[2020] UKFTT 0006 (TC)

TC07514

Value Added Tax – VAT grouping - recovery of input tax

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2016/03694

BETWEEN

MELFORD CAPITAL GENERAL PARTNER LTD **Appellant**

-and-

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

TRIBUNAL: JUDGE RACHEL MAINWARING-TAYLOR

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 15 January 2018

Michael Firth, counsel, instructed by Grant Thornton, for the Appellant

Edward Brown, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This case concerns the recovery of input tax by the Appellant. The Appellant is the general partner of Melford Special Situations LP ('the Fund'), an English limited partnership. Acting through the Appellant, the Fund holds the shares in Hyde Park Hayes Ltd ('HPH'), a company incorporated in the Isle of Man. HPH in turn holds the shares in a number of companies or special purpose vehicles ('the SPVs'), each of which holds a separate underlying asset, eg a commercial property.

2. Investors contribute capital to the Fund. The Fund finances investments by subscription for share capital in and interest free loans to the SPVs which in turn make investments in UK commercial property.

3. The SPVs' activities, for example letting property, are taxable where there is a valid option to tax. The SPVs return funds, for example rents generated or proceeds of sale where an asset is sold, to HPH, as dividends or liquidation proceeds. These funds are, in turn, passed by HPH to the Appellant, which distributes the proceeds to the partners in the Fund under the terms of the Limited Partnership Agreement ('LPA'). The Appellant receives priority profit shares under the LPA.

4. The Appellant is owned by Melford Capital Partners LLP ('the LLP'). The LLP is contracted to provide advisory, property management and administrative services (the Services) to the Fund. Each SPV enters into a deed of adherence in respect of the contract between the LLP and the Fund, under which the LLP provides the Services directly to each SPV in return for a fee payable directly by the SPV to the LLP. The supplies of the Services to the SPVs are standard rated.

5. The Fund (through the Appellant) incurs costs relating to the operation of the structure including:

   (1) the costs of setting up and attracting investors to create the investment structure; and

   (2) Operating Costs of running the business such as audit costs, fund operator costs, accounting and book-keeping costs and costs of due diligence for making new investments.

6. The LLP and the Appellant constitute a VAT group (the Group). HPH and the SPVs constitute a separate VAT group ('the Second Group').

7. There is a second investment structure, Melford Special Situations II LP ('the Second Fund'), which is structured similarly, with the Appellant as its general partner.

8. The Appellant disputes the decision of HMRC dated 22 May 2015 (and confirmed on 8 December 2015 and 7 June 2016) to refuse a claim to recover VAT incurred on costs including both set up and Operating Costs.

RELEVANT LEGISLATION

9. Article 9(1) of Council Directive 2006/112/EC ('Principal VAT Directive' or 'PVD') defines "taxable person" as follows:

> "1. 'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.
>
> Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be

regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity.

2. In addition to the persons referred to in paragraph 1, any person who, on an occasional basis, supplies a new means of transport, which is dispatched or transported to the customer by the vendor or the customer, or on behalf of the vendor or the customer, to a destination outside the territory of a Member State but within the territory of the Community, shall be regarded as a taxable person."

10. The provisions of the PVD have been implemented in UK law by the Value Added Tax Act 1994 ('VATA 1994') and regulations made under it. Section 24 VATA 1994 relevantly 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.

(2) Subject to the following provisions of this section 'output tax' in relation to a taxable person means VAT on supplies which he makes or the acquisition by him from another member State of goods (including VAT which is also to be counted as input tax by virtue of subsection (1)(b) above).

…

(5) where goods or services supplied to a taxable person, goods acquired by a taxable person from another member State or goods imported by a taxable person from a place outside the member States are used or to be used partly for the purpose of a business carried on or to be carried on by him and partly for another purpose -

(a) VAT on supplies, acquisitions and importations shall be apportioned so that so much as is referable to the taxable person's business purposes is counted as that person's input tax and

(b) the remainder of that VAT ('the non-business VAT') shall count as that person's input tax only to the extent (if any) provided for by regulations under subsection (6)(e)

…

(6) Regulations may provide-

…

(e) in cases where an apportionment is made under subsection (5), for the non-business VAT to be counted as the taxable person's input tax for the purposes of any provision made by or under section 26 in such circumstances, to such extent and subject to such conditions as may be prescribed."

