Neutral Citation: [2022] UKFTT 00422 (TC)

Case Number: TC08641

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing

Appeal reference: TC/2020/03516

VAT - to whom was the supply of the leases made? - contractual leases or commercial and economic reality - Airtours considered - Aldridge considered – appeal allowed

Heard on: 17 October 2022
Judgment date: 28 November 2022

Before

TRIBUNAL JUDGE ANNE SCOTT

Between

ASHTONS LEGAL (A PARTNERSHIP)

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Zizhen Yang, of Counsel, instructed by Tom Bailey of Ashtons Legal

For the Respondents: Fatouma Yusuf, litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. This is an appeal against HMRC's decision dated 20 March 2020 upheld on review on 28 August 2020 that input tax incurred in respect of two lease agreements entered into by an associated company was not recoverable.

2. With the consent of the parties, the hearing was conducted by video link using the Tribunal's video hearing system. A face-to-face hearing was not held because of the difficulty of ensuring the safety of all participants. The documents to which I was referred comprised a hearing Bundle consisting of 295 pages and an authorities Bundle extending to 247 pages. I had Skeleton Arguments for both parties. The witness statement from Edward O'Rourke was unchallenged. In the course of Submissions, in addition, Ms Yusuf referenced HMRC's guidance VTAXPER75000 which was not in the Bundle.

3. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

The facts

4. There is no real dispute about the facts.

5. The appellant is a firm of solicitors and is a trading partnership (the "Firm"). It has been registered for VAT since 1 October 2011. Historically, as the result of a merger, the Firm had three offices. For a number of years the Firm had been looking for alternative premises in order to consolidate their operations.

6. Eventually in 2017, Mr O'Rourke, the Chief Executive Officer ("CEO") of the Firm reported that suitable premises had been identified.

7. The minutes of the Management Board of the Firm dated 13 September 2017 record that the Firm had signed Heads of Terms for new premises although that was conditional on planning permission.

8. All negotiations in relation to the new leases were conducted by, and for, the Firm. The Firm's Management Board closely monitored the negotiations and regularly ratified their CEO's recommendations.

9. The CEO's report of December 2017 talked of "our" lease and it is beyond doubt that that meant the Firm.

10. The commercial relationship between the, putative and eventual, landlord ("the Landlord") and the Firm never involved Ashtons Legal Limited ("the Company"). The Company was introduced only latterly, as I explain below.

11. The Company was incorporated in March 2015 to protect the "Ashtons Legal" name. It has one director, Mr O'Rourke, as CEO of the Firm, and he holds the single £1 share on trust for the benefit of the Firm.

12. It is a dormant company, has never traded, held assets or held or operated a bank account. It has never had any employees. It is not disputed that it was, and is, a shell company acting as the Firm's nominee. In the relevant period its accounts make it explicit that it is a dormant company and that there are no transactions. There is no reference to the leases.

13. In early 2018 because, under the Law of Property Act 1925 ("the 1925 Act"), a partnership can enter into a lease in the name of no more than four partners, it was decided by the Firm that the leases should be in the name of the Company.

14. The Landlord had made it explicit, in an email dated 14 January 2018, that if they were to contract with a shell company with no assets then they would require a guarantee from the Firm.

15. It is clear from that email that the Landlord understood that the Firm would be in sole occupation of the premises and would meet all obligations of the Company in terms of the leases. Specifically the Firm would pay the rent.

16. On 1 and 16 May 2019, the Company entered into two leases of business premises. Four of the partners of the Firm were parties to the leases as the "Guarantors".

17. Clause 24.5 of the leases reads:-

> "The liability of each of the persons making up the Guarantor is joint and several. If any of the persons making up the Guarantor ceased to be a partner in Ashtons Legal (a Partnership) the Landlord shall release that person from his obligations under this deed provided that a replacement partner in Ashtons Legal (a Partnership) covenants with the landlord to observe and perform those obligations in place of the outgoing partner."

18. The Firm has at all times occupied both premises solely for the purpose of its business. The rental invoices raised by the Landlord were addressed to the Company but sent to the Firm marked for the attention of an employee of the Firm. The Firm processed and paid those invoices and reclaimed the VAT incurred through their VAT returns. The rent is shown in the Firm's accounts as a disbursement in every year.

19. There is no sublease in place between the Company and the Firm.

20. The Land Registry records that the Company holds the interest in the leased premises. Of course, however, the Registry does not record beneficial interests.

