



**TC01319**

**Appeal number: TC/2010/05584**

*VALUE ADDED TAX — bed and breakfast carried on from farmhouse by one appellant, and a farming business carried on by that appellant, her husband and son in partnership — direction to treat appellants as a single taxable person — VATA 1994 Sch 1 paras 1A, 2 – s 84(7) —whether direction reasonably made — no— appeal allowed*

**FIRST-TIER TRIBUNAL**

**TAX**

**A, D AND J FORSTER**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL: Judge Aleksander (Chairman)  
Mike Bell ACA CTA**

**Sitting in public at 45 Bedford Square, London WC1 on 10 June 2011**

**Glyn Edwards of Wolters Kluwer (UK) Ltd for the Appellants**

**Lynne Ratnett of the Appeals Unit, HM Revenue and Customs for the Respondents**

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## DECISION

1. The Appellants appeal against a decision of HM Revenue and Customs to make a direction dated 18 January 2010 under paragraph 1A, Schedule 1, Value Added Tax Act 1994 that two businesses should be jointly registered for VAT.

2. Mr Andrew Forster (“Mr Forster”) and Mrs Daniele Forster (“Mrs Forster”) are husband and wife, and live at the farmhouse at Parsonage Farm. Mr John Forster (“John”) is their son, and lives at a house in the village. The two businesses are (i) Mrs Forster’s sole proprietorship which trades as a bed and breakfast from the farmhouse (“the B&B”); and (ii) a farming partnership in which all three appellants are partners.

3. The Appellants were represented by Mr Glyn Edwards of Wolters Kluwer (UK) Ltd, and HMRC were represented by Lynn Ratnett of their Appeals Unit. In addition to witness statements of Mr and Mrs Forster and Mr Derek Taylor (the HMRC officer who made the direction) being produced, they each gave oral evidence. We also had before us an agreed bundle of documents.

### **The law**

4. The legislation governing the giving of directions is contained in Schedule 1, VAT Act 1994. The provisions relevant to this appeal are as follows:

1A(1) Paragraph 2 below is for the purpose of preventing the maintenance or creation of any artificial separation of business activities carried on by two or more persons from resulting in an avoidance of VAT.

(2) In determining for the purposes of sub-paragraph (1) above whether any separation of business activities is artificial, regard shall be had to the extent to which the different persons carrying on those activities are closely bound to one another by financial, economic and organisational links.

2(1) Without prejudice to paragraph 1 above, if the Commissioners make a direction under this paragraph, the persons named in the direction shall be treated as a single taxable person carrying on the activities of a business described in the direction and that taxable person shall be liable to be registered under this Schedule with effect from the date of the direction or, if the direction so provides, from such later date as may be specified therein.

(2) The Commissioners shall not make a direction under this paragraph naming any person unless they are satisfied—

- (a) that he is making or has made taxable supplies; and
- (b) that the activities in the course of which he makes or made those taxable supplies form only part of certain activities, the other activities being carried on concurrently or previously (or both) by one or more other persons; and

(c) that, if all the taxable supplies the business described in the direction were taken into account, a person carrying on that business would at the time of the direction be liable to be registered by virtue of paragraph 1 above;

5 [...]

5. This appeal is made under section 83(1)(u) VAT Act 1994. The Tribunal's jurisdiction is limited by section 84(7) as follows:

10 (7) Where there is an appeal against a decision to make such a direction as is mentioned in section 83(1)(u), the tribunal shall not allow the appeal unless it considers that HMRC could not reasonably have been satisfied that there were grounds for making the direction

15 6. Accordingly, we can only allow the appeal if we are satisfied that Mr Taylor, acting as a representative of HMRC, could not reasonably have concluded that it was appropriate to make a direction; it is not sufficient that we might ourselves, considering the matter at large, have reached a different conclusion (see *Associated Provincial Picture Houses v Wednesbury Corporation* [1947] 1 KB 223).

### **Background Facts**

7. The background facts were not in dispute and we find them to be as follows:

20 8. Parsonage Farm has been owned by the Forster family since 1936. The farm comprises 150 hectares and is wholly arable. It was originally owned and run by Mr Forster's father, but is currently a partnership between Mr and Mrs Forster and John. Mrs Forster takes no active part in the farming business and is a "sleeping partner". Mr Forster is over seventy and has largely retired from an active role in the farming business – which is now principally carried on by John. The farming partnership is registered for VAT, and the farming business has been VAT registered since the  
25 inception of VAT in 1973.

