[2015] UKFTT 0335 (TC)

TC04520

Appeal number: TC/2014/00251

VAT - input tax - whether input tax on costs of installation of kitchen and catering facilities undertaken by third party attributable to taxable bar sales and supplies - no - VATA s 24 and s 26 - appeal not allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

WHITEABBEY MASONIC CLUB **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL CONNELL
MEMBER PATRICIA GORDON

Sitting in public at Bedford House, Belfast on 6 February 2015

Mr Ian Spencer for the Appellant

Miss Sharon Spence, Officer of HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by Whiteabbey Masonic Club ("the Appellant/the Club") against the decision of The Commissioners for Her Majesty's Revenue and Customs ("HMRC") to raise an assessment pursuant to s 73 of the Value Added Tax Act 1994 ("the Act") in the sum of £5,604.00 (plus interest) representing VAT reclaimed as input tax by the Appellant in period 09/11, on the purchase of a kitchen.

2. The question for determination by the Tribunal is whether the Appellant has a right of deduction for input tax on the costs of installing a new kitchen in premises owned by an associated third party. HMRC disallowed input tax reclaimed by the Appellant, on the basis that it did not directly relate to the Appellant's taxable supplies.

3. The Appellant states in its Notice of Appeal that the new kitchen was purchased in order that its ability to make taxable supplies of bar sales would not be diminished by its inability to provide adequate catering facilities for its customers.

Background

4. The Appellant is a Masonic Lodge Social Club, operating from premises known as "Whiteabbey Masonic Centre" ("the Centre") at 51 Monkstown Avenue, Newtownabbey, County Antrim. The Appellant has been registered for the purposes of VAT as a 'non-profit making body' under registration number 454 6991 09 since 1 December 1987.

5. The Centre is owned by Whiteabbey Masonic Trustee Board which is legally responsible for the upkeep of the Centre and holds the property in Trust. The Trustee Board granted a free 25-year lease to Brookville Masonic Hall Company ("BM"). BM, in turn, has responsibility for the upkeep of the Centre. The Trustee Board has no income, no expenditure and does not carry out any duties or running of the Centre. Full Social Club membership is only open to members of the Masonic Movement, however non-members can also use the facilities when signed in by a member.

6. The Club has a Management Committee which -

- holds an entertainment and liquor licence (in the name of the secretary);
- meets fortnightly to manage all aspects of the running of the Centre;
- meets twice yearly with BM to provide an update on the running of the Centre;
- correspond with Provincial Grand Lodge of Ireland to confirm that operating practices conform with Masonic Principles;
- set up and manage all advertising, social media, website etc. to generate funds to operate cost effectively;

- generate funds from bar sales to pay for the Centre's overheads.

7. Forty-three separate Masonic Lodges occupy/use the Lodge rooms at the Centre. BM's role is to collect dues and capitation fees from the various Lodges who 'sit' in the Centre; manage Lodge rooms; collect an annual fee from an independent caterer, Glen Catering (who is the catering franchisee "the Caterer"); make payments to the Provincial Grand Lodge of Antrim and make payments in the form of grants to the Appellant.

8. BM (which is not VAT registered) has an informal agreement with the Appellant that the Appellant manages the Centre on behalf of BM. The running of the Centre includes monitoring the Caterer and function rooms and managing events like Lodge dinners.

9. There is no contract in place and no monies payable for the arrangement between the Appellant and BM, merely an understanding between the two separate entities linked solely by their involvement in the Masonic Movement i.e. there is no formal landlord/tenant or employer/employee agreement. It is understood by both parties that the Appellant will trade from the premises and it is a matter of fact that it generates income by operating its Social Club from the premises providing a bar and (free) room hire to the Lodges and third parties (other than the separate Lodge rooms).

10. The Appellant uses its income from bar takings to pay for the operating costs of the Centre and any surplus is used for upkeep of the facilities (including maintenance and where necessary the structure of the Centre). Where there is no surplus, both parties understand that BM will provide the Appellant with a grant, so that repair works and improvements can be undertaken when needed.

11. There is no written contract but a verbal agreement exists between BM and the Caterer. BM do not manage the Caterer; the Appellant's Management Committee liaises on a daily basis with the Caterer on operational matters such as complaints, kitchen cleanliness and maintenance etc. The Caterer's performance is monitored by the Appellant's Management Committee who report twice yearly to BM. The Appellant's Management Committee has a close working relationship with the Caterer and promotes the catering.

