TC 04595

Appeal number: TC/2014/05393

VAT – supplies of goods received and sold prior to registration – whether input tax can be claimed after registration – whether UK law in line with EU Directive -Held – UK and EU law aligned – pre-registration input tax not available for use against post registration supplies – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Earl Redway t/a Loktonic **Appellant**

- and -

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

TRIBUNAL: JUDGE Rachel Short

Sitting in public at Fox Court, 30 Brooke Street London on 25 June 2015

Mr Clive Evans for the Appellant

Mrs Jane Ashworth, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns the Appellant's ability to make a claim to offset input VAT incurred on supplies which it received for the purpose of its business prior to being registered for VAT in January 2014. The Appellant's case is that the UK law which restricts a non-registered trader from claiming input tax incurred prior to registration is not a correct application of the EU Principal Directive (2006/112 EC) (the "Principal Directive") from which the UK legislation is derived.

2. The facts in this case are not in dispute.

Background Facts

3. The Appellant, Mr Redway works full time for a wholesale business called Codringtons Limited. The directors of that business are not able to manage selling goods on the internet and Mr Redway has therefore taken over this part of the business in a private capacity, buying goods from Codringtons and selling them on-line. The goods in question are various types of security locks.

4. Mr Redway's on-line business was registered for VAT on 4 January 2014. In his first VAT return for the period January 2014 – May 2014 Mr Redway claimed input VAT relating to goods bought before 4 January 2014 in the period from March 2013 to December 2013. HMRC allowed a percentage of that claim on the basis that some of those goods had been bought but not sold prior to 4 January 2014 and so could be treated as "stock in hand" at the time of registration for which in-put tax could be re-claimed under VAT Regulation SI 1995/2518 Regulation 111, (the "VAT Regulations") however they denied the input tax re-claim relating to goods which had been bought and sold prior to registration.

5. At the request of Mr Redway, HMRC undertook a statutory review of their decision to refuse his input tax claim for the remainder of the amount and notified Mr Redway on 12 September 2014 that this review had confirmed that this element of the input VAT was not reclaimable. Mr Redway appealed to this Tribunal on 21 September 2014.

The law.

6. Article 9 of the Principal Directive

"1. '*Taxable Person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity*".

7. Article 168 of the Principal Directive

"*In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member*

State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services carried out or to be carried out by another taxable person"

8. Article 286 of the Principal Directive

"*Member States which, at 17 May 1977, exempted taxable persons whose annual turnover was equal to or higher than the equivalent in national currency of 5 000 European units of account at the conversion rate on that date, may raise that ceiling in order to maintain the value of the exemption in real terms*".

9. Article 289 of the Principal Directive

"*Taxable persons exempt from VAT shall not be entitled to deduct VAT in accordance with Articles 167 – 171 and Articles 173 to 177, and may not show the VAT on their invoices*".

10. VAT Regulations SI 1995/ 2518, Regulation 111- Exceptional claims for VAT relief.

"(2) *No VAT may be treated as if it were input tax under paragraph (1) above –*

(a) in respect of –

(i) goods or services which had been supplied, or

(ii) save as the Commissioners may otherwise allow, goods which had been consumed

by the relevant person before the date with effect from which the taxable person was, or was required to be, registered."

11. s 3 and Schedule 1 of the Value Added Tax Act 1994. ("VATA 1994")

3(1) "*A person is a taxable person for the purposes of this Act while he is, or is required to be, registered under this Act*".

Schedule 1

Liability to be registered

1 (1) Subject to paragraphs (3) to (7) below, a person who makes taxable supplies but is not registered under this Act becomes liable to be registered under this Schedule –

(a) at the end of any month, if the person is UK established and the value of his taxable supplies in the period of one year then ending has exceeded [£79,000]; or

(b) *at any time, if the person is UK established and there are reasonable grounds for believing that the value of his taxable supplies in the period of 30 days then beginning will exceed* [£79,000].

12. S 24 VATA 1994.

"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 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 purpose of any business carried on or to be carried on by him".

Authorities referred to:

13. *Nidera Handelscompagnie* BV v *Lithuanian State Tax Inspectorate* C-385/09.

14. *Schemepanel Trading Limited v Customs & Excise Commissioners [1996] STC 871.*

Taxpayer arguments.

15. The taxpayer argued that HMRC's interpretation of Article 9 of the Principal Directive and VAT Regulations Reg 111 was at best only partially correct. Article 9 defined a taxable person as any person undertaking an economic activity, with no further reference to other criteria such as whether or not they were registered for VAT. On that definition, Mr Redway was a taxable person as soon as he started his business and not only from the date when he was registered for VAT from 1 January 2014.

