[2020] UKFTT 0019 (TC)

TC07525

VAT – input tax - whether or not supplies of accommodation were made to the appellant – yes (jointly with another company) – whether or not HMRC acted reasonably in refusing to accept alternative evidence of the supplies – yes - appeals against the assessments dismissed – whether or not a penalty was correctly issued – yes – appeal against the penalty dismissed – cancellation of registration – whether or not the appellant was making supplies of management services to its subsidiary – yes – appeal against the cancellation of registration allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/01595

BETWEEN

ALTERNATIVE INVESTMENT STRATEGIES LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE RICHARD CHAPMAN QC
MRS JANET WILKINS

Sitting in public at Taylor House, 88 Rosebery Avenue, London, EC1R 4QU on 6 June 2019 with further written submissions dated 4 July 2019 and 15 July 2019.

Mr Tushar Patel, Director, for the Appellant

Mrs Mary Hendrick, Presenting Officer, of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. This appeal relates to the proper VAT treatment of purported supplies from a holding company, Alternative Investment Strategies Limited ("AIS") to its subsidiary, Hedge Funds Investment Management Limited ("HFIM").

2. AIS appeals against the following decisions:

(1) A notice of assessment dated 25 September 2017 which denied AIS' input tax for the periods 09/13 to 09/16, resulting in an assessment in the sum of £21,637.

(2) A decision dated 26 September 2017 adjusting AIS' 12/16 return to deny all input tax claimed and so reducing the £2,400 repayment to nil.

(3) A decision dated 8 November 2017 cancelling AIS' VAT registration with effect from 30 June 2017.

(4) A notice of penalty assessment dated 27 November 2017 charging AIS an inaccuracy penalty in the sum of £4,868.28 pursuant to Schedule 24 of the Finance Act 2007 upon the basis of careless behaviour. An explanation of the penalties was sent with a letter dated 25 October 2017.

3. At the beginning of the hearing, Mr Patel sought to adduce in evidence various documents which had only recently been disclosed to HMRC. Mrs Hendrick did not object to this providing HMRC were given the opportunity to make written submissions after the hearing. We therefore gave directions for written closing submissions from HMRC and a written response by AIS. These submissions were duly made, and we have considered them in making this decision.

FINDINGS OF FACT

4. We heard oral evidence from Mr Patel on behalf of AIS and from Officer Carole Esson on behalf of HMRC, both of whom had also submitted written witness statements. We also considered the documents provided by both parties.

5. We make the following findings of fact. In doing so, we bear in mind that the burden of proof in respect of the appeal against the notice of assessment, denial of input tax and cancellation of registration is upon AIS and the burden of proof to establish that the penalty is properly charged is upon HMRC.

Background

6. AIS is a company which was incorporated on 24 March 1999. A subscribers' and shareholders' agreement dated 27 June 2006 ("the Shareholders' Agreement") provided as follows in respect of its business and objects:

> "'Business' means the acquisition and holding of HFIM to enable HFIM to carry on regulated business, being the provision of specialist investment management and advisory services for the Offshore Fund, managing and advising fund of hedge funds and absolute return investment managers and related services, and such other business as the Board may agree should be carried on by the Company and/or its Subsidiaries and/or Holding Company.
>
> …
>
> 2.1. The primary object of the Company is to carry on the Business.
>
> 2.2. Unless otherwise agreed in writing by Shareholders representing not less than ninety per cent of the nominal value of the Shares from time to time

in issue, the objects of the Company shall be limited to the establishment of HFIM which itself shall provide services to the Offshore Fund in a way as to ensure that HFIM cannot be operated independently from the Company."

7. Mr Tushar Patel is a director and shareholder of AIS. He is also an employee pursuant to a service agreement dated 1 July 2006 ("the Service Agreement"). The Service Agreement sets out Mr Patel's role as follows ("the Employer" being defined as AIS and "the Executive" being defined as Mr Patel):

> "2.1. The Employer employs the Executive and the Executive agrees to serve as CO-CHIEF EXECUTIVE OFFICER of the Employer and CO-CHIEF EXECUTIVE OFFICER AND INVESTMENT MANAGER of its subsidiary HEDGE FUNDS INVESTMENT MANAGEMENT LIMITED".

8. HFIM is a wholly owned subsidiary of AIS. Mr Patel is a director of HFIM. Mr Patel's evidence was that AIS provided unregulated marketing and research services and HFIM provided investment advisory, execution and related regulatory services. HMRC did not challenge this aspect of Mr Patel's evidence and so we accept it.

9. An undated agreement headed "Management and Administrative Services Agreement" ("the Management Agreement") sets out the services to be provided by AIS (defined as "the Manager") to HFIM (defined as "the Company") and the fees and charges payable as follows:

> "The Management and Administrative Services
>
> The Manager shall provide the following services to the Company:
>
> I. Corporate Governance Services. The Manager shall assist and provide the Company in the provision of general company secretarial services, it will attend all board meeting, monitor the development of the subsidiary, report to the shareholders, and monitor adherence to compliance with the Shareholders agreement business plans and other agreements.
>
> II. Treasury Services. The Manager will support managing the treasury function of the Company.
>
> III. The Manager shall assist the Company in all matters relevant to the financing of the Company's activities, including the identification of sources of potential financing, negotiation of financing arrangements, and coordination of financing for the benefit of the Company.
>
> IV. The Manager will arrange, negotiate and provide Director and Officers Insurance.
>
> V. The Manager shall provide general advice and assistance to the Company in the procurement of other Insurance as may be necessary or prudent in order to comply with legal or contractual requirements, or otherwise prudently insure the risks of the Company.
>
> VI. Infrastructure. The Manager will be responsible for, arrange and provision of office space, technology infrastructure, and any other infrastructure mutually agreed to the [sic] of the operating of the Company.
>
> VII. General Administrative Services. The Manager shall provide services of officers or other employees of the Manager to perform as officers of the Company or provide such general administrative services, technical skills and investment staff including accounting services, access to and consolidation of information and assistance in the general administration and management of the business, with all of the duties of officers of the Company as provided by the Board of Directors of the Company subject to the sole direction of the Board of Directors.

VIII. The Manager will assist in protecting the assets, and goodwill of the Company which is in the interest and benefit for its Group shareholders.

IX. The Manager will assist in the preparation of annual financial statements, assist with appointment of auditor and other professional services.

X. Other services that may be mutually agreed between the Manager and the Company.

The Fees and Charges Payable

I. The Company agrees to reimburse the Manager for all costs and expenses reasonably incurred by the Manager in the provision of the Management, Administrative Services and any other support services provided by the Manager to the Company.

II. The Company shall pay to the Manager a management fee or charge, that will be agreed between the parties, which will be based on management time involved, the total costs incurred, amount of management time and other consideration together [with] any taxes.

