



TC01789

Appeal number: TC/2010/07126

Value Added Tax – deductibility of input tax – stabilisation works to Harewood Castle – whether directly attributable to taxable supplies or residual – appeal allowed.

FIRST-TIER TRIBUNAL

TAX

THE HAREWOOD ESTATE

Appellant

- and -

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

Respondents

**TRIBUNAL: LADY MITTING (TRIBUNAL JUDGE)
SUSAN STOTT (MEMBER)**

Sitting in public in Manchester on 11 January 2012.

Nigel Gibbon for the Appellant

Richard Mansell, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The Harewood Estate (“the Estate”) appeals against the Review Decision of the Commissioners notified by letter dated 27 January 2010 that the input tax incurred in a project to stabilise Harewood Castle (“the Castle”) should be regarded as residual and subject to partial exemption apportionment.

2. We heard oral evidence on behalf of the Estate from Mr Christopher Ussher, the Estate’s resident agent, and Mr Richard Fuller, a chartered accountant in independent private practice who advised the Estate and acted in the capacity of its financial controller. The Commissioners called no oral evidence.

The Estate and the Project

3. The Estate is owned in his personal capacity by Lord Harewood who at the relevant time was Viscount Lascelles, his father being the then Earl. Throughout this Decision, all references to Lord Harewood refer to the current Earl. Lord Harewood is registered for VAT as a sole trader and he runs the Estate as a profit making business. Harewood House Trust (“the Trust”) is a separate legal entity being a charitable trust and comprising Harewood House, its gardens and grounds. The Estate generates income from a number of diverse activities utilising the Estate’s resources. Its principal income streams include:

- Rental income from commercial and business units created out of a conversion of redundant farm buildings.
- Rental income from residential properties, let in the main we understand to Estate workers.
- Farming.
- Revenue from films and TV companies.
- Hosting a varied and diverse number of events including concerts, game fairs, a stage of the RAC Rally and a Girl Guide jamboree.

The VAT liability of these income streams is that all are taxable with the exception of the residential rents which are exempt. Responsible for masterminding and co-ordinating all the Estate activities and for ensuring that its potential is maximised is Mr Ussher, Lord Harewood’s resident agent.

4. On the Estate stands Harewood Castle, a Grade I listed building and a scheduled ancient monument, built in 1366 as a fortified manor house and last occupied just before the Civil War. The Castle is visually atmospheric and romantic and has been the subject over the years of a number of paintings including one by Turner. The derelict state of the Castle had been a matter of concern to a number of people for many years. Mr Ussher recalled his father, the then Earl’s land agent from the 1960s to the 1980s discussing their own concerns about the safety of the Castle. Lord Harewood and Mr Ussher were equally concerned but the Estate quite simply did not have the necessary funding to carry out the structural work to make it safe. English

Heritage had their own concerns about the building and in 2001 placed it on the Buildings at Risk Register. English Heritage were however unable to enforce repairs due to the Castle's status as a scheduled ancient monument. Not only was the Castle dangerous in itself but its poor state of repair had been the direct cause of the Estate losing a film contract for the remaking of Robin Hood because the Castle had been a necessary set but was too dangerous to be used. There was in effect a stalemate. Everyone wanted to be able to carry out the restoration work but no-one could afford it. The breakthrough came at the end of the 1990s when what is now Yorkshire Television sought to move and create its entire set for Emmerdale Farm on to the Estate. The original agreement with Yorkshire Television was for ten years from 1997 to 2007 with a five year break clause. From 2007 to 2010, negotiations were ongoing for the renewal of the agreement with no guarantee that terms could be agreed and therefore no certainty as to the continued income from it. Agreement was however then reached for a renewal of the contract and in 2010 a twenty year agreement with a ten year break was signed. In the manner described below, the signing of the lucrative Emmerdale contract in 1997 opened the way for a release of funding to enable works on the Castle to be carried out.