16. HMRC's interpretation of the UK legislation, and s 3 VATA 1994 in particular, was not in line with the Principal Directive because it made it a condition of being a taxable person that a person be registered for VAT in the UK. According to EU law, any supplies of goods or services which were not exempt supplies were taxable supplies.

17. Mr Evans referred to Article 286 of the Principal Directive on which HMRC relied to argue that supplies made below the UK registration threshold were exempt supplies, but said that the *Nidera* case made clear that it was not legitimate under EU law to restrict the right to reclaim input tax by reference to an administrative procedure including the need to be registered. The mere fact of registration could not change the nature of a taxable supply.

18. The taxpayer in *Nidera* purchased grain in Lithuania on which VAT was paid and exported the grain to non-EU countries. At the time of the transactions the taxpayer was not registered for VAT in Lithuania but became registered a few months later. The EU court found in that case that the taxpayer did have a right to offset input tax incurred prior to registration in Lithuania against the zero-rated supplies which it subsequently made as long as the taxpayer had registered for VAT within a reasonable time after the input tax had been incurred, saying that "*the principle of VAT neutrality requires deduction of input tax to be allowed if the substantive requirements are satisfied even if the taxpayer has failed to comply with some of the formal requirements*". [para 42]. Mr Redway suggested that the same principle should be applied to his case.

19. The taxpayer also relied on HMRC's own statements in Notice 700/1 at 2.3 that all supplies other than exempt supplies are taxable supplies, whether or not a taxpayer is registered for VAT. "*A supply which is not VAT exempt is always a taxable supply whether or not the person making it is registered for VAT*". On that basis any input tax which relates to taxable supplies made no more than a "reasonable time" before registration should be recoverable.

20. Mr Redway had made taxable supplies as defined by the Principal Directive prior to being registered for VAT and so should be able to deduct that input tax against the output tax payable when he did become registered. The supplies made prior to registration were taxable supplies, they were not outside the scope of VAT.

21. The taxpayer accepted that the input tax in dispute here related to goods which had been sold prior to the date of registration. The taxpayer's interpretation of Article 289 of the Principal Directive and VAT Regulations Reg 111 was they were intended to operate as a block on the issue of invoices with VAT included prior to registration, not as a block on reclaiming pre-registration input tax. (Reg 111 (2)(a)). Mr Evans said that the reference in Reg 111 (2)(a) to goods or services supplied or consumed by "a relevant person" was not a reference to Mr Redway, the taxable person, but to a third party and therefore the restrictions in Reg 111 (2)(a) were not applicable in this case.

HMRC arguments

22. Mrs Ashworth explained that in HMRC's view the UK and EU legislation were aligned. She accepted that the UK definition of a taxable person in section 3 VATA 1994 did not use the same terminology as Article 9, by limiting the definition of a taxable person to someone who was registered for VAT as required by Schedule 1 VATA. However, s 3(1) was in line with Article 9 because of the specific provision at Article 286 of the Main Directive under which the UK had the right to "exempt" taxable persons whose turnover was below a stipulated threshold from being registered and from being treated as making taxable supplies.

23. As a result of the application of Article 286, Article 289 applied to UK traders below the registration threshold; those traders were exempt from VAT and so were not entitled to deduct input tax under Article 168, since they were not making taxable

supplies; their sub-threshold supplies were exempt supplies. On that basis before he was registered Mr Redway was making exempt supplies and therefore could not claim any input tax in respect of those supplies.

24. HMRC made a distinction between Mr Redway's position and the taxpayer in the *Nidera* case; in *Nidera* the taxpayer was making zero-rated supplies (taxable supplies subject to a zero rate) whereas Mr Redway had been exempt from VAT prior to registration. The block on reclaiming input tax set out at Article 168 did not apply to *Nidera* but it did apply to Mr Redway because his input tax was incurred while he was, in UK terms, not a taxable person.

25. Mrs Ashworth accepted that VAT Regulations Reg 111 provided an exception to this block on re-claiming input tax but made clear that this was only in specific circumstances and the input tax claimed by Mr Redway did not fall within those circumstances because it related to goods which had been supplied by Mr Redway ("the relevant person") under paragraph 2(a) of Reg 111 before he was registered for VAT.

