TC06921

Appeal number: TC/2014/06184

VALUE ADDED TAX – input tax – housing and support provider - whether there was a direct and immediate link between the cost to the Appellant of accommodation costs and the Appellant's taxable supply – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ADULLAM HOMES HOUSING ASSOCIATION LIMITED	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE JANE BAILEY
MRS RAYNA DEAN

Sitting in public at Centre City Tower, Birmingham, on 23, 24 and 25 May 2017

Valentina Sloane, counsel, instructed by Booker Associates for the Appellant

James Puzey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal is against HMRC's decision, dated 15 September 2014, to restrict the Appellant's claim to input tax, for the period 1 February 2010 to 30 April 2014, from £1,314,198 to £548,419. The Appellant also appeals against the consequent assessment raised by HMRC to recover the input tax HMRC considered had been over-claimed.

Background

2. The Appellant, a charitable industrial provident society, provides supported accommodation to, and only to, people in need. Local authorities contract with the Appellant for the supply of standard rated support services and exempt accommodation.

3. The parties are agreed that the Appellant makes standard rated supplies of support services and exempt supplies of accommodation and, as a consequence, the Appellant is partially exempt. The Appellant is entitled to deduct input tax to the extent that the goods or services supplied to it are used in making taxable supplies. The parties also agree that if a supply to the Appellant is used by the Appellant exclusively in making an exempt onward supply, then the Appellant has no right to deduct the input tax it has incurred.

4. The supply in dispute in this appeal is the cost to the Appellant of acquiring, repairing, maintaining, securing and cleaning accommodation. (Unless explicitly otherwise, reference to "accommodation costs" is a reference to all of these costs.) HMRC's view is that there is no direct and immediate link between these costs and the supply of the support services, with the consequence that the input tax in relation to these services is wholly irrecoverable. The Appellant maintains that they acquire and maintain the accommodation as a necessary part of the supply of accommodation-based support services.

Evidence

5. We heard oral evidence from Mr Trevor Palfreyman, the Appellant's Chief Executive Officer, and Mr Christopher Judson, the Appellant's Director of Finance and Resources. We found both witnesses to be truthful and conscientious. However, both witnesses were better able to deal with the nature of the services provided under the contracts than with the wording of the contracts. As a consequence, the oral evidence was not always directed to the substance of this appeal. We also had the benefit of reading a witness statement from Mr Christopher Leng, a Senior Officer of HMRC, who we also consider to be truthful and conscientious. Mr Leng was not required to give oral evidence as the factual parts of his statement were not challenged. The Appellant made it clear that it did not accept Mr Leng's analysis of the law, also set out in his statement.

6. The eight lever arch bundles of documentary evidence before us included a number of sample contracts with associated paperwork, and a 2008 *Final Report on Research into the effectiveness of floating support services for the Supporting People programme*, ("Supporting People Report") undertaken by Civis Policy Consulting Research for the Department for Communities and Local Government. The Supporting People Report included some background to the Supporting People programme, introduced in 2003, and we found this report invaluable in understanding the context against which the Appellant's supplies were made. While it seems likely that the parties knew at the time – in the context of the Supporting People programme – what they had agreed in the various contracts, we did not find it altogether easy to identify what that was at this remove.

Facts found

7. On the basis of the oral evidence and the documents in the bundles before us, we find as follows:

a) The Appellant was founded in 1972, and currently operates in the north west of England and in the Midlands.

b) In general terms, local authorities throughout the UK have a duty to provide care, support and assistance to certain vulnerable people who are within that local authority's boundaries. Those people include people who are homeless, (including those who become homeless as a result of domestic abuse or leaving care), released prisoners and some families who need additional support at a time of crisis.

c) In 2003 the government launched the Supporting People programme which provided grants to local authorities to fund services to help vulnerable people to live independently. Many local authorities carry out their duty to assist vulnerable people in their area by commissioning services under the Supporting People programme from organisations such as the Appellant. The form of the support differs depending on the needs of the particular group of people to whom the support would be provided, and also differs depending on the intensity of support required.

d) The two types of services which would be commissioned were accommodation-based support and "floating support". We accept that the term "floating support" is used by different people in different ways and can be confusing. In the preamble to Supporting People Report, floating support was defined as follows:

> The definition of floating support for the research is "support services which are not tied to the accommodation". For the purposes of this review this means support that either
>
> - Floats off to another service user when the support is no longer required (usually crisis intervention or short term work); or

- Follows the individual as the service user moves through different types of accommodation (usually long term support).

e) In Chapter 4 of the Supporting People Report, accommodation-based support is described as:

> Accommodation-based support services have been developed primarily as a way of delivering integrated housing and support services. The models of housing support vary considerably with some accommodation based services providing 24 hour cover and others providing visiting support.

f) The types of accommodation-based services identified in Chapter Four of the Supporting People Report were hostels, supported housing (either shared housing or self-contained flats), foyers (for young people with accommodation and training provided on the same site), refuges (for women escaping domestic violence), sheltered housing (for older people) and extra care housing with a high level of adaption (for physically disabled people).

g) For clarity in this decision, we have referred to support as being either "accommodation-based" or "non-accommodation-based". In evidence the non-accommodation-based support was variously referred to as "floating" or "visiting" support, although floating support was sometimes also used to describe accommodation-based support.

h) By "accommodation-based" support we mean support, tailored to the needs of the recipient, which is provided to individuals or families in safe and secure accommodation which is supplied by the same provider under a single Supporting People services contract. The accommodation provided would be suitable for, or tailored to, the specific needs of the relevant user group. Some of the users of such accommodation were from unpopular groups, and so accommodation-based support could provide a community safety resource, with a level of supervision being provided by the support workers.