30 9. Mr and Mrs Forster moved into the farmhouse in 1971. Mrs Forster started the B&B in 1975 as she wanted to earn some money working from home independently from the farm – and at that time her parents-in-law were the main partners in the farm. The B&B has always traded below the VAT registration threshold, and has never been VAT registered. The annual turnover of the B&B for the last five or six years has been approximately £6000 to £8000. The farming partnership and the B&B maintain separate books of account. Mrs Forster has her own bank account, which she uses for the B&B business. The B&B covers the costs of window cleaning,  
35 laundry, and maintenance of the AGA. The B&B pays for soft furnishings, carpets, pillows, blankets, mattresses etc. The B&B used to engage and pay for a cleaner, but she has recently retired and will not be replaced, and Mrs Forster will undertake the cleaning herself. The B&B also pays for a gardener who works in the spring and summer for approximately three hours each week. Neither Mr Forster nor John are  
40 involved in running the B&B, and if Mrs Forster is ill or goes on holiday, then the B&B closes. Mrs Forster pays the costs of her accountant and the costs of advertising the B&B.

10. The farmhouse is on two floors. On the first floor are four bedrooms (one of which has an en-suite bathroom) and a “family” bathroom. One of the bedrooms is used by Mr and Mrs Forster, and the other three are used for the B&B. When they are not in use for the B&B, the bedrooms are used by Mr and Mrs Forster’s personal guests (such as their grandchildren). On the ground floor is a dining room (which is used by the B&B to serve breakfasts – when not in use for the B&B, it is used privately by Mr and Mrs Forster), a sitting room (used privately), a kitchen/conservatory (used privately as well as for preparing breakfasts for the B&B), a sewing room (used privately) and a “summer” room (used privately). There are also a back kitchen and pantry. In the immediate grounds of the farmhouse are an annex and the “Finn” cabin. The annex includes a garage, two bedrooms and an upstairs room used for storage of farm records and for Mr Forster’s hobbies. Although the two bedrooms in the annex have been used in the past by the B&B to supplement the bedrooms in the farmhouse, they are no longer so used. The Finn cabin has a desk and is used for farm business (although the management of the farm is now largely carried on from John’s house in the village). The Finn cabin is also used to store fishing tackle.

11. The farmhouse forms part of the farming partnership’s assets. An adjustment is made in the books of the farming partnership for the private use of the farmhouse. 85% of the costs of electricity, heating oil, water, general rates and insurance are adjusted as private use in the accounts and charged to Mr Forster’s current account in the partnership books. 25% of telephone costs are similarly adjusted.

12. On 25 June 2009 Mr Taylor telephoned Mr Forster to arrange a visit to Parsonage Farm as part of HMRC’s “Rural diversification project”. The visit took place on 24 August 2009. Mr Taylor met both Mr and Mrs Forster on that day and reviewed the books of the farming partnership and the B&B. The meeting took place in the Finn cabin – Mr Taylor did not inspect the farmhouse. Mr Taylor spoke to John by phone on 3 September 2009, when John confirmed that he had no involvement in the B&B.

13. Following his visit to Parsonage Farm, Mr Taylor considered that there were sufficient financial, economic and organisational links between the farm and the B&B to justify issuing a notice of direction. Notices of direction were issued to the Appellants by HMRC on 18 January 2010, and the combined registration took effect from 18 February 2010.

#### **HMRC’s reasons for making a direction**

14. HMRC content that the activities at Parsonage Farm are farming and the provision of bed and breakfast accommodation, and that these are closely bound by financial, economic and organisational links:

- (1) The farm pays for electricity used by the farm and the B&B
- (2) The farm pays for domestic fuel used by the farm and the B&B
- (3) The farm pays the rates bill

(4) The single telephone line used by the farm and the B&B is paid for by the farm

(5) The farm pays for the insurance

5 (6) There are no cross-charges between the two businesses for rent or a share of utility or other bills

(7) The B&B operates from the farmhouse using three bedrooms as guest accommodation

10 (8) The farmhouse kitchen is shared by the farm and the B&B which is used to cook and serve breakfasts for the guests. It is also used for the domestic use of the appellants

(9) The B&B operation is too small to be viable without use of the farmhouse. The B&B does not have premises of its own and is dependent on the use of the farmhouse. If it had to rent a farmhouse in its own right, then the business would not be viable.

15 (10) Advertising on the internet for the B&B show the name “Parsonage Farm Bed and Breakfast”. The accommodation binds itself to the farm and depends upon the farm for its appeal.

20 15. In summary, HMRC contend that the farm and the B&B are not sufficiently at arm’s length from each other, and that they do not have a normal commercial relationship with each other – and that the reality is that there is one business – being the business of farming activities *and* the bed and breakfast.

