[2011] UKFTT 706 (TC)

TC01543

Appeal number TC/2009/09731

Appeal against assessment made by HMRC applying the Capital Goods Scheme in respect of and excess of VAT input tax recovered – appeal allowed – Appellant made some exempt supplies and should have applied the standard method override but is now out of time to do so

FIRST-TIER TRIBUNAL

TAX

TURBINE MOTOR WORKS LTD **Appellant**

- and -

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

TRIBUNAL: S.M.G.RADFORD (TRIBUNAL JUDGE)
M.J.BELL

Sitting in public at 45 Bedford Square, London WC1 on 23-25 August 2011

Ms P Whipple QC for the Appellant instructed by Chantrey Vellacott DFK

Mr M Angiolini, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. HMRC assessed the Appellant for input tax over-recovered. The amount of the assessment which was dated 13 November 2008 was £232,750 plus interest of £17,310.

2. This assessment was made in connection with the disposal of a property during October 2006, which was treated by the Appellant as an exempt supply for VAT purposes. The disputed assessment applied the Capital Goods Scheme ("CGS") to adjust the input tax deduction which according to HMRC became necessary due to the change in circumstances from the time when the initial deduction of that input tax was made.

3. The Appellant appealed against the assessment.

4. Messrs Gunyon and Vaughan gave evidence for the Appellant.

Background and facts

5. The Appellant is a company whose business comprises the repair of aircraft engines. It has been registered for VAT since 1 April 2003 under VAT Registration Number 824 3690 26 and its business is wholly taxable (most of its supplies being aircraft repairs which are zero-rated pursuant to Schedule 8, Group 8 of the Value Added Tax Act 1994 ("VATA")).

6. Other companies within its corporate group provide related aircraft maintenance and repair services. Turbine Component Works Ltd ("TCW"), repairs aircraft engine components and is fully taxable, under a separate VAT registration; and Total Accessory Maintenance Repair and Overhaul Ltd ("TAMRO") repairs aircraft accessories and is fully taxable, under a separate VAT registration. Also in the corporate group is Kruses Properties Ltd ("KPL"), a property holding company.

7. In 2001/02 Tom Vaughan, the chief executive and majority shareholder of the Kruses Group of Companies, started to develop plans to establish several aeronautical repair and service facilities in the UK. The plan was to establish three separate companies to provide aircraft engine repair and overhaul; aircraft engine component piece part repair and overhaul; and aircraft engine and airframe accessories repair and overhaul. These companies would each need their own hangar.

8. The Appellant was set up in 2002 to provide the first of these services, that is aircraft engine repair and overhaul.

9. A search commenced for a suitable site for this business venture, and existing hangars at Upwood in Cambridgeshire ("the property") were identified. This was a large site owned by Strawson Holdings Ltd. It consisted of four very large aircraft hangars, each the size of some two football fields, together with a number of Nissan huts and other outbuildings, plus a former airfield.

10. The Appellant through Tom Vaughan entered discussions with Huntingdonshire District Council to ensure that planning permission would be available to allow the site to be developed and used in the manner intended. In particular, Tom Vaughan wrote to Huntingdon DC on 17 November 2003 setting out the business plan in overview, which was that the Appellant would operate its business from Hangar 1 and that other businesses in the corporate group would operate from Hangars 2 and 3, with Hangar 4 being used as a warehouse to support all three businesses.

11. Negotiations with Strawson Holdings Ltd continued. Although the agreement was reached in principle in November 2003, with the Appellant going into occupation with the benefit of a rent free licence to occupy from February 2004, the sale of the 999 lease formally completed on 1 June 2004 for £1.9 million together with VAT of £332,500. The Appellant only became aware very late in the day that the vendor intended to charge VAT on the sale price and so the Appellant had to arrange a loan to cover the VAT.

12. On 6 July 2004, Steve Gunyon, the then financial controller for the Appellant, telephoned HMRC asking how the VAT charged on the sale was to be recovered. The answer given is recorded as being that the VAT could be reclaimed on the company's VAT return as normal "as long as he submits an OTT (option to tax) on the property".

13. The Appellant however did not make any option to tax but nonetheless recovered the input tax in full on its next VAT return for VAT period 06/04.

