[2018] UKFTT 0566 (TC)

TC06740

Appeal number: TC/2016/03431

VAT – Flat Rate Scheme – Capital Expenditure Goods – expenditure on racing cars – whether VAT recoverable - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

RPD BUILDING LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ABIGAIL MCGREGOR

Sitting in public at Reading Employment Tribunal Centre on 22 February 2018

Mr R Dixon, director, for the Appellant

Mr Qureshi, presenting officer of HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns the ability of the appellant, RPD Building Limited ("RPD"), to deduct input tax on certain supplies relating to racing cars. It was agreed between the parties that the appeal would be decided in principle, with the specific amount of assessments being agreed between the parties after the outcome of this appeal is made known to them.

Evidence

2. The Tribunal was presented with a bundle of documentation containing correspondence, photographs, copies of invoices and bank statements.

3. Mr Dixon also gave evidence on behalf of RPD and was cross-examined by Mr Qureshi.

4. Finally, Mr Dixon provided additional evidence in the form of bank statements and credit card statements after the hearing.

Law

5. The flat rate scheme for VAT ("FRS") is a scheme based on the power in section 26B of the Value Added Tax Act 1994 to make regulations providing for a scheme under which a person pays VAT based on a percentage of turnover (rather than based on the supplies made to and by it under the usual principles).

6. The regulations made to bring the FRS into action are regulations 55A – 55V, 57A and 69A of the VAT Regulations 1995 (SI 1995/2518).

7. Under VATA 1994, s 26B(5) a participant in the FRS is not entitled to credit for input tax unless an exception is provided under regulations. One of those exceptions is in relation to capital expenditure goods ("CEG").

8. CEG are defined in VAT Regulations 1995, Reg 55A as:

> any goods of a capital nature but does not include any goods acquired by a flat-rate trader (whether before he is a flat-rate trader or not)—
>
> (*a*) for the purpose of resale or incorporation into goods supplied by him,
>
> (*b*) for consumption by him within one year, or
>
> (*c*) to generate income by being leased, let or hired;

9. Under VAT Regulations 1995, Reg 55E a flat rate trader:

(1) Is entitled to input tax credit in respect of a relevant purchase of CEG with a value, together with the VAT chargeable, of more than £2000;

(2) is entitled in those circumstances to treat the whole of the input tax on the goods concerned as used exclusively in the making of taxable supplies; but

(3) is not entitled to credit for input tax where such entitlement is excluded by virtue of an order made under VATA 1994, s 25(7), which includes:

(a) VAT (Input Tax) Order 1992 (SI 1992/3222), which provides at Article 7 that the supply to a taxable person of a motor car shall be excluded from input tax credit (subject to a series of exceptions).

Facts

10. The following facts were agreed between the parties:

(1) RPD Building Limited is a company which provides construction management services, largely through the services of Mr Robert Dixon, who is the owner and director of RPD;

(2) The construction services provided are of a large scale nature, for example the management of the dismantling of a nuclear reactor, rather than domestic building projects;

(3) RPD registered for VAT in 2007 and was approved to use the FRS in September 2007;

(4) It continued to use the FRS for all relevant periods under this appeal;

(5) In September 2015, HMRC selected RPD for a check of VAT returns for the periods from 03/12 to 06/15 and sent a letter to RPD explaining this and requesting information, specifically copies of invoices to support claims for input tax made on the relevant returns;

(6) After some further correspondence, RPD provided the majority of the invoices concerned;

(7) The invoices related to two categories of supply:

(a) A supply of a trailer; and

(b) Supplies related to cars (which are discussed further below);

(8) HMRC concluded that none of the invoices supported a categorisation of the supplies as CEG and therefore disallowed the entirety of the input tax claimed in the relevant periods and made appropriate assessments;

(9) After a request for a review from RPD, HMRC upheld their decision on review and RDP appealed to this Tribunal;

(10) There was a partially successful alternative dispute resolution ("ADR") process, through which an agreement was reached on the treatment of the trailer. Therefore this appeal relates only to the supplies related to cars.

Preliminary issue

11. Mr Dixon raised a preliminary issue at the start of the hearing, namely that HMRC had failed to comply with the deadline for submitting its statement of case and appeared to have suffered no adverse consequences for doing so.

12. When the deadline passed, the Tribunal service asked Mr Qureshi to explain why the statement of case had not been submitted.

13. Mr Qureshi explained that he had not been notified of the outcome of the ADR proceedings and had misunderstood his obligations with regard to timing of submitting the statement of case and therefore submitted the statement of case late, with an application for such late submission.