26. HMRC referred to the *Schemepanel* case in support of their position. That decision concerned supplies made to a taxpayer, a building contractor, in the form of staged supplies during which time the taxpayer became VAT registered. The taxpayer claimed input tax on supplies made and used by it prior to registration, arguing that it was not necessary to be VAT registered at the time when supplies were used in order to reclaim input tax. It was held, by reference to decisions of the higher courts including *Customs & Excise Commissioners v Apple & Pear Development Council* [1985] STC 383 and *BLP Group plc v Customs & Excise Commissioners* [1995] STC 424 that it is a basic principle of VAT that input tax can only be deducted in respect of supplies which are subject to output tax; they have to be "the cost components" of the supply on which output tax is charged: *"A taxable transaction in the Sixth Directive [now the Principal Directive] is a transaction that is subject to tax. In the present case the inputs related to outputs that were not subject to tax. They were not therefore cost components of a taxable transaction"*. [pg 8].

27. In HMRC's view Mr Redway was in a similar position, the supplies in respect of which he was claiming input tax had not been used to make taxable supplies, they had been used to make supplies while Mr Redway was treated as exempt from VAT prior to registration in the UK.

Decision.

Facts found.

28. The goods supplied to which the disputed input VAT related had been both bought and sold by Mr Redway prior to Mr Redway's registration for VAT.

29. None of the goods to which the disputed input VAT related could be treated as "stock in hand" at the date of Mr Redway's VAT registration.

Discussion

30. The taxpayer's arguments in this case would lead to a rather surprising result; that input tax is recoverable in the UK prior to registration and without accounting for output tax on the making of related taxable supplies, which is counter to the basic principle of VAT neutrality set out in the *BLP* case referred to in the *Schemepanel* decision; concerning s 24(1) VATA 1994 – *"this refers to the taxable supplies that are made to a person at a time when he is a taxable person and that are so used or to be used for the purpose of any business carried on by him at a time when he is a taxable person"*. Potts J at pg 8.

31. The Tribunal agrees with the taxpayer that the transposition of the EU law's definition of what it means to be a taxable person (Article 9) to UK law, with its reliance on registration as the trigger for creating a taxable person, is not straightforward in this instance particularly the way in which the UK law treats a taxable person whose supplies are below the threshold level.

32. The question for this Tribunal is whether, as in *Nidera*, the UK's registration thresholds are merely an administrative matter which should have no impact on the nature of the supplies made, or whether registration within the UK VAT code affects the substantive nature of the supplies made.

33. It is clear that as far as VAT is concerned EU law is paramount and any conflict between UK law and EU law has to be decided in favour of the EU legislation. The parties agreed that under EU law a taxable transaction was any form of economic activity and was not related to meeting any administrative hurdles as made clear in *Nidera*, as long as taxable supplies are made, there can be no restriction on input tax claims made in a reasonable time.

34. However, our view is that the taxpayer's interpretation of the EU law and the UK's implementation of it breaks down beyond this point. As HMRC suggested, the context of Article 286 goes beyond the application of VAT thresholds and concerns simplified procedures for charging and collecting VAT from small enterprises. It makes clear that supplies below any applicable threshold are exempt supplies for EU purposes. In the context of Article 286 registration is acting as more than an administrative procedure, it is the trigger which is used to turn exempt into taxable supplies. Article 286 gives the UK the right to determine the nature of supplies depending on whether they are above or below the UK's thresholds.

35. Added to this are the very clear statements in the *Schemepanel* (and the cases to which it refers) referring to the fundamental principle of VAT that input tax should only be claimed to the extent that it can be attributed to the making of taxable supplies, thus ensuring the principle of fiscal neutrality. The VAT Regulations at Reg 111 are reflecting this principle but also assuming that there can sometimes be a significant time lag between the receipt of supplies and the making of supplies by a taxable person, hence the four year and six month time limits imposed.

36. It was not disputed that the input tax which was disputed here related to goods which had been both acquired and sold before Earl Redway was VAT registered. The exceptional time limits in Regulation 111 do not therefore apply. Mr Redway's supplies fall within Reg 111(2)(a) having been made prior to registration. We do not accept the taxpayer's interpretation of Reg 111(2)(a) which we consider produces a result which is out of line with the fundamental approach of EU legislation and the principal of fiscal neutrality.

37. Unlike the position in *Nidera*, those supplies did not form part of any kind of taxable supply made by Mr Redway. There is therefore no basis on which this input tax can be re-claimed. UK law and EU law are aligned for these purposes, even if not perhaps in the most straightforward way.

38. For these reasons this appeal is dismissed and HMRC's refusal to repay input VAT in respect of the supplies received and sold prior to registration is confirmed.

39. 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.

RACHEL SHORT
TRIBUNAL JUDGE

RELEASE DATE: 21 AUGUST 2015