14. In June 2004, TAMRO was formed. Its personnel and equipment were housed on the property, initially within Hangar 1, moving to temporary accommodation outside Hangar 3, and then in March 2007 to Hangar 3 which had by then been refurbished.

15. Further to discussions with the bank in June 2005 on 1 November 2005 a presentation was made to the bank to discuss a bank loan to finance the refurbishments to the hangars. A copy of the presentation was produced to the Tribunal which included a timeline of the plans for the property.

16. On 12 July 2005, Mr H W Smith of HMRC visited the Appellant. By this time, despite the recorded entry against the Appellant's registration, there was no OTT in place, and TAMRO was already in occupation of parts of the property. It appears that Mr Smith did not query the position.

17. In January 2006, work began on assembling TCW. Staff was recruited and business assets and equipment located in Hangar 2. TCW was formed in May 2006. TCW moved into temporary accommodation outside Hangar 2 in September 2006, moving back into Hangar 2 which had been refurbished in February 2007.

18. The Appellant charged each of TAMRO and TCW a commercial rent. In part because there were commercial disadvantages in maintaining the whole of the property on the Appellant's balance sheet, the property was transferred to KPL on 6 October 2006. KPL was formed in June 2006.

19. Mr Gunyon gave evidence to the effect that the plan was always to have separate companies. This was why the property with its four hangars was so attractive as TAMRO and TCW could act as owners of their own hangars with autonomous management teams, have their own VAT registration and be independent.

20. He confirmed that he had not understood HMRC's reference to an OTT.

21. On cross-examination Mr Gunyon confirmed that the plan always was to expand and form companies which would deal in accessories and components as these would make more money.

22. Also on cross-examination Mr Gunyon confirmed that it was always the intention to have a property holding company to keep the companies together. Rent could not be charged until the companies had the necessary CAA and FAA approvals which were obtained in 2007. Until then work done by TAMRO was charged by the Appellant.

23. Mr Gunyon stated that there would have been no point in buying four hangars if the intention was not to have different activities operated by different companies operating each of the hangars.

24. Mr Vaughan confirmed that in 2004 there was a clear intent to let out hangars to sister companies. It was always inevitable that as a result of this it would be necessary to form a property company to hold the properties. He stated that to have the impact of all of the properties (hangars) on the Appellant's balance sheet and profit and loss account was unrealistic and so it was always known that they would have to be transferred to avoid distorting the Appellant's financial position.

25. In June 2005 business research on TAMRO and TCW had advanced. The likely costs of refurbishing Hangars 2 and 3 were higher than anticipated. This would cause further stress on the Appellant's balance sheet and so it was decided that it was necessary to form the property holding company as soon as possible.

26. Mr Vaughan stated that as a result of the transfer to KPL it was possible to revalue the property and obtain a bank loan to cover the major refurbishment costs of Hangars 2 and 3.

27. On cross-examination Mr Vaughan confirmed that the timing of the formation of KPL was keyed to the financial planning. It was necessary to have one vehicle in place to manage the bank loan.

28. Mr Vaughan confirmed that he had bought the heavy equipment and transferred it as a loan to the companies.

29. The rent charged on the hangars was a typical industry rate of £2.50 per square foot plus council tax and electricity charged quarterly. Hangar 4 costs were divided into three between the companies and charged accordingly.

30. The issue in dispute was first identified in a visit to the Appellant's premises by HMRC Officer Ian Arnott on 8 October 2008. On this visit it was identified that the company's accounts recorded a disposal of an asset on 6 October 2006, namely a leasehold interest in the property. Mr Arnott noted that the property had been transferred to KPL. No VAT was charged on this transfer and for accounting purposes the Appellant had treated the disposal as an exempt supply. Officer Arnott advised the Appellant that the asset fell within the CGS and its terms applied such that a disposal adjustment needed to be made.

31. Following the visit, on 13 October 2008 Officer Arnott wrote to the Appellant confirming his advice that an adjustment should have been made given that the Appellant had treated the disposal as an exempt supply and the value of the sale came within the scope of the CGS. Officer Arnott advised of his intention to raise an assessment for £232,750, this based on his assumption that the disposal had taken place between 1 April 2006 and 31 March 2007.