21. On 29 January 2020, the Firm's accountants ("Ensors") wrote to HMRC seeking a Non-Statutory Clearance in relation to the treatment of VAT incurred on the two leases. In summary, they argued that the supply of the lease was to the Firm and the Firm was entitled to reclaim VAT on the rental invoices. They relied on *Lester Aldridge v CCE* VAT Decision 18864 ("Aldridge").

22. Ensors pointed out that consideration had been given to whether the Company could have registered for VAT, opted to tax and entered into a sublease with the Firm but that would have given rise to exactly the same technical problem under the 1925 Act.

23. On 20 March 2020, HMRC responded stating that, on the information provided, there was a supply being made by the Landlord to the Company for the consideration payable under the leases and there was a further second supply made by the Company to the Firm for the same value. HMRC's view of the matter was that the supply to the appellant would be an exempt supply for VAT purposes as the Company had not opted to tax its interests in the properties.

24. On 28 August 2020 that decision was upheld in the review conclusion letter from HMRC.

25. The Firm appealed to the Tribunal on 23 September 2020.

26. In the interim, and solely as a protective measure, based on HMRC's express assurance that that would entitle the Firm to the input tax credit claimed, the Company registered for VAT and opted to tax with effect from 25 April 2020. When doing so HMRC were notified that neither the Company nor the Firm accepted HMRC's analysis and argue that there is only one supply of the leases and that is to the Firm by the Landlord.

The leases

27. In addition to Clause 24.5 of the leases to which I refer above, the following clauses are of interest:

(a) Clause 14 restricts use of the premises to "Permitted Use" which is defined at Clause 1.1 as "the use of the Premises for offices and storage".

(b) Clause 23 reads as follows:-

"23 Guarantee and indemnity

23.1 The Guarantor guarantees to the landlord that the Tenant shall pay the rents reserved by this lease and observe and perform the tenant covenants of this Lease and that if the Tenant fails to pay any of those rents or to observe or perform any of those tenant covenants, the Guarantor shall pay or observe and perform them.

23.2 The Guarantor covenants with the Landlord as a principal obligor and as a separate and independent obligation and liability from their obligations and liabilities under Clause 23.1 to indemnify and keep indemnified the landlord against any failure by the Tenant to pay any of the rents reserved by this lease or any failure to observe or perform of any of the Tenant covenants of this Lease."

(c) Clauses 24.1 and 24.2 provide that the Guarantor's liability under Clause 23 is to continue until termination of the leases and is not to be affected by any action of the Landlord *vis a vis* the Company.

(d) Clauses 24.3 and 24.4 provide that the Guarantor's liability will be released on the Firm's incorporation provided that as a result the value of the Company's assets exceeds a specified threshold.

(e) Clause 24.5 provides that if any of the individuals making up the Guarantor ceases to be a partner in the Firm they are released from their obligations under the leases provided that a replacement partner covenants with the landlord to assume the obligations of the outgoing partner.

(f) Paragraph 1.3 of Schedule 1, which provides for variations to the Superior Lease, incorporates into the Superior Lease, under which the landlord is the tenant, Clause 15.8 providing that the Company may share occupation of the premises with the Firm provided that that does not create a relationship of landlord and tenant.

The issue

28. It is common ground that the leased premises were occupied for the business purposes of the Firm and it made taxable supplies. Accordingly, the only issue for the Tribunal is whether the leases were supplied to the Firm by the Landlord.

Overview of HMRC's arguments

29. In essence, HMRC rely on the leases and the fact that the contracting parties were the Company and the Landlord.

30. The leases are supplied to the Company, which is a legal entity in its own right, for the consideration payable under the leases and a further supply is made by the Company to the Firm for the same value.

31. The supply to the Firm would be an exempt supply since the Company was not VAT registered and did not opt to tax. It was not a taxable person within the meaning of the legislation. Accordingly there would be no VAT for the Firm to recover.

32. The Firm did not receive taxable supplies of an interest in property but merely paid for them as the Guarantors. HMRC rely on *Kenwood Appliances Ltd* (VAT Decision 13876) ("Kenwood") for the proposition that guarantors do not receive supplies. Because the Firm paid the consideration as the Guarantors under the leases Paragraph 40, Schedule 10 Value Added Tax Act 1994 ("VATA") cannot apply as the Firm is not a beneficial owner of the leases.

33. HMRC do not accept that their guidance VAT 13440 (VAT Input Tax basics; leases to named individuals) can apply in this case since the Company is not an individual.