11. 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 or 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;

(b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;

(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this section.

(3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above, and any such regulation may provide for-

(a) determining a proportion by reference to which input tax for any prescribed accounting period is to be provisionally attributed to those supplies;

(b) adjusting, in accordance with a proportion determined in like manner for any longer period comprising two or more prescribed accounting periods or parts thereof, the provisional attribution for those periods;

(c) the making of payments in respect of input tax, by the Commissioners to a taxable person (or a person who has been a taxable person) or by a taxable person (or a person who has been a taxable person) to the Commissioners, in cases where events prove inaccurate an estimate on the basis of which an attribution was made; and

(d) preventing input tax on a supply which, under or by virtue of any provisions of this Act, a person makes to himself from being allowable as attributable to that supply.

(4) Regulations under subsection (3) may make different provision for different circumstances and, in particular (but without prejudice to the generality of that subsection) for different descriptions of goods and services; and may contain such incidental, supplementary, consequential and transitional provisions as appear to the Commissioners necessary or expedient."

12. Section 43 VATA 1994 deals with VAT groups and provides:

"(1) Where under sections 43A to 43D any bodies corporate are treated as members of a group, any business carried on by a member of the group shall be treated as carried on by the representative member, and -

(a) any supply of goods and services by a member of the group to another member of the group shall be disregarded; and

(b) any supply which is a supply to which paragraph (a) above does not apply and is a supply of goods or services by or to a member of the group shall be treated as a supply by or to the representative member; and

(c) any VAT paid or payable by a member of the group on the acquisition of goods from another member State or on the importation of goods from

> a place outside the member States shall be treated as paid or payable by the representative member and the goods shall be treated-
>
> > (i) in the case of goods acquired from another member State, for the purposes of section 73(7); and
> >
> > (ii) in the case of goods imported from a place outside the member States, for those purposes and the purposes of section 38,
>
> as acquired or, as the case may be, imported by the representative member;
>
> and all members of the group shall be liable jointly and severally for any VAT due from the representative member."

EVIDENCE

13. The Tribunal heard evidence from Mr Frederick Wingfield Digby, a director of the Appellant and member of the LLP. The Tribunal also examined the documents in the bundles to which it was directed by Counsel.

AGREED FACTS

14. The material facts, set out below, were common ground between the parties.

(1) The Appellant and the LLP (which owns it) together form a VAT group.

(2) The Group makes no exempt supplies.

(3) The Appellant is the general partner of the limited partnership referred to as the Fund.

(4) The Fund, through the Appellant as its general partner, holds the shares in HPH.

(5) HPH holds the shares in various SPVs.

(6) HPH and the SPVs form a (separate) VAT group.

(7) Investors provide funding to the structure via the limited partners of the Fund. This funding passes to HPH and on to the SPVs by means of subscription for shares and interest free loans.

(8) Each SPV holds an investment such as a commercial property which it exploits for profit.

(9) Investors receive returns by way of dividends from and liquidation proceeds of the SPVs, via HPH and the Fund. These are divided amongst the members of the Fund ('the limited partners') in accordance with the terms of the LPA.

(10) The Appellant, as general partner, carries on the business of the Fund, including raising equity and debt and making investment and divestment decisions.

(11) The Appellant incurs costs in the course of running the business of the Fund. These costs fall into two categories:

> (a) costs of setting up and attracting investment into the Fund, for example, legal and advisory costs ('the Set- up Costs'); and
>
> (b) general Operating Costs such as audit, accounting, bookkeeping, fund operator and due diligence costs ('the Operating Costs').

(12) The LLP provides investment and administrative advisory services to the Appellant as general partner of the Fund under a management agreement dated 8 September 2009 and restated on 14 July 2011 ('the Management Agreement').

(13) The LLP provides management and advisory services to HPH and to the SPVs for consideration under the terms of deeds of adherence ('DOAs') related to the Management Agreement.

(14) The DOAs set out how the SPVs are charged for the services provided by the LLP, with costs being calculated by reference to the amount of rental income each SPV generates.

ISSUE

15. The issue in this appeal is whether the VAT on the Set-up Costs and the Operating Costs is input tax which was fully deductible by the Appellant.