16. Ms Ratnett cited a number of cases in support of HMRC’s position.

25 17. *Smith (trading as “The Salmon Tail”)* (1999) VAT Tribunal Decision 16190 concerned a husband and wife partnership which carried on a pub business. Food was served at the pub, and in addition bedrooms above the pub were let. The Appellants’ contention was that the food and accommodation operations were a separate business run by Mrs Smith. Customs raised a VAT assessment on the basis that the food and accommodation was part of the pub partnership. The Tribunal upheld the assessment. Important factors taken into account by the Tribunal in considering whether there was  
30 one business or two were: the fact that the premises were rented by the partnership, utility and insurance bills were paid by the partnership, yet Mrs Smith did not make any payment to the partnership for her use of the premises. As there was no arrangement in place between the partnership and Mrs Smith to separate the catering and accommodation activities from the rest of the activities of the public house, as a  
35 matter of general English partnership law, they were part of the partnership, and the assessment was justified.

40 18. *Trippitt* (2001) VAT Tribunal Decision 17340 also related to a public house. The lease of the pub was taken by Mr Trippitt, and he ran the pub together with the ancillary catering activities. Mrs Trippitt ran a bed and breakfast business using the accommodation above the pub. Mr Trippitt rented the premises and paid the utility and insurance costs. However, in contrast to *Smith*, there was an oral agreement between Mr and Mrs Trippitt, and Mrs Trippitt contributed 35% of her income from

the bed and breakfast business to Mr Trippitt as payment for the use of the premises and her share of the overheads. Mrs Trippitt engaged her own staff to service the bed and breakfast business, and the bed and breakfast had a separate entrance from the pub. Although the bed and breakfast utilised the pub's kitchen and lounge for breakfast service, this was before the pub opened, and there was no time when the two businesses share the kitchen and lounge at the same time. Customs issued a direction requiring the two businesses to register as a single business on the basis that they were closely bound by financial, economic and organisational links. The Tribunal allowed the appeal against the direction, holding that the factors in favour of the Appellants' contention that the businesses were not closely bound, more than outweighed the factors which favoured Customs' contention. The Tribunal took particular note of the fact that the 35% contribution from bed and breakfast was a realistic and commercial and arm's length contribution, that the two businesses were run separately with separate bank accounts and with separate accounting records, and that the two businesses had separate staff.

19. *Hundsdoerfer* (1990) VAT Tribunal Decision 5450 concerned a bed and breakfast business conducted on a farm. Mr Hundsdoerfer was the tenant of the farm and carried on a farming business. Mrs Hundsdoerfer carried on a bed and breakfast business using a converted cattle shed. She paid rent to Mr Hundsdoerfer for the use of the premises. Customs issued a direction requiring the two businesses to register as a single business on the basis that they were closely bound by financial, economic and organisational links. The Tribunal allowed the appeal against the direction, taking into account (amongst other things) the arrangements for the payment of rent were an arm's length arrangement.

20. In her submissions, Ms Ratnett placed great emphasis on the fact that the B&B business made no contribution to the farming partnership towards overheads. Unlike the circumstances in both *Trippitt* and *Hundsdoerfer*, but like *Smith*, there was no contribution by the B&B to the "other" business. This demonstrated, in Ms Ratnett's view, the close links between the two businesses. Indeed in giving evidence, Mr Taylor told us that the absence of cross-charges for the use of premises and utilities was a strong indication in his view that there was not an arm's length relationship between the two businesses.

### **Submissions by the Appellants**

21. The Appellants' submissions fell into two categories. The first was that paragraph 1A(1) of Schedule 1 had to be read in priority to paragraph 1A(2). In other words before considering whether persons are closely bound to one another by "financial, economic and organisational links", you first had to consider whether the businesses carried on by those persons were "artificially separated". If the businesses were not "artificially separated", then there was no need to consider whether there were any financial, economic or organisational links, and no notice of direction could be issued.

22. We disagree. Paragraph 1A(2) states that "in determining ... whether any separation of business activities is artificial, regard shall be had to the extent to which

the different persons ... are closely bound to one another by financial, economic and organisational links.” Thus it is clear from the drafting that in reaching any decision as to whether businesses have been artificially separated, HMRC must take into account any financial, economic or organisational links. However we would note that the mere fact that there may be financial, economic or organisational links between two persons is not of itself sufficient to allow for a notice of direction to be issued. HMRC must have determined that there is an artificial separation of the businesses having taken due regard of the various links.

23. The Appellants other submissions were that the B&B and the farm were two separate businesses operating at arm’s length.

