

**FIRST-TIER TRIBUNAL TAX**

**SOPHIE HOLDINGS LTD**

**Appellant**

**- and-**

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

**Respondents**

**Tribunal: DR K KHAN (Judge)  
MR R J FREEST ON FRICS**

Sitting in public in London on 12 February 2009

**Hui Ling McCarthy**, Counsel, for the Appellant

**Mr S Singh**, Counsel, for the Respondents

## DECISION

1. The Appellant, Sophie Holdings Ltd ("SHL") appeals against three assessments raised by the Commissioners (collectively referred to as "the Assessments").
2. The Assessments are:
  - (a) 6 November 2006 in relation to the VAT period 11/03 in the amount of £15,725 and £3,096.80 interest.
  - (b) 29 January 2007 in relation to 02/04 tax period, in the amount of £23,751.00 and £4,697.65 interest and
  - (c) 16 April 2007 in relation to 05/04 tax period in the amount of £35,360 and £563.25.
3. The Assessments were raised in respect of input tax reclaimed by the Appellant regarding costs incurred by SHL on supplies it received during the course of the purported substantial reconstruction of a listed residential building, 41 Montague Square, London W1 (the "Property").

### **Background**

4. SHL purchased a freehold to the Property on August 2002 with the intention of substantially reconstructing the Property and then selling. The Property was sold on 4 September 2006 as a zero-rated supply.
5. The Appellant applied for VAT registration on 1 October 2003 (VAT registration number 821152275).
6. The VAT registration was to obtain credits for the input tax incurred in respect of standard rated supplies received in the relevant VAT period.
7. On 13 April 2006, the Respondents (the "Commissioners") received from the Appellant an application to cancel the VAT registration stating that they had ceased making taxable supplies and would not do so in the future. The Commissioners questioned the previous input tax credit claimed.
8. On 1 November 2006, Mr G Fletcher (an officer of the Commissioners), wrote to SHL querying the validity of its previous claims for input tax on the basis of the absence of the taxable onward supply against which the input tax credit had been claimed. The points made were:
  - (a) no assets and stock was recorded on the Business Assets and Stock Form ("Business Assets Form");
  - (b) no taxable supplies had been documented on its returns;
  - (c) the annual accounts for the year ended 31/12/2004 showed rented income; and
  - (d) the Commissioners had no record of an option to tax having been made.
9. When the Appellant applied for the VAT registration they had included with their application VAT calculations from their builders and a planning application for the

Property. In December 2003, the Commissioners conducted a review of SHL's VAT return (period 01/01/2003-30/11/2003) including VAT which had been reclaimed and sample invoices. The review officer, Mrs Sue Sims, stated that she was satisfied that the repayment should be made and had no reason to doubt the repayments and authorised the credit.

10. Following Mr Fletcher's letter, the Commissioners raised a protective assessment for the 11/03 period on 6 November 2006 (the "11/03 Assessment").
11. On 20 November 2006 the Appellant wrote to the Commissioners stating that following a substantial reconstruction, the building was sold as a zero-rated supply. The majority of input VAT claimed was in respect of VAT on materials and professional fees incurred on the project. They confirmed that the zero-rated sale of the Property was incorrectly omitted from Box 6 on the VAT return and the sale value of £4.725 million should have been included.
12. On 21 November 2006, the Commissioners wrote to the Appellant stating that the land registry records showed that a disposal of the Property on 4 September 2006, two years after the last VAT claim. The Appellant were asked for details of the use of the Property between the period of completion and the disposal in September 2006. The Commissioners requested documentary evidence to substantiate that the building was "reconstructed" in accordance with the Item 4, Group 6, Schedule 8, VATA 1994.
13. The Commissioners raised assessments for the period 02/04, 05/04 and 08/04 periods. Referred to individually as, "the 02/04 Assessments", and collectively as "the 02/04 Assessment et seq".
14. On 22 January 2007, the Appellant supplied details of the input tax claimed and a breakdown of VAT returns for periods from 11/03 to 08/04.
15. On 26 January 2007, the Commissioners stated that the calculations supplied satisfied the second condition of the test for substantially reconstruction but not the first, that the whole of the works actually constituted reconstruction.
16. On 29 January 2007, a Notice of Assessment was raised for the 02/04 period.
17. On 6 March 2007, the Appellant informed the Commissioners that no rental income was received from the Property stating that "the Property was not let between completion and disposal and no rent was received" and provided details of rental income from other properties.
18. On 14 March 2007, the Commissioners disallowed all input tax claimed as it did not relate to a taxable supply. The Commissioners stated that they had insufficient information to agree that the sale of the building was eligible to be zero-rated.
19. On 12 April 2007 a Notice of Assessment was raised in the amount of £35,360 and £526.25 interest (periods 05/04 and 08/04).
20. By a letter dated 27 April 2007, the Appellant wrote to the Commissioners enclosing a letter from Moulton Taggart explaining the construction work carried out on the Property.

