Appeal number: FTC/14/2011
[2012] UKUT 132 (TCC)

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER
ON APPEAL FROM THE FIRST-TIER TRIBUNAL (TAX CHAMBER)

BETWEEN:

(1) BENRIDGE CARE HOMES LIMITED
(2) MRS AND MRS P L MCLAUGHLIN
(trading as BENRIDGE REST HOME)

Appellants

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: JUDGE MALCOLM GAMMIE CBE QC
JUDGE CHARLES HELLIER

Sitting in public at 45 Bedford Square on 15 August 2011

Nigel Gibbon (Solicitor) instructed by Andrew Needham, VAT Specialists Ltd for the Appellant

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

DECISION

Introduction

1. This is an appeal from a decision of the First-tier Tribunal (Tax Chamber) (Chairman: John Dent) of 24 September 2010. The relevant facts can be briefly summarised. The second appellants, Mr and Mrs McLoughlin, operated in partnership a residential care home for the elderly from November 1980 until September 1986. At that point they incorporated their business and from September 1986 the care home was operated by the first appellant, Benridge Care Homes Limited. We shall refer to the business as conducted by the second appellants as "the Partnership" and the business as conducted by the first appellant as "the Company". We refer to the business as conducted by both as "Benridge".

2. Following the decision in *Kingscrest Associates Ltd v Commissioners of Customs and Excise* [2005] STC 1547, Benridge applied to be registered for VAT. The Company was registered on 30 October 2008 with effect from 15 September 1986. The Partnership was also registered on 30 October 2008 but with effect from 30 November 1980. The Partnership submitted a final VAT return for the period 30 November 1980 to 14 September 1986 showing net VAT reclaimed of £19,209.43. The Company submitted a final VAT return for the period 15 September 1986 to 31 March 1992 (when the Company ceased to trade) showing net VAT reclaimed of £47,713.34.

3. The returns prompted the Respondents to inspect Benridge's records, following which they wrote to the Appellants purporting to reduce the repayment claims to nil. Their justification for this action was that the returns did not correctly record amounts due as output tax for the periods in question. The input tax figures had been extracted from the annual accounts but no equivalent figure had been reconstructed for output tax. Furthermore, the Respondents considered that if the accounts had been used to estimate Benridge's output tax it would have shown that an amount was due to the Respondents rather than the reverse.

4. The Appellants accepted that their returns understated the amount of output tax. Indeed, in their grounds of appeal to this Tribunal the Appellants candidly admit that "the VAT return in this instance was incorrect" but the Appellants nevertheless go on to say that the First-tier Tribunal erred in law in deciding that the respondent Commissioners had the *vires* to reduce to nil the input tax deducted in the Appellants' returns. The Appellants explained that it had not been possible to agree a figure with the Councils to which the care services in question had been supplied. The Councils did not have the records to show the amount of care home fees that they had paid and were unwilling to agree 'best estimate' figures. Benridge said, however, that there was no risk to the Revenue because any output tax accounted for by Benridge could have

been reclaimed by the Councils to which it would have been charged. Accordingly, on the basis that the Respondents accepted that the input tax figures were reasonably calculated, Benridge contended that it was not open to the Respondents to disallow the input tax.

5. The First-tier Tribunal disagreed. It held that it was not open to a taxpayer to claim to recover input tax by under-assessing output tax for a period. The Tribunal therefore dismissed the Appellants' appeals and the question for us is whether the Tribunal arrived at the correct decision.

The legislative framework

6. By sections 1 and 4 Value Added Tax Act 1994 ("VATA"), VAT is charged in accordance with the provisions of the Act on the supply of goods or services 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.

7. Section 25 VATA provides as follows—

> "(1) A taxable person shall—
>
> (a) in respect of supplies made by him, …
>
> account for and pay VAT by reference to such periods (in this Act referred to as "prescribed accounting periods") at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.
>
> (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.
>
> (3) If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then, subject to subsections (4) and (5) below, the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the Commissioners; and an amount which is due under this subsection is referred to in this Act as a "VAT credit".
>
> (4) The whole or any part of the credit may, subject to and in accordance with regulations, be held over to be credited in and for a subsequent period; and the regulations may allow for it to be so held over either on the taxable person's own application or in accordance with general or special directions given by the Commissioners from time to time.
>
> (5) Where at the end of any period a VAT credit is due to a taxable person who has failed to submit returns for any earlier period as

required by this Act, the Commissioners may withhold payment of the credit until he has complied with that requirement.