III. Other fees for any other works or services agreed between the parties not explicitly set out in the agreement."

10. Mr Patel's evidence was that the Management Agreement regulated the relationship between AIS and HFIM. HMRC argued that as Mr Patel was a director of both AIS and HFIM, any services which he provided to HFIM were in his capacity as a director of HFIM and so were not provided by AIS. This conflicted with the Management Agreement and so effectively amounted to an argument that the Management Agreement did not govern the relationship between AIS and HFIM.

11. We find that the Management Agreement did govern the relationship between AIS and HFIM. Crucially, it was not put to Mr Patel (and HMRC did not argue) that the Management Agreement was a sham or that it did not reflect the relationship between AIS and HFIM. Further, we accept Mr Patel's evidence that AIS' obligations were carried out through him. Mr Patel's service contract was with AIS and there was no suggestion that he had any further service contract with HFIM. This is consistent with his services being referable to AIS, which were then carried out pursuant to the Management Agreement. We note that HMRC argue that AIS did not have any employees as AIS was not registered for PAYE. We do not accept that this is the case. The evidence of Mr Patel and in particular the terms of the service contract establish that Mr Patel was an employee of AIS; whether or not PAYE ought to have been operated in the light of that is a matter that is outside the scope of this decision and this appeal.

12. It is correct that Mr Patel was a director of both AIS and HFIM. He therefore owed duties to both AIS and HFIM. However, this does not define the work which Mr Patel was doing or which company he was doing it for. Mr Patel said that his work for HFIM was as a result of his service contract with AIS and there is no evidence to contradict what he says.

The Services Provided by AIS

13. There was a dispute of fact as to what services AIS provided HFIM from time to time.

14. Mr Patel's evidence was, in essence, that AIS had provided a range of management services to HFIM. However, HFIM became involved in litigation in the Seychelles which took up its time and resources to such a degree that HFIM and AIS' activities were scaled back for what, it was hoped, would be a temporary period. From the start of the litigation in 2011 until its resolution in 2017 (and so, importantly, covering the period in question in the present appeal of the VAT periods from 08/13 to 12/16) certain, but not all, services were suspended. Mr Patel said in his witness statement that he, as an AIS employee provided by AIS to HFIM, continued

to provide accounting services, regulatory reporting services, research services, litigation support and finance-raising services. In oral evidence, Mr Patel added that he also provided a regulatory function. He also said that his role went beyond what a director would do as this was effectively the work of a chief investment officer.

15. HMRC did not provide any evidence of their own. However, they relied upon various emails and documents from AIS to submit that AIS was not providing any services and that any work carried out by Mr Patel was in his capacity as a director of HFIM. HMRC note that no supplies were declared as outputs by AIS on their VAT returns. HMRC also argue that correspondence from Mr Patel gave the impression that services had been suspended completely.

16. We find that AIS was providing services to HFIM during the relevant period (being 08/13 to 12/16). Mr Patel gave his evidence in a frank and credible manner and did not give us reason to doubt what he said about the work that he carried out. Whether or not AIS ought to have declared the services as supplies on its VAT returns is outside the scope of this appeal; the fact that AIS did not do so does not mean that those services were not provided. Further, whilst the correspondence could have been clearer from Mr Patel, he does not go so far as to say that all services had ceased. In his letter dated 18 May 2017, he said that "normal services" were temporarily suspended. In his letter dated 17 August 2017, he focuses upon the suspension of invoices being charged but does not say that no services were being carried out. Indeed, it is clear from the letter dated 17 August 2017 and Mr Patel's evidence that it was intended that AIS would invoice HFIM in the future for management charges for those services. Even in the absence of such invoices, AIS and HFIM accounted for those management charges by way of an inter-company account between them. Mr Patel said that AIS charged HFIM a management charge of £12,000 per year. This is evidenced by AIS' profit and loss account for the years ending 30 June 2013, 30 June 2014 and 30 June 2015 showing income described as being from an "inter-company management charge" of £12,000, which is matched by HFIM's profit and loss account for same years showing expenditure in the same amounts with the same description. Whilst we were not shown any profit and loss account for the years ending 30 June 2016 or 30 June 2017, Mr Patel did not distinguish between any of the years in question and so we accept that the same approach was taken for these years.

17. Importantly, there was no dispute that HFIM was trading, at least for the purposes of dealing with its litigation and continuing to comply with its regulatory obligations. It is of note that there was no suggestion that Mr Patel was not carrying out work for HFIM; given the terms of the Management Agreement and Mr Patel's service agreement with AIS, this would itself be a provision of services by AIS pursuant to AIS' obligations under the Management Agreement. Again, for the reasons already set out in paragraphs 11 and 12 above, on the balance of probability Mr Patel was acting in his capacity as an employee of AIS in carrying out his work rather than as an employee of HFIM.

Accommodation Costs:

18. The input tax in dispute all relates to office accommodation costs which have been variously described as rent, facility fees, service charges and licence fees. For the purposes of this decision, we define all such costs as "the Accommodation Costs" and the supplies as "the Accommodation".

19. On 30 March 2011, AIS and HFIM entered into a licence agreement with the owners of accommodation in Crown Place, London, Crown Place Financial Limited ("Crown" and "the Property"). This was effectively a licence to use a room in the Property for a fee of £2,625 plus VAT of £525 per month. This continued until AIS and HFIM entered into a licence agreement dated 8 August 2016 with a different company Bourne Financial Ltd ("Bourne") in respect of

a different room for a fee of £3,000 plus VAT (wrongly calculated at £525) per month. The licence agreements are strikingly similar and do not provide any detailed terms and conditions other than the provision of a termination date and permission to AIS and HFIM (both defined as "the Client" in the agreements) to use the accommodation, services and facilities. The first licence agreement included "Pays Facility Fee" next to AIS' name and "Pays Service Charge" next to HFIM's name but this is not repeated in the second licence agreement. In the interests of clarity, we will refer to the "Licence Agreements" when both agreements are taken together and the "First Licence Agreement" and the "Second Licence Agreement" respectively when referring to them separately. Crown and Bourne are referred to together as "the Licensor").

20. Throughout the periods 08/13 to 12/16, the invoices for the Accommodation Costs were issued by Crown or Bourne to HFIM. Mr Patel says that this was an administrative mistake and relies upon a letter dated 9 July 2018 from a director of Bourne ("the Bourne Letter") which states as follows:

> "We write to confirm the following as the licensor of the property occupied by the above companies:
>
> 1. The two companies occupy an office within 30 Crown Place, London, EC2A 4EB under a licence agreement with Bourne Financial.
>
> 2. We have known the two companies since 2006, who have occupied our offices under a license agreement.
>
> 3. The companies are charged currently invoiced 3,000 pounds plus VAT on a monthly basis.
>
> 4. The invoice is required to be addressed to both companies. In the past there has been a clerical mistake where invoices were only addressed to HFIM. This has now been ratified [sic] and now addressed correctly that is been invoiced to both companies as per the licence agreement."