Overview of the Firm's arguments

34. It is trite law that the recipient of a supply is to be identified by reference to the commercial and economic reality of the arrangements having regard to all of the circumstances. Reliance is placed on *Airtours Holiday Transport Ltd v Revenue and Customs* [2016] UKSC 21 ("Airtours") at paragraphs 45 to 50 and the authorities cited therein as applied by the First-tier Tribunal ("FTT") in identifying the recipient of a supply in a tripartite situation in *Alternative Investment Strategies Ltd v HMRC* [2020] UKFTT 0019 (TC) ("AIS").

35. The facts and circumstances of this case closely mirror those in *Aldridge* and *Aldridge* was approved more recently in *NT Advisors Partnership v HMRC* [2017] UKFTT 625 ("NT") at paragraphs 148 to 150.

36. HMRC's reliance on "form over substance", that is to say looking at the contractual position only, is wrong.

VATA

37. The material provisions of sections 24 to 26 of VATA in relation to allowable input tax read:-

> "24 (1) Subject to the following provisions of this section 'input tax', in relation to a taxable person, means the following tax, that is to say –
>
> (a) VAT on the supply to him of any goods or services;
>
> …
>
> 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
>
> ….
>
> 25 (2) Subject to this section, [a taxable person] is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.
>
> 26 (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 […] 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;".

Airtours

38. The relevant paragraphs from *Airtours* read:

> "45. … As Lord Reed explained in *Revenue and Customs Comrs v Loyalty Management UK Ltd* [2013] STC 784, paras 66-67:
>
> > '66. [T]he speeches in *Redrow* should not be interpreted in a manner which would conflict with the principle, stated by the Court of Justice in the present case, that consideration of economic realities is a fundamental criterion for the application of VAT. … [T]he judgments in *Redrow* cannot have been intended to suggest otherwise. On the contrary, the emphasis placed upon the fact that the estate agents were instructed and paid by *Redrow*, and had no authority to go beyond Redrow's instructions, and upon the fact that the object of the scheme was to promote Redrow's sales, indicates that the House had the economic reality of the scheme clearly in mind. When, therefore, … Lord Millett asked, 'Did he obtain anything - anything at all - used or to be used for the purposes of his business in return for that payment?', [that question] should be understood as being concerned with a realistic appreciation of the transactions in question.
> >
> > 67. Reflecting the point just made, it is also necessary to bear in mind that consideration paid in respect of the provision of a supply of goods or services to a third party may sometimes constitute third party consideration for that supply, either in whole or in part. The speeches in *Redrow* should not be understood as excluding that possibility. Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded *a priori*. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation, the correct analysis is likely to be that the payment constitutes third party consideration for the supply.'
>
> 46. Lord Hope made the same point in para 110 in remarks which are perhaps particularly germane for present purposes:
>
> > 'I think that Lord Millett went too far [at p 418G] when he said that the question to be asked is whether the taxpayer obtained 'anything - anything at all' used or to be used for the purposes of his business in return for that payment. Payment for the mere discharge of an obligation owed to a third party will not, as he may be taken to have suggested, give rise to the right to claim a deduction. A case where the taxpayer pays for a service which consists of the supply of goods or services to a third party requires a more careful and sensitive analysis, having regard to the economic realities of the transaction when looked at as a whole.'
>
> 47. This approach appears to me to reflect the approach of the Supreme Court in the subsequent case of *WHA Ltd v Revenue and Customs Comrs* [2013] UKSC 24; [2013] STC 943 where at para 27, Lord Reed said that "[t]he contractual position is not conclusive of the taxable supplies being made as between the various participants in these arrangements, but it is the most useful starting point". He then went on in paras 30 to 38 to analyse the series of transactions, and in para 39, he explained that the tribunal had concluded that 'the reality is quite different' from that which the contractual documentation suggested. Effectively, Lord Reed agreed with this, and assessed the VAT consequences by reference to the reality. In other words, as I said in *Secret Hotels2 Ltd v Revenue and Customs Comrs* [2014] STC 937, para 35, when assessing the VAT

consequences of a particular contractual arrangement, the court should, at least normally, characterise the relationships by reference to the contracts and then consider whether that characterisation is vitiated by [any relevant] facts.