(6) A deduction under subsection (2) above and payment of a VAT credit shall not be made or paid except on a claim made in such manner and at such time as may be determined by or under regulations; and, in the case of a person who has made no taxable supplies in the period concerned or any previous period, payment of a VAT credit shall be made subject to such conditions (if any) as the Commissioners think fit to impose, including conditions as to repayment in specified circumstances."

The Appellants' contentions

8. The Appellants' contentions were straightforward. Mr Gibbon said that section 25(2) entitled taxpayers to credit input at the end of the prescribed accounting period. In this case Benridge had claimed the deduction of the stated amounts of input tax in accordance with section 25(2) and Regulation 29 of the VAT Regulations 1995 (SI 1995/2518). Accordingly, section 25(3) required HMRC to repay the input tax to the extent that it exceeded the output tax shown in the return.

9. Mr Gibbon noted that both the First-tier Tribunal in reaching its decision and the Respondents in supporting it were in fact objecting to the fact that Benridge had under-declared its output tax for the prescribed period. Mr Gibbon did not dispute that the output tax was understated and, as we have noted, this was a specific admission by the Appellants in their grounds of appeal. Mr Gibbon said, however, that the Respondents had chosen to deal with the understatement by reducing the input tax figure to nil, which was not a step that was open to them.

10. Mr Gibbon went on to consider the Respondents' options for dealing with VAT returns that they regarded as being incorrect because they understated output VAT. He noted that section 73(1) of the Act allowed the Respondents to assess the correct amount of the VAT due to the best of their judgment. He also noted that Regulations 34 and 35 provided other means of correcting the position. What they were not entitled to do, however, was to reduce to nil input tax figures that were agreed to be correct.

11. He went on to argue that the Respondents had formed the view that the proper method for calculating output tax was to use the turnover figures shown in the accounts. Nevertheless, the Respondents had made no attempt to estimate any output tax figure. Instead their decision letters, which he said should be regarded as assessments, had reduced the output tax figure to nil (rather than attempting to increase the figure assessed) and had disallowed the input tax. In essence, Mr Gibbon invited us to reverse the First-tier Tribunal's decision and to confirm the figures shown in the VAT returns on the basis that the Respondents had accepted that the input tax figure was correct and had not

sought to increase the output tax figure in any assessment, even though Benridge admitted that the output tax figure was under-stated.

12. Mr Gibbon said that, in essence, there was no *vires* for the Respondents' action. The fact that in adopting the course that they had, they were acting in accordance with their published policy on changes in interpretation of the law did not confer on them any power to do what they had done. The input tax should therefore be repaid as claimed in the return and the First-tier Tribunal had erred in concluding otherwise.

The Respondents' contentions

13. In its conclusions the First-tier Tribunal referred to the Respondents' decision letters reducing the output and input tax figures in the VAT returns to nil as assessments. Mr Chapman for the Respondents accepted that the Tribunal was wrong if it had in fact so regarded the letters but suggested that their mistake was purely one of labelling and did not affect the outcome. He also pointed out by reference to *BUPA Purchasing Ltd v Commissioners for Revenue and Customs (No 2)* [2008] STC 101 (hereafter "*BUPA*") that it is not possible to assess output tax and input tax separately (see Arden LJ at [36] to [42]). An assessment functions to assess the amount of VAT due, which is the outcome produced by deducting input tax from output tax.

14. Mr Chapman said, however, that the letters were still effective to disallow Benridge's claim for a VAT credit following verification. The authority for this he derived from *R (on the application of UK Tradecorp Ltd) v Commissioners of Customs and Excise* [2005] STC 138 (see Lightman J at [17] and [30]). Furthermore, he said that the First-tier Tribunal had correctly relied upon *Sunningdale Golf Club v Commissioners of Customs and Excise* [1997] VATDR 79. In that case the VAT and Duties Tribunal had noted that input tax was simply an element in the calculation of the output tax for which a taxable person must account and that it would never be right to repay input tax where there is a net liability for output tax because the input tax would already have been 'repaid' by offset against the output tax.

15. Mr Chapman formulated the following propositions of law—

    i) Input tax is an element in the calculation of output tax that the taxpayer must pay;

    ii) There is no right to a VAT credit for input tax without reference to the output tax; and

    iii) If the output tax exceeds the input tax figure then credit will already have been given for that input tax.