SUBMISSIONS

Appellant's submissions

16. The Appellant submitted that:

(1) the activities of the Fund should be treated as the activities of its general partner, ie the Appellant;

(2) the activities of the Appellant as general partner, including those of the Fund and those of the LLP should be treated as activities of a single entity for VAT purposes, namely the Group; and

(3) the Group actively managed its investment in the SPVs and made only taxable supplies, so it should be entitled to full recovery of its input tax.

17. It is common ground that the activities of a limited partnership should be treated as the activities of the general partner.

18. The Appellant submitted that it was a well-established principle that members of a VAT group were treated as a single taxable person (section 44 VATA 1994 and Article 11, Directive 2006/112), citing Case C-7/13 *Skandia America Corporation v Skatteverket* [2015] STC 1163 at paragraph 29:

> "In this connection, treatment as a single taxable person precludes the members of the VAT group from continuing to submit VAT declarations separately and from continuing to be identified, within and outside their group, as individual taxable persons, since the single taxable person alone is authorised to submit such declarations (judgment in *Ampliscientifica and Amplifin*, C-162/07, EU:C:2008:301, paragraph 19). It follows that, in such a situation, the supplies of services made by a third party to a member of a VAT group must be considered, for VAT purposes, to have been made not to that member but to the actual VAT group to which that member belongs".

19. It follows, the Appellant maintained, that the activities of all members of the VAT group are attributed to the single taxable person that is the group.

20. Therefore, instead of viewing the LLP as providing taxable management services and the Appellant as holding investments in and through HPH, for VAT purposes one must see a single taxable person, the Group, that both held investments in and through HPH and provided taxable management services to HPH and the SPVs.

21. This was confirmed, the Appellant submitted, by the Upper Tribunal in *HMRC v BMW (UK) Holdings Ltd* [2016] UKUT 434 (TCC) para 165:

> "Those factors guided the CJEU's decision in *Ampliscientifica* that implementing legislation must have the effect that members were not individually to be recognised as taxable persons, and in Skandia that the individual identity of the members was to be disregarded for VAT purposes.

> It is also an inevitable consequence of these factors that supplies between members of the group must be disregarded."

22. For VAT purposes, therefore, the investment structure consisted of one entity, the Group, that owned shares in and provided management services to another entity, the Second Group. This was directly equivalent to the traditional holding company/subsidiary relationship.

23. That a holding company incurring costs in relation to the acquisition/operation of its subsidiaries does not carry on an economic activity unless it actively manages those subsidiaries, by way of making taxable supplies to them, was a well-established principle (see C-28/19 *MVM Magyar* [2017] STC 452 ('*MVM Magyar*') paras 32 and 34). This was common ground between the parties.

24. Where a holding company did actively manage its subsidiaries, although it may receive two income streams (fees for management and dividends as shareholder) and although the receipt of dividends was an investment/non-economic activity, there was no apportionment of the holding company's input tax between the two income streams.

25. In Case C-142/99 *Floridienne SA and Berginvest SA v Belgian State* [2000] STC 1044, [2000] ECR I-9567 ('*Floridienne'*) Belgium and the Commission argued that the dividends constituted consideration for the economic activity of managing the subsidiary and this should be included in the denominator of the fraction used to calculate the deductible proportion of input tax. The ECJ rejected this:

> "… art 19 of the Sixth Directive is to be interpreted as meaning that the following must be excluded from the denominator of the fraction used to calculate the deductible proportions: share dividends paid by its subsidiaries to a holding company which is a taxable person in respect of other activities and which supplies management services to those subsidiaries, and interest paid by the subsidiaries to the holding company on loans it has made to them, where the loan transactions do not constitute, for the purposes of art 4(2) of the Sixth Directive, an economic activity of the holding company."

26. The Appellant went on to argue that this was confirmed in Case C-16/00 *Cibo Participations SA v Directeur regional des impots du Nord-Pas-de-Calais* [2002] STC 460 ('*Cibo*'):

> "In the circumstances, it is appropriate to emphasise that, since the receipt of dividends does not fall within the scope of VAT, dividends paid by subsidiaries to their holding company which is a taxable person in respect of other activities and which supplies management services to those subsidiaries must be excluded from the denominator of the fraction used to calculate the deductible proportion under art 19 of the Sixth Directive (see *Floridienne* … para 32)."