32. On 24 October 2008 Officer Arnott confirmed that the £232,750 assessment would be made. He explained that the calculation had been made because property consisting of the land and buildings at the former RAF Upwood was acquired by the Appellant on 1 June 2004. Input tax of £332,500 was recovered in the VAT return for the VAT period 06/04. On transfer of the property no VAT was charged as no election to waive exemption had been made, so the disposal was exempt from VAT. Since this was the case and the value of the asset exceeded £250,001.01 the CGS was applicable and the initial recovery of input tax had to be reviewed in accordance with the provisions of the CGS.

33. The assessment was issued on 13 November 2008. The Appellant appealed by Notice of Appeal dated 31 March 2009, asserting that “there had been no change from the originally intended use of the hangars in question. The original deduction was wrong but this should not be corrected using the CGS”.

34. On 13 November 2008, the Appellant's representatives Chantrey Vellacott DFK wrote to Officer Arnott noting that it had concerns over the equity of the assessment, stating that "(t)he assessment you propose to issue would not have arisen had our client decided to establish a VAT group or opted to tax the property. Consequently it is reasonable to assume that the VAT system did not intend for the tax to stick with TMW. If it has then it is because of a simple error”.

The Legislation

35. Schedule 4 paragraph 5 of VATA states:

> Where by or under the directions of a person carrying on a business goods held or used for the purposes of the business are put to any private use or are used, or made available to any person for use, for any purpose other than a purpose of the business, whether or not for a consideration, that is a supply of services.

36. Schedule 4 paragraph 9 of VATA states:

(1) Subject to sub-paragraphs (2) and (3) below, paragraphs 5 to 8 above have effect in relation to land forming part of the assets of, or held or used for the purposes of, a business as if it were goods forming part of the assets of, or held or used for the purposes of, a business.

(2) In the application of those paragraphs by virtue of sub-paragraph (1) above, references to transfer, disposition or sale shall have effect as references to the grant or assignment of any interest in, right over or licence to occupy the land concerned.

37. Paragraph 7 (1)(b) of Schedule 6 of VATA states:

> Where there is a supply of services by virtue of—
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> (b) paragraph 5(3) of Schedule 4 (but otherwise than for a consideration),
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> the value of the supply shall be taken to be the full cost to the taxable person of providing the services except where paragraph 10 below applies.

38. Part XIV of the VAT Regulations 1995 deals with input tax and partial exemption.

39. Regulation 99(4) provides that:

> A taxable person who incurs exempt input tax during any tax year shall have applied to him a longer period which shall correspond with that tax year unless he did not incur exempt input tax during his immediately preceding tax year or registration period, in which case his longer period shall—
>
> (a) begin on the first day of the first prescribed accounting period in which he incurs exempt input tax, and
>
> (b) end on the last day of that tax year,
>
> except where he incurs exempt input tax only in the last prescribed accounting period of his tax year, in which case no longer period shall be applied to him in respect of that tax year.

40. Regulation 107 B provides:

> (1) Other than where input tax falls to be attributed under regulation 101(8) or regulation 107(1)(b) or (c) this regulation applies where a taxable person has made an attribution under Regulation 107(1)(a) or (d) according to the method specified in regulation 101 and that attribution differs substantially from one which represents the extent to which the goods or services are used by him or are to be used by him, or a successor of his, in making taxable supplies.
>
> (2) Where this regulation applies the taxable person shall—
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> (a) calculate the difference, and
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> (b) in addition to any amount required to be included under regulation 107(1)(g) , account for the amount so calculated on the return for the first prescribed accounting period next following the longer period or the return for the last prescribed accounting period in the longer period if applicable, except where the Commissioners allow another return to be used for this purpose.
>
> (3) But where a registered person has his registration cancelled at or before the end of a longer period, he shall account for any adjustment under this regulation on his final return.

41. Regulation 107C provides:

> For the purposes of regulations 107A and 107B, a difference is substantial if it exceeds—

(a) 150,000: or

(b) 50% of the amount of input tax falling to be apportioned under regulation 101(2)(d) within the prescribed accounting period referred to in regulation 107A(1), or longer period, as the case may be, but is not less than £125,000.

