[2017] UKFTT 0261 (TC)

TC05743

Appeal number: TC/2015/04747

VALUE ADDED TAX – Assessments to VAT – Output tax – whether exports from UK – no – Input tax – whether sufficient evidence available to substantiate claim – yes in part only – Penalties not appealed – Sections 7,24,25,26,30(6) and 73 Value Added Tax Act 1994 ("VATA") – Regulations 29 and 129 Value Added Tax Regulations 1995 – HMRC Notice 703 - appeal allowed in part.

FIRST-TIER TRIBUNAL
TAX CHAMBER

OPEN SAFETY EQUIPMENT LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE W RUTHVEN GEMMELL WS
MEMBER: PETER R SHEPPARD, FCIS, FCIB, CTA

Sitting in public at George House Edinburgh on 16 January 2017

Dr Alexander Deas for the Appellant

Mrs Sharon Spence, Officer of HMRC, for the Respondents

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DECISION

1. This is an appeal by Open Safety Equipment Limited ("OSE") against decisions by HMRC notified on 13 January 2015 for under-declared VAT in the amount of £207,104. This total is made up of £159,707 in respect of output VAT assessed by HMRC at the standard rate on supplies treated as zero-rated exports but where HMRC say there is no evidence of export, and £47,397 of input tax disallowed where the evidence was not satisfactory to HMRC. The amounts of disputed tax related to the periods 06/12, 3/13, 6/13 and 09/13.

2. Evidence was given by Alexander Deas, PhD, FIET.C.Eng ("AD") a director of OSE and by Brian Stewart ("BS"), a Senior Officer of HMRC who visited the business premises occupied by OSE and inspected their books and records on 7 April 2014 and 12 May 2014. BS left his position on 1 August 2014 and the case was taken up by Officer Lynn Greig who notified the assessment to OSE. Both witnesses were credible and were examined and cross-examined.

3. The Tribunal had before them a bundle of documents including BS's witness statement. At the hearing OSE provided three copies of a file of documents, most of which they claimed were more legible copies, which they were, of those provided by HMRC. HMRC raised objections to these documents being presented to the Tribunal as they stated they had not been given copies prior to the hearing.

4. Reference was then made to the directions issued on 28 January 2016 which OSE stated they had complied with. On the face of it, the directions requested all parties to provide a list of documents to the other and for HMRC to bring three copies of the documents on which they wished to rely to the hearing. On further reading of the Directions, however, it was clear that not later than 21 days before the hearing HMRC were obliged to provide the appellants with a "bundle" of documents to include "(a) all the documents on the list of documents served under Rule 27".

5. Having been provided with the list of documents and the right to take copies, the Tribunal were of the view that in relation to these particular directions, the responsibility for producing the documents in "the bundle" and producing three copies lay with HMRC as the Respondents. HMRC had, however, contacted OSE on 21 December 2016 sending the bundle and requesting OSE to advise them if there were any documents missing which they had not been previously made aware of but received no response.

6. During and at the conclusion of the tribunal hearing, the Tribunal were of the opinion that there remained misunderstandings by both parties and that the overriding objective of the Tax Tribunal would be best served by issuing directions to clarify the information and invoices that were available, further information on the origin of the goods supplied and where they were sent and copy statements relating to payment ("the post hearing evidence").

7. The parties were given further time in which to make submissions in relation to any further evidence provided ("the post hearing submissions") and a further request by OSE for a further 30 day extension was considered but refused.

Legislation

8. See Appendix 1.

Cases Referred To

9. See Appendix 2.

The Facts

10. OSE's principal place of business is in St Petersburg, Russia but it also operates from facilities in the UK and China. Of relevance to this appeal, OSE contracts out the manufacture and the shipping of those goods OSE sells, to Electrical & Mechanical Assembly Limited (EMA) who own a factory in Glasgow and where OSE has a place of business for which it does not pay rent. Another contractor is Baltic Assessment Institute ("BAI") in St Petersburg, Russia who, like EMA, provides OSE with operational space. OSE pays these contractors for the manufacturing and shipping costs of goods. There are a minimal amount of transactions where other arrangements are made.

11. The main business activity of OSE is the design, manufacture and sale of diving equipment and, in particular, what are known as rebreather units which in simple terms are breathing backpacks which allow deep sea divers to dive to deeper depths without the need for more oxygen and allow them to work underwater for greatly extended periods of time without having to transport and refill gas cylinders. This is achieved by absorbing carbon dioxide from exhaled air so allowing the air to be re-used. OSE, which was formed in August 2008, contracts out its operations for design, manufacture, sales, accounting and patents to third-party companies.

12. The rebreather units and diving equipment are used for sporting activities, commercial activities, such as examining the hulls of cargo ships, or military use. The weight and size of the units designed for these specialist markets differs with the larger units weighing approximately 51kg ("larger rebreather units"). These larger units are known as "UR units" or "Umbilical Rebreathers". AD estimated that these units had hundreds of parts with a probable maximum of 900 parts.