27. The Appellant submitted that the costs in dispute were in the nature of overheads or general costs incurred for the purpose of the activities of the Group, that the Group only made taxable supplies and therefore all the disrupted costs should be recovered, following (joined) Cases C-108/14 and C-109/14 *Beteiligungsgesellschaft Larentia + Minerva mbH & Co KG and Finanzamt Hamburg-Mitte v Finanzamt Nordenham and Marenave Schiffahrts AG* [2015] STC 2101 ('*Larentia + Minerva*'), paras 24 -29:

> "However, a taxable person also has a right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do have a direct and immediate link with the taxable person's economic

> activity as a whole (see, inter alia, judgments in *Cibo Participations*, C-16/00, EU:C:2001:495, paragraph 33 and *Portugal Telecom*, C-496/11, EU:C:2012:557, paragraph 37).
>
> In those circumstances, as the Advocate General stated in point 39 of his Opinion, the expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involves itself in their management and which, on that basis, carries out an economic activity, as was noted in paragraph 21 of the present judgment, must be regarded as attributed to that company's economic activity and the VAT paid on that expenditure gives rise to the right to full deduction, pursuant to Article 17(2) of the Sixth Directive.
>
> It is therefore only in the event that the referring court finds that the shareholdings resulting from the capital transactions carried out by the holding companies at issue in the main proceedings were attributed in part to other subsidiaries in the management of which those holding companies were not involved that, as is envisaged in the referring court's first question, the VAT paid on the costs of those operations could be deducted only in part."

28. The Appellant cited as further authority for its assertions *Mayflower Theatre Trust Ltd v HMRC* [2007] EWCA Civ 116, *CEC v Redrow Group plc* [1999] STC 161 (at 169 per Lord Millett) and C-408/98 *Abbey National Plc* [2001] STC 297 paragraphs 35-36.

29. The Appellant noted that VAT grouping can affect VAT recovery, for example, in *MVM Magyar* where the holding company procured legal, accounting and business services on behalf of the corporate group but made no charge to other group members and so was not entitled to recovery, the separation out of the different activities between holding company and subsidiaries resulted in input tax not being deductible whereas, had the same activities all been carried out by a single company it would have been.

30. The Appellant argued that it followed that if separation of activities could alter the VAT position, the combining of activities by formation of a VAT group must also be capable of affecting the tax position.

31. The effect of a VAT group on input tax recovery was recognised in *Larentia + Minerva*. That case also went on to consider whether VAT grouping could be restricted to entities with legal personality linked to the controlling company in a relationship of subordination:

> "As the Advocate General stated in point 55 of his Opinion, contrary to the doubts expressed in that regard by Ireland in its written observations, the answer to that question is likely to be of relevance to the solution of the disputes in the main proceedings. The status of VAT group conferred on the holding company and its subsidiaries could result in that group, in respect of transactions effected for remuneration between the subsidiaries and third-party undertakings, being eligible to the benefit of full deduction of input VAT linked to capital transactions carried out by the holding company"

HMRC's submissions

32. HMRC say that the issue in the appeal should properly be the analysis of the costs and whether they were components of an economic activity, not the status of the Appellant as a member of a VAT group. HMRC submitted that whilst the Group provided some taxable services, it also carried on non-economic activities and that the split in the Group's activities between taxable and non-economic meant that the recovery of input tax by the Group should be restricted.

33. HMRC noted that the LLP provided management services to the Appellant which were provided within the VAT group and therefore disregarded for VAT purposes and also

management services to the HPH VAT group under the deed of adherence, which were taxable at the standard rate.

34. The Appellant also provided funds through HPH to the SPVs, from investment it attracted from third parties in the form of capital and loans. This investment was provided with no interest being charged by or to HPH or the investors. Capital was returned to the investors from dividends or as cash. As such, the finance was provided without charge to the SPVs. Had a charge been made, the supply would have been exempt. The fact that no charge was made did not mean the activity could be completely disregarded. The provision of finance in return for dividends was a non-economic activity of the Group.

35. HMRC submitted that:

(1) the input VAT relating to day to day Operating Costs relating to the management of the business (audit costs, fund operator costs, accounting and bookkeeping costs, due diligence costs) were recoverable, subject to apportionment as between the taxable and non-economic activities of the business; but

(2) the costs of setting up and dissolving the Fund and attracting investment, ie legal and advisory costs were not recoverable because these costs only had a direct and immediate link to the investment i.e. non-economic activity of the business.