42. Regulation 107D provides:

For the purposes of regulations 107A and 107B a person is the successor of another if he is a person to whom that other person has—

(a) transferred assets of his business by a transfer of that business, or part of it, as a going concern; and

(b) the transfer of the assets is one falling by virtue of an Order under section 5(3) of the Act to be treated as neither a supply of goods nor a supply of services;
and the reference in this regulation to a person's successor includes references to the successors of his successors through any number of transfers

43. Regulation 107E provides:

(1) Regulations 107A and 107B shall not apply where the amount of input tax falling to be apportioned under regulation 101(2)(d) within the prescribed accounting period referred to in regulation 107A(I), or longer period, as the case may be, does not exceed—

(a) in the case of a person who is a group undertaking in relation to one or more other undertakings (other than undertakings which are treated under sections 43A to 43C of the Act as members of the same group as the person), £25,000 per annum, adjusted in proportion for a period that is not 12 months; or

(b) in the case of any other person, £50,000 per annum, adjusted in proportion for a period that is not 12 months.

(2) For the purposes of paragraph (1) above, "undertaking" and "group undertaking" have the same meaning as in [section 116] of the Companies Act 2006.

44. Part XV of the Regulations deal with adjustments to the deduction of input tax on capital items.

45. Regulation 112 deals with the interpretation of Part XV and states:

(2) Any reference in this Part to a capital item shall be construed as a reference to a capital item to which this Part applies by virtue of regulation 113, being an item which a person "(hereinafter referred to as "the owner') uses in the course or furtherance of a business carried on by him, and for the purpose of that business, otherwise than solely for the purpose of selling the item.

46. Regulation 113 defines the capital items which qualify for the CGS:

The capital items to which this Part applies are items of any of the following descriptions--

(b) land, a building or part of a building or a civil engineering work or part of a civil engineering work where the value of the interest therein supplied to the owner, by way of a taxable supply which is not a zero-rated supply, is not less than £250,000 excluding so

much of that value as may consist of rent, [(including charges reserved as rent) which is neither payable nor paid more than 12 months in advance nor invoiced for a period in excess of 12 months.

47. Regulation 114 deals with the period of adjustment and provides:

(1)The proportion (if any) of the total input tax on a capital item which may be deducted under Part XIV shall be subject to adjustments in accordance with the provisions of this Part.

(2) Adjustments shall be made over a period determined in accordance with the following paragraphs of this regulation

(3) The period of adjustment relating to a capital item of a description falling within-- .

(c) any other description shall consist of 10 successive intervals, determined in accordance with [paragraphs (4) to (5B) and 7 (2) below

48. Regulation 115 deals with the method of adjustment and provides:

(1) Where in a subsequent interval applicable to a capital item, the extent to which it is used in making taxable supplies increases from the extent to which it was so used [or to be used at the time that the original entitlement to deduction of the input tax was determined], the owner may deduct for that subsequent interval an amount calculated as follows—

(b) where the capital item falls within regulation 114(3)(c)—

(2)Where in a subsequent interval applicable to a capital item, the extent to which it is used in making taxable supplies decreases from the extent to which it was so used [or to be used at the time that the original entitlement to deduction of the input tax was determined] the owner shall pay to the Commissioners for that subsequent interval an amount calculated in the manner described in paragraph (1) above.

(3) Where the whole of the owner's interest in a capital item is supplied by him, or the owner is deemed or, but for the fact that the VAT on the deemed supply (whether by virtue of its value or because iris zero-rated or exempt) would have been not more than [the sum specified in paragraph B('1) of Schedule 4 to the Act] , would have been deemed to supply a capital item [pursuant to that paragraph] " during an interval other than the last interval applicable to the capita; item, then if the supply (or deemed supply) of the capital item is—

(a) a taxable supply, the owner shall be treated as using the capital item for each of the remaining complete intervals applicable to it wholly in making taxable supplies or

(b) an exempt supply, the owner shall be treated as not using the capital item for any of the remaining complete intervals applicable to it in making any taxable supplies.

and the owner shall/, except where paragraph (3A) below applies calculate for each of the remaining complete intervals applicable to it, in accordance with paragraph (1) or (2) above, as the case may require, such amount as he may deduct or such amount as he shall be liable to pay to the Commissioners, provided that the aggregate of the amounts that he may deduct in relation to a capital item pursuant to this paragraph shall not exceed the output tax chargeable by him on the supply of that capital item.