21. We were given no evidence as to how this administrative mistake occurred or as to why it was not corrected by the Licensor, AIS or HFIM earlier. However, in the light of the Bourne Letter and the fact that AIS and HFIM are both liable to the Licensor for the Accommodation Costs pursuant to the licence agreement, we accept that this was a mistake and that both AIS and HFIM ought to have been invoiced.

22. In the course of HMRC's investigation before making the various decisions, AIS showed HMRC various samples of bank statements which in turn showed that the payments for the Accommodation Costs were paid by HFIM. It was AIS' evidence that on various occasions HFIM paid for the Accommodation Costs but that these payments were on behalf of AIS and were accounted for between the companies as being AIS' obligation. In the course of the appeal, AIS also provided copies of various cheques which reveal occasions upon which AIS paid for the Accommodation Costs directly. We find as a matter of fact that AIS and HFIM each paid the Licensor for the Accommodation Costs from time to time.

23. AIS and HFIM accounted for the Accommodation Costs as between each other. AIS provided a letter from AIS and HFIM's auditors dated 10 December 2018 which stated that the Accommodation Costs were accounted for as expenses in the accounting records of AIS. When it has been paid by HFIM this has been on behalf of AIS and accounted for through inter-company accounts. We have also seen the profit and loss accounts for AIS and HFIM which show the Accommodation Costs (referred to as "Rent") as an expense for AIS but not HFIM. We accept Mr Patel's evidence that this reflects the position as between AIS and HFIM (although the companies' accounting processes between each other do not affect our findings above as to the separate question as to which company paid the Licensor from time to time).

24. We make the point that our findings as set out above arise from the documents, evidence and submissions made to us during and after the hearing of the appeal. Mr Patel sent HMRC a licence agreement on 18 May 2017. However, we note that our hearing bundle shows the attachment to the 18 May 2017 email to be only the Second Licence Agreement. This is consistent with Mr Patel referring in the email to "the BFL contract" as Bourne was the licensor under the Second Licence Agreement but not the First Licence Agreement. Mr Patel stated in his email dated 17 August 2017 that he had already sent a copy of the agreement and attached another copy. Our hearing bundle does not show an attachment to the 17 August 2017 email but we assume from the wording in the email that it was a replacement copy of the Second Licence Agreement. Indeed, the First Licence Agreement was included in the additional documents provided to HMRC by AIS recently before the hearing and so we take it that the First Licence Agreement was provided in the context of the appeal rather than prior to the decisions and review. Further, we find that the only evidence provided to HMRC at the time of either the decisions or the review showed payments to the Licensor by HFIM as the payments to the Licensor by AIS were only provided in the course of this appeal. We also find that Mr Patel stated in his emails dated 18 May 2017 and 17 August 2017 that (as between AIS and HFIM) the invoices were allocated to AIS to be recharged to HFIM when it has the funds to pay them. However, no further evidence was provided to HMRC prior to the decisions and review as to this inter-company accounting. In particular, the letter from AIS and HFIM's auditor and the profit and loss accounts were only provided in the context of this appeal.

HMRC's Decisions

25. HMRC's decision dated 25 September 2017 is not a picture of clarity. However, the following reasons for denying the disputed input tax are to be taken from the decision letter as amplified by the review decision dated 26 January 2018:

(1) The Accommodation Costs do not relate to a supply to AIS or paid for by AIS.

(2) The Accommodation Costs were not invoiced to AIS and there was insufficient alternative evidence to allow the input tax.

(3) AIS did not make (and did not intend to make) any taxable supplies.

26. For the avoidance of doubt, we find that HMRC decided not to accept alternative evidence to allow the input tax because the decision letter and review letter refer to HMRC asking for invoices and evidence to support the input tax claim and HMRC not being satisfied as to the same. In particular, HMRC stated as follows in the review letter:

> "Were you the recipient of a supply of goods or services?
>
> You claimed input tax in relation to charges of office rental by Bourne Financial Ltd. HMRC asked you to provide evidence to support the input tax claim in relation to the supply you were receiving and invoices concerning the transaction were provided.
>
> The invoices that have been provided are addressed to HFIM and not to AIS and HMRC's enquiries indicate that payment of the supplies of rental accommodation have been made by HFIM and not by AIS.
>
> You have stated that the underlying agreement is that both companies are part of the Bourne Financial Ltd [sic] and that the invoice has been made out to HFIM in error. However, the fact remains that HFIM have been invoiced for the entirety of the supply, have paid for it, and it is not your input tax to reclaim."

27. The decision dated 26 September 2017 in respect of the period 12/16 was effectively upon the same basis as the other periods and was dealt with in the same review.

28. The decision dated 8 November 2017 to cancel AIS' registration resulted from HMRC's finding that AIS was not making (and was not intending to make) any taxable supplies. This was cancelled with effect from 30 June 2017.

29. The decision dated 27 November 2017 to issue a penalty related to the denial of the disputed input tax. HMRC treated the relevant behaviour as careless and the disclosure as prompted. A penalty percentage of 22.5% was applied which included only 50% of the potential reductions for co-operation. HMRC considered whether or not there were any special circumstances and found that there were none.

THE ISSUES

30. The grounds for appeal and the parties' submissions give rise to the following issues for determination:

(1) Whether or not the Accommodation was supplied by the Licensor to AIS or to HFIM.

(2) Whether or not AIS has provided sufficient alternative evidence of the supplies.

(3) Whether or not AIS was making taxable supplies (which is relevant both to the assessments and the cancellation of AIS' registration).

(4) Whether or not the penalty was correctly imposed.

31. There was no dispute as to the amounts of the various assessments other than in respect of the level of reduction of the penalty. We note that Mr Patel did not raise any issues as to special circumstances in respect of the penalty.

THE SUPPLY OF THE ACCOMMODATION BY THE LICENSOR

The Legal Framework

32. There was no dispute as to the legal framework.

33. Section 24(1) of the Value Added Tax Act 1994 ("VATA 1994") provides as follows:

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

34. Section 25(2) of VATA 1994 provides as follows:

> "(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him."

35. Sections 26(1) and (2)(a) of VATA 1994 provide as follows:

> "(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; …"

The Parties' Submissions

HMRC

36. Mrs Hendrick submitted that the supplies of the Accommodation were not made to AIS and instead were made directly by the Licensor to HFIM. She noted that the Licensor's invoices were addressed to HFIM and the bank statements shown to, and considered by, HMRC during the investigations all showed HFIM paying the Accommodation Costs directly to the Licensor.