5. An agreement under Section 106 of the Town and Country Planning Act 1990 required that the Estate should deposit monies with the Local Authority as part of the process of granting planning permission for the Emmerdale Village site. The monies were then to be used for such purposes as the planning authorities deemed or agreed to be necessary to enhance or improve the surrounding environment. In this case it was agreed by all parties that the monies were to be used to fund the Castle works. With the ability of the Estate through its section 106 fund to put in a substantial sum towards the works, English Heritage agreed to match the Estate's contribution. Estimated costs were fractionally under £1 million to which English Heritage contributed half with the remaining half coming from the section 106 fund. The English Heritage grant was subject to a number of conditions, principally, for the purposes of the issue before us, that the Castle should be opened to access by members of the public for a minimum of sixty days per year, although the manner of that access was a matter for the Estate. The purpose of the work was to create from an unsafe ruin a safe ruin. There was never any intent to carry out a wholesale restoration but to conserve and stabilise the surviving structure. Work on this stabilisation project got off the ground in approximately 2002 and lasted some years as it was a meticulous and painstaking and highly specialised task. There was a hiatus in the completion of the project during the 2007-10 negotiations with Yorkshire Television because of the uncertainty that they created over the continuation of funding. With the signing of the new agreement in 2010 came completion of the works on the ruin itself and importantly the access to the site. The opening up of the Castle is to be launched in Spring 2012 to coincide with the annual opening by the Trust of Harewood House.

The VAT Position

6. As the works progressed, quarter by quarter the Estate sought to recover the input tax on the cost of the project, it being the view of the Estate that the tax was wholly recoverable. The dispute between the parties as to the recoverability of the input tax arose on a routine visit to the Estate by Officer David Adams on 1 March 2006. Mr

Adams did not give evidence but we did have his visit report in front of us. Mr Gibbon pointed out that the report would not have been made up contemporaneously, suggesting therefore a question mark over the accuracy of what had been written. We do not know when it was compiled but we have no reason to doubt that it accurately recorded Mr Adams' notes and his understanding of what he was told at the time. His interview had been with Mr Fullerton and covered a number of topics including the tax treatment of the Castle project. The relevant part of Mr Adams' note reads as follows:

“b) Substantial costs incurred in connection with the restoration of Harewood Castle. Again there appears to be no business activity here. Mr Fullerton thought it might be the intention to rent it to Harewood House Trust who run Harewood House stately home and gardens. In which case as there is no Option to Tax in place this would be an exempt supply and all related I/t would be non deductible. Mr Fullerton thought that the I/t had been agreed with Customs. No record in the EF Documents section downloaded to my laptop. Mr Fullerton to research the matter prior to my return visit in two weeks. On my return visit I was informed that when the grants to restore the castle were obtained one of the main conditions was that the castle would be made available to the general public. The logical way to do this was for it to be done through Harewood House Trust Ltd as part of their commercial activities. The intention has always therefore been to rent the castle to HHTL and prior to making any rent charge to put an Option to Tax in place. This is to be done in the near future. Requested sight of evidence to show that at the time input tax was reclaimed there was in place an intention to make taxable supplies, i.e. tax advisers advice, business plan, etc. “

An option to tax the Castle site was applied for on 24 March 2006 and granted with effect from 23 March 2006. A further visit took place on 17 July 2007 when Officer Katherine Chapman visited the Castle itself and again met with Mr Fullerton. Her note records.

“Mr Fullerton advised that admission to the general public was not the intention (and given the access difficulties it's not hard to see why). Instead the Castle would be open for accompanied tours to special interest groups (local history, academic etc) and would be available for this purpose for 60 days a year (this is a condition of the English Heritage grant funding). Mr Fullerton advised that 'narrow advertising' would take place to attract such visitors.

There would be no such thing as a formal rent between my trader and the Trust but there will be some form of commercial relationship. This has been described as a 'facility fee' for things like parking, staff time etc. and will be charged in both directions. Details to be confirmed by letter.

The other prospective business use was hiring the Castle out as a filming location. Details to be confirmed by letter.”

7. Throughout the period from the first visit to the final review decision, there took place protracted correspondence between the parties which we were taken through by Mr Gibbon and Mr Mansell. It is not necessary to record it at length here but certain

themes are detectable. It is clear that in the light of what Mr Adams understood to be the position regarding the use to which the Castle was to be put, the Commissioners had doubts over a number of issues: Was there any business purpose? Having concluded that there was, did the cultural exemption apply if the Castle was to be rented out to the Trust? Repeated requests were made for evidence as to intended use including for example a business plan. Although information and documentation were at stages provided to the Commissioners, they never received sufficient evidence to be able to be satisfied that the Estate should be entitled to recover its input tax in full. The Commissioners' final position was set out in the following terms in their review letter of 27 January 2010 and this became the principal argument put forward by Mr Mansell before the Tribunal.