(5) For the purposes of this regulation—

"the original entitlement to deduction" means the entitlement to deduction determined in accordance with Part XIV of these Regulations;

"the total input tax on the capital item" means, in relation to a capital item falling within—

(a) regulation 113(a) or (b), the VAT charged on the supply to, or on the importation or acquisition by, the owner of the capital item, other than VAT charged on rent [(including charges reserved as rent) which is neither payable nor paid more than 12 months in advance nor invoiced for a period in excess of 12 months (if any),

...and shall include, in relation to any capital item, any VAT treated as input tax under regulation 111 which relates to the capital item, other than such VAT charged on rent (if any); and for the purposes of this paragraph reference to the owner shall be construed as references to the person who incurred the total input tax on the capital item;

"the adjustment percentage" means the difference (if any) between the extent, expressed as a percentage, to which the capital item [was used or to be used for the making of taxable supplies at the time the original entitlement to deduction of the input tax was determined], and the extent to which it is so used or is treated under paragraph (3) above as being so used in the subsequent interval in question.

(7) Subject to paragraph 8 below a taxable person claiming any amount or amounts, or liable to pay any amount or amounts, pursuant to paragraph (3) above, shall include such amount or amounts in a return for the second prescribed accounting period next following the interval in which the supply (or deemed supply) in question takes place except where the Commissioners allow another return to be used for this purpose.

49. In the decision in the case of *HJ Banks & Company Ltd* TC 00347 at paragraphs 39 and 40 the Tribunal stated:

"39. Regulation 107B enacts the standard method override which was introduced by HMRC in exercise its powers under section 26 of the VAT Act 1994 to counter avoidance schemes based on the standard method and to deal with situations where the result of the method is clearly unreasonable. Under regulation 107B a provisional attribution of input tax to taxable supplies for a long period under regulation 107 (1)(a) shall be adjusted if the attribution differs substantially from one which represents the extent to which the goods or services are used in the making of taxable supplies. Regulation 107 defines the threshold of £50,000 or 50% of the input tax for a substantial difference.

40. The above analysis of the legislation dealing with the right to deduct demonstrates that its overriding purpose is to ensure that the right to deduction is confined to input tax attributable to taxable supplies. In domestic legislation this purpose is achieved by detailed regulations enacted under section 26(3) of the VAT 1994 which requires the regulations to secure a fair and reasonable attribution of input tax to taxable supplies. The regulations achieve this by identifying a method for attributing input tax to taxable supplies including the apportionment of residual input tax between taxable and exempt supplies and by requiring the taxpayer to carry out the attributions every quarter followed by an annual adjustment. The de minimus limits in regulation 106 come into play after the calculation of the deductible input tax in accordance with the standard method has been completed for each period. Regulation 106 applies to relevant input tax. Regulation 106(3) defines

relevant input tax as input tax attributed to exempt supplies which can only be known at the end of the calculation arising from the standard method."

HMRC's Submissions

50. Mr Angiolini submitted that in order to resolve this appeal, the Tribunal would have to decide whether the property came within the definition of capital goods for the purpose of the CGS. If so, what was the use or intended use by the Appellant of the property? In particular, did the Appellant have a firm and specific intention to make exempt supplies of the property to companies within the same corporate group? If so to what extent did the exempt sale by the Appellant to KPL in 2006 amount to a change in the use or intended use of the site?

51. Mr Angiolini contended that the property clearly fell under the definition of capital goods pursuant to Regulation 113 of the VAT Regulations 1995.

52. He contended that the use to which the Appellant put the property up until the sale of the same to KPL was fully taxable and always intended to be so. Insofar as other companies within the corporate group occupied parts of the property the Appellant had provided no contemporaneous evidence that such occupation would be pursuant to an exempt leasing of those parts of the property nor had it provided any evidence that those other companies actually paid any rent prior to the sale of the property to KPL. In those circumstances the only use of the property between its purchase in 2004 and its sale in 2006 was a taxable one.

53. Mr Angiolini submitted that if the Tribunal were to accept that the Appellant intended and did in fact make any such exempt rental supplies to TCW and TAMRO, contrary to HMRC's contention, this would not invalidate the assessment altogether but might require a reworking of its calculations.