AIS

37. Mr Patel submitted that there was a supply to AIS. He said that the invoicing of HFIM rather than HFIM and AIS was a mistake by the Licensor. He also said that, historically, AIS paid the invoices issued to HFIM from its bank account. HFIM occasionally paid the Accommodation Costs but this was charged to AIS' accounts and so accounted for as a debt of HFIM to AIS in AIS' financial statements. He produced a letter from the companies' accountant to this effect and referred us to the extracts from the financial statements which showed rent as an expense in AIS' books (this was in the sum of £28,350 for 2015, £31,500 for 2014 and £31,500 for 2013). Mr Patel also argued that the fact that the Management Agreement provided for AIS to procure accommodation for HFIM made it clear that the supply was from the Licensor to AIS which would then be supplied from AIS to HFIM.

Discussion

38. The identification of the recipient of a supply in a tripartite situation was the subject of consideration by the Supreme Court in *Revenue and Customs Commissioners v Airtours Holidays Transport Ltd* [2016] UKSC 21, [2016] STC 1509. The recipient of the supply is to be identified by reference to the contractual documentation unless this does not reflect the economic reality. Lord Neuberger stated as follows at [50] and [51] (see also [42] to [49]):

> "[50] From these domestic and Court of Justice judgments, 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.
>
> [51] On this analysis, it appears to me that, subject to considering a further way in which Airtours' case is put, it also fails on the second question. The Contract, consisting of the Letter and the Terms, did reflect the economic reality, and was not in any way an artificial arrangement. It is true that Airtours benefited from the Contract, but the benefit which it was getting was not so much the Services from PwC, but the enhanced possibility of funding from the Institutions for its restructuring (a possibility which eventuated into reality thanks, to a substantial extent, to the Report). And it was to improve the prospects of such refinancing that Airtours was prepared to pay for the provision of the Report."

39. Economic reality was further considered by the Upper Tribunal in *U-Drive Ltd v Revenue and Customs Commissioners* [2017] UKUT 112 (TCC), [2017] STC 806 (Proudman J and Judge Sinfield) at [38] as follows:

> "[38] In conclusion, we consider that it is clear from *Airtours* and the cases referred to in that case that determining who is receiving a supply is a two-stage process. The starting point is to consider the contractual position and then consider whether, taking account of all the circumstances, the contractual analysis reflects the economic reality of the transaction. If, as a matter of contract, a party undertakes to provide services to another person in return for consideration from that person or a third party then there is, subject to the question of economic reality, a supply to that person for VAT purposes. It is clear from Lord Neuberger's comments in [50] of *Airtours* that where a person who provides the consideration is not entitled under the contractual documentation to receive any services from the supplier then, unless the documentation does not reflect the economic reality, there is no supply to the payer. We consider that, similarly, where a contract shows that one party is obliged to provide services to another person but, on consideration of all the circumstances, it is found that the contractual analysis does not reflect the economic reality of the transactions then there will not be a supply to the other person."

40. The circumstances in which a contract does not reflect the economic reality of a transaction are not restricted to situations of artificiality or sham. In the First-tier Tribunal decision of *American Express Services Europe Ltd v Revenue and Customs Commissioners* [2019] UKFTT 548 (TCC) (Judge Sinfield and Mrs Janet Wilkins), the point was explained as follows at [85] to [89]:

> "[85] We do not accept that the absence of artificiality means that there is no room to consider the economic and commercial reality of the transactions. As the use of the words 'in particular' by the Court of Justice in *Newey CJEU* show, artificiality is not the only test of economic reality. As Henderson LJ noted in *HMRC v Newey (t/a Ocean Finance)* [2018] EWCA Civ 791 ('*Newey CA*'), when it had returned to the UK and reached the Court of Appeal, at [101] 'total artificiality is not an invariable requirement, but rather a paradigm example of where the contractual terms do not reflect economic and commercial reality.'
>
> [86] While it appears to be clear that a contract designed to implement a purely artificial arrangement is unlikely to reflect the economic and commercial reality of a transaction, there is very little guidance on the meaning of economic and commercial reality where arrangements are not purely artificial.
>
> [87] In *Newey CJEU*, one of the questions was whether, notwithstanding the fact that under the contractual terms a company, Alabaster, was the recipient of supplies of advertising services provided by Wallace Barnaby, the contractual terms did not genuinely reflect economic reality and it was Mr Newey, and not Alabaster, who was actually the recipient of the supplies of advertising services provided by Wallace Barnaby. In paragraph 48 of the judgment, the Court of Justice indicated that it was 'conceivable [on the facts stated in the reference] that the effective use and enjoyment of the services at issue in the main proceedings took place in the United Kingdom and that Mr Newey profited therefrom'. Henderson LJ provided more detail about the facts as stated in the reference in *Newey CA* at [62]:
>
> > 'As is apparent from this passage, the CJEU did not rule out the possibility that, in the light of its knowledge of the facts found by the FTT and reflected in the order for reference, the transactions in issue might constitute an abuse in the Halifax sense. The key paragraph for this purpose is paragraph 48, which requires account to be taken of the

economic reality of the relevant business relationships between each of Mr Newey, Alabaster, the lenders and Wallace Barnaby, as well as the matters of fact mentioned in the third question referred to the Court.

The third question reads as follows:

'(3) In circumstances such as those in the present case, in particular, to what extent is it relevant:

(a) Whether the person who makes the supply as a matter of contract is under the overall control of another person?

(b) Whether the business knowledge, commercial relationship and experience rest with a person other than that which enters into the contract?

(c) Whether all or most of the decisive elements in the supply are performed by a person other than that which enters onto the contract?

(d) Whether the commercial risk of financial or reputational loss arising from the supply rests with someone other than that which enters into the contracts?

(e) Whether the person making the supply, as a matter of contract, sub-contracts decisive elements necessary for such a supply to a person controlling that first person and such sub-contracting arrangements lack certain commercial features?'

[88] In paragraph 48 of *Newey CJEU*, the Court of Justice did not refer to all the matters of fact mentioned in the reference but focussed on two elements, namely where were the services effectively used and enjoyed and who benefited from them. This approach was reflected in *U--Drive*, where the Upper Tribunal considered, at [44], that whether U-Drive had an interest in the supply for which it was paying was relevant in assessing whether, in economic reality, the company received the supply.

[89] Mr Mantle submitted that this stage of the analysis involves considering all the facts relevant to the economic and commercial reality of the transaction to see if any of those facts vitiate the conclusion based on a purely contractual analysis. We agree that we must have regard to all the circumstances, viewed objectively. It appears to us that, in ascertaining the economic and commercial reality of a transaction involving a supply of services, we should have regard to several factors. It is clear that such factors may include where the services are effectively used and enjoyed as well as who benefits from or has an interest in them in an economic or commercial sense. We consider that we should also ask why the consideration for the services is paid to determine the true nature and purpose of the transactions. Not every factor will be relevant in every case and there may be other factors."