    Mr Chapman further supported those propositions by reference to *Proceedings brought by Uudenkaupungin kaupunki* (Case C-184/04) [2008] STC 2329, paragraph 24, *Commissioners of Customs and Excise v University of Sussex*

[2004] STC 1 (per Auld LJ at [146] to [152]) and *Barclays Bank plc v Commissioners of Customs and Excise* (VAT Tribunal Decision 18410, paragraph 29). In short, he said that Benridge could not take the benefit in its VAT returns of input tax without at the same time accepting the burden of properly reporting the output tax. The fact that input tax and output tax are not assessed separately but an assessment reflects the net position was the natural outcome of that basic requirement.

16. Mr Chapman went on to argue that an assessment under section 73(1) was not the only option open to the Respondents to correct the position. In effect, they had refused Benridge's claim and reduced the figures in the VAT return to Benridge's benefit. He noted that Lady Justice Arden in *BUPA* had recognised that in the context of an assessment there could be adjustments to the input and output tax figures (for which separate appeal rights existed under section 83) but that the assessment related to the net VAT due and not those figures as such (see at [40] and [41]). Later in her judgment she had noted that there was no express power for the Commissioners to amend the input and output tax elements of the computation but that such a power should necessarily be implied (see at [58]).

17. In the present case Mr Chapman said that the Appellants sought to emphasise the requirement for some authority to reduce the amounts shown in the boxes of the return. The emphasis, however, should properly be on whether there was any entitlement to credit in the particular circumstances. "Nilling down" the boxes was the practical method of giving effect to the process by which one arrived at the amount of the credit to which Benridge was entitled in this case. If instead the Respondents had adjusted the output tax figure a net amount of VAT would have become due. Benridge's real problem was that Benridge would be unlikely to persuade the Councils to pay that output tax. Had it been otherwise Benridge could just have entered the output tax figure and recovered the tax from the Councils, leaving them to make any repayment claims.

18. Mr Chapman also suggested that if Benridge were correct that input tax had to be repaid without reference to the proper amount of output tax for the period, the repayment might be unlawful State Aid (Case C-172/03 *Wolfgang Heiser v Finanzamt Innsbruck*). Finally, as alternative arguments Mr Chapman referred to section 25(3) as authority for the proposition that the right to repayment only arises if the input tax exceeds the output tax, which was not the case. Further, the adjustment to produce a nil return took effect to set off the output tax against the input tax (see *Birmingham Hippodrome Theatre Trust Ltd v Commissioners for Revenue and Customs* [2011] STFD 473 (paragraphs [74] to [78]).

Our analysis

19. Section 25(2) entitles the taxpayer to credit input tax for the prescribed accounting period and to deduct that amount from any output tax "that is due

from him". The language of the sub-section indicates that input tax is a credit entry in the calculation of the tax that must finally be paid for the period. It also indicates, however, that the right of deduction arises by reference to the output tax that is properly due and not some deliberate understatement of that amount. Section 25(3) is also explicit that the amount that a taxpayer can claim to be paid is not the input tax *per se* but only that amount of input tax net of the output tax due at the end of the period. The Appellants' case rests therefore on the proposition that the Respondents are bound to pay them the input tax declared in the return net of the output tax figure stated even in a case in which it is acknowledged that the return understates the output tax due in respect of the period in question.

20. In approaching this case it is necessary to say something about HMRC's letters of 2 and 3 February 2009. In those letters the writers say "I have now decided that this claim is to be reduced to nil" and then "The revised return details will be as follows [all boxes £0]" There is then an explanation that this arises because the Appellants had not accounted properly for their output tax.

21. In this respect HMRC do not have a general power to revise or adjust VAT returns. The most that they can do is to require the taxpayer to do so under regulation 35. Mr Chapman acknowledged, correctly in our view, that the letters did not purport to exercise the Commissioners' power under that Regulation. However, the passages in those letters which purport to revise the return details by reducing the output tax and input tax figures to nil are in our view no more than an attempt to put into a simple framework the outcome produced by the explanation that follows. That explanation is not that input tax should be zero or that output tax is zero, but that the amount of output tax exceeded the input tax claimed. Read as a whole, the letters reflect the Commissioners' decision not to seek all the VAT due and instead to treat the net amount of VAT due as nil. It is not possible in our view to read the letters as indicating that HMRC considered that no output tax arose (or that the input tax allowable was nil).

22. The issues that then arise are whether this is a course that the Respondents are entitled to adopt without raising an assessment, whether the letters were in fact assessments and whether in fact there is any relevant appeal right under section 83 to deal with the circumstances that have arisen in this case.