13. At the time of BS's visit to the facility owned by EMA, approximately 50 sports rebreathers ("smaller rebreather units") were in production and one was on final test and evident on an inspection bench. Also within those premises were a number of plastic crates which were used by EMA for shipping. The larger rebreather units are made outside the EU mainly in Russia. The design work for the rebreathers was not carried out by AD or the other directors but by a contractor, BAI, in Russia. Similarly, OSE has an Australian director and uses an Australian contractor who sells both sports equipment and underwater diving equipment to various commercial and military organisations.

14. AD and his fellow directors acquired OSE in March 2011 as the original management could not obtain the European Union/CE approval whereas they could because of their qualifications, technical expertise and access to test facilities. OSE had purchased a number of parts from Deep Life Limited ("DL"), a company which deregistered for VAT on 12 April 2012.

15. During the 7 April 2014 inspection, HMRC noticed that over £185,000 (gross) of purchases were received from DL many of which they considered appeared after the date of the latter's deregistration. The inspection also noted that the "majority of sales" were with Russia where invoices were seen and which had been treated as zero-rated exports for VAT purposes.

16. It was explained by OSE that the reason worldwide sales were included in the accounts of OSE was to provide full transparency amongst the directors of all the company's activities. The effect of this inclusion was, however, to raise questions and OSE subsequently provide accounts which deal only with units which require VAT and keep separate records for those that they consider do not.

17. At that stage, it became evident that HMRC considered that a majority of sales were with Russia and failed to see sufficient export evidence. At this juncture, one of the numerous misunderstandings in this case became apparent where AD understood the comments to mean that the majority of sales by number (whereas what was meant by HMRC was the majority of sales by value) and was referring to sales shipped by OSE from Russia and which concerned the larger rebreather units. An example was given of sales to Pandora Underwater Systems in Switzerland where the units came from Russia and the technical services delivered over the Internet came from the UK in accordance with the VAT Notice 741A, Section 12.

18. HMRC say that at this meeting AD stated he did not have any export evidence and he did not need any as the goods were exported in baggage. He would, they say, take two sports rebreathers, the smaller rebreather units, at a time, pack each of them in a plastic crate and simply put them through as merchandise in baggage ("MIB"). The reason given for this method of delivery was that there was a high level of corruption in Russia and because of the high value of goods, approximately £25,000 for sporting equipment.

19. AD stated to HMRC that the exports were usually made by its manufacturing contractors, whether in Russia, China or in the UK and that, in the case of Russian-based sales, the goods "went down the corridor" from OSE to BAI to ship them. In the case of exports from the UK, generally the export was arranged by EMA, as OSE's agent, who booked the shipping company or courier directly and invoiced OSE. During the period prior to April 2012, EMA charged DL and DL charged OSE.

20. AD stated that in a few cases some rebreathers were made in the UK and exported as accompanied baggage because in some cases an export licence required that a rebreather had to be accompanied. AD explained that the 32 examples of electronic plane tickets referred in the main to trips made to test equipment or to seek modifications to equipment and not to make sales and that only three of these journeys involved the transport of units which were subsequently sold.

21. At this stage of the enquiry, HMRC's attention turned to the issue of OSE's export by MIB and their concerns that there was insufficient proof to meet the law and regulations which allowed these transactions to be zero-rated and in particular referred to the failure to produce documentation, primarily being C88 Customs' forms. It was in relation to this issue that Mrs Spence said she was instructed in this appeal as regards output tax which HMRC claimed was due by OSE.

22. AD claimed that the reason for this was the failure of the customs facilities at Edinburgh airport which had insufficient staff for him to complete this process when attempting to leave for a flight without an unreasonable delay and without having to visit the airport the day before flying. AD stated that in any event this form of export related to a small number of rebreathers with the majority being exported, either from BAI or EMA, using normal couriers or not exported from the UK at all.

23. HMRC requested copies of OSE's bank accounts in the UK and were advised by AD that the company had struggled to get a UK bank account and had to resort to using an employee's account for the business but said that there were foreign bank accounts. AD stated this was because UK banking legislation made it difficult to open bank accounts where there were any overseas directors or shareholders.

24. On 4 November 2014, HMRC wrote to OSE giving an opportunity to comment on their findings and calculations prior to HMRC making an assessment. In relation to zero rated exports, the letter stated "It appears from the records already seen by my colleague, Mr Stewart, that a high proportion of sales have been declared as zero rated exports, however, although Mr Stewart has been in contact with you since January 2014, he is yet to see evidence of these exports"

25. As stated, on receiving this, AD interpreted the phrase "a high proportion of sales" to mean a high proportion of sales by volume which OSE state they are unable to provide evidence for, as they originated in Russia, rather than a high proportion of sales by value which it became evident was the interpretation given by HMRC. This letter also set out the zero-rated sales and the period to which they related but did not point to any specific transactions which AD claim they only became aware of when they received the Statement of Case.

26. BS stated that on visiting OSE, he had been given a great many records but that he had not time to go through each transaction individually and during the tour of EMA's factory and during the description of OSE's business, he was exposed to a great deal of technical jargon. BS felt that there was insufficient evidence that the sales which he considered to be to an associate company in Russia could be zero-rated exports for VAT purposes because of the failure to provide any export documentation to prove the goods were shipped to Russia.