41. With these authorities in mind, we find that both the contract and the economic reality establish that the Accommodation was supplied to both AIS and HFIM. This is for the following reasons.

42. The starting point is an analysis of the Licence Agreements which gave rise to the supply of the Accommodation and the payment of the Accommodation Costs. It is of note that both AIS and HFIM are parties to the Licence Agreements and are therefore both entitled to occupy the room. In turn, both AIS and HFIM were obliged to pay the Licensor, irrespective of any further arrangements between AIS and HFIM. As such, we find that the contractual position in respect of the supply by the Licensor was that it was a supply of the Accommodation to both AIS and HFIM.

43. We find that the economic reality is consistent with the Licence Agreements. We note Mr Patel's evidence that both AIS and HFIM occupied the Property. It was not put to him by Mrs Hendrick that this was incorrect. Indeed, Mr Patel asked Officer Esson in cross-examination whether or not she accepted that both companies occupied the Property and she said yes. We also note that Bourne states in the Bourne Letter that both companies occupy the Property. There was no evidence that both HFIM and AIS did not occupy the Property. In any event, even if we had found that AIS did not physically occupy the Property, the Licence Agreements would still constitute a supply to AIS of the right to occupy the Property jointly with HFIM.

44. At various points, Mr Patel suggested that the Accommodation was licensed to AIS and then AIS sub-licensed it to HFIM. This is not what the Management Agreement provided for. Paragraph VI of the Management Agreement obliges AIS to "be responsible for, arrange and provision of office space." This does not mean that it is for AIS to license and then sub-license it. In effect, AIS' obligation is to procure the office space, which it did by procuring the Licence Agreements. The procuring of the Accommodation is different to the supply of the Accommodation. Even if we are wrong in this construction of the Management Agreement, the suggestion that AIS was licensing the Accommodation from the Licensor and then sub-licensing it to HFIM is wholly inconsistent with the fact that, as set out above, HFIM was entitled to occupy the Accommodation in its own right pursuant to the Licence Agreements. Indeed, there is also no evidence of any such sub-licence. As such, this does not disturb our finding that the supply was to both AIS and HFIM.

45. It follows that we disagree with the element of HMRC's decisions which found that no supply was made to AIS. However, this is not sufficient on its own for the appeal to succeed as HMRC refused to accept AIS' evidence of the supplies.

EVIDENCE OF THE SUPPLIES

The Legal Framework

46. Again, there was no dispute as to the legal framework. This is summarised as follows by the Upper Tribunal (Rose J (P) and Judge Hellier) in *Scandico Ltd v Revenue and Customs Commissioners* [2017[UKUT 467 (TCC), [2018] STC 153 ("*Scandico*"), at [14] to [21], [39] and [40]:

> "[14] The obligation on suppliers to provide a VAT invoice was imposed by art 220 PVD and the details of what information must be included in a VAT invoice were set out in art 226, including the full name and address of the customer and the customer's VAT identification number. It was common ground before us, as it had been before the FTT, that the till receipts given by Apple to the runners did not constitute compliant VAT invoices.
>
> [15] So far as the relevant domestic legislation is concerned, input tax in relation to a taxable person is defined by s 24(1) of the Value Added Tax Act

1994 ('VATA') as including VAT on the supply to him of any goods or services, being goods or services used or to be used for the purpose of any business carried on or to be carried on by him. Section 24(6)(a) (as amended) provides for the making of regulations:

> '… for VAT on the supply of goods or services to a taxable person … to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents or other information as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases.'

[16] Regulations have been made for this purpose, namely the VAT Regulations 1995, SI 1995/2518:

> (1) Regulation 13 provides that where a registered person makes a taxable supply in the United Kingdom to a taxable person he shall provide that person with a VAT invoice.
>
> (2) Regulation 14 specifies what must be included in a VAT invoice, including the date of issue of the document, the name, address and registration number of the supplier, the name and address of the person to whom the goods or services are supplied, a description sufficient to identify the goods, the rate of VAT and the amount payable excluding VAT and then the total amount of VAT chargeable.
>
> (3) There is a relaxation of the rules stipulating the contents of a VAT invoice in a case where the consideration for a supply does not exceed £250 and the supply is a domestic one. In such a case, the VAT invoice that the registered person is required to provide need only contain a more limited amount of information which does not include the name and address of the person to whom the goods are supplied: see reg 16A.
>
> (4) Regulation 29(2) deals with claims for input tax. It provides that at the time of claiming deduction of input tax in a VAT return a person shall, if the claim is in respect of a supply from another taxable person, hold a VAT invoice which is required to be provided under reg 13.
>
> (5) There is a proviso to reg 29(2) which allows the deduction of input tax to be made without a VAT invoice:
>
> > 'provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold or provide such other … evidence of the charge to VAT as the Commissioners may direct.'
>
> [17] Thus, arts 180 and 182 PVD empower the member state to allow a deduction of input tax to be made in accordance with conditions set by that member state and, in the United Kingdom, reg 29(2) of the VAT Regulations 1995 confers on the Commissioners a discretion in a particular case to direct that a deduction can be made in the absence of a VAT invoice if the taxpayer provides such evidence of the charge to VAT as HMRC may direct.
>
> [18] The role of the tribunal on an appeal against a refusal to allow a deduction in circumstances where HMRC has rejected alternative evidence supporting a claim that input tax was incurred was discussed in *Kohanzad v Customs and Excise Comrs* [1994] STC 967 ('*Kohanzad*'). In that case the Commissioners had conceded before the tribunal that they had a discretion to accept a claim for input tax credit in the absence of VAT invoices. The taxpayer was unable to provide

any documentation to support the claim for credit. The taxpayer had produced purchase invoices and contended that in respect of accounting periods before and after those in dispute, the Commissioners had accepted his purchase invoices without question. He submitted that the Commissioners had acted unreasonably in refusing to allow any credit for input tax. An appeal against the decision was dismissed by the VAT Tribunal and the further appeal was also dismissed by Schiemann J sitting in the High Court, Crown Office List. Schiemann J held that the effect of the provision in the VAT (General) Regulations 1985, SI 1985/886 (which was the predecessor to reg 29(2) of the 1995 Regulations) was that prima facie a registered taxable person is not entitled to any credit in respect of input tax unless at the time of claiming such a credit he holds a tax invoice in relation to that supply. The second effect of the provision was that the Commissioners have a discretion to allow credit for input tax, notwithstanding that the registered taxable person does not hold such a tax invoice. They had exercised that discretion against the taxpayer. The jurisdiction under which the tribunal could review that decision was the provision in the VAT Act 1983 drafted in the same terms as s 83(1)(c) VATA.