“The conclusion is that costs involved in this case are by way of running the business as a whole rather than just the project alone. Therefore the VAT incurred on this project should be treated as residual income tax and it will therefore be necessary to apportion the input tax in the same proportion as the input tax already claimed on your client's Returns for the periods involved”.

Oral Evidence

8. Mr Ussher's evidence focused on the intended use of the Castle once the work had been completed. As far as Mr Ussher was concerned, every Estate asset has to be considered in the light of what it can produce for the Estate. There had never been any intention that the Castle would not be used to generate income once the works had been carried out although when running any large estate commercially, the income streams vary and evolve. It was this concept of evolution that made the preparation of a cogent business plan back in 2002 unrealistic and unhelpful. There were a number of core income generating activities which Mr Ussher and Lord Harewood had always had in mind for the Castle from the very beginning. It had always been the intention of the Estate to allow paying public access although how that access would be managed was not to be resolved for a number of years. Equally, it had always been intended that, once safe, the Castle could and would be used for film shoots and the production of plays. It was Lord Harewood's intention that DVDs should be produced of the Castle. These activities were always present in the minds of Lord Harewood and Mr Ussher, but as Mr Ussher pointed out, for as long as the Castle was enveloped in scaffolding it could not properly be marketed. Once that scaffolding was removed then the Estate could begin to market its potential much more actively. Further opportunities for its use were evidenced by correspondence put before the Tribunal. A letter dated 20 October 2011 from the York Archaeological Trust suggested a dig. A letter dated 16 November 2011 from the Senior Locations Manager for Emmerdale sought permission to use the Castle in an up and coming storyline and also asked if its details as a location could be passed on to the planners of other programmes. The potential uses were many and varied and evolving but, said Mr Ussher, all would be charged for and nothing would be free. Much thought was given to how the public access could be administered because this was not something within the expertise of the Estate. The favoured idea was that the Trust with their depth of expertise would take on the day to day management of the public access and how this could work and its costings were evidenced by a letter from Jennifer Auty, the Trust's Head of Learning dated 21 October 2011. Mr Ussher

was adamant that there had never been any intention of renting the Castle out to the Trust. Mr Ussher pointed out that this could never happen because every other activity which the Estate had planned would thereby be frustrated if the Estate had surrendered its interest to the Trust. The Trust was merely to be the conduit through which visitor access was to be handled.

9. Mr Fullerton also repeated in his evidence that there was never any intention to rent the Castle out to the Trust. The Trust's involvement would merely be one of administration. He denied that he had ever told Officer Adams that the Estate intended to rent out the Castle and said that Mr Adams' recorded note was inaccurate.

10 **Documentary Evidence**

10. In addition to the correspondence between the parties the Estate put into evidence a draft news release dated 6 November 2001, an undated newsletter and an extract from the Yorkshire Post dated 30 July 2005. Although marked draft, we have no reason to believe the final version of the news release differed from the draft. The news release quotes Mr Ussher as saying:

“We are delighted to receive confirmation of this substantial grant to what we consider to be a historical project that will be of great interest to a wide number of people. We are now fine tuning a strategic plan to ensure the money is spent to best effect over the next three years. We are committed to a tasteful renovation, avoiding turnstiles and all the usual trappings of tourist attractions. However, the scheme is also considering various interpretive packages that will allow the site to be seen and approached by a wider audience, through personal visits and via the internet.”

11. Although undated, the newsletter would appear to date from 2001/2002 as it begins by saying “you will, I am sure, have seen that scaffolding has appeared around the Castle....” This must date it to the very beginning of the structural works. The newsletter describes the objective of the works as being to “consolidate the structure and preserve it as is, keeping it as the magical ruin you come upon in the woods”. It goes on to say:

“The final objective is to facilitate access to the Castle once the work has been completed. How this access will be operated on a day to day basis has yet to be finally agreed between the Estate and English Heritage. Once agreed, however, it is likely that Harewood House Trust will take on the day to day management of the access and also offer extensive interpretation of the Castle and its immediate surroundings, both on and off site, through computer graphics and virtual reality. This is, indeed, something to look forward to in the not too distant future.”