27. BS stated that there were no bills of lading or invoices from couriers. BS was under the impression from his visit that AD personally took goods to Russia as MIB to avoid the high level of corruption in Russia and because of the high value of the units. Added to this, he was unable to access any bank statements. BS was not aware of the different sizes and weights of the different rebreathers which he saw referred to in the invoices. BS

thought that the invoices dated 25 March 2013, 3 June 2013 and 30 September 2013 might relate to the sales of diving equipment and that he may have seen them during his site visit.

28. The 25 March 2013 invoice referred to five Umbilical Rebreather ('UR') units, the larger rebreather units, which AD stated weighed 150 kg and which, for example, could not possibly have been carried in a plastic crate, one of which was brought to the Tribunal hearing, let alone carried on an aeroplane as MIB/passenger luggage. AD stated that these five units had been assembled in Russia and delivered in Russia.

29. The 3 June 2013 invoice from OSE to BAI related to 50 jacket assemblies which had been, it was claimed, made in Hungary and are required for buoyancy. Shipping these, it was stated, would require 17 of the plastic crates exhibited to the Tribunal and could not have been taken as passenger luggage.

30. The 30 September 2013 invoice also related to 50 jacket assemblies and a USR rebreather. The amounts in these invoices were in euros but, on the conversion rate stated, corresponded to the entries on which HMRC had made an assessment.

31. Throughout the discussions between OSE and HMRC, OSE stated that they did not know what transactions were the subject of the output tax assessment until they had received the Statement of Case some weeks before the Tribunal hearing. OSE say that they could now produce the relevant invoices to show that these are goods which have never been in the UK and cited the 25 March, 3 June and 30 September invoices in support of the assessment for output tax for the relevant periods.

32. Similarly in relation to the input tax claims, OSE drew the Tribunal's attention to the invoice from Biggart Baillie which related to the period 06/12 in an amount of £1,250 and claim that, other than the transaction "Import UMG" for £4,240, for which they no longer had the appropriate documentation, they have the relevant documentation in the form of purchase invoices, evidence of payment or import documents to substantiate the claims.

33. In view of this evidence, HMRC stated that they would revisit the calculation of the assessments and the consequent effect this would have on the penalties charged.

34. A further visit by HMRC took place on 12 May 2014 with BS accompanied by Officer Julie Nelson at which time a discussion took place about MIB in which it was explained to BSE that the UK assembled rebreather tanks, the smaller rebreather units, are distributed/transported in plastic crates brackets (1 unit, 1 crate) with a total weight of up to 25 kg and put through normal check-in baggage.

35. BS again asked for evidence of OSE's export and bank statements but none were produced so Lynn Greig of HMRC issued the assessment by letter dated 13 January 2015. As a result of these under-declarations, OSE became liable to a penalty under Schedule 24 of the Finance Act 2007, notified on 19 August 2015, in an amount of £98,705.75.

36. On 24 March 2016, BS was asked by Mrs Spence to review over 300 pages of documents in relation to OSE's case, including 100 pages of invoices from EMA to DL and OSE and an agreement between Pandora and OSE and related documents. BS found that the documents contained little or no relevance to the assessment under appeal and that the majority of the paperwork was dated prior to the period under assessment.

37. BS submitted a signed copy of his witness statement to the Tribunal at the hearing.

38. Throughout the hearing OSE claimed that they could not provide evidence for something they had not done, i.e. export and, accordingly, could not prove a negative. OSE were asked if they could produce further documentation to evidence the transactions under the assessment in relation to the output tax, in addition to the three invoices which had been identified and considered by the Tribunal. Similarly, OSE were asked if they could produce other documentation and invoices in relation to the input claims.

39. It was agreed by the parties that directions would be issued giving OSE a period of time in which to produce these documents and, thereafter, for the parties and, principally HMRC, to make submissions in relation to those documents and, where necessary, as had already been conceded, to consider amending that assessment and the level of penalties.

40. The Tribunal accordingly issued directions requesting this information, together with a request for details of OSE's company in Russia, including how it operates and why invoices were issued by the UK registered company if supplies were made and sold by the Russian business. In addition, OSE were asked to provide official or commercial evidence that the disputed supplies' sales were made in Russia and not in the UK.

41. The post hearing evidence of OSE provided an explanation of how it traded with companies in Russia with which it trades and why invoices were issued by the UK registered company when the supplies were made and sold by the Russian business.

42. In summary, OSE set out the commercial realities of working in Russia where they claimed that there was in effect a failure of the rule of law and instead that there was a large body of regulations, some of which were introduced retrospectively and where failure to comply can result in Draconian penalties. The regulations and Russian tax codes are, they say, ambiguous and in particular impose limits on trading by Western companies and only Russian trading companies are permitted to trade in Russia. These regulations do not, however, restrict selling something made in Russia in a facility owned by a Russian trading company where the contractual arrangement is that an overseas company owns the goods or products.

43. OSE say that in a Russian tax inspection in 2002, a design centre run by their current management team was found to have made one sale (out of thousands) to a Russian entity and was fined a seven figure sum. This was appealed to the courts which was successful but the Russian tax authorities obtained copies of OSE's bank statements and sent those to HMRC in the UK suggesting to HMRC that they look at OSE's UK compliance in respect of the Russian activity.