[19] Schiemann J went on to say (at 969):

> 'It is established that the tribunal, when it is considering a case where the commissioners have a discretion, exercises a supervisory jurisdiction over the exercise by the commissioners of that discretion. It is not an original discretion of the tribunal, it is one where it sees whether the commissioners have exercised their discretion in a defensible manner. That is the accepted law in this branch of the court's jurisdiction, and indeed it has recently been decided that the supervisory jurisdiction is to be exercised in relation to materials which were before the commissioners, rather than in relation to later material.'

[20] The judge cited a number of cases in support of that principle including *Customs and Excise Comrs v Peachtree Enterprises Ltd* [1994] STC 747.

[21] More recently the supervisory nature of the tribunal's jurisdiction in these circumstances was reiterated by the Upper Tribunal in *Best Buys Supplies Ltd v Revenue and Customs Comrs* [2011] UKUT 497 (TCC), [2012] STC 885 ('*Best Buys*'). The Upper Tribunal confirmed the test in Kohanzad, stating that although the jurisdiction of the First-tier Tribunal was appellate since the appeal was made under s 83(1)(c), the tribunal could not substitute its own decision for that of HMRC but could only decide whether the discretion had been exercised reasonably by HMRC: see para [49] of the judgment in *Best Buys*.

…

THE CORRECT APPROACH TO APPEALS OF THIS KIND

[39] The role of the First-tier Tribunal is to examine a decision that HMRC have taken and decide whether that decision was right or wrong. Sometimes the test that is applied in examining HMRC's decision is a full merits appeal. Sometimes it is a review as to whether the decision fell within the reasonable bounds of HMRC's discretion. We have considered carefully the precise content of the decision that the case officer made in this case. Mr Pickup argued that the decision letters

> showed that she had in fact decided that there had been no taxable supply from Apple to Scandico. We do not agree that that is the correct reading of the letters although we accept that the letters could have been better worded to make this clear. We agree with the conclusion arrived at by the FTT in para [117] of its judgment that in this case HMRC have not taken a decision about whether there was a taxable supply of the phones to Scandico. What the case officer decided is that, in the absence of VAT invoices from Apple to Scandico, there was not enough information provided by Scandico for HMRC to decide whether there has been a taxable supply or not. HMRC has therefore exercised the discretion conferred on it by reg 29(2) of the VAT Regulations 1995 by declining to direct that the alternative evidence that Scandico provided should be treated as sufficient evidence of the supply of the iPhones to Scandico. That is the decision which has been taken by HMRC and hence it is the decision that can be appealed and it is the decision that the tribunal should address.
>
> [40] In these circumstances we firmly disapprove of the two-stage approach which the parties in this case encouraged the FTT to adopt and which has, we understand, been adopted in similar cases. We regard the two-stage approach as seriously flawed both in juridical and practical terms."

The Parties' Submissions

HMRC

47. Mrs Hendrick argued that no invoices had been provided with AIS' name on them, with the effect that the input tax could not be claimed unless HMRC exercised its discretion to accept alternative evidence. Mrs Hendrick argued that it was reasonable for HMRC to reject this evidence as it was not sufficient to establish that a supply had been made. The evidence of a clerical error did not go far enough and was only provided after the decision had been made. Further, the only evidence available at the time of making the decision was to the effect that payments had been made by HFIM rather than AIS (the photocopies of cheques having been provided two days before the hearing of the appeal).

AIS

48. Mr Patel relied upon the same evidence as set out above in respect of his argument that the Accommodation was supplied to AIS to establish that it was unreasonable for HMRC to refuse to exercise its discretion in favour of allowing credit for the disputed input tax.

Discussion

49. We find that there were no satisfactory invoices and that HMRC acted reasonably in refusing to exercise their discretion in favour of AIS. We note that, in accordance with *Scandico*, the question of whether or not HMRC acted reasonably is to be considered in the light of the evidence placed before HMRC at the time of the decision and the review (the review being relevant because the evidence was effectively considered again by the reviewing officer in the present case).

50. AIS clearly accepts that the invoices are addressed to HFIM rather than to AIS as this is the basis for Mr Patel's explanation that this was a clerical error by the Licensor. In any event, all the invoices which we have been shown are addressed to HFIM by the Licensor.

51. HMRC's reasoning for finding that there was insufficient evidence of the inputs is within the part of the review letter recited at paragraph 26 above and focuses upon the invoice beings being addressed to HFIM and the payments having been made by HFIM not AIS. HMRC

mentions the Licence Agreements and the assertion as to the error in the invoices being made out to HFIM and so we accept that these matters were taken into account. This decision was a reasonable one for the following reasons.

52. First, the only invoices made available to HMRC at the time of the decisions and the review were made out to HFIM. There was no explanation as to how the mistake had been made, why it had not been noticed, why it had not been resolved and what the Licensor's position was. Crucially, the Bourne Letter was provided in the context of this appeal and not prior to the decisions or the review.

53. Secondly, the only evidence of payment to the Licensor made available to HMRC at the time of the decisions and the review were payments made by HFIM. Again, the evidence of payments by AIS was provided in the context of this appeal.

54. Thirdly, the only evidence of intercompany accounting for the Accommodation costs made available to HMRC at the time of the decisions and the review was the assertion by Mr Patel, which did not itself provide any full detail or explanation. Again, the evidence from AIS and HFIM's auditor and the provision of the profit and loss accounts were provided in the context of this appeal. It might be that accounts would have been filed at Companies House by the time of the decisions and the review but it is not for HMRC to have to obtain these.

55. Fourthly, the Second Licence Agreement was insufficient on its own to provide sufficient evidence as it conflicted with the evidence provided to HMRC in respect of invoices and payment. Even if we were to have found that the Second Licence Agreement had not been taken into account, this would not have rendered the decision unreasonable in view of the evidence of the invoices and the payment provided to HMRC and given that the First Licence Agreement had not been provided.

WHETHER OR NOT AIS WAS MAKING TAXABLE SUPPLIES

The Legal Framework

56. As set out above, section 24(1) of VATA 1994 requires, amongst other things, the goods or services which make up the claim for input tax to be "used or to be used for the purpose of any business carried on or to be carried on by him."

57. In the context of registration, Schedule 1, paragraphs 13(2) and (5) of VATA 1994 provide as follows:

> "(2) Subject to sub-paragraph (5) below, where the Commissioners are satisfied that a registered person has ceased to be registerable, they may cancel his registration with effect from the day on which he so ceased or from such later date as may be agreed between them and him.
>
> …
>
> (5) The Commissioners shall not under sub-paragraph (2) above cancel a person's registration with effect from any time unless they are satisfied that it is not a time when that person would be subject to a requirement, or entitled to be, registered under this Act."