The extract from the Yorkshire Post concludes again with a quote from Mr Ussher:

“We hope that we will not only be able to take people to the Castle, but offer ‘off-site’ access and interpretation through the use of computer technology as well. Our access plans will hopefully be published towards the end of the year.”

The Law

12. Sec. 26 (1) and (2) VAT Act 1994 entitles a taxable person to credit for so much of his input tax as is allowable by regulation as being attributable to taxable supplies made or to be made by the taxable person in the course of furtherance of his business.

5 13. Regulation 101 (1) VAT Regulations 1995 provides that the amount of input tax which a taxable person shall be entitled to deduct shall be the amount which is attributable to taxable supplies in accordance with the Regulation.

14. Regulation 101(2) (b) provides that there shall be attributable to taxable supplies the whole of the input tax on such supplies as are used or to be used by him
10 exclusively in making taxable supplies.

15. Regulation 101(2) (c) provides that no part of the input tax on such goods or services as are used or to be used by him exclusively in making exempt supplies shall be attributable to taxable supplies.

16. Regulation 101(2) (d) goes on to provide that there shall be an attribution to
15 taxable supplies such proportion of the residual input tax as the value of his taxable supplies bears to the value of all his supplies.

Submissions

17. By the time the case reached hearing, the Commissioners had accepted that the
20 Castle was a business asset and that the VAT incurred on the cost of the stabilization project was input tax and therefore deductible by the Estate. The Commissioners however contended that the costs of the work were attributable to the business purposes of the Estate as a whole and should therefore be treated as residual and apportioned in accordance with the standard partial exemption method used by the Estate. By contrast it was the contention of the Estate that the costs were incurred in
25 relation solely and exclusively to the Castle and the taxable supplies to be made from it and the input tax and was therefore wholly deductible. This was the nub of the issue before the Tribunal and the approach to be taken by the Tribunal was agreed by both parties, namely, that we should look at the intention of the Estate in carrying out the project at the time when it was being carried out. We now set out in rather more
30 detail the contentions of each party.

18. Mr Gibbon, for the Estate, put his argument that the input tax recoverable in its entirety in two alternative ways. His primary submission was that it had always been the intention of the Estate to make taxable supplies using the Castle and that there was a direct and immediate link between the works done and that intention. Whilst
35 accepting that it had not been possible to date to make any taxable supplies, that was not relevant as the intention had always been there and it was sufficient that there should be a direct and immediate link to intended supplies. In the alternative, if the Tribunal were to find that it had not been the intention of the Estate to make taxable supplies from the Castle but the Castle was merely a part of the Estate, an Estate run
40 for business purposes, then one had to carry out a Section 101 attribution before looking at the pot. If one does that the only possible benefit of the Castle to the Estate would be in the making of taxable supplies and there would therefore be a direct

attribution. All the events which the Estate would be able to put on, using the Castle, would be taxable supplies and the presence of a safe Castle on the Estate could therefore only be attributed to activities which are taxable. The only exempt supplies made by the Estate are the residential lettings and there could be no attribution whatsoever to those. Even in that event therefore the input tax had to be fully recoverable.

19. Mr Mansell in his submission began by asking two questions. What was the intention at the time the costs were incurred and in incurring the costs to what was there a direct and immediate link? He referred us to the case of *Midland Bank Plc v Customs and Excise Commissioners* [2000] STC 501. This was an ECJ case which concluded in paragraph 35 as follows:

“2. It is for the national court to apply the ‘direct and immediate link’ test to the facts of each case before it. A taxable person who makes transactions in respect of which VAT is deductible and transactions in respect of which it is not may deduct the VAT in respect of the goods or services acquired by him, provided that such goods or services have a direct and immediate link with the output transactions in respect of which VAT is deductible, without it being necessary to take into account art 17(2), (3) or (5) of the Sixth Directive. However, such a taxable person cannot deduct in its entirety the VAT charges on input services where they have been utilised not for the purpose of carrying out a deductible transaction but in the context of activities which are no more than the consequence of making such a transaction, unless that person can show by means of objective evidence that the expenditure involved in the acquisition of such services is part of the various cost components of the output transaction.”