44. HMRC apologised that they had received these bank account statements from their counterparts in Russia and confirmed that it was unlawful for them to receive them in

this manner but, as they had received them, they asked OSE to reconcile every entry with their UK CT 600 accounts. As a consequence of this, OSE changed their business model for business worldwide, other than in the home state, which affected how they operated in the UK as well as in Russia.

45. The consequence of this was that they contracted an independent Russian company to provide everything OSE required to operate in Russia and also to distribute their products in Russia. Consequently they say, all sales are from the UK company to the Russian company because it is unlawful for OSE to do otherwise in Russia.

46. OSE's explanation of how this model of working operates in the UK is that EMA operate in a similar manner to BAI, other than that BAI distributes OSE's products, so EMA send OSE invoices to OSE customers, because OSE is a registered UK business. If OSE were to be registered overseas, eg in Portugal, then they would assign distribution to EMA just as they do to BAI, such that EMA invoice their customers and OSE sell to EMA.

47. The arrangements between BAI and OSE are similar to those between EMA and OSE in that BAI provide space, manpower, development, assembly, testing and acting as a contractor but, additionally, BAI act as a distributor for OSE under a separate distribution agreement. BAI have refused OSE authority to disclose the service agreement between OSE and BAI, out of concern that if HMRC supplied it to the Russian tax authorities then BAI will incur substantial costs in going through each line proving compliance with Russian law, in the same way as happened when the information was sent by the Russian authorities to HMRC.

48. OSE has never held any shares in BAI nor have OSE been represented in any way on the board of BAI. In 2013 BAI bought around 10% of OSE's shares during an investment round and received a board seat on OSE along with a UK investor who bought 12.5% of OSE's shares.

49. OSE say that invoices were issued in the UK to BAI in Russia because Russian regulations pertaining to OSE status in Russia do not allow OSE to issue invoices from a Russian address, even when the goods are in Russia and OSE are running a production activity in Russia. In two of the four BAI invoices queried by HMRC, the goods originated from OSE's activity in China, so the actual transfer of goods is not from Russia, but China. OSE does not raise invoices with any Chinese address because its status in China is the same as its status in Russia.

50. OSE does not have a legal status to allow it to import into Russia itself, so BIA are the importer. This is why the invoices are under FOB or Ex-Factory terms, and BAI arrange the shipping of goods from China.

51. OSE prefer to sell the goods in China as FOB or Ex-Factory, because OSE perceives significant risk in the import of goods into Russia due to what they say is the highly inefficient customs clearance processes in Russia and a mountain of shifting regulations. The two sales that were made within Russia by "wheeling the goods down the corridor"

from OSE's dedicated space in BAI's premises to BAI, in the same building, are sales where no customs clearance is involved.

52. OSE say that BAI are not present in any shape or form outside Russia and never have been.

53. OSE provided further copy invoices in relation to the output and input tax assessments and provided a presentation document in relation to UR units, the large rebreather units, in commercial diving; delivery notes dated 25 June 2012 and 25 March 2013, the latter being for sale in China, and accompanying pre-shipment checklists for UR units; and delivery notes dated 3 June 2013 and 30 September 2013 where delivery was by Pandora Underwater Systems in Switzerland. The delivery note of 3 June 2013 stated that the product in question was developed by OSE but produced and distributed by Pandora in Switzerland and USA. The delivery note of 30 September 2013 stated that the product was developed by OSE but produced and distributed by Pandora.

54. OSE also provided RBS bank statements for the period 12 June 2012 to 30 April 2013 and included a commentary on each document and a request for a further extension of the period in which to provide additional reconciliation and source invoices.

Submissions by OSE

55. OSE say that there is sufficient evidence of export, where this can be produced and in any event dispute whether the requirement for evidence of export applies in cases where no export from the UK occurred, in particular for sales from non-UK localised facilities.

56. OSE further dispute the degree of evidence required when the export is a technical service delivered through the Internet.

57. In relation to input VAT, OSE say that purchase information was available for the current period during the initial inspection but that HMRC ran out of time as it went through every single sales invoice from the company's inception checking every VAT computation.

58. OSE say that even where they produce invoice evidence, such as the Biggart Baillie invoice, this was disputed because they could not produce evidence of a bank payment.

59. OSE say that they have not received any information about why HMRC are rejecting input VAT for suppliers in one period when it is allowed in others, for example, from EMA, despite having provided a full list of 138 invoices that OSE has from EMA to end 2015, together with their VAT break down.

60. In relation to the output tax assessment, OSE say that during the initial VAT inspection, the inspectors asked AD about exports and accompanied goods and then latched onto that issue, ignoring the fact it related to just three export sales. OSE then received a broad-brush assessment for output VAT on all zero-rated sales in four periods. In response, they provided a full and detailed VAT reconciliation. They reject HMRC's claim that there were insufficient records kept and say that they had sight or copy of invoices by the main export agent used by OSE to ship from the UK, namely EMA. They

say that this along with the sales invoice and the payment by the buyer is evidence the export occurred.