58. We were referred to the Upper Tribunal case of *Norseman Gold plc v Revenue and Customs Commissioners* [2016] UKUT 69 (TCC), in which Warren J stated as follows at [124]:

> "[124] Accordingly, Norseman needs to establish that, when it incurred input tax in the relevant period, it had either already made supplies for a consideration (the first question) or that it had the intention of making at some time in the future supplies for a consideration (the second question). If it is right to conclude that Norseman had not already made such supplies and that

it had failed to establish such intention, then it is right also to conclude that it was not entitled to recover input tax. It is clear from the decision in *Finland* that the mere receipt of payment does not, *per se*, mean that a given activity is economic in nature: thus payment does not *per se* amount to consideration. What needs to be established is a direct and immediate link between the services supplied and the charges levied or to be levied."

59. This was applied in the context of holding companies in *Tower Resources plc v HMRC* [2019] UKFTT 442 (TC). We recognise that this is a First-tier Tribunal decision and so not binding upon us but it remains a helpful summary of the law in this matter. Judge Brooks stated as follows at [43] to [48]:

"[43] In cases, such as the present, concerning a holding company and its subsidiaries, the CJEU has held that where the only activity of a holding company is the holding of shares in in its subsidiaries is not carrying on an economic activity (*Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen* [1993] STC 222.

[44] However, in *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* [2002] STC 460 ("*Cibo*"), in answer to a request for the criteria establishing whether the involvement of a holding company in the management of companies in which it has acquired a shareholding constitutes an economic activity for Article 9 PVD purposes the CJEU stated:

'19. It is clear from case-law that that conclusion is based, amongst other things, on the finding that the mere acquisition and holding of shares in a company is not to be regarded as an economic activity, within the meaning of the Sixth Directive, conferring on the holder the status of a taxable person. The mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis because any dividend yielded by that holding is merely the result of ownership of the property (see the judgments in Case C-333/91 *Sofitam* [1993] ECR I-3513, paragraph 12, and in Case C-80/95 *Harnas & Helm* [1997] ECR I-745, paragraph 15).

20. However, the Court has held that it is otherwise where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired, without prejudice to the rights held by the holding company as shareholder (*Polysar*, paragraph 14, and *Floridienne and Berginvest*, paragraph 18).

21. It is clear from paragraph 19 of the judgment in *Floridienne and Berginvest* that direct or indirect involvement in the management of subsidiaries must be regarded as an economic activity within the meaning of Article 4(2) of the Sixth Directive where it entails carrying out transactions which are subject to VAT by virtue of Article 2 of that directive, such as the supply by a holding company such as Cibo of administrative, financial, commercial and technical services to its subsidiaries.

22. The answer to the first question referred for a preliminary ruling must therefore be that the involvement of a holding company in the management of companies in which it has acquired a shareholding constitutes an economic activity within the meaning of Article 4(2) of the Sixth Directive where it entails carrying out transactions which are subject to VAT by virtue of Article 2 of that directive, such as the supply by a holding company to its subsidiaries of administrative, financial, commercial and technical services.'

[45] The CJEU in *Beteiligungsgesellschaft Larentia & Minerva mbH & Co. KG v Finanzamt Nordenham* (Case C-108/14) [2015] STC 2101 ("*Larentia*") stated, at [21] that:

> 'The involvement of a holding company in the management of companies in which it has acquired a shareholding constitutes an economic activity within the meaning of Article 4(2) of the Sixth Directive where it entails carrying out transactions which are subject to VAT by virtue of Article 2 of that directive, such as the supply by a holding company to its subsidiaries of administrative, financial, commercial and technical services (see, *inter alia*, judgments in *Cibo Participations*, C-16/00, EU:C:2001:495, paragraph 22, and *Portugal Telecom*, C-496/11, EU:C:2012:557, paragraph 34).'

[46] In *MVM Magyar Villamos M vek Zrt v Nemzeti Adó-és Vámhivatal Fellebbviteli Igazgatóság* (Case C-28/16) [2017] STC 452 ("*MVM*") having noted, at [31], that the mere acquisition and holding of shares in a company is not to be regarded as economic activities for Article 9 purposes and that the acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis as any dividend is merely the result of ownership of the property the CJEU continued:

> '32. The position will be otherwise where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired, without prejudice to the rights held by the holding company in its capacity as shareholder (judgment of 16 July 2015, *Larentia + Minerva and Marenave Schiffahrt*, C-108/14 and C-109/14, EU:C:2015:496, paragraph 20 and the case-law cited).
>
> 33. In that respect, it follows from settled case-law of the Court that the involvement of a holding company in the management of companies in which it has acquired a shareholding constitutes an economic activity within the meaning of Article 9(1) of Directive 2006/112 where it entails carrying out transactions which are subject to VAT by virtue of Article 2 of that directive, such as the supply by a holding company to its subsidiaries of administrative, financial, commercial and technical services (judgment of 16 July 2015, *Larentia + Minerva and Marenave Schiffahrt*, C-108/14 and C-109/14, EU:C:2015:496, paragraph 21 and the case-law cited).
>
> 34. Thus, the mere involvement of a holding company in the management of its subsidiaries, without carrying out transactions subject to VAT under Article 2 of Directive 2006/112, cannot be regarded as an 'economic activity' within the meaning of Article 9(1) of that directive (see, to that effect, order of 12 July 2001, *Welthgrove*, C-102/00, EU:C:2001:416, paragraphs 16 and 17). Accordingly, such management does not come within the scope of Directive 2006/112.'

[47] The conclusion drawn from these cases by Judge Beare in *W Resources Plc v HMRC* [2018] UKFTT at [55] ("*W Resources*"), with which I respectfully agree and adopt, was that:

> "in the case of a holding company supplying management services to its subsidiaries, a finding that those management services are being supplied for a consideration for the purposes of Article 2 PVD must lead inexorably to the conclusion that the holding company is also carrying on an economic activity for the purposes of Article 9 PVD."

> [48] When considering whether there was a supply for consideration within Article 2 PVD or economic activity within Article 9 PVD it is necessary, in addition to the contractual position between the parties, to have regard to commercial and economic reality of the transactions concerned."

60. We were also referred to the First-tier Tribunal decision of *David Love Marketing Ltd v HMRC* [2015] UKFTT 0506 (TC) (Judge Robin Vos and Mr Julian Sims) to the effect that our jurisdiction when considering whether or not a person is making taxable supplies and entitled to be registered for VAT is appellate rather than supervisory.