36. HMRC's conclusion was therefore that the £180,000 referred to as 'Set-up Costs' were not recoverable but a proportion of the £85,000 annual costs were.

37. HMRC submitted that the Appellant's argument that "without these costs there could be no investment structure" was irrelevant: the business structure required costs to be incurred in respect of the investment fund, the returns on which were not a taxable supply and do not permit recovery.

38. HMRC cited Article 9(1) which defines a taxable person as someone carrying out "any economic activity" and goes on to define economic activity (see above), before noting that under ss24 and 26 VATA 1994, to be deducted as input tax the VAT on a supply to a taxable person must be both used for a business purpose and attributable to taxable supplies.

39. HMRC submitted that the investment activity of the Fund (carried out through the Appellant) was not in the course of a taxable business. Therefore, the costs attributable to the investment activity did not have a direct and immediate link to an economic activity or taxable supply.

40. HMRC accepted that the LLP made some taxable management supplies to the Second Group and was therefore entitled to deduct input tax which related to those management activities, but not to the investment activity of the Fund.

41. HMRC submitted that it was not correct to state that the Appellant indirectly managed all of its investments through its shareholding as the Appellant was not the holding company for the SPVs; HPH held the shares and the Appellant acted as general partner of the Fund.

42. HMRC submitted that the Set-up Costs were components of the activity of investing and not that of managing investments of subsidiaries. The shares held by the Fund in HPH were held as investments so as to receive dividends or a return on capital on a sale. The returns from the SPVs were in the form of dividends or liquidation proceeds, received as cash by HPH and paid out to the Fund as dividends. The Fund did not charge interest on the capital contributions made to the SPVs. Accordingly, the role of the Fund was simply to make investments. This activity did not give rise to supplies which gave rise to the right to deduct input tax.

43. HMRC argued that the fact the Appellant acted as general partner of the Fund and was a member of a VAT group which made taxable supplies did not mean that the Fund was engaged in economic activity. The issue in the appeal should properly be the analysis of the costs and whether they were components of economic activity, not the status of the Appellant as a member of a VAT group.

44. HMRC stated that the Group had some activities that came within the scope of VAT and some that did not and therefore some VAT input tax should be restricted.

45. HMRC cited paras 13 and 14 of Case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen* [1993] STC 222 ('*Polysar*'):

> "The mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purposes of obtaining income therefrom on a continuing basis because any dividend yielded by that holding is merely the result of ownership of that property.
>
> 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."

46. HMRC pointed to C-155/94 *Wellcome Trust* [1996] STC 945 at para 32 and C-4/94 *BLP Group* [1995] STC 424 paras 11, 19, 21-24 and 28 as further authority of the same point.

47. HMRC cited *Floridienne* where further requirements for a management company to be treated as carrying on an economic activity were set out, stating the management of subsidiaries must include transactions which are subject to VAT, such as administrative, accounting and information technology services (para 19). Where payments are made that did not constitute consideration for services (e.g. by way of dividends) they were outside the scope of VAT. The fact that management services were performed did not turn dividend income into consideration for a taxable supply, since there was no direct link between the two. HMRC referred further to AG paras 2 and 25 and paras 7, 18, 26-30 and 32 of the judgment.

48. In C-437/06 *Securenta Gottinger Immobilienanlagen und Vermogensmanagement AG v Finanzamt Gottingen* [2008] STC 3473 ('*Securenta*') the CJEU held that where a holding company raises capital for shareholdings in more than one subsidiary but only intends to provide taxable supplies to some of them and not others, then it has both economic activity in relation to those subsidiaries it intends to provide management services to and non-economic investment activity in relation to those subsidiaries where it has no involvement in the management. In such cases there must be an apportionment of general costs between economic and non-economic use (judgment para 37).

49. HMRC submitted that the situation in question here was not akin to a holding company providing management services to its subsidiaries because the Appellant was not a holding company and provided services to the Fund. The difference in structure from a holding company gave rise to a different VAT outcome.

50. HMRC argued that *Larentia + Minerva* was not in point because the present case did not involve a holding company structure, the Group engaged in non-economic (investment) activity and the costs in question were not general overheads but costs with a direct and immediate link to the non-economic activity of fund management.