61. OSE say that they consider HMRC were aware that the sales in Russia were made from OSE's facility in Russia and were treated by OSE as not UK VAT localised and, accordingly, declared as non-VAT, or outside the scope of UK VAT, unless the buyer was possibly UK localised, in which case the UK VAT was charged, paid and reported for the sales. The same applied for exports they made from China.

62. OSE say that HMRC fails to address the localisation issue but appears to instead - proceed on the basis that all exports are MIB exports from the UK which is absurd and in fact only three were. For sales involving exports from the UK to outside Europe or to VAT registered entities in Europe, each sale has a sale invoice and a payment received. All but three zero-rated exports in that period were performed using couriers. In the case of the three not made with couriers, the goods were taken as MIB, exhibited and then shipped with evidence that a sale had taken place, namely as a sales invoice, customer payment and follow-up correspondence with the customer.

63. OSE say there is no basis in law or reality for HMRC to require documentation showing proof of export from the UK of goods manufactured outside the UK and Europe and sold outside the UK and Europe to non-EU and non-UK customers. When in any doubt OSE paid VAT on overseas sales.

64. OSE further say that HMRC are assessing output VAT for export of goods whereas in fact the supply was of technical services delivered over the Internet when VAT Notice 714A, Section 12 states that non-output VAT is applicable. Accordingly, there is no basis in law for HMRC to apply UK VAT to zero-rate or non-VAT sales by OSE, for example, sales to Pandora Underwater Systems in Switzerland. When technical services are provided as a means of research and development, there is no tangible item being exported, there is therefore no export documentation other than the contract with the customer, invoices and payments from the customers.

65. OSE say that there is alternative proof to the Form C88 which can provide adequate evidence of export in respect of the three shipments because they provide, on the balance of probabilities, sufficient evidence that the export was made and the documentation meets the statutory minimum requirements.

66. That alternative evidence includes a sale invoice, proof of payment and receipt by the customer or local shipping to the customer. OSE say that the problems of providing custom stamped C88 forms at UK airports is well known and has been the subject of a published complaint to and response by the Parliamentary and Health Service Ombudsman.

67. They say that DTI BERR rules require some rebreathers to be either accompanied by a user or to have an export licence. As a result, the movement of rebreathers as accompanied baggage is common within the industry but in OSE's case relates to only three sales out of hundreds of units.

68. OSE say they have met the conditions in Notice 703 in respect of all goods exported from the UK and that HMRC appear to be attempting to impose the conditions on services exported from the UK on goods made and supplied outside the UK.

69. In respect of evidence to support input tax claims, OSE say they can provide this evidence in the form of copy invoices and bank statements. They conceded that they have been unable to trace evidence supporting one import in period 03/2013 where VAT of £4,240 was claimed.

70. The post hearing submissions by OSE relate to their explanation of the difficulties they had encountered in trading in Russia, their experience of having a dispute with the Russian tax authorities, their experience of HMRC having received unlawful information and the subsequent action taken and, consequently, the change in their business model which they adopted for their business worldwide other than in the home state.

71. In essence, OSE say that the invoices are issued by OSE in the UK to BAI in Russia because Russian regulations pertaining to OSE's status in Russia does not allow OSE to issue invoices from a Russian address, even when the goods are in Russia and OSE is running a production activity in Russia.

72. They say that two of the four invoices relate to goods that originated from China so the actual transfer of goods is not in Russia, they are in China, and that OSE does not raise invoices with any Chinese address because its status in China is the same as its status in Russia. OSE does not have a legal status to allow it to import into Russia itself, so BAI is the importer. This is why the invoices are under FOB or Ex-Factory terms and why BAI arrange the shipping of goods from China.

73. OSE prefer to sell goods in China as FOB or Ex-Factory and the two sales that were made in Russia by moving the goods down the corridor from OSE space within BAI's premises to BAI, in the same building, are sales where no customs clearance is involved.

HMRC's submissions

74. HMRC say that OSE is not entitled to zero-rate his supplies because they have failed to meet the conditions defined in Section 30(6) of VATA and because they have not satisfied HMRC that the goods have been exported to a place outside the Member States. Similarly, OSE has not met the legislative conditions contained in Public Notice 703 which HMRC are entitled by law to impose.

75. OSE has not provided any of the requisite export advice, bank statements or contracts and has received no paperwork from the UK or Russian authorities when AD left the UK with the goods or when he brought the goods into Russia. Therefore OSE is not in a position to provide evidence of export in respect of disputed supplies.

76. Furthermore, OSE has not met the requirements nor provided proof or evidence when exporting by means of MIB.

77. Consequently, VAT is due at the standard rate on supplies of goods which the appellant has wrongly treated as zero-rated exports.

78. HMRC say that OSE is not entitled to the input tax claimed on the purchases set out in the assessment because the evidence that was provided was either non-existent or not satisfactory for various reasons. For example, the supplier was deregistered or there was an invalid invoice or no purchase invoice or no evidence of payment or no C79 import documents.

79. HMRC's post hearing submissions and consideration of the post hearing evidence set out that they had amended their assessment of input tax from £47,397 to £42,772 as a result of the receipt of missing evidence and made no change to their assessment of £159,707 of output tax on the same basis as before. They also stated that the related penalties under Schedule 24 of the Finance Act 2007, which had not been appealed, would be revised accordingly.