48. The same approach was adopted by the Court of Justice in *Revenue and Customs Comrs v Loyalty Management UK Ltd* and *Baxi Group Ltd* (Joined Cases C-53/09 and C-55/09) [2010] STC 265, paras 39 and 40, where they stated, citing previous judgments, that 'consideration of economic realities is a fundamental criterion for the application of the common system of VAT', and added that that issue involved consideration of 'the nature of the transactions carried out' in the Page 16 particular case. To much the same effect, in *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509, para 14, the Court of Justice said that 'a supply of services is effected 'for consideration' … only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance', which it explained as meaning 'the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient'. In the context of the supply of goods, the Court made the same point in *Primback Ltd v Customs and Excise Comrs* (Case C34/99) [2001] 1 WLR 1693, para 25, where it described "the determining factor" as "the existence of an agreement between the parties for reciprocal performance, the payment received by the one, being the real and effective counter-value for the goods furnished to the other".

49. In *Revenue and Customs Comrs v Newey* (Case C-653/11) [2013] STC 2432, para 40, the Court of Justice again emphasised that 'that a supply of services is effected 'for consideration', within the meaning of article 2(1) of [the Sixth] directive, and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient' In para 41, the court went on to explain that 'the supply of services is therefore objective in nature and applies without regard to the purpose or results of the transactions concerned and without its being necessary for the tax authorities to carry out inquiries to determine the intention of the taxable person'. The court then observed in paras 42-43 that 'consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT' and that 'the contractual position normally reflects the economic and commercial reality of the transactions'. An exception to the normal rule that the contractual relationship is central was then identified by the court as being where 'those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions' (para 45).

50. From these domestic and Court of Justice judgments, it appears clear that, where the person who pays the supplier is not entitled under the contractual documentation to receive any services from the supplier, then, unless the documentation does not reflect the economic reality, the payer has no right to reclaim by way of input tax the VAT in respect of the payment to the supplier."

NT

39. Obviously I am not bound by *NT* but the relevant paragraphs read:

"148. ...I agree with the appellant that *Aldridge* is clear authority that scotches any suggestion that the fact that it was 2009 LLP which instructed the barristers and it was to 2009 LLP that the invoices were (eventually) addressed makes any difference and prevents deductibility.

149. *Aldridge,* a decision of the Vat & Duties Tribunal, is not binding on me. But I follow it, as a decision of a sister, predecessor, Tribunal and of an experienced and knowledgeable chairman (Mr Edward Sadler) who was a Special Commissioner and who became a judge of both this and the Upper Tribunal because it is a decision which not only is not obviously wrong but is consistent in all respects with the decision of the Court of Appeal in *Midland Co-op* which obviously is binding on me.

150. *Aldridge* stresses the economic reality in a case where a firm of solicitors entered into a lease using a nominee company as the named party. HMRC prayed in aid paragraph 8 Schedule 10 VATA, which for some reason they referred to in their Statement of Case here, but it was not mentioned in Mr Purnell's skeleton. Mr Sadler showed that paragraph 8 was irrelevant in *Aldridge* as it is irrelevant to this case. As a matter of economic reality the appellant succeeded to 2009 LLP's business, its assets and its liabilities (apart from the excluded assets and liabilities which are not relevant here and which do not relate to the transferred business). **It is pedantry to point to the specific addressee of invoices as somehow denying deductibility to the appellant."** (emphasis added)

Discussion

40. Obviously, I agree with, and I am bound by Lord Clarke at paragraph 62 (vi) in *Airtours* where he says that payment is not decisive, so the mere fact that the Firm pays the rent does not necessarily mean that the supply for VAT purposes was made to the Firm. Lord Clarke pointed out that "substance and reality remain critical".

41. As in *Aldridge,* the contractual arrangements are tripartite with the Firm being central to the very existence and working of the leases. As can be seen from my Findings in Fact, it is clear that the leases were negotiated with a view to the Firm taking the leases and occupying the premises for the purposes of its business. The Company was only introduced late in the day, to avoid the technical issues with the 1925 Act, and only subject to the condition that four partners of the Firm were at all times the Guarantors.

42. I have no hesitation in finding that the facts in this case are very similar to those in *Aldridge.* As was the case in *Aldridge,* as the Tribunal pointed out at paragraph 29, when negotiating the terms of the leases the partners of the Firm were fully aware of the legal difficulties and they sought to deal with them with the full cooperation of the landlord. They used the device of the dormant company to take the grant of the leases, with special guarantee rights arranged, in effect, so that only the partners for the time being were liable to the landlord in ensuring compliance with the terms of the leases (see paragraphs 17 and 27 above).

43. Like in *Aldridge* (paragraph 32) I conclude that the leases and guarantees are specific to the parties in the sense that each party only entered into these contractual arrangements because of the "identity, role and relationship between the other parties".