i) By "non-accommodation-based" support we mean support received by people in accommodation that was not supplied directly by the support provider. The accommodation might be owned by the individual but was more likely to be rented from the local authority, a housing association or the private sector. It was still necessary for this accommodation to be appropriate for the individual or family, and sufficiently safe. The support provided was, again, tailored to the needs of the recipient.

j) The choice of whether support would be accommodation-based or non-accommodation-based was that of the local authority and depended upon the needs of the user group. People who were already, or who were about to become, homeless were more likely to require accommodation-based support than those who already had accommodation but were experiencing a period of crisis. As the vast majority of people who required support were in receipt of housing benefit (estimated by the Appellant to be 97% of people in the period

with which we are concerned) there was little difference in cost between the two types of contract to the local authority as it would, in either case, be paying housing benefit to those in need to enable them to pay rent for the accommodation supplied to them. However, where the local authority contracted for the provision of non-accommodation-based support, and itself supplied the accommodation directly to support recipients, then the local authority would have to manage that accommodation and (to the extent that the costs could not be passed on to the support recipients) the local authority would have to bear the costs of maintenance and repair. If the local authority contracted out its obligation to provide accommodation then the other party to the contract would have to manage those costs.

k) On the basis of the Supporting People Report and the contracts we saw, we are satisfied that when Supporting People services were commissioned from the Appellant, the support commissioned by a local authority was either accommodation-based support or non-accommodation-based support. Over the period with which we are concerned, the Appellant entered into both accommodation-based support contracts and non-accommodation-based support contracts. About 90% of the support provided by the Appellant was provided under accommodation-based support contracts.

l) The hope and expectation of the Appellant, and of the commissioning local authority, was that a person who received accommodation-based support would develop the skills and confidence necessary to move into his or her own accommodation in due course. On this basis, accommodation-based support was provided only in the short to medium term (six months to two years), and people were encouraged to move into more permanent accommodation as soon as they were able to do so. Once a person moved into more permanent accommodation, non-accommodation-based support could be provided, if required (and if the appropriate referral was made by the local authority), with the intention that the person would progress to live completely independently in due course.

m) We were shown a number of sample contracts. We focus upon two of these, one is an accommodation-based contract, the other is non-accommodation-based.

n) We start with the April 2013 contract between the Appellant and Cheshire East Borough Council for the provision of accommodation-based support for homeless single parent families with support needs. Under the terms of this contract the Appellant agreed to carry out "support services" at specified premises for three years. Although the premises were not always specified in contracts of this type (sometimes there was simply a description of the type of property and the locality which the local authority considered acceptable), under this contact the premises were specified as eight "units" each at two specific addresses. "Unit" is not a defined term but on the basis of other references in the contract we find that each unit was accommodation suitable for one single parent family, and that in this case the units consisted of accommodation in a

hostel. It was a requirement of the contract that the Appellant enter into a tenancy agreement with the landlord of the units at each of the two addresses as soon as practicable on or before completion of the contract. We find that this was in order for the Appellant to be able to place 16 referred homeless single parent families into the 16 units of accommodation that it would control and manage.

o) The amount paid to the Appellant under the contract was an annual price for each of the "support services" provided. That annual price was calculated as a set weekly amount per unit, multiplied by 52. This type of payment was described as being "block gross".

p) The "support services" were described in Schedule 1A as:

> The service provides short term accommodation with housing related support for single parent families with support needs.
>
> The service aims to offer individual needs led support to facilitate the development of life skills that will enable vulnerable parents to maintain independent living, offering them the opportunity to improve their quality of life.
>
> The service will provide timely move-on for people using the accommodation. It is not expected that clients will reside at this accommodation for longer than 6 months.

q) This description was expanded in section B of Schedule 1B. Section B1.1 describes the support services, including the following:

> B1.1.1 The Service will be available to single parent families and their children with support needs
>
> B1.1.2 The Service provides a supported accommodation based service for single parent families … with support needs.
>
> B1.1.8 The Service will generally be delivered within the hostel, or at appropriate premises locally.

r) Section B1.2 set out the principles and objectives of the support service. These included:

> B1.2.1 Assess the individual needs of each service user and work with individuals to develop realistic expectations of the move-on options available.
>
> B.1.2.4 You will work with the re-settlement or mental health floating support service to ensure that clients are moved onto shared or individual accommodation as soon as is practical, and that clients are provided with the necessary skills to do so.

> B1.2.5 You will provide some structured group activities as well as 1:1 support sessions in order to ensure that clients develop the skills necessary for independent (and where appropriate group) living to progress their lives in a sustainable way

s) Section B1.3 of Schedule 1B set out the required standard of support provided, which was to be at or above Level B using the standards defined in the Quality Assessment Framework. A copy of the 2009 version of the Quality Assessment Framework, published by the Department for Communities and Local Government, was provided in our bundles. This framework set out indications of the standards expected at levels A, B and C. This included, at S 2.3, living environment standards. A special note explained that:

> This objective only applies in services where accommodation and support are provided as a single linked package. If a service user may move home (within the locality) to a dwelling of his or her own choice and still receive the same service then the accommodation and support should not normally be considered as linked and so this Objective does not apply.

t) There were a number of boxes along the top of page, labelled as Supported housing, Sheltered housing, Very short term accommodation, et cetera. Despite that special note, the box labelled "floating support" was also ticked. This indicated to us that the term "floating support" could apparently be used as meaning accommodation-based support in some circumstances and the term was not to be relied upon as indicative of what was provided.

u) There were nine living environment standards at level B. These ranged from objective appraisement of the accommodation for suitability of purpose, through to use of surveillance equipment, to the decoration of the accommodation. The standard also referred to the provision of communal spaces and public rooms. The standards required the living environment provided to be suitable for its stated purpose, accessible, safe and well-maintained, non-institutional, appropriate for the needs of residents and meeting the requirements for independence, privacy and dignity. It is clear that these standards were intended to apply only to accommodation provided by a person or organisation who was being assessed against the Quality Assessment Framework, and not to landlords generally.

v) Returning to the East Cheshire contract, Section B1.5 of Schedule 1B provided for capacity and staff cover:

> B1.5.1 The Service will have the capacity to offer support to a minimum of **16** units providing **74** hours of support per week overall across the two schemes.
>
> B1.5.2 These support hours should generally be used to staff the hostels across a 7 day week and support should be provided on a flexible basis. Support hours will be delivered flexibly and be available at varying times

between 8am and 10pm in order to meet individual needs. It is not expected therefore that support will only be offered during office hours.