14. There was at least one letter from the Tribunal service which provided an incorrect statement of the position as at the date of the letter to Mr Qureshi.

15. Mr Dixon wrote a letter to the Tribunal service objecting to Mr Qureshi's late submission of the statement of case. No reply to that objection was included in the bundle provided to me (and Mr Dixon was not aware of any), hence he raised it again at the hearing.

16. After that objection, the case management proceeded as expected for a normal case, i.e. directions were issued, lists of documents required, dates to avoid requested and bundles provided.

17. Having considered the overriding objective in rule 2 of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, SI 2009/273, in particular in light of:

(1) The contribution of the Tribunal service to the misunderstanding and misapplication of deadlines; and

(2) Mr Dixon's desire to provide additional evidence in relation to the payment of invoices after the hearing (a matter that it was apparent from much earlier would be pertinent to the case),

I decided it was in the interests of justice for the hearing of the substantive issue to proceed.

Parties Arguments

RPD's arguments

18. Mr Dixon submitted, on behalf of RPD, that the expenditure does have a link with his business because he was using the racing cars as promotional tools for his business, by:

(a) Showing and racing the cars at racing meetings;

(b) Standing in the 'paddock' at racing meetings and speaking to people who might turn into potential customers;

(c) Using social media to promote his racing activities, which he expected to have a knock on promotional effect on RPD;

19. Although Mr Dixon conceded at the hearing that expenditure on fuel, coolant, oil and transport (e.g. hiring a trailer to move the vehicles) was consumable in nature and therefore would not qualify as CEG, the remaining expenditure was on parts and labour for the construction of an entirely new and significantly improved engine which:

(1) Was capitalised as an asset in his accounts;

(2) Transformed the car from a 200 horse power engine to a 800 horse power engine, rendering the car a completely different asset from the original car.

20. Mr Dixon suggested that the question of the treatment of labour was a finely balanced one, but argued that labour should be capital because it contributed to the creation of the asset, being the enhanced car.

21. Mr Dixon argued that although the majority of the invoices were addressed to him personally, they were paid by RPD and he could provide evidence of this through bank statements (but had not yet done so).

HMRC arguments

22. HMRC argues that:

(1) The restriction in Reg 55E(4) of the VAT Regulations 1995 requires a consideration of the motor vehicle block;

(2) Under Article 7(1) of the VAT (Input Tax) Order 1992, recovery of input tax on motor cars is disallowed unless certain criteria are met; and

(3) Mr Dixon has failed to show that the car has been supplied exclusively for the purposes of a business carried on by him.

23. Further HMRC argues that:

(1) The statement in VAT Notice 733, section 15.1 that "Nothing in this section allows a business using the Flat Rate Scheme to reclaim VAT on goods which it would not be able claim under the normal VAT rules" requires a consideration of the basic principles of input tax recovery i.e. outside the FRS;

(2) There must be a direct and immediate link between the underlying costs incurred and the taxable supplies being made, relying on the case of BLP Group PLC v C&E [1995] STC 424, in order for a deduction for input tax to be available; and

(3) The invoices were addressed to Mr Dixon and no evidence has been provided that they were in fact paid by RPD, therefore RPD has failed to hold the appropriate evidence to support an entitlement to recover input VAT under VATA 1994, s 24 and VAT Regulations 1995, Reg 29.

24. Finally, HMRC argues that the items acquired under the invoices concerned do not meet the definition of CEG for the purposes of the FRS because:

(1) The labour supplied is a supply of services not goods and CEG is limited to goods;

(2) Consumable items, such as fuel, oil etc are not capital items and therefore cannot be CEG;

(3) The parts fitted to the car are also not capital items because they are all replacements for something that was already there and that the asset in question is the whole car, not the individual constituent parts.

Discussion

25. Having considered the arguments put by both sides, I proceed to answer the following questions:

(1) Were the amounts expended on the cars 'Capital Expenditure Goods'?

(2) If they are CEG, are there any other rules, within the FRS or otherwise, that would prevent such a deduction?

Were the amounts expended Capital Expenditure Goods?

26. In order to answer this question, I find the following further facts with regards to the contents of the invoices in question:

(1) A large bundle of invoices was provided to the Tribunal;

(2) The vast majority of the invoices came from two third parties: Advanced Motorsport and Engineering Limited and Eurospec 2000;

(3) Some of the invoices came to a total (including VAT) that was less than £2000, but the majority exceeded £2000;

(4) Most of the invoices contained multiple lines of items and labour supplied.