21. On 30 April 2007, the Commissioners stated that the information supplied by Moulton Taggart was not sufficient to show that the work undertaken amounted to a "substantial reconstruction". The figures which had been supplied were based on the planning application which stated "alterations including remodelling fourth floor, small extension, at rear first level to create access to retain existing roof terrace at rear and new garage doors to Bryanston Mews East". It showed that the Property was not substantially reconstructed. The Commissioners requested more information including full planning permission and details of the building before and after the work has started. By a letter dated 31 August 2007, Mr Petrarca, Head Business Unit, North London, confirmed that in accordance with HMRC Internal Guideline, section 11.5.3, there was no substantial reconstruction of the Property. At a meeting of all parties held on 2 October 2007, the Commissioners required further confirmatory proof of a substantial reconstruction of the building.
22. By a letter dated 14 November 2007, the Commissioners upheld their original decision and further tax assessments were issued on 29 January 2007 (02/04) and 16 April 2007 (05/04).
23. The Appellant served a Notice of Appeal on 13 December 2007.

### **The law**

- (1) The Commissioners' power to assess is derived from s.73(2) VATA 1994 which states:

"(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."

- (2) The time limit for an assessment under s.73(2) VATA 1994 are set out in s.77(6) VATA 1994, which provides:

"(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."

- (3) S.77(1)(a) VATA 1994 sets out the overriding three year limit for making an assessment, it 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 [3 years] after the end of the prescribed accounting period or importation or acquisition concerned, or

(b) in the case of an assessment under section 76 of an amount due by way of a penalty which is not among those referred to in subsection (3) of that section, [3 years] after the event giving rise to the penalty."

- (4) The entitlement to be registered for VAT is in para 9 of Schedule I VATA 1994 which provides:

"9. Where a person who is not liable to be registered under this Act and is not already so registered satisfies the Commissioners that he –

(a) makes taxable supplies; or

(b) is carrying on a business and intends to make such supplies in the course or furtherance of that business,

they shall, if he so requests, register him with effect from the day on which the request is made or from such earlier date as may be agreed between them and him."

- (5) The meaning of "substantial reconstruction" is found in Note 4 to Group 6 of Schedule 8 VATA 1994, which provides:

"(4) For the purposes of item 1, a protected building shall not be regarded as substantially reconstructed unless the reconstruction is such that at least one of the following conditions is fulfilled when the reconstruction is completed –

(a) that, of the works carried out to effect the reconstruction, at least three-fifths, measured by reference to cost, are of such a nature that the supply of services (other than excluded services), materials and other items to carry out the works, would, if supplied by a taxable person, be within either item 2 or item 3 of this Group; and

(b) that the reconstructed building incorporates no more of the original building (that is to say, the building as it was before the reconstruction began) than the external walls, together with other external features of architectural or historic interest;

and in paragraph (a) above "excluded services" means the services of an architect, surveyor or other person acting as consultant or in a supervisory capacity."

### **The Appellant's submissions**

24. The Appellant says that the Commissioners had sufficient evidence since December 2003 as to the nature of the proposed work, and there were two occasions specifically requiring the Commissioners to consider that evidence and satisfy themselves whether the proposed works amounted to a "substantial reconstruction". This information and the intentions of the Appellant were known at registration and the Commissioners were in a position to assess all information the moment each VAT return was submitted.
25. The Appellant says that the assessments were out of time and cannot be raised within section 73(6)(b) VATA. It is agreed that the Assessments were not raised within the normal two year time limits pursuant to section 73(6)(a) VATA and are not within the three year cap in section 77(1)(a) VATA.