44. Realistically only the Firm could give the covenants that were given. The Company could only enter into the leases because of those covenants due to its dormant status and lack of assets.

45. Ms Yusuf argued that the Firm had made the choice to insert the Company into the leases and therefore the Firm should shoulder the inevitable consequence which was that the VAT was not recoverable. In that context, HMRC made a bland and unsupported assertion in both their Amended Statement of Case and their Skeleton Argument that they referred or relied on "…the cases of *Amarasti Land Investments* C707/18 and *Lloyds Banking Group* TC/2016/02336 which had found that such a set of circumstances as in the Appellant's case would in fact create a chain of supply."

46. I agree with the Ms Yang that the former case is irrelevant as it deals with Article 28 of the Principal VAT Directive and has no application in relation to the facts of this case since the Company was not acting as an undisclosed agent and we are dealing with a supply of a lease which is a supply of goods and not services. The latter case was decided by considering the commercial and economic reality and does not support HMRC's reliance on the name of the tenant in the leases.

47. Ms Yusuf also argued that the Firm could, and should, have structured matters differently. HMRC argue that the Company could, and should, have registered for VAT, opted to tax and then supplied the leases to the Firm. Of course, as can be seen from paragraph 27(f) above, that is prohibited by the leases.

48. The Tribunal in *Aldridge* addressed that argument at paragraph 43 and I agree with the conclusion there reached that that is not an argument which relieves either HMRC or the Tribunal "from looking carefully at the true nature, for VAT purposes, of the transaction which the [Firm] for good commercial reasons did in fact enter into."

49. I am bound by *Airtours* and the quotation at paragraph 38 above which makes it absolutely clear that I must look objectively, without regard to the purpose or results of the leases, at the economic and commercial reality.

50. HMRC's argument that the Company should have made an onward supply to the Firm ignores the whole reason that the leases were constructed as they were. As the Tribunal pointed out in *Aldridge* at paragraph 36, that would give rise to exactly the same problems with the 1925 Act that the parties were seeking to avoid in the first instance.

51. I too think that that is too narrow an approach because HMRC have concentrated on what has been granted by the Landlord rather than on what has been received by the Firm. The issue is whether the Firm is entitled to recover input tax. It had a liability in terms of the leases to make the payments of rent if the Company did not; as everyone involved knew, as a dormant company with £1 share capital and no assets or trade, the Company was in no position to pay the rent. If the Firm wished the leases to continue it had to pay the rent. In return for that rent the Firm secured the premises from which it operated its business.

52. That is the economic and commercial reality. The Company was a mere cipher and inserted into the leases in these particular circumstances to deal with the 1925 Act. The reality is that, as I have said at paragraph 41 above the Firm was at the centre of these leases as the leases themselves make explicit.

53. I have added emphasis to the last sentence in paragraph 150 of *NT* because I agree with it. I am concerned with the economic and commercial reality and that is that the invoices were sent to the Firm, albeit addressed to the Company and the Landlord expected that the Firm would pay them and the firm did so.

54. Whilst I understand why HMRC's starting point was the contracts and therefore the leases, I cannot agree that the Firm is, as Ms Yusuf put it, "just a guarantor". The terms of the lease make it clear that it was a great deal more than that. *Kenwood* does not assist HMRC. It is based on completely different facts and more pertinently it makes it explicit at paragraph 59 that the "basic principle" is that it is the "recipient of the supply who obtains the credit". I agree with that statement.

55. It was referred to in *AIS* at paragraph 40 and I agree with the analysis in *American Express Services Europe Ltd v Revenue and Customs Commissioners* [2019] UKFTT 548 (TCC) (Judge Sinfield and Mrs Janet Wilkins), at paragraph 88:-

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

For the reasons that I have set out I have no hesitation in finding that the Firm used, enjoyed and benefitted from the rental of the premises and had a vested interest in the supply of those premises for which it was paying.

Decision

56. Viewing the arrangements entered into by the Firm in their entirety, the Firm can rightly be regarded as receiving for VAT purposes a taxable supply of goods by virtue of the leases for which it made payment, and the goods so supplied were used for the purposes of the business carried on by the firm. The VAT charged on the rent was therefore input tax of the firm and recoverable as such.

57. The appeal is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

58. 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.

ANNE SCOTT
TRIBUNAL JUDGE

Release date: 28th NOVEMBER 2022

Amended pursuant to Rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (as amended) on 23rd November 2022.