23. Dealing with the last of these issues first, the Tribunal is given jurisdiction to hear appeals by section 83 VATA. This lists a series of headings under which an appeal may be made. Those headings are not mutually exclusive: as Arden LJ said in *BUPA*, "The draftsman has created a long list of appealable matters and it is likely that the draftsman has erred on the side of caution rather than precision in creating the list."

24. The only headings which could be relevant in this appeal are those in respect of:

i) "the VAT chargeable on the supply of any goods or services…" (s.83(1)(b))

This paragraph applies in our view not only to the questions of whether a particular supply is chargeable and what the amount chargeable on the supply is, but also (by reading in the plural in accordance with the Interpretation Act) what the total amount of VAT chargeable on a number of supplies is.

ii) "the amount of any input tax which may be credited to a person…" (s.83(1)(c))

It is to be noted that this heading does not encompass the amount of input tax which may be payable to a person. Crediting input tax is the first step in determining the VAT payable or repayable (see Art 18(2) and (4) Sixth Directive and section 25(2) VATA). An appeal under this heading relates only to that first stage – determining the amount of the credit.

iii) "an assessment … under section 73(1) or (2) in respect of a period for which the appellant has made a return … or the amount of such an assessment." (s.83(1)(p))

In *BUPA* Lady Justice Arden noted at [37] that there is no statutory definition of "assessment", but that "it is in general a legal act on the part of the Commissioners constituting their determination of an amount of VAT …that is due…"; later she held at [38] that an assessment had to assess the net amount of VAT due.

25. Section 83 permits appeals against certain claims made by a taxpayer and disputed by HMRC (see for example (1)(f) and (1)(h)). It also, in paragraph (t), provides for the adjudication of a claim to repayment under section 80 but it does not provide any right of appeal in relation to the refusal by the Commissioners to make a repayment required by section 25(3). At first sight the contrast with the provision enabling the challenging of an assessment is surprising since both an assessment and the amount repayable under section 25(3) relate to net amounts - the one assessed by the Commissioners as due to them, and the other assessed by the taxpayer as due to him. Nevertheless, the scheme of the Act and the Regulations do not require a separate right of appeal to be read into section 83 in relation to the refusal by the Commissioners to pay a surplus of creditable input tax over output tax.

26. An assessment is needed to tell a taxpayer how much the Commissioners say he owes. The amount of that assessment becomes (by section 73(9) and para 5(1) Sch 11) a debt due to the Crown. The taxpayer is given the right in section 83(1)(p) to challenge the amount claimed. That challenge may be determined only through the statutory appeal procedure starting with an appeal to the First-Tier Tribunal (see *Glaxo Group v HMRC* [1995] STC 1075 at

1080-1084 and the cases there cited), but once so determined, or if not challenged by appeal to the Tribunal, the Commissioners may pursue the debt in the Courts.

27. A repayment claim arises by virtue of making a claim to deduct input tax under section 25(2). Such a claim must by Regulation 29 of the VAT Regulations 1995 be made in a return. The return will show the amount of tax that the taxpayer says the Commissioners owe him. If they dispute that amount they have a public law obligation to explain why (see Lightman J at [26] in *Tradecorp* and Arden LJ in *BUPA* at [44 et al]). There can only be three reasons: (1) they dispute the amount of output tax in the return, (ii) they dispute the amount of input tax claimed, or (iii) they say that there is some arithmetic error in arriving at the net amount payable. The resolution of (i) and (ii) is reserved to the appeals process and will ordinarily be covered by section 83(1)(b) and (c).

28. It is true that section 83(1)(t) provides for an appeal in relation to a repayment claim under section 80 for the repayment of output tax paid which was not due. But the issues to be resolved in such a claim extend beyond the determination of output tax chargeable and input tax creditable: they embrace questions of whether the tax was paid and of unjust enrichment. No such issues arise in relation to a right to repayment under section 25(3). Nor does it seem to us that in *University of Sussex* it was accepted that an appeal lay under section 83 in relation to section 25(3). In that case HMRC had used regulation 29A to deny a credit for input tax. The appeal lay under section 83(1)(c) in respect of the amount of input tax which might be credited for the purposes of the section 25(3) claim, not the section 25(3) right itself.

29. In this appeal the Commissioners provided reasons in their letters of 2 and 3 February 2009 for their refusal to make any repayment. The Appellants' appeal must be considered under the various limbs of the Tribunal's jurisdiction.

(i) (1)(c) input tax which may be credited (not "repayable")

30. Mr Chapman did not dispute that the input tax claimed by the Appellant was creditable. No evidence was offered that it was not. HMRC implicitly accepted the method of calculation used by the Appellants.