20. Mr Mansell contended that the Castle was merely part and parcel of the Estate and the works to the Castle were carried out as part and parcel of the business of running the Estate. The input tax was therefore deductible only to the extent that the costs upon which it was incurred were to be used in making taxable supplies. Mr Mansell pointed out that there had in fact been no taxable supplies made and he contended that there was insufficient evidence of intention. He highlighted the notes of Officer Adams indicating that exempt supplies were to be made and as there had been no option to tax in place at the time, an attribution would have to be to those exempt supplies. Mr Mansell further submitted that the work to the Castle was in fact only carried out at the behest of English Heritage executing its responsibility to ensure that listed buildings were preserved. The aim of the works was only to make the Castle safe, not to carry out any intended or specific economic activity. The works carried out were attributable to the business purposes of the Estate as a whole and were therefore residual.

Conclusions

21. We begin by saying that we accept without reservation the entirety of the oral evidence of Mr Ussher and Mr Fullerton. The facts in the main were uncontentious, the only area of difference between the parties being on the contents of the discussion between Mr Fullerton and Officer Adams on the Officer’s first visit to the Estate. We accept that Mr Fullerton at no time told Mr Adams that it was the intention of the

Estate to rent the Castle out to the Trust. This is not to imply any deliberate mis-recording by Mr Adams. It may be that Mr Fullerton did not make himself clear or that Mr Adams misunderstood what Mr Fullerton was telling him. We also find as a fact that there was never any intention that the Castle would be rented out to the Trust.

5 As Mr Ussher said, if the Estate were to surrender its interest in the Castle to the Trust, all the other income generating activities which the Estate were considering would be frustrated. The inter-action between the Estate and the Trust in regard to the Castle would be one of day to day management only.

22. Mr Mansell makes a powerful argument that the works were carried out only at the behest of English Heritage and thus with the sole purpose of making the structure safe. It is not however an argument which we accept. As Mr Ussher again pointed out, the Estate was putting a vast sum of money into the remedial works and the Castle had to make itself pay. The Estate had already lost a film contract because the Castle was unusable. Its business potential was huge but the structure had to be safe and sound before that potential could be realised. In committing its funds to the works, we find that the Estate at all times intended that the Castle should be used as an income generating asset and it was wholly and exclusively to that end that the works were carried out.

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23. We can again see the point of Mr Mansell's case that nothing appeared to be concrete, and the plans were nebulous but as we were told in oral evidence, they had to be because who knew what opportunities were going to arise for the Castle? We accept that from the beginning the intention was to open it to the paying public and make it available to film and television companies. We appreciate the Commissioners' frustration at the lack of any cogent business plan but we accept the evidence we heard that any attempt to put a business plan in place would be unrealistic and would serve no useful purpose.

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24. The oral evidence alone is sufficient for us to reach the conclusions we have just set out but that oral evidence is supported by the press release, the newsletter and the news report. The power of these documents is that they were all prepared contemporaneously with the work being carried out. They all refer to the intention to open the Castle to paying public access and for wider artistic and creative activities. We find the combination of the oral and documentary evidence compelling and we conclude that the intention of the Estate in carrying out the works was to enable the Castle to be used for income generating activities, all of which would be taxable supplies. There is therefore a direct and immediate link between the works and the intended supplies. The involvement of English Heritage was to make the plan possible. Their monetary intervention allowed the rectification work to be carried out.

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25. We conclude by commenting on the reference to the cultural exemption. This was an argument raised by the Commissioners in early correspondence and we can understand how it arose, given Mr Adams' belief that the Castle was to be rented out to the charitable Trust. This argument appeared to have been abandoned in correspondence and was not referred to in the Commissioners' Statement of Case. However, it was referred to by Mr Mansell in his closing arguments and we were uncertain as to whether or not it was still being treated by the Commissioners as a live

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issue. For the avoidance of any doubt therefore we should make it clear that given that there was never any intention to rent out the Castle to the Trust, and that the intention was that the Castle would at all times be operated by the Estate being run purely and simply as a profit making business, the cultural exemption could never apply.

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26. For all the reasons given above the appeal is allowed.

27. 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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TRIBUNAL JUDGE

RELEASE DATE: 31 January 2012