26. The Appellant contends that the 11/03 Assessments should be treated differently from the 02/04 Assessment et seq.
27. In respect of the 02/04 Assessment et seq the following points are made.
  - (a) It is clear that the Commissioners were not relying on the Business Assets Form as evidence of facts upon which these late assessments were based.
  - (b) These assessments were based simply on the Commissioner: disagreement as to the classification of onward supply of the Property as being zero-rated.
  - (c) The material evidence in support of the Commissioners' view the conditional listed building consent letter (the "Consent") and conditional permission for development letter (the "Permission") had been in their knowledge from the time of registration in October 2003.
  - (d) The evidence was available and should have been considered by the Commissioners twice, first, as a precursor to accepting the Appellant's registration as a taxable person in October 2003 and second, as a precursor to satisfying themselves that SHL's first VAT reclaim was valid in December 2003.
  - (e) The Assessments have arisen because of the differing views on "substantial reconstructions" between the Commissioners authorised to consider this information at different times (in particular the different view of Officer Sue Sims and Officer G Fletcher). For these reasons, the Commissioners cannot take advantage of the time extension permitted by section 73(6)(b).
  - (f) In respect of the 11/03 assessments, the Appellant says that this assessment was raised because the Business Assets Form received in May 2006 is the last piece of evidence from which an inference could be drawn that no onward supply had taken place against which the previous claims to output tax could be attributed.
28. The Appellant accepts the 11/03 Assessment was raised because of the Business Assets Form which was the last piece of evidence from which an inference could be drawn that no onward supply had taken place against which the previous claims to input tax could be attributed. However, the Appellant submits that the Commissioners should be precluded from relying on the Business Assets Form as it is not evidence of any operative fact substantiating the assessment and the assessment is therefore out of time.
29. The Appellant draws reference to the Court of Appeal decision in *Pegasus Birds Ltd v C&E Commissioners* [1999] STC 95 where the Court said that the purpose of section 73(6) is "to protect the taxpayer from tardy assessments".
30. The Appellant says that the information provided to the Commissioners was sufficient and it was patently obvious that the proposed work fell significantly short of satisfying the Commissioners' published standards on a "substantial reconstruction". The knowledge they had was actual knowledge of the extent of the intended works and the Commissioners failed to appreciate that the works are set out in Permission and Consent did not in fact conform to a substantial reconstruction.
31. The Appellant made further written submissions following the hearing. The Appellant says that the Commissioners originally claimed that the Appellant intended onward supply was not taxable (i.e. zero-rated). However, during the course of the hearing, the Commissioners' objection appeared instead to be with the nature of the onward supply

that actually occurred (rather than that intended) and the Commissioners sought to justify the Assessments on the basis of evidence coming to their knowledge in relation to the actual supply that eventually took place. The supply that eventually took place was an exempt supply.

32. If that which a trader originally intends to do cannot be classified as taxable as a matter of law, then from the outset, the trader is not entitled to input tax credit under Regulation 101 VAT Regs 1995 irrespective of what he thinks the nature of his intended supply might be and irrespective of what he might actually do at the end of the day. The Appellant is therefore saying that one has to look, at the time of registration, to see if taxable supplies are to be made.
33. If a trader intends to make a genuinely taxable supply, then he is entitled to input tax credit under Regulation 101 VAT Regs 1995. If, however, his intention changes or an exempt supply occurs, then at that point, an obligation arises to account for the sum of all input tax credit he has received to date and to repay the total amount to the Commissioners in respect of that later period in which his intention changes or actual exempt use takes place.
34. The Appellant say this influences the way in which the Appellant should be assessed. If the trader never had an entitlement to input tax, from the start, then there should be an assessment for each credit in respect of each period in which it was paid. If the trader's repayment obligation arises later (e.g. after having made an exempt supply) then a single assessment for a total amount in respect of that later VAT period must be made.
35. The Appellant is saying that the Commissioners cannot have it both ways. An assessment can be raised on the basis of the original intention or the later exempt supplies but not on the basis of both.

#### **The Commissioners' submissions**

36. The Commissioners contend that the Assessments were raised within time, under section 73(6)(b), which allows the Commissioners to make an assessment within one year after evidence of facts sufficient in their opinion to justify an assessment.
37. The Commissioners were made aware of the Appellant's intention to undertake a substantial reconstruction of the property, for zero-rated sale under Item I, Group 6, Schedule 8 VATA 1994, when the Appellant submitted an application for VAT registration in October 2003. The sample invoices provided appeared to be consistent with their described activity and the intention at the time, and the claim was therefore allowed.
38. It was not until April/May 2006, however when the Appellant submitted an application for VAT deregistration and a Business Asset Form, showing nil assets and stock, that the Commissioners became concerned at the lack of support for the VAT claims made. Following an analysis of the Appellant's annual accounts, the Appellant was requested to provide evidence explaining the taxable activity that had taken place in respect of the Property and to show that the intended substantial reconstruction had taken place. A protective assessment was issued on 2 November 2006, for the 11/03 VAT period, pending receipt of the information requested. Two more assessments were issued on 29

January 2007 for the period 02/04 and 12 April 2007 for the period 05/04 pending receipt from the Appellant of the evidence requested by the Commissioners.