54. The Appellant had contended that the initial deduction of input tax should have been adjusted downwards under the standard method override ("SMO"), that in fact it was not and that it was too late to correct that error by the time that officers of HMRC investigated the matter. For an SMO adjustment to be calculated a fixed timetable of uses would be needed. This would mean knowing when TAMRO and TCW would be formed and would start to pay exempt rentals for exclusive occupation of their hangars. For instance if it were known in April 2004 that TAMRO would occupy Hangar 2 from July of 2006 then the exempt use of that area from that point onward could be reflected in the initial attribution.

55. Mr Angiolini contended that no leasing or letting agreement had been disclosed by the Appellants in relation to the use of Hangars 2 and 3 by TCW and TAMRO and that no disclosure had been provided to show that any rent was actually charged (or indeed intended to be charged) by the Appellant to those companies for use of the hangars.

56. In particular he contended that it would appear from the evidence provided that TAMRO did not, in fact have any exclusive use of any part of the property until after

the sale to KPL was effected, an essential element of any exempt supply of land. Mr Angiolini referred to the case of Case C 275/01 *Sinclair Collis*. He said that the same reasoning applied to TCW, with no evidence having been provided that they had any exclusive right of occupation prior to the sale to KPL or that any rent was actually charged to them before that sale. In those circumstances, the burden of proof being on the Appellant, it would appear that no exempt supplies were made prior to the sale of the property.

57. In the light of those facts HMRC asked the Tribunal to find as a fact that until an exempt sale of the property was made by the Appellant to KPL there was no exempt supply of land or no intention to make any exempt supplies to either TCW or TAMRO and that, therefore, the only use or intended use was a fully taxable use by the Appellant.

58. Even if TCW and/or TAMRO were allowed to use some parts of the property, no evidence had been put forward to show that such use was pursuant to any payment made to the Appellant, so that no VAT supply would arise. The evidence did not support a fixed plan of occupation of the site known when the site was acquired. At its highest, evidence at the point of acquisition could only be said to support that TAMRO and TCW would be started in due course, if business levels justified this. This was insufficient to justify or quantify a SMO.

59. Mr Angiolini submitted that the most that could be said was that the Appellant had an expectation to form TCW and TAMRO at some point in the future but that, at the time of the purchase it was not clear that those companies must be formed, as this depended on the performance of the business, or that exempt supplies would be made to those companies by the Appellant.

60. He submitted that at the time that the property was purchased it was uncertain if or when it would be transferred and indeed at that time there was no clear intention to do so.

61. He submitted that in those circumstances, it was therefore clear that the initial use of the property by the Appellant was fully taxable and that the initial deduction was correct, subject to possible adjustments under the CGS, which led to the disputed assessment by HMRC. In particular a SMO adjustment was neither due nor calculable.

62. The Appellant had provided no contemporaneous evidence to show that the use it made of the property prior to its exempt sale was anything other than taxable use. In that respect, the fact that the Appellant may not have physically used some of hangars at the start of its business was entirely irrelevant.

63. A change of use is a use different to that expected at acquisition and reflected in the initial attribution of the input tax on the capital item. The Appellant had contended that the initial attribution should have been set under the SMO and based on what was known when the site was acquired.

64. There cannot be any doubt that an adjustment would need to be made under the CGS to take account of such change of use or intended use. It therefore followed that the assessment was properly made, in the light of such an exempt supply of the whole site which had never been intended at the time of purchase.

65. Even if the Appellant were correct in their contentions that the initial full recovery of VAT was erroneous due to an intention to make exempt supplies of leasing or letting of part of the property to other group companies (which HMRC deny), that would not negate the need for an adjustment to be made when a fully exempt supply of the property was made in 2006. If the Tribunal were to accept the Appellant's contention at its highest, this could not lead to the appeal being allowed but would, at most, lead to the assessment having to be re-worked on the basis of the Tribunal's findings of fact, particularly over what the full intended use of the site was when it was acquired. Such reworking of figures would (in HMRC's view) be easily achieved between the parties without recourse to the Tribunal.

Appellant's Submissions

66. Miss Whipple submitted that it was common ground that the property was a capital item in the hands of the Appellant and when transferred to KPL in 2006.

67. The Appellant over-deducted input tax on its purchase of the property in 2004. It should not have deducted 100% of the input tax incurred on the transfer of the property to it, given that there was no OTT or VAT group in place and the intention always was to let out parts of the site to other group companies.