B1.5.3 Support hours do not include management time which must be delivered in addition to the contracted support hours.

w) Section B2.5 set out performance indicators. The first three were as follows:

Performance indicator	Short description	Long description
SP1	Availability (accommodation based services)	This indicator calculates the number of contracted units that are available (in weeks or days) as a percentage of the total units contracted (in weeks or days). An accommodation based unit is available where it is either occupied by a service user or is vacant and available for letting.
SP2a	Utilisation (accommodation based services)	Service utilisation for accommodation based services is defined as occupancy. Occupancy is defined as the number of weeks or days for which a service user is liable for rent. This indicator calculates the number of unit weeks or days that a service is occupied as a proportion of the total number of unit weeks or days for which it is available.
SP2b	Utilisation (support services)	This indicator calculates the number of days that support is utilised by service users (under a support plan) as a percentage of the number of days support is contracted. The calculation of the total number of days that support is contracted involves multiplying the number of contracted places by the number of days in the reporting period

x) The Appellant's targets under this contract were 97% for each of indicators SP1 and SP2a. There was no target for SP2b, despite the number of support hours having been specified in Section B1.5 of Schedule 1B. We find that this is because there was no need for a support services target to be set in an accommodation-based contract where it was understood by both contracting parties that the support was to be provided by a support worker being available for the specified number of hours at the contracted premises. The inclusion of performance indicator SP2b in the contract, even though it was not applicable, demonstrates the very generic, one size fits all, nature of the contracts we saw.

y) Section B1.9 made provision for referrals from the commissioning authority, Cheshire East Council. It included:

> B1.9.1 Referrals must only be accepted from the Cheshire East single point of access for Supporting People services (SPA).
>
> B1.9.6 The support provider must accept and accommodate all referrals made by the SPA.

z) The Appellant was also required to inform the SPA if there was any reduction in the number of units available or if there were any vacancies. We find that the Appellant had no control over who would be accommodated in the 16 units as it was only in exceptional circumstances that the Appellant could refuse to accommodate a referred family. In the (unlikely) event that units remained empty because there were no referrals, the Appellant could not offer the units to other homeless single parent families. The units could only be provided to families referred by the SPA. If one or more units remained empty the Appellant had to bear the costs of the staff and those premises. If a tenant had damaged the unit then the Appellant had to bear the costs both of repair and of the unit being void while those repairs took place. The Appellant was unable to recover any of these costs under the contract.

aa) The second contract on which we focus is an example of a support contract which was non-accommodation-based. This was an April 2012 contract between the Appellant and Bury Council, for 95.78 hours of support to be provided each week to young people including teenaged parents, in the locality of Bury who were at risk of homelessness. A staff to service user ratio, of 1:6, was prescribed.

bb) Under this contract the Appellant did not provide accommodation. This is clear from the Service Specification Schedule which has no figure entered for the number of housing units to be provided. It is also apparent from the payment provision. Under the contract, payment was specified as either block gross or block subsidy (so that does not identify the type of payment). The block subsidy payment was to be calculated by reference to the number of service users. The Appellant had strict reporting conditions to ensure that both parties knew the number of service users referred and the number of service users still making use of the support provided by the Appellant. The part of Schedule 2 which would have set out the block gross price was left blank. It is by the omission of a block gross price in the relevant box that we deduce that the payment was block subsidy, and so the contract was non-accommodation-based.

cc) The support to be provided was "Housing Related Support Provision". This was explained as being:

> … for young people and teenage parents and is designed to support those individuals who need help to establish and maintain stable tenancies. This may be so the Service user can maximise the benefits of other services.

dd) The objectives show that the purpose of the support was to enable people to set up their own homes and to stay in their own homes, by being able to manage their budgets (including claiming social security benefits to which they were entitled) and being able to deal with issues which arose, such as reporting repairs, understanding personal security and knowing how to use household appliances. A variety of types of tenure were considered appropriate for the recipients of this support.

ee) There were further sample contracts in our bundles but we do not intend to go into such detail with each of them. Instead we pick put common features of all of these contracts. We are able to do this because of their rather generic nature. Across the contracts there was a surprising number of references to factors (pricing, performance indicators, et cetera) which were relevant only to the other type of contract. (We have mentioned the reference to both forms of contract pricing in the Bury non-accommodation-based support contract.) We formed the impression that the contracts used by the Appellant, and possibly often used in this sector, were created from templates designed to deal with all eventualities, and that non-relevant parts were not omitted much of the time.

ff) The main aspect we noted from the contracts is that the support services described under the contracts were near identical whether the contract was for accommodation-based support or for non-accommodation-based support. There were differences in the aim of the support, but that varied according to the aims of the project and rarely because of the type of support contract under which it was offered. Under cross-examination, Mr Palfreyman agreed that the service outcomes were the same for both accommodation-based and non-accommodation-based contracts.

gg) We also noted that, in addition to the generic nature of the contracts, the terminology used made it difficult to understand the exact nature of the contract. Despite Mr Palfreyman's very extensive knowledge of the sector and knowledge of the work undertaken pursuant to these contracts, he occasionally seemed bemused by the Appellant's contracts as if what was written was not quite in accordance with what he had understood to be the position on the ground. We also formed the impression that the terminology used often differed in meaning depending on who was using the term – the terms "visiting support" and "floating support" seemed to be used interchangeably although Mr Palfreyman was not entirely clear that they meant the same.

