



TC03352

Appeal number: TC/2012/04242

VAT-input tax-input VAT on purchase of power boat- whether boat intended for the purpose of a business of obtaining catering contracts at Powerboat races.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

LAI'S LIMITED

Appellant

- and -

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

**TRIBUNAL: JUDGE CHARLES HELLIER
CLAIRE HOWELL**

Sitting in public in Exeter on 7 October 2013

Roger Bibby instructed by Bedford & Co, accountants for the appellant

Martin Priest for the Respondents

DECISION

Introduction.

5 1. In the VAT quarter ending 30 June 2010 Lai's limited purchased a powerboat from an American builder. The total cost recorded in its fixed assets register was £297,991, and it claimed input tax of £31,219¹.

2. HMRC concluded that the boat had not been acquired for the purpose of a business or an economic activity, and made an assessment to recover the input tax
10 credited (together with some smaller associated items). Lai's Limited appeals, contending that the purpose of the acquisition of the boat was to aid or enable a business of providing catering facilities at international powerboat racing events.

3. A penalty assessment which had originally been part of the appeal was withdrawn by HMRC before the hearing of the appeal.

15 The relevant law.

4. There was no dispute as to the relevant law. Articles 167 to 169 of the principal VAT directive 2006/112 confer on a taxable person carrying on an economic activity the right to deduct input tax on goods used for the purposes of the taxed transactions of that person.

20 5. In *Belgium v Ghent Coal Terminal NV* [1998] STC 260, the CJEU held that the right of deduction was exercisable immediately in respect of goods supplied for the purposes of use in connection with taxable transactions, and that, once established that right was not lost if the intended taxable transactions did not materialise by reason of circumstances beyond the taxpayer's control.

25 6. The provisions of the Directives are reflected in the UK domestic legislation. Section 26 VAT Act 1994 provides for the credit of input tax attributable to taxable supplies made, or to be made, and to supplies made or to be made outside the UK which would be taxable if made within the UK where those supplies are made in the course or further at the taxpayer's business. Input tax is defined by section 25 of that
30 Act to be VAT on the supply to the taxpayer of goods or services used or to be used for the purposes of any business carried on to be carried on by him.

7. In relation to the requirement that the purpose of taxpayer must be to use the input in an economic activity both parties referred us to *Ian Flockton Developments v HMRC* [1987] STC 394. Describing the test for deductibility, Stuart Smith J said:

35 "The test is were the goods or services which were supplied to the taxpayer used or to be used for the purposes of any business carried on by him? The test is a

¹ It also claimed £875 of input tax on the purchase of a lorry to tow the boat from place to place, and £175 in relation to a life raft to be used with the boat.

subjective one: that is to say, the fact-finding tribunal must look into the taxpayer's mind as it was at the relevant time to discover his object. Where the taxpayer is a company, a relevant mind or minds are those of the person or persons who control the company or are entitled to and do act for the company.

5 "In a case such as this, where there is no obvious and clear association between the taxpayer company's business and the expenditure concerned, the tribunal should approach any assertion that it is for the taxpayer's companies business with circumspection and care, and must bear in mind that it is for the taxpayer company to establish its case and the tribunal should not simply accept the word
10 of the witness, however respectable. It is both permissible and essential to test such evidence against the standards and thinking of the ordinary businessman in the position of the applicant. If they consider that no ordinary businessman would have incurred such an expenditure for business purposes that may be grounds for rejecting the company's evidence, but they must not substitute that as the test. It is only a guide or factor to take into account in considering the
15 credibility of the witness, and no doubt there will be many other factors which bear on that question which the tribunal should well understand.

"The tribunal must look at all the circumstances of the case and draw such inferences as they think fit. In the end it is a question of fact for them whether
20 they were satisfied on the balance of probability that the object in the taxpayer's company's mind at the time the expenditure was incurred was that the goods and services in question were to be used for the purposes of the business."