12. The Caterer is based in the Centre providing catering to the Centre's patrons. The Caterer pays an annual fee of £2,000 to BM for their use of gas and electric at the Centre and this is forwarded on by BM to the Appellant's Management Committee who use it to pay utility bills.

13. The current caterer, Glen Catering, has operated from the Centre since 1993 and has been used for outside catering by patrons of the Club since 1988.

14. Third parties can hire function rooms at the Centre without charge but on condition that the bar must be operated by the Appellant, thus generating income for the Appellant. Lodges and third parties may use the kitchen to heat food and boil

water, but only when not in use by the Caterer or they may engage the Caterer to provide food.

15. Where Lodges require catering, they contract separately with and pay the Caterer directly. The Caterer cannot trade in the Centre unless the Appellant's bar services are open.

16. Payment for the kitchen was made by the Appellant, however, the funds were provided by BM.

The legislation

17. The relevant legislation in VATA 1994 is as follows:

Section 3 states:

> (1) A person is a taxable person for the purposes of this Act while he is, or is required to be, registered under this Act.
>
> (2) [Schedules 1 to 3A] shall have effect with respect to registration.

Section 4 states:

> (1) VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.
>
> (2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.

Section 5 states:

> (1) Schedule 4 shall apply for determining what is, or is to be treated as, a supply of goods or a supply of services.
>
> (2) Subject to any provision made by that Schedule and to Treasury orders under subsections (3) to (6) below—
>
> > (a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration;
> >
> > (b) anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right) is a supply of services.

Section 24 states:

> (1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—
>
> > (a) VAT on the supply to him of any goods or services;
> >
> > being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

Section 24(6)(a) provides:

> Regulations may provide -

(a) for VAT on the supply of goods or services to a taxable person to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents (or other information) as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases.

Section 25 states:

(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.

Section 26 states:

(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—

(a) taxable supplies;

(b) …..

Section 73 provides:

(1) Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.

(2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—

(a) as being a repayment or refund of VAT, or

(b) as being due to him as a VAT credit,

an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly.

(6) An assessment under subsection (1), (2) or (3) above of an amount of VAT due for any prescribed accounting period must be made within the time limits provided for in section 77 and shall not be made after the later of the following-

(a) 2 years after the end of the prescribed accounting period, - or

(b) one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge,

but (subject to that section) where further such evidence comes to the Commissioners' knowledge after the making of an assessment under subsection (1), (2) or (3) above, another assessment may be made under that subsection, in addition to any earlier assessment.

Section 77(1) provides:

(1) Subject to the following provisions of this section, an assessment under section 73, 75 or 76, shall not be made -

(a) more than [4 years] after the end of the prescribed accounting period or importation or acquisition concerned,….

The Appellant's case

18. The Appellant's stated grounds of appeal as contained in its Notice of Appeal are:

"There is no dispute between the parties about there being a supply made to the Appellant. The only area of dispute is whether there is a sufficiently clear link between the costs incurred by the Appellant and its making of taxable supplies. The Appellant maintains that it acquired the new kitchen in question in order that its ability to make taxable supplies would not be diminished by its inability to provide adequate facilities for its customers to be supplied with catering."

19. In order to raise funds to enable it to undertake its day to day role and provide for the upkeep of the Centre the Appellant Club operates bars within the building, selling beers wines and spirits to members of individual Masonic Lodges occupying different Lodge rooms.

20. In addition to providing social and recreational facilities for the Masonic Lodges the Club also seeks to gain income from private individuals by means of providing facilities in order that such individuals might hold a function at the Centre on the understanding that the Club will operate a bar for the function.

21. To make the offering more attractive to third parties, the Club decided to provide a catering facility. Having taken account of the risks of engaging full time catering staff it was decided that it would be preferable for catering to be provided by an outside caterer and therefore the Caterer is introduced to third parties, should they require such a facility. They then contract separately with the Caterer.

22. Costs incurred on the new kitchen by the Club do not provide any direct benefit for any of the associated entities (i.e. BM or the Trustee Board). The only entity other than the Club which enjoys any financial gain from the provision of the kitchen facilities, is the Caterer who has no association with the Club.

23. The Appellant Club submits that the only reason it provides catering facilities is that it is better able to attract outside parties to use its facilities at the Centre and generate further profit from bar sales. The installation of the kitchen was therefore a cost component of the Club's business activities. Whilst there is no direct linkage between the VAT incurred on its installation of the new kitchen and the sales it makes

(as it does not directly provide the catering), there is nonetheless sufficient linkage between that VAT and its taxable bar sales.