hh) While we accept (on the basis of the Supporting People Report) that there is a difference between what is provided under an accommodation-based contract and a non-accommodation-based contract, it seems to us that there are only two real differences between the contracts: the reference to the provision of premises (which might be a specific address) and the pricing structure adopted. When giving his evidence, Mr Palfreyman told us that one particular contract must be accommodation-based because it had a block gross price.

ii) Taking the evidence as a whole, we are satisfied that under the terms of an accommodation-based support contract, the commissioning local authority had the right to refer a number of people in a specified category (up to a maximum at any one time which equalled the number of units) to the Appellant for accommodation-based support. The contract did not give the local authority the right to be able to enter the premises or any other rights over land.

jj) In return for a price agreed per unit, the Appellant undertook to provide the specific number of referred people at a time with integrated accommodation and support which was in accordance with the aims of the project and appropriate to the referred person's needs. The Appellant was required to co-operate with the local authority in carrying out statutory duties. The Appellant also undertook to accept only referrals from the local authority into the accommodation, and (except in exceptional circumstances) could not refuse to accept an individual so referred.

kk) Once referred under the terms of an accommodation-based agreement, an individual entered into a contract with the Appellant under which the Appellant agreed to provide the individual with accommodation. This accommodation could be at an address specified in the contract between the Appellant and the local authority but could also be generically described (such as bedsits in a certain locality). By reference to the Quality Assessment Framework, the local authority required the accommodation to meet certain standards and, so far as possible, to be of a non-institutional nature.

ll) Under the terms of the housing agreement which the Appellant entered into with the referred individual, the individual paid rent to the Appellant for the accommodation, usually funded from housing benefit. The price was fixed under a rent formula which was applicable for social housing (but might be less if the rent which the Appellant itself was charged was less than the formula rent).

mm) In our bundle is an Excluded Licence Agreement which provided an individual with a furnished private room in a hostel where there was access to a shared kitchen, lounge and bathrooms. It was a term of the licence that the individual agreed to the services which the Appellant supplied but, in the licence, the services described were of general repair and maintenance. (It is unclear if absence of a reference to support was a deliberate or accidental omission.) The licence could be ended if the individual no longer needed, or wanted, the services which the project aimed to provide, or if the individual would not accept the services or if the individual needed greater support. There was no explanation of the project or the services which the project aimed to deliver.

nn) We were also shown an Assured Shorthold Tenancy for self-contained accommodation. This was explicitly stated to be granted:

> … on the basis that the Tenant is in need of the specialised type of accommodation provided by [the Appellant] in accordance with the aims

> and objectives of the Adullam Project, of which these premises are part. It is a condition of this agreement that the tenant continue to be a person having that specific need. If the tenant ceases to fulfil that condition [the Appellant] may take steps to terminate the tenancy.

oo) Both the licence and the lease referred to "House Rules" and both required the tenant to keep to the House Rules. We were shown a document headed "Shared House Agreement" which appeared to be an example of the House Rules (in a shared property). This provided, amongst other things, that support plan meetings must be kept.

pp) We were shown a more detailed document labelled "House Rules / Agreement". Under the sub-heading "Support/ Positive engagement", the document stated:

> Tenancies with [the Appellant] are issued due to you being assessed in need of support. The conditions of residence you signed on induction up to a programme of 10 hours per week positive engagement. This includes attending your weekly support meetings with your project worker and attending residents meetings and activities.

qq) The House Rules also set out that the resident was responsible for the rent in full until the Appellant received housing benefit paid in respect of that claimant. A resident was required to submit a claim for housing benefit within five days of taking up the tenancy. A separate weekly charge was made by the Appellant to the individual to cover items not covered by the housing benefit. Mr Judson told us that this charge was for things such as electricity, gas and the cleaning of communal areas and, while this charge was priced to recoup the costs the Appellant incurred, it also provided a small stream of income for the Appellant.

rr) The individual was also required to agree to pay for damage he or she caused to the accommodation provided.

ss) We now look at the economic aspects of the two types of contract from the Appellant's perspective. We heard evidence about the Appellant's business model from Mr Palfreyman who explained the historical position when there were generous grants which had enabled organisations such as the Appellant to purchase appropriate properties. Since 2003 and the introduction of the Supporting People programme, the Appellant had increasingly frequently obtained properties on a short-term lease arrangement with other similar organisations. Since 2003, renting properties had increasingly become more viable than purchasing a property. We are satisfied that over time the Appellant acquired and maintained a portfolio of properties in order to provide the accommodation-based support it was contractually obliged to provide. This portfolio included properties owned by the Appellant and properties leased by the Appellant for the purpose of complying with its contractual obligations. At the end of the 2014 financial year the Appellant owned 433 properties and rented a further 238. On occasion the properties specified under a contract would, at the outset of the contract, be owned by, or leased to, other

organisations like the Appellant or by the local authority. A side agreement would be reached for the Appellant to buy or rent the properties in question so that it could provide them under an accommodation-based contract. This meant that, on occasion, the Appellant would be renting properties from the local authority with which it had also contracted for the provision of accommodation-based support services to vulnerable people. The Appellant acquired properties solely to comply with its contractual obligations and, if the Appellant subsequently lost a contract, which it could not replace in the foreseeable future it would dispose of the properties associated with that contract.

tt) Mr Palfreyman and Mr Judson both told us that the likely costs of capital expenditure and more minor repairs were not taken into account when the Appellant agreed a price for accommodation-based support contracts. From the correspondence between the parties prior to this appeal we find that these costs encompassed acquisition costs, minor repairs, more substantial renovation of a capital expenditure nature (such as the installation of new bathrooms, kitchens and boilers), security, cleaning and utility costs. Some of these costs (such as the cleaning and utility costs) were passed on to residents but met by the Appellant when a unit of accommodation was vacant. The costs of maintenance were not factored into the charges made to the local authority.