8. And, in relation to the question of whether or not an activity was a business or
25 economic activity, we were referred by Mr Priest to the indicia in *Lord Fisher* [1981] STC 238. The six indicia were these :-

- (i) whether the activity is a serious undertaking earnestly pursued;
- (ii) whether the activity is an occupation or function actively pursued with reasonable or recognisable continuity;
- 30 (iii) whether the activity has a certain measure of substance as measured by the quarterly or annual value of taxable supplies made;
- (iv) whether the activity was conducted in a regular manner on sound and recognised business principles;
- (v) whether the activity is predominantly concerned with the making of supplies
35 to consumers for a consideration; and
- (vi) whether the taxable supplies are of a kind which, subject to differences in detail, are commonly made by those who seek to profit from them.

9. But we note that the cases show that in determining whether there is a business, private enjoyment may indicate that there may not be a business, and in relation to an

asset capable of private enjoyment there needs to be a careful examination of all the circumstances.

10. Deductibility is, in our view thus dependent on an assessment both (a) of the subjective intention of the taxpayer – what did he intend to do with the supply to him?- and (b) of the objective nature of the activity in which he intended to use that supply – was that activity a business or an economic activity?

11. Finally we should note that HMRC did not argue that the powerboat was "something in the nature of a luxury, amusement or entertainment" within section 84(4)(c) of VAT Act. Section 84(4) purports to limit the functions the tribunal in a case relating to input tax on such items to consideration of whether HMRC's determination was a reasonable. In *Myatt & Leason* VATD 13780 the tribunal cast doubt on a literal interpretation of that section.

The evidence and our findings of Fact.

12. We had before us a bundle of documents. We heard oral evidence from Mr Lai, a director of Lai's Limited, and also from Helena Walker, an officer of HMRC. We find as follows.

13. Mr Lai opened a Chinese restaurant in Exmouth in 1984. It was successful. He opened further restaurants in the following years in half a dozen other towns in Devon. These businesses, and the properties in which they were conducted, were owned and operated by one of Lai's Limited or a partnership called the Bamboo Group, each of which were controlled by Mr Lai or Amana Limited (which, in turn, was also controlled by Mr Lai). In the early 2000's most of the restaurant businesses were sold and rental income from the properties was received by one of the other firms. In 2009 the only restaurant being run by the company was in Pinhoe. This was owned and run by Lai's Limited.

14. Mr Lai controlled each of the companies and made all the strategic decisions. He told us, and we accept, that his mode of operation had been to open and run Chinese restaurants and then to sell them. He investigated a chosen area: looked at the area, the concentration of similar businesses, and the price and availability of premises. If he thought he could open a restaurant and then sell it for a good profit he would. He said, and we accept, that he prepared no formal plans for these ventures. He had a good business sense for how profitable a restaurant would be or become and whether the business could eventually be sold at a profit.

15. In about 2000 Mr Lai developed an interest in powerboat racing. The boat bought a 'rib' boat ("Boat 1") for about £10,000. We understood it was bought by him personally. He did not see it its purchase as a business venture but as for recreation. He entered into competitions, and between 2000 and 2004 did well in them. He still owns this boat, and on occasion he uses it.

16. In 2005 or 2006 a second powerboat ("Boat 2") was bought. This was 32 feet long and was more expensive. It cost £35,000 or so. He bought it because he needed a large boat to compete in the world championships (in which the rib could not

compete). He entered these championships and, in one year, finished third. Between 2000 and 2006 he also obtained income from the boat: people paid to steer it and he obtained sponsorship from Shepherd Neame Limited in 2007/2008. However, Boat 2 sunk in 2009. Mr Lai arranged the sale of its hull for something under £20,000.

5 17. Whilst Boat 1 had been bought by Mr Lai personally, we believe that Boat 2 was bought by Ocean Dragons Racing Ltd, a subsidiary of Lai's Limited and that Ocean Dragons Racing Limited earned the sponsorship and other monies which arose in connection with its use. The activities of Ocean Racing Ltd were transferred to Lai's Limited in 2011.