24. Mr Spencer for the Club says that any economic benefit generated from the kitchen (outside of that received by the Caterer) does not belong to BM, and is received by the Appellant Club. In some cases the Club may make a small profit on the catering where it pays a lower amount to the Caterer than it charges the third party. In most instances no direct profit is received by the Club from catering, but the economic benefit it does receive is from increased third party room hire, together with bar sales (in which instance all income generated is proper to the Appellant Club). He says that without reliable and reputable caterers, any income from its room hire and bar sales would be greatly diminished, therefore the fact it receives no direct benefit from the catering is of limited consequence

25. Mr Spencer explained that the Centre's previous kitchen facilities were condemned by the local authority and without immediate improvement Lodges using the Centre would have used other facilities with a resultant huge reduction in bar sales and the possible closure of the Centre.

26. We were referred to a number of cases in support of Mr Spencer's arguments:

In the case of *Hartridge t/a Hartridge Consultancy* MAN 97/1158 (VTD 15553) a dispute arose between the partners in a firm of surveyors. One of the partners (H) issued a writ seeking the dissolution of the partnership. The other partners responded by issuing a notice expelling him from the partnership. The matter was referred to arbitration. The arbitrator upheld the expulsion notice, but H was allowed to retain certain clients (which, under the partnership deed, he would not have been permitted to do). H subsequently registered for VAT as a consultant. In his first return he reclaimed input tax relating to the arbitration proceedings. Customs issued an assessment to recover the tax but the tribunal allowed H's appeal, finding that there was a clear nexus between the arbitration proceedings and H's subsequent consultancy business. The chairman observed that, as a direct result of pursuing the arbitration proceedings, H had been able to continue working with clients whom he might otherwise have lost.

In the case of *Giffenbond Ltd*, MAN/94/1238 (VTD 13481). A company (G) which supplied engineering services received planning permission for the construction of a double garage in the grounds of the house which its controlling director owned and occupied. The director transferred ownership of the plot on which the garage was built to G. The garage was used to house a car which G owned, and which the director drove mainly but not exclusively for business purposes. G reclaimed input tax on the construction of the garage. Customs issued an assessment to recover the tax, on the basis that the effect of what is now VATA 1994, s 24(3) was that the tax was not deductible. The tribunal allowed G's appeal in part, holding that the provision of the garage fell within s 24(3) and that the tax should be apportioned. (The tribunal rejected Customs' contention that the use of the garage for business purposes was a breach of the relevant planning permission and that the tax was therefore not deductible.) On the evidence, the tribunal held that 85% of the use of the garage was for business purposes, so that 85% of the input tax was deductible.

In *Myatt & Leason*, [1995] VATDR 440 (VTD 13780) a family partnership carried on business as monumental masons. In January 1994 they purchased a racing car at a cost

of £19,000 and reclaimed the input tax thereon. Customs issued an assessment to recover the tax, considering that the car had not been purchased for the purposes of the business, but for the personal pleasure of one of the partners (M), and that the car was a 'luxury, amusement or entertainment', within what is now VATA 1994, s 84(4). The partnership appealed, contending that the car had been purchased for advertising purposes. In 1994 M had driven the car in a competition, sponsored by Dunlop Rover, which comprised twelve races, and this had attracted publicity for the partnership in local newspapers and on local radio. The car had been sold in early 1995. The tribunal accepted the partnership's evidence and allowed the appeal, finding that the car had been purchased for advertising purposes, and holding that it was not a 'luxury, amusement or entertainment', so that s 84(4) did not apply. The tribunal chairman also observed that, even if the car were deemed to fall within s 84(4), the assessment would have been unreasonable on the grounds that the VAT officer responsible for it had not attempted to interview any of the partners.

In *SRI International v HMRC UKUT 2011 UKUT 240* (TCC) [2011] STC 1614 a Delaware company was incorporated in 1999. It entered into a 15-year lease of premises in London, but ceased trading in 2001. A Californian corporation (S) had guaranteed the rent under the lease. In 2004 S paid the lessor £1,500,000 plus VAT in order to be released from its guarantee. S reclaimed the VAT under VAT Regulations, SI 1995/2518, reg 186. HMRC rejected the claim on the basis that they were not satisfied that S was carrying on a business. S appealed. The Upper Tribunal allowed the appeal, reversing the decision of the First-tier Tribunal. Sir Stephen Oliver held that the only requirement under reg 186 was that the VAT would be 'input tax' if the trader was a taxable person in the UK. If that requirement was satisfied, all of the VAT was recoverable. On the evidence, the payment that S had made to the lessor was incurred for the purposes of its business, and the VAT would have been input tax if S had been a taxable person in the UK.