80. HMRC maintain their position in respect of the assessment for output tax on the four transactions at issue on the grounds previously set out but with the additional submission that if, as OSE said, the goods were supplied in Russia, not from the UK, OSE had not provided any tangible evidence to demonstrate that these supplies took place in Russia as opposed to the UK.

81. HMRC state that the four transactions at issue account for almost 90% of the net sales declared in OSE's VAT returns to the periods 04/12 to 12/13 and that OSE and their advisers could be in no doubt at an early stage as to which transactions proof of export was required.

82. Despite this, OSE continue to maintain that the goods were exported as MIB and as proof of export, provided HMRC with 39 airline tickets by email of 3 March 2015. This, HMRC say, was contradicted in OSE's letter of 11 January 2016 where it states that in a small number of cases a rebreather is re-exported as accompanied baggage.

83. HMRC say that there is a contradiction in OSE's evidence that whereas they refer to carrying breathers in baggage, at the hearing, they stated that the rebreathers were to heavy/bulky to be taken in baggage. HMRC say that a crate and not a rebreather was produced at the tribunal hearing and so proves nothing. They say the production of airline tickets and flight receipts does not provide sufficient commercial proof of export.

84. HMRC rely on the findings of the Court of Appeal in *Henry Moss of London Ltd & Another v C & E Commissioners* [1981] STC 139 as evidence to illustrate that the conditions imposed by Notice 703 are reasonable. This case relates to the provision of zero rating of goods for export. Similarly, they refer to the decision in *Keen Jewellery Limited* 2009 where proof of export was considered in relation to a pearl necklace taken to the Channel Islands and sold there.

85. HMRC say that, in complete contradiction to the information provided to HMRC previously, OSE has contended more recently, and at the hearing, that the goods at issue were not actually exported from the UK after all and, therefore, the supplies were outside the scope of UK VAT.

86. HMRC made reference to Section 7 of VATA which contains the provisions for goods supplied outside the UK to be outside the scope of UK VAT:- "…….. if the supply

of any goods does not involve their removal from or to the United Kingdom they shall be treated as supplied in the United Kingdom if they are in the United Kingdom and otherwise shall be treated as supplied outside the United Kingdom."

87. HMRC say that in the absence of corroborative evidence to support OSE's recent contention that the supplies were not made in the UK, OSE has not demonstrated that supplies at issue are outside the scope of UK VAT and, therefore, Section 7 VATA is not applicable.

88. They say that the post hearing evidence, being the invoices dated 25 June 2012, 25 March 2013, 3 June 2013 and 30 September 2013, are evidence that supplies have been made, that they are issued by OSE UK which suggests that the goods were supplied by the UK company. They say the presentation document on UR units and commercial diving does not provide proof of export nor proof that goods were supplied to or from Russia; that the photographs provided of the EMA rebreather assembly area in the UK again provides no proof of export and instead would suggest goods were supplied from the UK.

89. They say that the delivery notes and shipping checklists are documents generated by OSE which had not been provided previously and that they have an official looking stamp which bears the name of BAI in Russia. HMRC say they are not adequate proof of export alone and moreover question why these types of documents would be required, if the goods were moved from one part of a building in Russia to another part of the same building in Russia.

90. HMRC say that the bank statements do not relate to any of the payments supposedly going to the accounts quoted on the invoices at issue, including one invoice which was to be paid into the RBS account. In relation to the other three invoices, they were to be paid into a bank account with Citadel Bank in Riga and the statements have never been seen nor supplied.

91. HMRC say that if relevant bank statements had been provided it would have gone some way to demonstrate how supplies at issue were paid for and where payment came from and to whom the supplies were made.

92. In relation to the input tax assessments, HMRC maintained their previous submissions for disallowing the tax.

Decision

93. The Tribunal considered that this case involved complex matters of fact, technical jargon, supplies of goods which were, in their view, unfamiliar to HMRC, dealt with alleged supplies to countries such as Russia where the terms of trade, commercial practices and regulations were complicated, convoluted and restrictive in circumstances where the corporate structure and relationships of OSE were by no means simple nor clear and which, as a consequence, had resulted in multiple misunderstandings between the parties during the communications leading up to the hearing, at the hearing, and which continued in the post hearing evidence and submissions.

94. Several matters arose during the hearing which demonstrated this. The most significant was the issue of what type of rebreather unit was being considered by both the parties when evidence was being requested or provided. Coupled to this was the claim by OSE that they did not know which type of supply was the subject of the assessment until they received the Statement of Case and the ambiguity of referring to "a high proportion of sales" which was interpreted differently by each party when making enquiries and providing responses.

95. AD, the director of OSE, who represented OSE at the hearing, provided long and detailed explanations which were very thorough but which, in the opinion of the Tribunal, did not entirely displace what the Tribunal consider to be the fundamental misunderstandings. The most prominent of these was in relation to the size of the rebreather units and, consequently, what type of rebreather, small or large, was in question when an issue arose.