uu) Mr Judson told us that when there was the opportunity to bid for a new contract, a multi-disciplinary team from the Appellant would consider whether they could make a bid. We accept that the Appellant would not bid for an accommodation-based contract unless it had a suitable property available to provide the housing and living environment required. If the Appellant had, or was able to obtain appropriate accommodation then the price tendered by the Appellant was based upon the number of hours of support the Appellant considered was required, and the cost of providing that support. The Appellant's bid for a block gross price contract was submitted as an overall contract price. Mr Palfreyman told us that it was the local authority which expressed that overall price as a price per person per week (to produce the block gross price). Mr Judson told us that the contract price also did not factor in the rent which was charged to individuals. The rent was set by a central government formula applicable to social housing, and this rent was usually agreed with the local authority's housing benefit team prior to the commencement of a contract. Mr Judson told us that if the Appellant was renting a property from another organisation then the rent which was charged to the Appellant would be passed on to the tenant; we find that this could only have been the case if the rent charged was lower than the rent which would be produced under the social housing formula for rent.

vv) In his evidence Mr Judson told us that the two main streams of income for the Appellant were (1) income from residential tenancies and (2) payments under support contracts with local authorities which (in a correction to his witness statement) he accepted could come from accommodation-based and non-accommodation-based support contracts. Both of these had declined over the period 2012 to 2016, but other sources of income had increased.

ww) Mr Judson explained, and we accept, that the format of the Appellant's accounts had to follow the Statement of Recommended Accounting Practice for Housing Associations.

xx) In setting its budget, the Appellant looked to the accommodation-based support contracts agreed, which gave a fixed figure for the Appellant's annual income over the lifetime of the contract. These contracts also prescribed the number of residential units required by the Appellant to supply the necessary units of accommodation. The rent to be paid by individuals and families was usually agreed between the Appellant and the local authority's housing benefit team in advance of the contract starting but would, in any event, not exceed the central government formula. Allowing a small percentage discount for vacant units and for residents not paying their rent, the Appellant was able to predict its income from its two main income streams. The day to day property management expenses and the capital renovation costs were treated as an overhead of the business, to be met out of what the Appellant had remaining once fixed costs such as salaries had been accounted for. Mr Judson told us that the Appellant's income and expenditure was managed at a portfolio level so it could be flexible on spending targets within its overall budget target.

yy) We find that none of the costs the Appellant incurred in acquiring, repairing and maintaining the properties were reflected in either the price of the accommodation-based support services to the local authority, or in the rent charged to residents of the properties. Where the Appellant's spending on property maintenance exceeded its target, that overspend was met by savings in other areas of the Appellant's expenditure (such as salaries).

zz) Except in unusual circumstances (such as tenants overstaying when a contract was lost or the Appellant putting in property guardian tenants in order to prevent vandalism before selling a property), the Appellant did not provide accommodation to anyone other than under an accommodation-based support contract with a local authority. (With one exception of one property which Mr Palfreyman was not really able to explain), where the Appellant provided non-accommodation-based support to an individual, then the Appellant did not also separately provide accommodation to that person. This was because the Appellant acquired property for a contract and then disposed of that property if that contract was lost (sometimes, it seems, to the organisation who took over the contract).

The parties' submissions

The dispute before us concerned the nature of the supply made by the Appellant to the local authorities, and whether that was linked to the accommodation costs.

The Appellant's case

8. The Appellant put its case before us on the basis that the accommodation costs it incurred had a direct and immediate link to its supply of accommodation-based

support services. The Appellant relied heavily on *HMRC v Mayflower Theatre Trust Limited* [2006] EWCA Civ 116, but referred also to the opinion of the Advocate General in *Iberdrola Inmobiliaria Real Estate Investments*, C-132/16. (Since the hearing before us, the European Court has released its judgement in *Iberdrola*.)

9. The Appellant argued that it was not necessary for the cost of the input to be factored into the cost of an output for there to be an immediate and direct link, relying on *Mayflower*, *Dial-a-Phone v Commissioners for Customs and Excise* [2004] EWCA Civ 603 and *North of England Zoological Society v HMRC* [2015] UKFTT 287 (TC). The Appellant also argued that the cost of acquiring and maintaining properties was not directly factored into either the prices charged to the commissioning local authority by the Appellant or the rent charged to support recipients who had been referred. So, on the basis that all property repair and maintenance costs were met out of all income streams, the cost of the input was met by the cost of all of its supplies.

10. The Appellant argued that HMRC had misunderstood the nature of its supply to the local authorities. In response to HMRC's point regarding the Appellant's accounts, the Appellant noted that it was obliged to follow financial reporting protocols for all social housing landlords and so could not dictate the layout of its own accounts.

HMRC's case

11. HMRC's case was that there was a direct and immediate link between the input and the Appellant's exempt supply of accommodation to individuals and families. The costs incurred were a cost component of that exempt supply and not of the support and welfare advice provided by the Appellant under its agreement with the local authorities. HMRC argued that the Appellant was the final consumer of the accommodation inputs.

12. HMRC referred to *BLP Group plc v Commissioners for Customs and Excise*, C-4/94 as the "cornerstone", and argued it was essential to go back to first principles to see how the inputs were used. Here the output were the supply of rental property and the supply of support at that property. The question which should be asked in relation to that latter output was, how does that output bear these costs? HMRC argued that the supply was in substance the same whether the support was provided at the Appellant's premises or at other premises, and relied on the evidence of Mr Palfreyman in this regard.

13. HMRC also noted the potential mismatch on recovery if the Appellant's case was correct, where recovery would be possible if the Appellant incurred costs on maintaining a property under an accommodation-based contract but not recoverable on that same property if another organisation took over provision of the accommodation but did not simultaneously provide support at the premises.