31. To the extent (a) that the letters of 2 and 3 February 2009 were decisions that no input tax was creditable, and (b) that the Appellants' appeals included an appeal against that decision, their appeal should succeed and the amount of input tax creditable was that claimed in their returns by the Appellants.

32. In fact, the Respondents have never disputed the amount of input tax that is creditable (in contrast to the amount that should be repaid) and in our view the letters did not amount to decisions that no amount of input tax was creditable (see paragraph 21 above). Accordingly, the Appellants had no grounds to

appeal the letters as decisions against the amount of input tax that was creditable and they therefore stand as decisions to that effect.

(ii) VAT chargeable on the supply of goods or services.

33. The Respondents did not argue that VAT was not chargeable on the services supplied by the Appellants. The Appellants did not dispute that the amount of output tax chargeable was at least equal to the input tax claims.

34. In the letters of 2 and 3 February 2009 the Respondents make clear that they have decided that the output tax payable exceeded the input tax in each relevant period:

> "..it is reasonable and fair to expect that figures could also have been extracted for the accounting of output tax. If this had been completed all returns rendered would have been payment returns…"

35. That is a decision which is "with respect to … the VAT chargeable on [supplies] of services" within section 83(1)(b). An appeal lies against that decision to the Tribunal. It is not an assessment of a net amount due under section 73, but a decision about the VAT chargeable on supplies. In some cases such a decision could form part of the reasoning for an assessment, but the headings in section 83 are not mutually exclusive.

36. To the extent that the Appellants' appeal is against that decision then it must fail. The Appellants admitted that their returns understated the amount of output tax actually due for the period in question. Furthermore, the Appellants did not dispute the Respondents' contention that if the Appellants had properly estimated their output tax, the output tax figure in the return would have exceeded the input tax figure, so that no amount would have been due to be repaid to the Appellants. The Appellants only point was that the Respondents would have been bound to repay any amount of output tax to the Councils in question. That is not, however, a matter for the Tribunal in these appeals, which are concerned solely with the Appellants' claim of the creditable input tax, the *vires* of the Respondents' actions and the resolution of those matters by this Tribunal under one or other heads of appeal in section 83.

(iii) an assessment or the amount of an assessment

37. An assessment is, as Arden LJ said, the determination of an amount of VAT that is due. It is the way in which the Act permits the Commissioners to quantify their claim on the taxpayer, and part of the mechanism by which that amount becomes a debt due to the Crown under section 73(9) and para 5(1) Sch 11.

38. In the present case the letters did not purport to be assessments and Mr Chapman did not seek to establish the Respondents' case on the basis that they were. We do not think that they were assessments: they reflect a conclusion that no assessment is required or should be made because no net amount of

VAT is sought. Even allowing for Arden LJ's comments in *BUPA*, as an administrative act we consider that the Commissioners, as the assessing body, must believe that they are making an assessment. We do not think that they can assess, so as to speak, "by accident". In this respect we think that the First-tier Tribunal was in error if and to the extent that it arrived at its decision on the basis that the letters constituted assessments.

39. There is no need, however, to assess where no amount of tax is due. The statutory mechanism does not need such an assessment to be made. It would be particularly incongruous if there were to be implied a power for the Commissioners to adjust input tax and output tax figures in a case in which an assessment has been made but for there to be no such power to do so in arriving at the conclusion that no amount of tax is due so that no assessment need be made.

40. Accordingly, we have concluded that the Respondents were entitled to deal with the matter as they did in their letters of 2 and 3 February 2009, in effect notifying the Appellants that they considered that the output tax due was at least equal to the amount of the creditable input tax claimed, so that the practical effect was that all amounts in the return netted off to nil.

Our conclusion

41. The First-tier Tribunal described the letters of 2 and 3 February as assessments. We have concluded that they were not. They were instead the notification by the Commissioners of their reasons for concluding that no amount of VAT fell to be repaid to the Appellants because the output VAT chargeable on the Appellants' supplies for the period exceeded the creditable input tax claimed in the period, albeit the Commissioners were agreeing not to take steps to recover the net amount of VAT due by assessment.

42. That was action that the Commissioners were entitled to take and in respect of which the Appellants had a relevant appeal right to the Tribunal. The result of our decision on those issues, however, is that the Appellants' appeals are dismissed.

TRIBUNAL JUDGE:

Malcolm Gammie QC

Charles Hellier

RELEASE DATE: 26 April 2012