27. As Mr Dixon conceded at the start of the hearing, there are a number of items included in these invoices that are clearly not CEG, namely fuel, oil, gas cans, lubricants, coolants and transport services, because they are consumed in the process of using and driving the vehicles. Therefore to the extent that the input tax claimed amounted to these consumable items, it should not be allowed.

28. In addition, it is clear from VAT Regulations 1995, Reg 55E(1) that where invoices amounted to a value of less than £2000 (including VAT), there can be no claim for the input VAT incurred on those invoices.

29. The more substantive question is whether (on invoices over £2000) parts for rebuilding car engines and the associated labour can be CEG under the FRS. There has been limited case law in this specific area, but there are two decisions of this Tribunal that are instructive. In *Sally March* [2009] UKFTT 94 (TC), the Tribunal

found that supplies of combined goods and labour by electrical and building suppliers in the course of constructing a riding arena were supplies of services as the goods acquired were consumed entirely in the construction of the building, being the asset ultimately purchased. In *Simon Thomas (trading as The Stableyard)* [2015] UKFTT 276 (TC), the taxpayer had sought to deduct input tax on invoices relating to the services of a solicitor and surveyor in the sale of land used in the business. Such deductions were not allowed because the supplies were of services, not of goods and therefore could not be CEG.

30. I adopt the approach of the Tribunal in *Sally March* and conclude that the items acquired in the process of rebuilding the engines to transform the cars into high performance racing vehicles were items consumed in the construction of the asset in question, being the car as a whole, not individual items of capital expenditure. I agree with HMRC that the asset in question is the car, not the engine. Therefore I find that the expenditure was not CEG and therefore RPD were not entitled to claim input tax in relation to the invoices in question.

31. This is sufficient to dispose of the appeal, but having heard argument on the other points, I will briefly address each of them.

Are there any other rules, within the FRS or otherwise, that would prevent a deduction for input tax on CEG?

32. If I am wrong on the first question, i.e. that the amounts were expended on CEG, HMRC put forward three alternative reasons as to why expenditure on the cars should not be allowed:

(1) because the motor vehicle block applies;

(2) because there is no direct and immediate link between the expenditure and the business supplies; or

(3) because the invoices were addressed to Robert Dixon, not RPD and RPD has not provided alternative evidence to support recovery.

33. I agree that the motor vehicle block in VAT (Input Tax) Order 1992 (SI 1992/3222), Article 7, overrides the ability of a FRS trader to deduct input tax on CEG by virtue of VAT Regulations 1995, Reg 55E(4). However, none of the input tax disputed in this case relates to the supply, acquisition or importation of a motor car. All of the invoices related to parts, labour and consumables and therefore Article 7 is not relevant.

34. HMRC sought to argue, mainly based on the statement in the VAT notice, that input tax could be disallowed under the FRS on normal principles of input tax recovery, including the need for there to be a direct and immediate link between the supply received and the supplies made by the trader. Although some elements of VAT notice 733 have the force of law, paragraph 15 does not and therefore is a statement of HMRC opinion only.

35. I do not agree that all the principles of input tax recovery can apply to a FRS trader. The FRS is a specific scheme for small businesses that fundamentally alters the ability of a trader to recover input tax. The rules on CEG are a specific carve out from the general prohibition under that scheme and provides for recovery of input tax on certain types of expenditure. Regulation 55E(2) states that, where the conditions for CEG input tax recovery are met "the whole of the input tax on the goods concerned shall be regarded as used or to be used by the flat-rate trader exclusively in making taxable supplies". I find that this deeming provision would, if the goods had been CEG, have overridden the general principles of input tax recovery.

36. Finally, HMRC sought to argue that the input tax should be disallowed because the invoices were addressed to Mr Dixon and not to RPD and RPD had not provided alternative evidence that would enable HMRC to allow deductions.

37. As mentioned above in relation to the preliminary matter, RPD was given additional time to provide suitable alternative evidence to the Tribunal, which it did in the form of bank statements and credit card statements which showed payments being made to the relevant suppliers by RPD, rather than Mr Dixon himself, corresponding to the majority of the invoices in question. I would suggest that this might have been sufficient alternative evidence for HMRC to accept the incidence of this expenditure fell on RPD. However, given my decision on CEG above it is not determinative of this appeal.

Decision

38. For the reasons given above, I find that the expenditure incurred did not meet the criteria to be treated as capital expenditure goods and therefore the appeal is dismissed.

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.

ABIGAIL MCGREGOR
TRIBUNAL JUDGE

RELEASE DATE: 29 September 2018