Discussion and decision

14. Our starting point is the relevant legislation. Articles 168 and 173 of the Principal VAT Directive ("PVD") provide:

Article 168

In so far as the goods and services are used for the purposes of the taxed transactions of taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from which 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;

Article 173

1. In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.

15. In domestic law, Section 26 VATA 1994 provides:

(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business –

(a) taxable supplies;

16. Subsection 26(3) provided that HMRC shall make regulations for securing a fair and reason attribution of input tax to supplies. The standard method of apportioning between taxable and non-taxable supplies is set out in Regulation 101(2)(d) of the Value Added Tax Regulations 1995. This can be replaced by a special method approved or directed by HMRC.

17. As recently explained by the Court of Justice of the European Union ("EUCJ") in *Ryanair Limited v Ireland,* C-249/17:

23 The deduction system is intended to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT (judgment of 14 September 2017, *Iberdrola Inmobiliaria Real Estate Investments*, C-132/16, EU:C:2017:683, paragraph 26 and the case-law cited).

18. As is obvious, the goods or services purchased must be used in making taxable supplies by the taxpayer if that neutrality is to be achieved. The EUCJ has been clear that there must be a direct and immediate link between the goods or services purchased and a taxable supply made. The parties disagree on whether the facts of this case disclose such a link.

19. As noted above, in arguing that there was no direct and immediate link, HMRC relied upon *BLP*. BLP had paid for professional services in connection with the exempt sale of shares held in a subsidiary company, and claimed that the shares were sold to pay off debts which arose as result of its taxable activities. BLP's claim to deduct the VAT incurred on the professional services was refused by the Commissioners, and this refusal was ultimately upheld by the Court of Justice of the European Communities. The ECJ rejected BLP's argument that its consequent use of the funds was relevant, stating at paragraph 24:

> Moreover, if BLP's interpretation were accepted, the authorities, when confronted with supplies, which, as in the present case, are not objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective nature of the transaction in question.

20. In relying on *BLP*, HMRC also argued that the inputs were not a cost component of the taxable output. HMRC referred to paragraph 37 in the Opinion of Advocate General Lenz who, after noting that the High Court had found that the professional services formed a cost component of the exempt sale of shares, continued:

> That is not affected by the argument put forward by BLP at the hearing that the costs of the services on which input tax has been paid (and hence that input tax itself) are ultimately incorporated into the price of the goods and services which it sells by means of its taxable transactions. Even if it were possible to construct such an effect in commercial or book-keeping terms, that would merely be a cascade effect, which can always occur if taxable and exempt transactions are carried out at the same time within a unitary undertaking. That circumstance does not make the services in question into cost components of the taxable transactions and cannot therefore alter the attribution stated above.

21. It seems to us that *BLP* was a case of professional services being engaged as a consequence of (unsuccessful) taxable activities, and not for the purpose of taxable activities. To the extent that HMRC might be arguing that the input here must be a directly traceable cost component which influences the price of the taxable supply, we do not consider that this correct.

22. In *HMRC v Associated Newspapers Limited* [2017] EWCA Civ 54, the Court of Appeal considered an appeal and cross-appeal concerning the costs to ANL of buying in retailer vouchers, in one case directly, in another case through an intermediary, which were given away for free to customers of its newspapers in a (as it turned out,

successful) bid to improve newspaper circulation. The proceedings raised various points regarding vouchers but the Court of Appeal also considered whether the cost of acquiring the vouchers via the intermediary could be deducted by ANL. Picking up this issue at paragraph 29, Patten LJ began:

> ***Were the supplies of vouchers to ANL cost components of a taxable supply?***
>
> **[29]** It is common ground that both the direct and intermediate supplies of face-value vouchers to ANL were supplies of services: see VATA Sch 10A para 2. Putting aside the issue of whether the direct supplies were taxable having regard to Sch 10A para 4(2), the right of ANL to deduct any VAT which it has paid on its purchase of the vouchers depends in the first place on those services being 'used for the purposes of the taxed transactions of a taxable person': see PVD art 168. Under VATA s 24(1) this is expressed in terms of their being used for the purpose of a business carried on by the taxable person but it has not been suggested that these words were intended to do any more than to transpose into domestic law the relevant provisions of the PVD and they fall to be construed conformably with the tests laid down by the authorities on what is now art 168.
>
> **[30]** These establish that in order to be treated as what PVD art 1(2) refers to as cost components of the output transactions, the taxable person must establish either a direct and immediate link between the goods and services and the relevant taxable transactions or that the cost of the goods or services purchased are part of the overheads of the taxable person and therefore cost components of the undertaking's taxable activities. If they are to be treated as overheads there may, as I have said, be an issue about the apportionment of the costs between ANL's taxable and non-taxable activities but that is an issue for the future. But to be overheads at all it is still necessary to establish a sufficient connection between the goods or services supplied to the taxable person and his taxable economic activities. Therefore, if in the present case the purchase of the vouchers by ANL should be treated as directly (and exclusively) linked to the free supply of the vouchers to its customers, the input tax will be irrecoverable.

23. After setting out the purpose of deduction, Patten LJ continued:

> **[32]** But the attribution of the input supplies of goods and services to some taxable economic activity, which is ultimately a question of law, will frequently involve a contest between specific and immediate supplies (which may not be taxable) and the wider business of the taxable person which will be. The present case is no exception. ANL succeeded in persuading the FtT that the vouchers were attributable for the purposes of art 168 to its business of supplying newspapers and the advertising they contain. The voucher promotions were designed to and succeeded in boosting the circulation of its titles. But HMRC's case is that this takes no account, or no adequate account, of the existence of the supplies of services constituted by the free distribution of the vouchers. Since this provides the most direct and obvious link with the purchase of the vouchers, it is not legally necessary or possible to look beyond them to the supplies of newspapers or more generally the taxable business of ANL. The vouchers are

not a necessary component of the cost of producing newspapers even if they sell more and can therefore be said to have benefited the business as a whole.