96. The Tribunal consider that the rebreather units that were in the UK were smaller rebreather units that fitted into plastic crates and that much of the evidence and debate in relation to these was irrelevant in relation to the four invoices being the subject of the output tax assessments, which instead the Tribunal considered on the evidence before them, related to larger rebreather units. The Tribunal considered that the larger rebreather units were never in the UK and that only one of that type of unit was ever seen in the UK and a credible explanation given for its presence.

97. The Tribunal accepted the difficulties of OSE in proving a negative that the larger rebreather units were not in the UK but also took into account the lack of actual evidence put forward by HMRC that the larger rebreather units, as opposed to the smaller rebreather units, weighing half as much and which were much smaller in size, were in the UK.

98. Accordingly, on the evidence before it and on the balance of probabilities, the Tribunal considered that the four invoices, being the subject of the output tax assessment, related to larger rebreather units which should be treated as supplied outside the United Kingdom as they had never been in the United Kingdom in terms of Section 7 VATA. Further confusion had occurred because the sales of these units had for VAT purposes been treated as "zero-rated" to indicate no output VAT was payable. To a VAT specialist a zero-rated sale of goods such as rebreathers suggests an export. As the goods were never in the United Kingdom there was no export. A supply of goods manufactured and sold outside the United Kingdom does not attract UK VAT and is categorised as outside the scope of the UK VAT system, so it is neither zero-rated nor standard rated.

99. The Tribunal accepted that the exceedingly complex corporate structure, and the historic dealings and relationships, of OSE and its, albeit internally transparent and helpful, decision to record all its sales in its accounts, including those where there was no UK supply, had the ability to cause confusion and misunderstanding in anyone analysing those accounts. The position appeared to be exacerbated by the request by HMRC following the information they had received from the Russian tax authorities and OSE's reaction to prevent a similar situation arising in the future.

100.The Tribunal accept the explanations put forward by OSE as the reasons why they had issued the invoices and included the transactions within their accounts but did not accept that this expressly or impliedly meant that there were supplies from the UK, in all the circumstances set out.

101.The Tribunal do not consider that the authorities put forward by HMRC were relevant as these related to proof of export when, in the Tribunal's view, there was no export from the UK. Similarly, the Tribunal consider that the four invoices at issue contained sufficient information to substantiate the submissions of OSE that the larger rebreather units were not in the UK and accepted their submissions as credible that the sales invoices were issued from OSE in the UK, although in two of the disputed sales the goods were manufactured and supplied in Russia. Because of legal restrictions and practices in Russia, in the other two disputed sales, the goods were imported by BAI in Russia from China and sold to BAI Russia.

102.The Tribunal considered that HMRC were correct in their submissions that the lack of bank statements did not assist in OSE proving how the supplies at issue were paid for, where payment came from and to whom the supplies were made, but the Tribunal did not consider this was material enough, when taken with all the other evidence and the reasons given in relation to the provision of banking facilities, to change their conclusions.

103.Accordingly, in relation to the output tax assessment of £159,707, the appeal is allowed.

104. In relation to the input tax, the Tribunal consider that OSE have had more than sufficient time and requests from HMRC and the Tribunal to provide the relevant documentation to successfully challenge the assessment and have failed to do so. Accordingly, the input tax assessment, as amended, of £42,772 is upheld and on that issue the appeal is dismissed.

105.As penalties under Schedule 24 of the Finance Act 2007 had not been appealed, these are also applicable and should be reduced in line with the reduced assessments as appropriate.

106.This decision 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.

RUTHVEN GEMMELLWS
TRIBUNAL JUDGE
RELEASE DATE: 28 MARCH 2017

Appendix 1 Legislation [and HMRC Guidance Note]

Value Added Tax Act 1994

Section 7 Place of supply.

(1) This section shall apply (subject to sections 14, 18 and 18B) for determining, for the purposes of this Act, whether goods or services are supplied in the United Kingdom.

(2) Subject to the following provisions of this section, if the supply of any goods does not involve their removal from or to the United Kingdom they shall be treated as supplied in the United Kingdom if they are in the United Kingdom and otherwise shall be treated as supplied outside the United Kingdom.

(3) Goods shall be treated —

(a) as supplied in the United Kingdom where their supply involves their installation or assembly at a place in the United Kingdom to which they are removed; and

(b) as supplied outside the United Kingdom where their supply involves their installation or assembly at a place outside the United Kingdom to which they are removed.

(4) Goods whose place of supply is not determined under any of the preceding provisions of this section shall be treated as supplied in the United Kingdom where—

(a) the supply involves the removal of the goods to the United Kingdom by or under the directions of the person who supplies them;

(b) the supply is a transaction in pursuance of which the goods are acquired in the United Kingdom from another member State by a person who is not a taxable person;

(c) the supplier —

(i) is liable to be registered under Schedule 2; or

(ii) would be so liable if he were not already registered under this Act or liable to be registered under Schedule 1; and

(d) the supply is neither a supply of goods consisting in a new means of transport nor anything which is treated as a supply for the purposes of this Act by virtue only of paragraph 5(1) or 6 of Schedule 4.