24. During the course of cross-examination, Mr Taylor was referred to his visit notes which listed fourteen factors which he considered when reaching his decision to make a direction (these are also summarised in HMRC’s Statement of Case). Mr Edwards asked Mr Taylor to review each of these factors and state whether they weighed in favour or against the giving of a direction. Mr Taylor’s responses were as follows:

	<b>Factor</b>	<b>Weight given by Mr Taylor</b>
i	B&B run from farmhouse by Mrs Forster with 3 bedrooms as guest rooms	In favour of direction – premises used both for farm and B&B
ii	Mrs Forster has own records, bank account, and annual accounts, and considers the B&B to be her own separate business which she has operated since the 1970s	Against direction
iii	Mrs Forster takes bookings, cooks the breakfasts, and cleans the rooms herself with the help of a part-time cleaner that is paid for by the B&B	Against direction
iv	In the case of absence or illness, bookings are cancelled	Against direction
v	Mr Forster plays no part in the B&B	Against direction
vi	The current turnover of the B&B business is about £8000 which Mrs Forster does not intend to expand as she is 67 yrs old	Neutral
vii	There has been no DEFRA grant	Neutral
viii	The only refurbishment costs have been a new carpet which was bought by the B&B	Against direction
ix	The kitchen is shared for domestic use and for cooking and serving breakfasts	In favour of direction- because of shared use

	for the guests	of kitchen
x	Direct costs of B&B such as furnishings, part-time cleaner, food and cleaning materials are all paid for by the B&B	Against direction
xi	Mrs Forster is responsible for any profits or losses of the B&B and declares the income on her own tax return	Against direction
xii	The farm pays for rates, domestic fuel, electricity, insurance and phone	In favour of direction
xiii	There are no cross-charges from the farm to the B&B for rent or a share of the utility bills	In favour of direction
xiv	John has nothing to do with the B&B which he understands is run by his mother	Neutral

25. Mr Edwards noted that of these fourteen factors, the overwhelming majority were either neutral or weighed in favour of the B&B being treated as a separate business.

26. The only factors weighing in favour of a direction were that the B&B shared the use of the farmhouse, and that there was no cross-charge for the use of the shared facilities or the utilities. There was no evidence that the farmhouse was used by the farming business – indeed the evidence was that the farm was now run from John’s home and the Finn cabin. An adjustment was made in the books of the farming partnership for the private use of the farmhouse by Mr and Mrs Forster. 85% of the costs of electricity, heating oil, water, general rates and insurance are adjusted as private use in the farm’s books and charged to Mr Forster’s current account in the partnership books. 25% of telephone costs are similarly adjusted. Ms Ratnett commented that the adjustment had been charged to Mr Forster and not Mrs Forster – but Mr Edwards submitted that the point was that Mrs Forster made use of “private” expenditure – and whether it was recharged to her or to Mr Forster was irrelevant. By analogy, if Mrs Edwards had set up a B&B in Mr Edwards’ home, and Mr Edwards paid for the utilities and did not recharge the cost to Mrs Edwards, that was a private matter between the spouses. The key issue in this case was that the costs associated with the private use of the farmhouse by Mr and Mrs Forster (including Mrs Forster’s B&B) were not carried by the farming partnership as they were recharged to Mr Forster’s current account in the partnership books.

### Conclusions

27. We determine unanimously that HMRC could not have been reasonably satisfied that there was an artificial separation of the farming and B&B businesses, having regard to the extent to which Mrs Forster and the farming partnership were closely bound to each other by financial, economic and organisational links.



28. In reaching this decision we note that HMRC did not take into consideration the fact that the B&B business had been started by Mrs Forster in the 1975, when her parents-in-law were the main partners in the farm. The B&B had been started by Mrs Forster independently of the farming business for entirely legitimate and understandable reasons.

29. We note that Mrs Forster runs the business herself separately from the farm, with her own bank account and books of account. She meets the direct costs of the business herself. If for any reason she is not available (for example because of illness or holidays), the business closes.

30. We also note that the B&B is carried on from the farmhouse, which is no longer used by the farming partnership for its farming business, and the partnership recharges Mr Forster for the private use of the farmhouse by Mr and Mrs Forster (including the B&B) through the partnership books.

31. We therefore conclude that the B&B is not closely bound to the farming business by financial, economic or organisational links.

32. We also note that Mr Taylor did not seek to inspect the farmhouse premises where the B&B business was conducted.

33. We are satisfied that Mr Taylor, acting as a representative of HMRC, could not reasonably have concluded that it was appropriate to make a direction. We therefore allow the appeal, and the direction of 18 January 2010 has no effect.

34. 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.

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**NICHOLAS ALEKSANDER**  
**TRIBUNAL JUDGE**  
**RELEASE DATE: 13 July 2011**

35 Cases referred to in argument but not mentioned in the decision:

*Burrell v CCE* [1997] STC 1413  
*Allen* (1995) VAT Tribunal Decision 12,209

40 Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 19 July 2011.