27. With regard to the case of *Rosner (FW) (t/a London School of International Business)* (QB 1993) [1994 STC 228] which HMRC will be referring to, Mr Spencer argues that the principles laid down in that case, that is the requirement for there to be a direct or immediate linkage to costs and a person's taxable business, does not necessarily contradict the Appellant's assertion that the link between the costs of the kitchen in order to provide catering facilities and its onward supplies of bar sales allows input tax recovery.

HMRC's case

28. In accordance with sections 25 and 26 VATA, a taxable person is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is attributable to the making of taxable supplies and to deduct that amount from any output tax that is due from him if he holds evidence of the tax charged.

29. Input tax is defined in s 24 VATA, in relation to a taxable person, as VAT on the supply to him of any goods or services used or to be used for the purposes of his business.

30. The right to deduct input tax is not an absolute right. To exercise its right to deduct, the taxable supply must be made for the purposes of the taxpayers business.

31. The Appellant Club provides a service of managing the Centre on behalf of BM. No monetary consideration is received in respect of this service. Therefore, the service is not a supply within the scope of VAT (s 4 of the Act).

32. The only taxable supplies the Appellant Club makes, relate to bar sales. Therefore there is no direct or immediate link between the costs of the kitchen and the Club's taxable supplies. Whether or not there is some residual benefit is not sufficient to demonstrate the right to deduct the VAT incurred as input tax.

33. This view is supported by the High Court case of *Rosner (FW) (t/a London School of International Business)* which highlights this important distinction:

> A proprietor of a business was convicted of conspiracy to defraud. He reclaimed input tax on legal costs contending it was for the purposes of his business. The Commissioners disallowed the claim on the ground that the expenses incurred were not for a supply of goods or services used for the purpose of any business carried on by the taxpayer. The tribunal found that the outcome of the criminal proceedings was connected to the taxpayer's business and ordered that an apportionment be made. However the Queen's Bench found that the tribunal had misdirected itself in law and upheld the assessment holding that the fact the business had benefitted from the expenditure was not conclusive and that there must be a real connection, a nexus between the expenditure and the business. Thus establishing an important principle that the business needs to show a clear link between the expenditure and the actual taxable sales carried out by the business. If this link does not exist then VAT cannot be recovered.

34. The High Court pointed out in its judgement:

> "One only has to state that proposition [that expenditure incurred to defend the owner/manager of a business against criminal proceedings was for the benefit of the business] to appreciate that there can be no question of describing sensibly the legal expenses of a person who has been charged with an offence wholly unrelated to his business as being expenses incurred for the purposes of the business. Benefit, therefore, cannot be the test.
>
> By the purpose of the business in this context I mean by reference to an analysis of what the business is in fact doing. It is only by identifying what the nature of the business is in that way, that one can determine the extent to which any given expenditure can be said to be for the purposes of that business."

35. The principle of a clear link was further underlined by the European Court of Justice in the case of *BLP Group plc* [ECJ case C.4/94]:

> A holding company sold off one of its subsidiaries by selling its shares. They did this because the group as a whole was in financial difficulty and needed funds so that they could continue to trade. The ECJ found that in order to confer a right to deduct, the goods or services supplied to the claimant must have a direct and immediate link with the taxable transactions carried out by the taxable person claiming the right to deduct. The ultimate purpose of the sale, therefore, was so that the group could continue to trade. In particular the reason for the sale was so that BLP could continue to charge taxable management charges to its other subsidiaries. BLP sought to link the costs of

the exempt share sale to this ultimate purpose and deduct them as directly attributable to those taxable management charges.

36. The case brought out several important concepts, all arising from fundamental EU VAT law. Firstly it highlighted the need for a direct and immediate link between an input supply and taxable outputs for there to be any entitlement to deduct. The ECJ observed -

> "37. That is not affected by the argument put forward by BLP at the hearing that the costs of the services on which input tax has been paid (and hence that input tax itself) are ultimately incorporated into the price of the goods and services which it sells by means of its taxable transactions. Even if it were possible to construct such an effect in commercial or bookkeeping terms, that would merely be a cascade effect, which can always occur if taxable and exempt transactions are carried out at the same time within a unitary undertaking. That circumstance does not make the services in question into cost components of the taxable transactions and cannot therefore alter the attribution stated above.
>
> On the basis of that attribution, the right to deduct input tax is excluded in the present case, it being of no relevance whether the sale of the shares was for the benefit of the taxable activity of the taxable person on the basis of the discharge of indebtedness intended and effected."