24. In paragraphs 33-46 Patten LJ then traced a history of relevant authorities from *BLP*, through *Midland Bank plc v Customs and Excise Commissioners* Case C-98/98 and *Skatteverket v AB SKF* Case C-29/08, to the then most recent decision of the EUCJ on input tax recovery: *'Sveda' UAB v Valstybine mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* Case C-126/14. Having considered those decisions, Patten LJ continued at paragraph 47:

> **[47]** It seems to me that the CJEU has clearly moved away in these recent decisions from any disregard of the ultimate economic purpose of the relevant expenditure in considering whether it should be treated as linked to the taxpayer's wider economic activities. This is not a question of subjective intent but requires an objective analysis in terms of the taxpayer's identifiable economic activities of why the input supplies were acquired. Although there must, I think, be some evidence that the cost of the input supplies was passed on as part of the cost of the supplies which the taxable person subsequently makes, the absorption of those costs as part of the expenditure of running the business is not to be ignored merely because they also facilitated the making of supplies which in themselves were either exempt or outside the scope of the PVD.
>
> **[48]** So in the present case the cost to ANL of acquiring the vouchers can be treated in purely causal terms as attributable to the onward supply of the vouchers. Without the purchase of the vouchers their free distribution could not have taken place. However, in economic terms, the cost of purchasing the vouchers was also part of ANL's overall expenditure in the production and sale of its newspapers which the vouchers were intended to promote. The fact that the vouchers were provided free to buyers of the newspapers merely serves to confirm that they were cost components of the business rather than the onward supply of the vouchers.

25. Patten LJ then considered the test applied by the Upper Tribunal and concluded that it had been correct. He went on to consider two other arguments, raised by Mr Beal for HMRC. Firstly, whether the vouchers were necessary, and then whether the Upper Tribunal had conflated the commercial objective of acquiring the vouchers with the output transaction with which they were most closely linked. In making this second point HMRC relied on the reasoning set out in *Mayflower*. In rejecting each these arguments in turn, Patten LJ stated:

> **[51]** Mr Beal in his skeleton argument has highlighted the fact that the purchase of the vouchers was not necessary for the operation of ANL's business but was a necessary pre-condition to the operation of a non-business activity comprised in the free issue of the vouchers. They were supplies of the same physical items. So far as that argument goes, I agree with it and there is no dispute between the parties that the issue of the vouchers as part of the scheme was not in itself an economic activity. But the characterisation of the onward supply is not what is in issue and a simple causative test of whether the newspapers could have been

> produced and sold without the benefit of the vouchers does not answer the question of whether the cost of the vouchers was economically a cost component of those supplies and that business when the vouchers were acquired in order to sell the papers.
>
> …
>
> **[55]** In the *Mayflower Theatre Trust* case Carnwath LJ seems to have been concerned to remain true to the reasoning in *BLP* as he understood it by not extending the test of what constitutes a direct and immediate link: see the references at [33] of the judgment to a slippery slope. But, in the light of the judgment in *Sveda*, a different approach seems now to be required. The fact that services in the form of the vouchers were acquired in order to make non-taxable output supplies of the same items to ANL's customers is not determinative if the cost of those supplies is in fact a component of ANL's taxable business: see *Sveda* at para 34.

26. It is useful to briefly look at *Sveda*, which concerns the construction of a Baltic mythology recreational and discovery path. This path was constructed under an agreement between the Lithuanian Ministry of Agriculture, which met 90% of the construction costs, and Sveda which met the remaining 10%. The path was to be open to the public free of charge but Sveda intended to offer to supply food, drink and souvenirs to visitors to the path. The EUCJ held in favour of Sveda in principle, determining:

> 34. Therefore, immediate use of capital goods free of charge does not, in circumstances such as those in the main proceedings, affect the existence of the direct and immediate link between input and output transactions or with the taxable person's economic activities as a whole and, consequently, that use has no effect on whether a right to deduct VAT exists.
>
> 35. Thus, there does appear to be a direct and immediate link between the expenditure incurred by Sveda and its planned economic activity as a whole, which is, however, a matter for the referring court to determine.

27. *Associated Newspapers* was followed by the Court of Appeal in *JDI International Leasing Ltd v Revenue and Customs Commissioners* [2018] UKUT 214. After quoting paragraphs 47 and 48 of *Associated Newspapers* (set out above), the Upper Tribunal held:

> 48. It is quite clear from this that the test is not one of subjective intention, but rather an objective one, requiring consideration of the taxpayer's economic activities to determine why the relevant input was acquired, and whether in economic terms the input can properly be regarded as a cost of taxable supplies.

28. Finally, we have also had the benefit of the EUCJ's decision in *Iberdrola* which concerned Iberdrola's reconstruction of a waste water pump station in a holiday village in a municipality in Bulgaria. Once the pump station was completed, Iberdrola was able to build holiday apartments and connect them to the pump station.

Iberdrola's claim to deduct input tax on the costs of reconstruction was initially refused because it did not make any charge to the municipality which owned the pump station for the reconstruction. The EUCJ allowed Iberdrola's claim in principle, stating:

> 31. It is apparent from the case-law of the Court that, in the context of the direct-link test that is to be applied by the tax authorities and national courts, they should consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the taxable person's taxable activity. The existence of such a link must thus be assessed in the light of the objective content of the transaction in question (see, to that effect, judgment of 22 October 2015, *Sveda*, C-126/14, EU:C:2015:712, paragraph 29).