10 18. With Boat 2 Mr Lai entered the P1 World Cup Championship in 2006 and later years. At the racing events he met a director and the CEO of Powerboat P1 Management Limited ("P1"). P1 had a contract with Union International Motonautique (which was described as the powerboat sport's governing body) under which it was licensed to organise world championship powerboat events in various
15 maritime cities around the world.

19. The P1 championship events organised by P1 generally spread over a week. At the beginning of the week the teams and their support staff would arrive, and at the end of the week, and across the weekend, there would be several days of different classes of races.

20 20. After attending a number of these events Mr Lai came to the conclusion that there was money to be made in providing the catering for them. He noticed that it had not been done well at some of the events he had attended. He had some considerable expertise in catering and would be able to organise catering for the whole event. Food would be prepared and reheated in mobile kitchens. Kitchen staff would come from
25 the UK, and porters and waiters would be hired locally. The greatest demand would be over the weekend racing days. He indicated that the possible catering was divided between that which was organised directly by P1 and outside catering. He concluded that if he obtained the contract for the P1 catering he could break even over a week, but he hoped to get the outside catering contracts – “his name would be there” - on
30 which he said he might make £30-£40,000 in a week. There were about six events a year so it was a lucrative possibility.

21. Mr Lai had a family and business contacts in Hong Kong. In 2009 he became involved in P1's attempt to obtain the Hong Kong authorities' blessing for an international motor boat race in Hong Kong. He was the only Chinese powerboat
35 racer who took part in the world championships. He attended various meetings. He assisted in speaking to the Hong Kong tourist board. However the attempt was unsuccessful: a letter from Martin Wicks of P1 indicates that there was insufficient commercial support for the event with the result that the attempt failed. The letter also says that it was likely that Mr Lai could have obtained sponsorship income from his
40 participation but makes no mention of catering.

22. In 2010 P1 told Mr Lai that since 2002 they had lost some £30 million in their activities and had decided to move out of large powerboat racing events. It appears that thereafter the organisation of those events ceased.

23. In 2010 Mr Lai also became involved in an attempt by a company called Global Assets to promote powerboat race racing in Asia between 2011 and 2015. Boat 3 had on it the legend "Powerboat Asia Event 2011 -2015".

24. Mr Lai told us that he could see that unless he was involved in, and committed to powerboat racing in the P1 competitions he would not be able to secure the catering contract from P1. He thought that he needed to race and to do well in the racing to be taken seriously.

25. He said that he then decided to buy Boat 3. This was 42ft long and capable of offshore racing. It was ordered in 2009 from America. There were problems with the builders and the costs rose. Mr Bedford told us that he thought that the finance had been provided as to £140,000 indirectly by Mr Lai, and that £100,000 came from the Barclay's mortgage. It was not delivered until 2010. Although it was not in service in 2009 Mr Lai said that those at P1 knew that it had been ordered and that he would participate in the events.

26. Mr Lai told us that he bought Boat 3 in order to enable him to get the contracts to provide catering facilities for P1 events: that is to say the P1 catering and the external catering. Getting the P1 catering would give him a platform from which to build up outside catering for the events. P1 said that they would help him to get to the outside catering contracts. He also intended to get sponsorship.

27. In 2010 Mr Lai used Boat 3 in the Torquay to Cowes race but obtained no sponsorship or other income in connection with the event. In 2011 he took part in the same event and Lai's Ltd obtained £6,500 of income of which £500 was income from a sponsor who sat on board and steered while Mr Lai controlled the throttle, and £1000 related to meals arranged by Mr Lai for guests.