51. In *Larentia + Minerva* the relevant corporate entities were investing in subsidiary vehicles and making taxable supplies in exchange for consideration. The holding companies were directly engaged in the management of the subsidiaries and receiving consideration. As

such, all input VAT was treated as recoverable. The Court expressly followed *Securenta* as to the need to apportion between economic and non-economic activities (para 27).

52. In this case, the Fund did not take part in any management activities. The holding company, HPH, sat outside the Group. Taxable supplies of management services were made by the Group to HPH, but the investment of capital and the return on investments was made through HPH, that is through the holding company which was not the Appellant.

53. With the exception of day to day management costs, the costs of the Group were components of the non-business, non-economic investment activity of the Fund. The management of the Fund did not give rise to taxable supplies or any supplies carrying a right to deduct input tax. The supply within the Group, from the LLP to the Appellant, was disregarded. The activity of the Fund outside the Group was not in the course or furtherance of a business; it was an investment activity. Shares in the holding company were not held as part of a continuing activity of trading. Loans were made from the Fund to the SPVs but no interest was charged. The returns from the SPVs were in the form of (cash) dividends or liquidation proceeds. The cash was paid to the HPH as the controlling shareholder of the SPVs and further distributed by HPH.

54. Membership of a VAT group did not make a non-business activity taxable or extend the right to deduct to non-business activity. HMRC cited the Advocate General in C-85/11 *EC Commission v Ireland* [2013] STC 2336:

> "The forming of a VAT group results in the creation of a single taxable person for VAT purposes which is in all aspects comparable to a taxable person consisting of only one entity. Regardless of its nature as a special scheme, VAT grouping neither introduces limitations nor broadens the rights of a taxable person as defined in Article 9 of the VAT Directive.
>
> The VAT system achieves the highest degree of simplicity and neutrality under two conditions: when the tax is levied in as general a manner as possible and when its scope covers all stages of production, distribution and the supply of services. The VAT regime should result in neutrality in competition, so that within the territory of a Member State similar goods and services bear the same tax burden, regardless of the length of the production and distribution chains. When functioning optimally, this so-called neutral taxation should not affect either competition or the decisions economic operators make when organising their activities, such as legal form or organisational structure.
>
> The establishment of a VAT group initiates the tax liability of the VAT group, and terminates the separate tax liability of those of its members who were taxable persons for VAT purposes before joining the group. The VAT treatment of the group's transactions, both to and from entities outside the group, is comparable to VAT treatment of a single taxable person operating individually. Transactions between the individual members of the group, and which remain therefore within the group, are considered as having been carried out by the group for itself. Consequently, a VAT group's internal transactions do not exist for VAT purposes.
>
> When a VAT group acts in accordance with the rules of the VAT regime, the right of the persons belonging to the VST group to deduct VAT for purchases is not expanded. This right continues to be applicable only to those supplies that are made for the activities subject to VAT by the VAT group. Nor are the members of the VAT group entitled to deduct VAT on supplies made for VAT exempted activities."

55. HMRC argued that the existence of a VAT group registration made no difference to the correct split between the VAT group's taxable and non-taxable activities. The Group was a

single taxable person but its activities were not fully taxable because the Fund was engaged in non-taxable investment activity. The cost components of that non-taxable activity were not recoverable and the remainder of the costs required apportionment.

56. HMRC submitted that it would be erroneous to treat the Group in this case in the same way as a holding company. Unlike a holding company, the role of the Fund was circumscribed, for example, by the terms of the investment prospectus, and permitted capital to be provided only on certain terms. The Fund did not operate as a normal holding company. The Fund did make non-taxable supplies of loans and investment and receive dividends and liquidation proceeds, none of which were taxable.

57. HMRC submitted that the activity of the Fund did not give rise to supplies with a right to deduct input tax. This position was not changed by the VAT group registration. The relevant focus should be on the nature of the activity and not whether an entity was a member of a VAT group. VAT grouping could not render non-taxable activity taxable.

DISCUSSION

58. The point at issue is whether the VAT incurred on both the Set-up Costs and the Operating Costs is fully deductible by the Appellant as input tax.