37. In the present case, the cost of the kitchen is most immediately linked to the catering activity which takes place as a result of an agreement between the Caterer and BM. The kitchen is directly linked to the taxable supplies made by the Caterer directly to patrons of the Club. There is an annual charge paid by the Caterer to BM for use of gas and electricity which is then passed back to the Appellant by BM. However there is no taxable supply between the Appellant and the Caterer. There is no taxable supply between the Appellant and BM.

38. It is accepted that the Appellant does 'benefit' from having a kitchen facility which provides for the Caterer's and customers' needs. It is also accepted that the improved kitchen facility has some causal linkage to the Appellant's taxable supplies of bar sales. This may also have the knock on effect of attracting more customers and increasing bar sales although there is no evidence to support this.

39. HMRC analysed VAT returns submitted by the Appellant from the years ending 31 December 2005 to 31 December 2014, by grossing up output tax declared, to arrive at estimated total annual net standard-rated sales. The analysis shows that taxable sales in the years prior to the installation of the new kitchen were on average £10,000 higher than in the years from 2011 onwards. Therefore there is no discernible evidence that the new kitchen has had the effect of increasing bar sales.

40. Moreover, as demonstrated by *Rosner* and the other cases referred to in HMRC's submissions, benefit is not the test. The relevant question is whether the link is direct and immediate. The 'immediate link' here is to the non-taxable supplies made by BM to the Lodges and to the Appellant.

41. Alternatively, the immediate link is with the non-taxable supplies made by the Trustee Board which owns the Centre in which the kitchen was installed.

42. The Appellant seeks to rely on the Upper Tier decision in *SRI International*. HMRC submit that this decision was made on the facts of the particular case. The Upper Tier found that there was a sufficient connection/nexus between the expenditure and the business. The facts in the present case are not sufficiently comparable to those in *SRI*.

43. Consequently the Appellant has no entitlement to re-claim the VAT incurred on the installation of the kitchen as input tax and the assessment has been correctly made in accordance with s 73 VATA.

Conclusion

44. VAT may only be recovered to the extent that it can be treated as input tax - VAT does not automatically become input tax simply because it has been incurred by a VAT registered person.

45. Input tax in relation to a taxable person is defined at s 24(1) of the VAT Act 1994. For VAT incurred by a taxable person to be input tax, it must relate to an onward supply by that taxable person in the furtherance of their business.

46. There must be a real connection, a nexus, between the expenditure and the business. The supplies by the Appellant are those of bar sales, not catering facilities. The ultimate purpose of a business is irrelevant because VAT is a transaction-based tax. It is only the immediate supply to which any input is a cost component that matters.

47. Although the Appellant paid for the installation of the kitchen, BM provided the money to do so. The kitchen was therefore installed at the cost of BM for the benefit of its premises and although this in itself would not be a bar to the recovery of input tax, it indicates that there is no immediate link for VAT purposes to the Appellant's service of maintaining the Centre.

48. BM has, under its lease from the Trustee Board, primary responsibility for the upkeep of the Centre and for the provision of facilities which will attract customers. BM entered into an agreement with the Caterer who has primary use of the kitchen. As HMRC argue, the 'immediate link' is to the non-taxable supplies made by BM to the Lodges and to the Appellant, or to the non-taxable supplies made by the Trustee Board which owns the Centre in which the kitchen was installed.

49. The Appellant seeks to rely on the First-tier Tribunal decisions in *Hartridge t/a Hartridge Consultancy, Giffenbond Ltd and Myatt & Leason.* These decisions are not binding on the Tribunal and are not in accordance with the principles established by either the High Court in *Rosner* or by the ECJ in *BLP*.

50. The cost of the kitchen is directly and immediately linked to the Appellant's service of maintaining the Centre for BM. However as that service is not a supply for

VAT purposes, that is, it is not a taxable supply, the VAT is not recoverable as input tax.

51. For the above reasons we therefore confirm HMRC's decision to raise the assessment pursuant to s 73 of the Act in the sum of £5,604.00 and dismiss the appeal.

52. 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.

MICHAEL CONNELL

TRIBUNAL JUDGE
RELEASE DATE: 8 July 2015