to trade in this case.

35. In all the circumstances, this appeal is dismissed.

36. 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.

ALISON MCKENNA
TRIBUNAL JUDGE

RELEASE DATE: 29 August 2012