(5) Goods whose place of supply is not determined under any of the preceding provisions of this section and which do not consist in a new means of transport shall be treated as supplied outside the United Kingdom where—

(a) the supply involves the removal of the goods, by or under the directions of the person who supplies them, to another member State;

(b) the person who makes the supply is taxable in another member State; and

(c) provisions of the law of that member State corresponding, in relation to that member State, to the provisions made by subsection (4) above make that person liable to VAT on the supply;

but this subsection shall not apply in relation to any supply in a case where the liability mentioned in paragraph (c) above depends on the exercise by any person of an option in the United Kingdom corresponding to such an option as is mentioned in paragraph 1(2) of Schedule 2 unless that person has given, and has not withdrawn, a notification to the Commissioners that he wishes his supplies to be treated as taking place outside the United Kingdom where they are supplies in relation to which the other requirements of this subsection are satisfied.

(6) Goods whose place of supply is not determined under any of the preceding provisions of this section shall be treated as supplied in the United Kingdom where—

(a) their supply involves their being imported from a place outside the member States; and

(b) the person who supplies them is the person by whom, or under whose directions, they are so imported.

(7) Goods whose place of supply is not determined under any of the preceding provisions of this section but whose supply involves their removal to or from the United Kingdom shall be treated—

(a) as supplied in the United Kingdom where their supply involves their removal from the United Kingdom without also involving their previous removal to the United Kingdom; and

(b) as supplied outside the United Kingdom in any other case.

(8) For the purposes of the preceding provisions of this section, where goods, in the course of their removal from a place in the United Kingdom to another place in the United Kingdom, leave and re-enter the United Kingdom the removal shall not be treated as a removal from or to the United Kingdom.

(9) The Commissioners may by regulations provide that a notification for the purposes of subsection (5) above is not to be given or withdrawn except in such circumstances, and in such form and manner, as may be prescribed.

(10) A supply of services shall be treated as made—

(a) in the United Kingdom if the supplier belongs in the United Kingdom; and

(b) in another country (and not in the United Kingdom) if the supplier belongs in that other country.

(11) The Treasury may by order provide, in relation to goods or services generally or to particular goods or services specified in the order, for varying the rules for determining where a supply of goods or services is made.

Sections 24 to 26 Payment of VAT

Section 30 Zero-rating.

(1) Where a taxable person supplies goods or services and the supply is zero-rated, then, whether or not VAT would be chargeable on the supply apart from this section—

(a) no VAT shall be charged on the supply; but

(b) it shall in all other respects be treated as a taxable supply;

and accordingly the rate at which VAT is treated as charged on the supply shall be nil.

(2) A supply of goods or services is zero-rated by virtue of this subsection if the goods or services are of a description for the time being specified in Schedule 8 or the supply is of a description for the time being so specified.

(2A) A supply by a person of services which consist of applying a treatment or process to another person's goods is zero-rated by virtue of this subsection if by doing so he produces goods, and either—

(a) those goods are of a description for the time being specified in Schedule 8; or

(b) a supply by him of those goods to the person to whom he supplies the services would be of a description so specified.

(3) Where goods of a description for the time being specified in that Schedule, or of a description forming part of a description of supply for the time being so specified, are acquired in the United Kingdom from another member State or imported from a place

outside the member States, no VAT shall be chargeable on their acquisition or importation, except as otherwise provided in that Schedule.

(4) The Treasury may by order vary Schedule 8 by adding to or deleting from it any description or by varying any description for the time being specified in it.

(5) The export of any goods by a charity to a place outside the member States shall for the purposes of this Act be treated as a supply made by the charity—

(a) in the United Kingdom, and

(b) in the course or furtherance of a business carried on by the charity.

(6) A supply of goods is zero-rated by virtue of this subsection if the Commissioners are satisfied that the person supplying the goods—

(a) has exported them to a place outside the member States; or

(b) has shipped them for use as stores on a voyage or flight to an eventual destination outside the United Kingdom, or as merchandise for sale by retail to persons carried on such a voyage or flight in a ship or aircraft,

and in either case if such other conditions, if any, as may be specified in regulations or the Commissioners may impose are fulfilled.

Section 73 Failure to make returns etc.

Value Added Tax Regulations 1995

Regulation 29 Claims for input tax

Regulation 129 Supplies to overseas persons

(1) Where the Commissioners are satisfied that —

(a) goods intended for export to a place outside the member States have been supplied, otherwise than to a taxable person, to —

(i) a person not resident in the United Kingdom,

(ii)a trader who has no business establishment in the United Kingdom from which taxable supplies are made, or

(iii) an overseas authority, and

(b) the goods were exported to a place outside the member States,

the supply, subject to such conditions as they may impose, shall be zero-rated.

(2) This regulation shall not apply in the case of a supply to any person who is a member of the crew of any ship or aircraft departing from the United Kingdom or the Isle of Man.

5 **HMRC Guidance**

VAT Notice 703: export of goods from the UK

Paragraph 6 Proof of Export

Paragraph 7.3 Merchandise in Baggage (MIB)

Appendix 2

Cases Referred to

Henry Moss of London Ltd and Another v. C & C E Commissioners [1981] STC 139

Keen Jewellery Ltd v. HMRC [2206] London Tribunal Centre Decision Number 20096