28. Since 2011 Boat 3 has not been used. It stands on Mr Lai's drive, and he has been attempting to arrange its sale.

30 **The parties' arguments.**

29. Mr Priest submits:

(1) That Mr Lai had a personal interest in power boats and power boat racing. It had been a private leisure interest. A degree of scepticism should thus be applied in assessing whether Mr Lai's subjective intention was to use the boat for the purposes of a catering business;

(2) No P1 catering materialised. The indicia in *Fisher* suggested that there was not a business activity in which the boat was to be used.

30. Mr Bibby submits:

- (1) The question is the true motive for the acquisition of Boat 3;
- (2) The intention of the appellant is that of Mr Lai;
- (3) Mr Lai's evidence was believable and clear, namely that he intended to use the boat to obtain the catering work. Mr Lai also had an eye to making money from sponsorship and contacts with the media and other powerboat event organisers such as Global Assets;
- (4) Catering was Mr Lai's expertise – his business. He acted in the same manner as any other business imbued with entrepreneurial spirit. The acquisition of the boat was a measured speculative decision in pursuit of and in the course of an economic activity.

Discussion.

31. Mr Lai's oral evidence and Mr Bibby's submissions presented a picture which was quite different from that which we had obtained from our initial reading of the papers. Mr Lai appeared to us to be a successful businessman who knew how to make money. We accepted that he controlled Lai's Limited and made all strategic decisions. We accept that he saw no need to prepare formal business plans for his ventures and that he had the commercial acumen to spot a venture which was likely to be profitable.

32. We were also persuaded that he would have been able, and that he knew he would have been able, to deliver catering to the racing events on the requisite scale, and that it was likely that if he was able to obtain the rights to all the catering he would have made a good profit.

33. It was also clear to us that on its own the provision of catering at P1 world championship events would have been a business or an economic activity: it would have been a serious undertaking earnestly pursued, a venture entered into for profit on a commercial basis, making supplies of a taxable nature.

34. Further we were persuaded that before Mr Lai bought Boat 3 he had identified the possibility of obtaining the catering work and that, in his discussions with P1, he raised the possibility of obtaining it. We note however that he had not been awarded any such contract by 2009 or 2010.

35. It was clear to us from Mr Lai's evidence that the purpose of acquiring Boat 3 was not to obtain sponsorship. Not only did he not say so to us (although he indicated that he intended to seek sponsorship), but the amount of sponsorship income which had been earned in relation to Boat 2, even if multiplied severalfold, would not have made the purchase of Boat 3 a commercial venture. The amounts would not even have been icing on the cake. Thus the company's case depends only upon whether Boat 3 was acquired for the purpose of the P1 racing event catering contracts as a business activity.

36. We have said that we accept that Mr Lai identified that owning and racing a large powerboat might assist him in getting the catering contracts, but we do not

accept that this was his principle intention for the acquisition of the boat. That is for the following reasons.

5 37. First, although we accept that Mr Lai had in mind the possibility that acquiring Boat 3 might help with obtaining the catering contract, the realisation of that possibility could not in our view have been his sole purpose in the acquisition. Mr Lai was an astute businessman. He would have known a dicey proposition when he saw one, and would have been able to distinguish it from a real business venture. This was a dicey proposition. He must have had in mind the real possibility - the real likelihood - that he would not obtain the outside catering contracts

10 38. Therefore, because the commercial benefit was remote, in order to spend such an amount on the boat he must have had in mind the other benefits which came from acquiring Boat 3. He was aware of those benefits from his experiences with Boat 2: participating in offshore racing and becoming further involved in the world of P1, all of which he had started to do before ordering Boat 3.

15 39. We are not persuaded that the fact that the boat has been mothballed since P1 pulled out of Powerboat events indicates that its intended use was only to get the catering contracts. There are no longer P1 championship events in which to compete, and without the lure of competition, the use of the boat may be less attractive – as the difficulties with its sale suggest.