The Parties' Submissions

HMRC

61. Mrs Hendrick argued that AIS was not making any supplies and did not intend to. She said that this was relevant both to whether or not input tax could be claimed and also as to whether or not HMRC was entitled to cancel AIS' registration. In particular, she relied upon the fact that Mr Patel had said in correspondence that AIS' trading had been suspended due to the litigation in the Seychelles. She also relied upon the absence of any outputs declared on AIS' returns. She said that the necessary features were missing and referred us to the cases of *C&E Commissioners v Lord Fisher* [1981] STC 238 and *Institute of Chartered Accountants in England and Wales v Customs and Excise Commissioners* [1999] STC 398: the activity was not a serious undertaking earnestly pursued or a serious occupation not necessarily confined to a commercial or a profit making undertaking; the activity was not an occupation or function actively pursued with reasonable or recognisable continuity; the activity did not have a certain measure of substance as measured by the quarterly or annual value of the taxable supplies made; the activity was not conducted in a regular manner and on sound recognised business principles; the activity was not predominantly concerned with the making of taxable supplies to consumers for a consideration; and the supplies were not of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them.

AIS

62. Mr Patel submitted that whilst the litigation meant that the services provided by AIS were reduced, it was still making supplies. This was for the purposes of a business because it gave rise to inter-company management charges which had been accrued albeit not invoiced until after the conclusion of the litigation. Mr Patel also deployed these arguments for both his appeal against the assessments and his appeal against the cancellation of AIS' registration.

Discussion

63. By virtue of our findings of fact as set out above, we find that AIS was supplying services to HFIM. As set out in those findings of fact, AIS was providing management services.

64. Further, we find that these services were taxable supplies. Crucially, consideration was given for these services by virtue of the inter-company account which appeared in both companies' accounts. HMRC did not suggest that this was artificial or a sham. Whether or not these were invoiced (and whether or not they should have been invoiced) does not affect whether or not these were taxable supplies from AIS to HFIM.

65. This does not assist AIS in respect of its claim to input tax for the reasons set out above. However, the finding that AIS was making taxable supplies means that HMRC was not entitled to cancel AIS' registration. We also note that HMRC did not explain why the cancellation took effect from 30 June 2017. There is no suggestion that this was a date agreed between the parties and on HMRC's own case the cessation of business was long before 30 June 2017.

66. We also find that AIS intended to make supplies to HFIM in the future. The only evidence before us was that AIS and HFIM intended that the services which were suspended during the litigation were to resume once the litigation was determined.

THE PENALTY

The Legal Framework

67. The penalty regime for inaccuracies on VAT returns is contained within Schedule 24 of the Finance Act 2007 ("Schedule 24"). The following paragraphs of Schedule 24 are relevant in the present case. Paragraph 1(1) provides for a penalty to be payable where conditions 1 and 2 are satisfied. Paragraph 2(2) sets out condition 1, which is that the document contains an inaccuracy which amounts to or leads to an understatement of a liability to tax. Paragraph 2(3) sets out condition 2, which is that the inaccuracy was careless, which is defined in paragraph 3 as where it is, "due to failure by P to take reasonable care." By virtue of Paragraph 4, the penalty for an inaccuracy which is careless is 30% of the potential lost revenue. Pursuant to paragraphs 9 and 10, this can be mitigated to 15% if the disclosure is prompted and if the person discloses the matter by telling HMRC about it, giving HMRC reasonable help in quantifying the under-assessment, and allowing HMRC access to records for the purpose of ensuring that the under-assessment is fully corrected. Paragraph 11 also provides the power for HMRC to reduce the penalty for special circumstances.

68. The Tribunal's powers are dealt with as follows in paragraphs 15 to 17:

> "15(1)A person may appeal against a decision of HMRC that a penalty is payable by the person.
>
> (2) A person may appeal against a decision of HMRC as to the amount of a penalty payable by the person.
>
> …
>
> 16(1) An appeal under this Part of this Schedule shall be treated in the same way as an appeal against an assessment to the tax concerned (including by the application of any provision about bringing the appeal by notice to HMRC, about HMRC review of the decision or about determination of the appeal by the First-tier Tribunal or Upper Tribunal).
>
> (2) Sub-paragraph (1) does not apply in respect of a matter expressly provided for by this Act.
>
> 17(1) On an appeal under paragraph 15(1) the tribunal may affirm or cancel HMRC's decision.
>
> (2) On an appeal under paragraph 15(2) the tribunal may
>
> (a) affirm HMRC's decision, or
>
> (b) substitute for HMRC's decision another decision that HMRC had power to make.
>
> (3) If the tribunal substitutes its decision for HMRC's the tribunal may rely on paragraph 11
>
> (a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or
>
> (b) to a different extent, but only if the tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed.
>
> …

> (6) In sub-paragraphs (3)(b), (4)(a) and 5(b) "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.
>
> …"

The Parties' Submissions

HMRC

69. Mrs Hancock relied upon the penalty schedule within the bundle to argue that the penalty was due, that it was in the correct amount and at the correct percentage. The explanation for HMRC's decision as to carelessness was broadly similar to the substantive basis for the assessment. This was said to be prompted because AIS did not tell HMRC about it before it had reason to believe that HMRC would discover it. The reduction for quality of disclosure was limited to 50% because:

> "Telling: The inaccuracies were not disclosed at the start of the compliance check, and you did not tell us everything about the extent of the inaccuracies as soon as you could.
>
> Helping: Several requests had to be made to obtain all of the relevant information from you, because you did not answer my questions in full at the outset.
>
> Giving: Relevant information was only given in response to specific, detailed request. You did not respond to all of my requests for information on time."

AIS

70. Mr Patel disputed that any penalty was due at all because the assessment ought to be cancelled. It follows that it was his position that AIS had not acted carelessly because, on AIS' case, it had acted correctly. Mr Patel also argued that AIS had co-operated fully. No dispute was raised by Mr Patel as to special circumstances.

Decision

71. We find no basis for disturbing the penalty.

72. For the reasons already set out, we accept that the assessments were correct. We find that AIS acted carelessly because a taxpayer acting with reasonable care would have realised that the invoices were addressed to HFIM.

73. Further we find that HMRC's approach to, and conclusion in relation to, co-operation was correct. Mr Patel did not explain AIS' position fully in correspondence and left room for ambiguity in respect of his explanation as to the suspension of part of AIS' services. Crucially, AIS provided documentation (including copies of cheques from AIS) in the course of the appeal proceedings which it did not provide to HMRC during its enquiries.

DISPOSITION:

74. It follows that, for the reasons set out above:

> (1) The appeals against the assessments dated 25 and 26 September 2017 are dismissed.
>
> (2) The appeal against the decision dated 8 November 2017 cancelling AIS' VAT registration is allowed.
>
> (3) The appeal against the penalty assessment dated 27 November 2017 is dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

75. 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.

RICHARD CHAPMAN QC
TRIBUNAL JUDGE

RELEASE DATE: 10 JANUARY 2020