68. Miss Whipple submitted that the issue in the case was whether the capital goods scheme was the correct mechanism by which to adjust what was undoubtedly an over deduction of input tax in 06/04. The Appellant claimed it was not, and that the over-deduction in 2004 was a straightforward error which was now and was by the time it was recognised in 2008 too late to correct.

69. Miss Whipple submitted that Part XV of the 1995 Regulations contained provisions for adjustment to the deduction of input tax on capital items. Adjustments under the capital goods scheme were to be made "in accordance with the provisions of this Part" (Regulation 114(2)). She submitted that in other words this was a complete code and adjustment could only be made under the CGS if provided for in these regulations and not otherwise.

70. She submitted that HMRC relied on Regulation 115(2), which provided for adjustment "where in a subsequent interval applicable to a capital item, the extent to which it is used in making taxable supplies decreases from the extent to which it was so used or to be used at the time that the original entitlement to deduction of the input tax was determined."

71. She submitted that as was clear from the evidence and the summary of facts outlined above, the actual use to which the site had been put was precisely what was always intended, namely use by the Appellant and other companies in the corporate group for their separate businesses. In the absence of an option to tax or a VAT

group, that use (namely the supply of property on a lease or by way of letting) was by default exempt.

72. Miss Whipple submitted that it was quite clear that the Appellant never had any "intention" to opt to tax. Neither Mr Gunyon nor Mr Vaughan understood what an OTT was, and the matter was never discussed or determined. HMRC's own policy confirmed that in the absence of an option or some very clear documentary evidence that the taxpayer intended to opt to tax, the taxpayer could not assert any intention to make taxable supplies for VAT purposes.

73. The Appellant did not opt to tax which was an unfortunate fact. There was no documentary evidence at all let alone any clear documentary evidence that it intended to. It plainly did not and so the Tribunal should find.

74. It followed that for tax purposes, the Appellant's intention was at all times to make exempt supplies of the property to other companies in its group. That intention was present in 2004 at the time of purchase (and deduction of the input tax), and was borne out by the subsequent actions by the Appellant in letting its sister companies into occupation. There was no change of intention at all. There was no decrease in the extent of actual or intended taxable supplies.

75. Miss Whipple agreed that the Appellant could have made an OTT or structured its affairs differently. It was an unfortunate fact that they did not do so, and it was agreed that that could not affect the technical position although it did have a bearing on the merits of HMRC's case overall.

76. The provisions for adjustment under the CGS are matters of law, not policy. The initial attribution by the Appellant did not reflect its intention to make exempt supplies to its sister companies and was incorrect.

77. Miss Whipple agreed with HMRC that SMO should have applied and that it was an error not to make an adjustment in that way. She agreed with HMRC that this should have occurred in period 06/05 and that HMRC are now precluded from raising an assessment to correct this error because of the capping provisions.

78. The SMO would have been due by the end of June 2005 because on any view the Appellant intended an exempt use of the property. Miss Whipple contended that HMRC's suggestion that a definite timeline was needed for the SMO would derail the legislation. Instead it was necessary to arrive at a reasonable estimate.

79. She submitted that the SMO could be adjusted over time if the assumptions under the CGS were wrong and she referred to paragraphs 39 and 40 of the *HJ Banks* case. She contended that the CGS dealt with different issues. It was there to deal with situations during which the use to which big ticket items were put was radically different to the intended use. In this matter the CGS did not apply because what took place was no different to what was decided in 2005.

80. From the outset of the operations in 2004 it was inevitable that a sale to a property holding company would be made and by June 2005 the intention was fixed

and discussed with the bank. The repayment of the input tax was made on the 28 June 2004. 31 March 2005 was the end of the 04/05 VAT year. As a result of Regulation 99(4) of the VAT Regulations 1995 this would be a longer period and Regulation 107 meant that an annual adjustment was required.

81. The VAT return for period 06/05 was due on 30 June 2005 and Regulation 107B applied.

82. She submitted that the issue was not whether the Appellant intended to make an "exempt sale" or even whether the Appellant had a "fixed intention to make an exempt sale several years after purchase", as HMRC had asserted, but rather whether the Appellant had an intention in 2004 to make exempt supplies of any sort whether by the sale of the property or by leasing or letting it.