20 40. Second Mr Lai agreed with Mr Priest that none of the other powerboat racers were catering contractors. It seems unlikely that Mr Lai would have thought that owning and racing a boat of the right size was key to winning those contracts if none of the existing contractors had pursued that route. And Boat 2 had already brought Mr Lai into contact with the important people at P1 from 2006 onwards. Had it been
25 clear that having a Boat was the only way to get the contracts it would have been more likely that Mr Lai's principle intention could have been to use it for that purpose.

30 41. Further, in our judgement, even if Mr Lai's sole purpose in acquiring Boat 3 had been to use it to obtain the catering contracts, that would not have been an intention to use it for a business. That is for the following reasons.

35 42. First, we were not convinced that Mr Lai seriously pursued the catering contracts. It was clear that he had provided real assistance to those attempting to organise a Hong Kong powerboat event. We accept that if that event occurred there would have been a prospect that he would obtain the P1 catering contracts and would have some chance of obtaining the outside contracts (although it was not shown that they were in the gift of P1) . But there was no evidence, other than that of his expressed hope, that he pursued the award of those contracts. The serious pursuit of that business would surely have involved more direct approaches and perhaps formal responses, and also some further investigation of the requirements for the external
40 contracts. But there was no evidence of that either before or after 2009. And despite his contact with P1 from 2006 onwards no mention of catering was made by Martin Wicks in his letter (see [21]).

43. Second, in determining whether there is a business the activities to be examined must include the cost of the input on which deduction is sought. Thus it must include the acquisition, and the cost of acquisition, of Boat 3. But we were not persuaded that the activity which encompassed both the acquisition of the powerboat and the hope of
5 obtaining the outside catering contracts was a commercial venture – that is to say something conducted on sound and recognised business principles. For such a venture to be profitable in net profits from the catering activity would have had to have covered the original costs of Boat 3 (some £250,000) and its running and travel costs. Mr Lai thought he could break even on the P1 catering and make a profit if he
10 obtained the outside catering contracts. But he recognised that the prospect of outside catering contracts was a "hope" rather than a degree of expectation. Buying a lottery ticket is not in our view a business venture, even though it may be defensible and turn out to be profitable; there may come a stage when a mere hope of profit broadens into a real possibility of success, and the activity in pursuit of that possibility becomes a
15 commercial venture, but we were not persuaded that Mr Lai had any more than a hope of success.

44. Third, we do not view the proposed catering activity as a simple extension of the appellant's existing business. Mr Lai had organised dinner parties abroad and was an expert manager of restaurant cooking, but that is different from the provision at
20 overseas venues of food for large numbers from mobile dispensaries. We could not therefore regard the acquisition of the Boat as being for the purpose of the existing business.

45. The distinction between this appeal and that of *Ghent Coal* illustrates these reasons. In that case land was bought to extend a port installation, surveys were
25 carried out, high voltage cables were installed and the land was levelled. Then the municipal authorities compulsorily acquired the land, ending the venture. In *Ghent Coal* the new installation was earnestly pursued as part of an existing business. In this appeal there appears to have been little pursuit of the contracts and merely a hope of their being awarded.

30 46. In *Ghent Coal* the Advocate General referred to *INZO*, a case which concerned a company set up to exploit processes for turning sea water into drinking water. The company had investors, borrowings, a bureau, and land for a desalination plant. It conducted a profitability study from 1976 for several years. As a result of problems thrown up by that study some investors withdrew and the venture was liquidated. The
35 ECJ held it was entitled to reclaim the input VAT on its expenditure. In *INZO* the company was engaged in a speculative venture, but it pursued it in a serious organised manner; and the fact that external investors were willing to invest suggests that the chance of success was more than a hope.

47. We therefore conclude (a) that the acquisition of the boat with the hope of
40 acquiring the external catering contracts was not a business or an economic activity; and (b) that Lai's Ltd's intention in acquiring Boat 3 was not shown to be in order to make taxable supplies as part of an economic venture.

Conclusion

48. We dismiss the appeal.

49. 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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CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 19 February 2014

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