29. *Iberdrola* was referred back to the Bulgarian national courts to determine whether the reconstruction work went above what was required for the holiday apartments. If it did not then, as Iberdrola would go on to make taxable supplies in respect of those holiday apartments, its claim should be allowed. The EUCJ considered that it did not matter that the municipality had obtained the reconstruction for free as there was a direct link between the reconstruction costs and taxable supplies which would be made by Iberdrola.

30. Following *Associated Newspapers*, we do not consider that it is necessary for there to be a direct tracing through from the input cost to the Appellant to the pricing of the Appellant's taxable supply. The fact that the cost of the input does not determine the price of the Appellant's supply does not prevent there from being a direct and immediate link between input and supply. We consider it sufficient that the cost of the inputs is absorbed as part of the cost of running the business and is a cost component of the economic activities as a whole.

31. We consider that the relevant test, as set out in *Sveda* and reaffirmed in *Iberdrola*, is whether there is a direct and immediate link between the input and the output transactions or between the input and the taxable person's economic activities as a whole.

32. Applying that test to this case, we look first at the Appellant's economic activities as a whole. We are satisfied that the main taxable supply of the Appellant is its supply under both types of support contracts (although the accounts suggest that other income may soon supersede this, and we have limited information about those other sources of income). We are aware of other taxable supplies made by the Appellant (such as the charge to individuals for cleaning communal areas, a service which seems to us to be divisible from the letting) but we have concluded that we should consider this appeal on the basis that the Appellant's economic activities equate to the Appellant's supplies under both types of support contracts.

33. We have concluded that the Appellant's supply under an accommodation-based contract was an undertaking to the local authority that it would provide any referred person in a specified category (up to a specified maximum at any one time) with

integrated accommodation and support; that is, support which was appropriate to that person's circumstances and also accommodation which was safe, secure and met certain specified standards. We conclude that the Appellant's ability to offer suitable accommodation to a referred vulnerable person was as important to the local authority as the Appellant's ability to offer support – with an accommodation-based support contract, a local authority would not have accepted either one as being sufficient without the other. In providing integrated housing and support to a referred person, the Appellant carried out the local authority's duty to house that referred person.

34. This contrasts with the supply under a non-accommodation-based contract which was simply an undertaking to provide referred people in a specified category with a specified number of hours of appropriate support. The Appellant could offer no guarantee as to the quality of the accommodation in which that support was to be provided. It was for the local authority either to find suitable accommodation or to satisfy itself that any housing the person already had was satisfactory.

35. We have reached this conclusion without regard to the subjective intention of the Appellant. We consider that objective view can be derived from the contracts and the context in which those contracts are formed. We bear in mind that there were other organisations, like the Appellant, bidding for accommodation-based support contracts with local authorities. The terms which a local authority agreed were not unique to the Appellant because of a special or unusual desire of the Appellant. The accommodation-based support contracts were agreed because the local authority wished to contract out its duty to support and house certain categories of vulnerable people, including those who were homeless. It was an efficient way for the local authority to manage its obligations.

36. HMRC made the point that the support described as being offered under an accommodation-based support contract appeared identical to the support described as being offered under a non-accommodation-based support contract. We agree that appeared to be the case but we do not consider that it is relevant. The support provided and the support outcomes may be the same for the individual but the supply to the local authority is different. Under an accommodation-based support contract the Appellant undertakes to provide integrated accommodation and support to people referred by the local authority. If the Appellant only supplied support then the local authority would be obliged itself either to manage accommodation for referred individuals or to contract out that obligation to a third party.

37. If the Appellant had not been able to offer appropriate accommodation to the people referred by a local authority, the Appellant would have been in breach of its contractual obligations. Mr Judson told us that there were occasions when the Appellant had not bid for an accommodation-based contract because it had not been able to secure appropriate housing at an affordable rent.

38. There was some limited discussion before us about the supply by the Appellant was a single supply or whether one element was ancillary to another. We consider that the Appellant's supply to the local authority under an accommodation-based support contract was one supply with two strands. We do not consider the

Appellant's agreement with the local authority that it would provide a referred person with accommodation was ancillary to the Appellant's agreement that it would provide that person with support, or vice versa. Under an accommodation-based support contract, the local authority required a commitment that accommodation and support would be provided together to the individual. The Appellant's undertaking to the local authority is, economically, a single supply. While it is obvious that a commitment to supply either support or accommodation can be provided alone, we consider it would be artificial to split in two the Appellant's undertaking under an accommodation-based support contract. What the local authority has required is for both aspects to be supplied together.

39. So, having determined what was supplied by the Appellant under an accommodation-based support contract, we look at the inputs.

40. We have found that the inputs were the costs of acquiring, maintaining, repairing, cleaning and keeping secure residential properties. These costs were incurred in order that the Appellant had clean, safe and secure properties of a certain standard available. We have concluded that the Appellant incurred these costs in order that it could bid for accommodation-based support contracts and, if successful in those bids, thereafter supply the environment required by the local authority and the accommodation to the individuals and families referred under those contracts.

41. It follows that we consider that there is a direct and immediate link between those costs and the Appellant's taxable supply under an accommodation-based contract (and therefore to the Appellant's economic activities as a whole).

42. We have been careful not to apply a "but for" test. We consider that it was not just that the Appellant could not carry out its contractual obligations if it did not have accommodation available; it was the case that the Appellant acquired and maintained the properties specifically in order to bid for contracts and then (if successful) supply integrated housing and support in accordance with its contractual obligations.

43. We conclude that the inputs in dispute here do have a direct and immediate link to the Appellant's taxable supplies. We agree with the Appellant that it is entitled to deduct those costs.

44. We did not hear argument about specific figures but nor were we asked to provide a decision in principle. If the parties are unable to agree the figures as a result of this decision, they are at liberty to seek a further hearing for specific figures to be determined.

Conclusion

45. Therefore, for the reasons set out above, this appeal is allowed.

46. 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.

JANE BAILEY
TRIBUNAL JUDGE

RELEASE DATE: 3 November 2018