83. She submitted that the Appellant's intention was always to make exempt supplies. She said that was clear from the fact that there was no OTT, and there was no clear documentary evidence to indicate an intention to opt (applying HMRC's own published policy). The witness statements had put the position beyond doubt. There was at no time any intention to make taxable supplies of the property.

84. Miss Whipple agreed that the CGS operated to account for actual changes in use, or intended use. Her point however was that there had been no change in the actual or intended use of this property. The Appellant had done with the property precisely what it had always intended.

85. She submitted the assessment was misguided. The CGS did not apply. The Appellant should have restricted the initial deduction, and it was an error not to have applied the SMO. That error was not capable of correction under the CGS.

86. She submitted that HMRC's case was predicated on one fact: that taxable use was intended from the outset, in relation to the whole site, so that the original attribution of the input tax was correct. But, she submitted, that predicate was incorrect. There was no intention to make taxable use of the whole site. The original attribution was incorrect and required correction but HMRC was out of time to do that.

87. She contended that the fact that TAMRO did not pay any rent until the CAA and FAA approvals were obtained did not negate the fact that there was an exempt supply. Schedule 4 paragraph 5(4) of VATA provided that where goods were made available to a person for use whether or not for a consideration, that was a supply of services. Paragraph 9(1) of the Schedule provided that paragraph 5 should have effect in relation to land as if it were goods forming part of the assets of a business and paragraph 9(2) provided that a licence to occupy land was included. Schedule 6 paragraph 7(1)(b) provides that this is a supply at full cost.

88. TAMRO and TCW had an exclusive right of occupation. There were concrete lean-tos to Hangar 1 and there was exclusive storage in Hangar 3 plus the right to storage in Hangar 4. This was a supply of leasing or letting and the right to occupy areas as owner with the right to exclude others. This was as in the *Sinclair Collis* case.

The right to store goods in Hangar 4 formed part of the leasing of Hangar 3 and so was not a separate taxable supply.

89. Miss Whipple asked that costs be awarded to the Appellant if successful. Rule 29 of the Value Added Tax Tribunals Rules 1986 should apply as the case is a transitional one which commenced under these rules.

Findings

90. We found Messrs Gunyon and Vaughan to be truthful and found the evidence which they gave credible.

91. We found that they were both completely ignorant of the VAT implications when the vendor decided at the last minute to charge VAT. We found that the Appellant had accepted that it had inadvertently in error over-deducted input tax on its purchase of the property. We found however that the way to correct this should have been by way of an SMO and that by the time this was discovered in 2008 it was too late to do so.

92. We found that despite HMRC's contention to the contrary there was a fixed plan of occupation of the property known at the time the property was acquired.

93. We found that at no time did the Appellant intend a different use for the hangars than what occurred.

94. We found that unless there was a fixed intention at the time the property was bought to split the businesses so that they were independent, there would have been no point in buying a property with four very large hangars.

95. We accepted that it was inevitable that a property holding company was formed to hold the property as the intention was always to transfer the property to a property holding company, revalue the property and raise a loan in order to finance the refurbishment. The documents produced for the bank were evidence of this.

96. We found that the Appellant made exempt rental supplies to TCW and TAMRO. We accepted that the fact that TAMRO and TCW did not pay any rent until the necessary approvals were obtained did not negate the fact that there was an exempt supply of leasing or letting.

97. We found that a supply occurred despite HMRC's contention that a supply could only occur if payment was made. Schedule 4 paragraph 5(4) of VATA provides that where goods are made available to a person for use whether or not for consideration that is a supply of services (see paragraph 87 above).

98. TAMRO and TCW had an exclusive right of occupation. There were concrete lean-tos and exclusive storage plus the right to storage in Hangar 4. This was a supply of leasing or letting with the right to occupy areas as owner with the right to exclude others. We accept that the right to store goods in Hangar 4 formed part of the leasing of the hangars and so was not a separate taxable supply.

Decision

99. The appeal is allowed.

Costs

100. Miss Whipple has made an application that costs be awarded to the Appellant if successful. Accordingly it is hereby directed that HMRC shall pay the costs of the Appellant of and incidental to and consequent upon this appeal on the standard basis to be determined on detailed assessment by a costs judge.

101.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.

TRIBUNAL JUDGE
RELEASE DATE: 3 November 2011