59. The Appellant argues that it/the Group makes only taxable supplies and both categories of costs relate to those supplies and so it is entitled to full input tax recovery on them.

60. HMRC argues that:

(1) the Set-up Costs are not recoverable at all because they relate solely to investment activities which do not constitute 'economic activity' within the meaning of the VAT rules; and

(2) the Operating Costs are recoverable but subject to apportionment to reflect that they relate partly to taxable supplies and partly to the non-economic investment activities.

61. In essence, a taxable person may deduct "input tax" (broadly, VAT on supplies to him of goods or services) from the "output tax" he charges on supplies made by him and account to HMRC only for the difference, to the extent the input tax relates to supplies to him used for the purpose of any business carried on by him and the supplies made by him are not exempt (sections 24 and 26 Value Added Tax Act 1994 (VATA 1994)).

62. Where a VAT group is formed, transactions between members of the group are ignored for VAT purposes and all supplies made to or by any member of the group are deemed to be made to and by a single taxable person, the representative member, who is responsible for completing and submitted a VAT return on behalf of the group (sections 43 to 43D VATA 1994).

63. For the VAT on goods or services supplied to a taxable person to be input tax (and so deductible from his output tax) they must be supplied for the purposes of a business carried on by him (section 24(1) VATA 1994).

64. In order for a business to be carried on there must be an economic activity. Whether it amounts to a business will turn on the facts of the case. The business must be carried on by the taxable person.

65. Where goods and services are used partly for the purposes of a business carried on and partly for non-business purposes, the tax arising on supplies to the taxable person may be apportioned between the two purposes so that only the part attributable to business purposes is deemed to be input tax and deductible (section 24(5) VATA 1994).

66. The VAT rules around holding companies' costs are the subject of a body of case law. It is established that the mere acquisition and holding of shares in other companies does not amount to a business activity (see *Polysar*) but the provision of management services to subsidiaries may do (see *Cibo*) if such services are provided for consideration.

67. The mere holding of shares does not constitute economic activity (*Polysar*).

68. The exploitation of tangible or intangible property for the purpose of obtaining an income therefrom on an ongoing basis is regarded as an economic activity (Article 9(1)).

69. The provision of management services for consideration to subsidiaries constitutes economic activity (*Cibo*).

70. The Appellant does not carry out either of the above activities directly itself.

71. The SPVs may be exploiting tangible property for the purpose of obtaining an income but their actions are not attributed to the Appellant as they are in a separate VAT group.

72. The LLP provides investment and administrative services to the Appellant as general partner of the Fund but these are disregarded for VAT purposes as intra-group supplies.

73. The LLP provides management services to HPH and the SPVs via an agreement with the Appellant, supplemented by tripartite DOAs between the LLP, the Appellant and each of HPH and the SPVs. Consideration is payable by the SPVs and HPH under the DOAs.

74. Supplies made by the LLP are deemed to be made by the Appellant as the representative member of the Group.

75. For the purposes of the VAT rules, due to the existence of the Group, the Appellant is engaged in an economic activity (the provision of management services to its subsidiaries) and makes taxable supplies in the form of these services.

76. Costs incurred by the Appellant, or deemed to be incurred by the Appellant as representative member of the Group, in the course of the furtherance of this business are therefore recoverable as input tax.

77. Are the costs in question incurred for the purpose of the business carried on by the Appellant? The economic activity in this case is the provision of management services for consideration. It does not seem to me that the Appellant carries out a separate investment business, distinct from its activities as active holding company for HPH and the SPVs; its activities (and that of the Fund on behalf of which it acts) are acting as holding company and it provides management services for consideration to all of its subsidiaries. The Set-up Costs are incurred for the purpose of subscribing for shares in or providing loans to HPH and the SPVs with the intention of providing the advisory services to them. On this basis, there appears to be a direct and immediate link between the Set-up Costs and the economic activity carried out.

78. It is accepted by HMRC that the Operating Costs are recoverable as input tax to the extent that they relate to the economic activity undertaken. Since the Tribunal has not found that separate economic and non-economic activities are undertaken here it must follow that these costs are recoverable in full.

CONCLUSION

79. For the reasons set out above, the Appellant's appeal is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

80. 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.

JUDGE RACHEL MAINWARING-TAYLOR
TRIBUNAL JUDGE

Release date: 30 December 2019