39. The Commissioners contend that despite the Appellant's intention expressed and relied upon in October 2003, a substantial reconstruction of the property did not take place and the Commissioners could not have been aware of this until enquiries, prompted by the Appellant's deregistration without taxable activity or current assets being declared, were made.
40. The Respondents say that at the time the Appellant submitted their application for VAT registration and supporting documentation in October 2003, no facts had come to the knowledge of the Commissioners which would have justified, in the opinion of the Commissioners, any assessment to recover the input tax to be claimed by the Appellant.
41. Further, insofar as there was any ambiguity at the time of registration about whether the Appellant proposed work amounted to a substantial reconstruction of the Property, there was no obligation on the Commissioners to make enquiries to seek to clarify the position. The Commissioners did not know as a fact that the property was not going to be substantially reconstructed at the time of the Appellant's VAT registration.
42. At the time of registration, the Appellant was informed both that a repayment of input tax was subject to the condition that the Commissioners may require a refund of all input tax claimed if taxable supplies are not made by the business and further that if there was no longer an intention to make taxable supplies or any change of circumstances affecting the registration that they should be notified to the Commissioners within 30 days of the change. The Commissioners say that there was a duty on the Appellant to pass material information to them which was relevant since VAT is a self-administered tax and, as the Court of Appeal confirmed in the *Pegasus Birds* case, it can often be the taxpayer who supplies evidence of facts sufficient to justify the raising of an asset.
43. The Commissioners say that it was only after the Appellant applied for deregistration that the Commissioners came to know that no taxable supplies had been made and that no substantial reconstruction has taken place. They find support in the witness statement of Officer Fletcher, who stated, that "this was only evident to me from examination of the plans and quantification of works actually undertaken and they were requested and provided subsequent to my first letter initiating the query on 01/11/06".
44. The Commissioners say that they were justified in making an assessment and the assessments were not made out of time.
45. The Tribunal was provided with two ring files, one being an agreed bundle of document and the second the Appellant's bundle of authorities. These included a witness statement by Officer Fletcher, who also gave oral evidence. There was an extended hearing day to allow the matter to be completed and it was agreed that further written submissions would be made by the Appellant and a reply by the Respondents. The Respondents provided no reply to the further written submissions.

#### **Let us examine the evidence and law**

46. The Commissioners' power to assess is derived from section 73(2) VATA

47. The time limit for an assessment under section 73(2) VATA is set out in section 73(6) VATA which provide that "An assessment ... 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".
48. The Appellant says that with regard to the 02/04 Assessment et seq the relevant information for making an assessment was available within the knowledge of the Commissioners from the time of registration in October 2003 or in December 2003 when a decision to allow input tax recovery was made and therefore the assessment is out of time.
49. For completeness, with regard to the 11/03 Assessment, the Appellant says that the Business Assets Form information were not operative facts substantiating the assessment and therefore the assessment is also out of time.
50. The Court of Appeal in *Pegasus Birds Ltd v Customs and Excise Commissioners* [2000] STC 91 (CA) in agreeing with the early High Court decision approved the following principles as necessary in deciding whether an assessment is out of time
  1. The Commissioners' opinion, in section 73(6)(b) VATA is an opinion as to whether they have evidence of facts sufficient to justify the making of the assessment. Evidence is the means by which the facts are proved.
  2. The evidence in question must be sufficient to justify the making of the assessment in question.
  3. The knowledge referred to in section 73(6)(b) is actual, and not constructive knowledge. Constructive knowledge means knowledge of evidence which the Commissioners did not in fact have, for which they could and would have if they had taken the necessary steps to acquire it.
  4. The tribunal approach is (i) to decide what were the facts which, in the opinion of the officer making the assessment on behalf of the Commissioners, justify the making of the assessment, and (ii) to determine when the last piece of evidence of these facts of sufficient weight to justify making the assessment was communicated to the Commissioners. The period of one year runs from the date in (ii).
  5. An officer's decision that the evidence of which he has knowledge is insufficient to justify making an assessment, and accordingly, his failure to make an earlier assessment, can only be challenged on *Wednesbury* principles, or principles analogous to *Wednesbury*.
  6. The burden is on the taxpayer to show that the assessment was made outside the time limits specified in section 73(6)(b) VATA.
  7. The role of the Tribunal was explained in a decision of *Heyfordian Travel Ltd v Customs and Excise Commissioners* [1979] VATTR 139 (at para 12) where the Tribunal stated:

"In our view, a tribunal considering the possible application of the subsection must decide what were the facts which, in the opinion of the officer making the assessment on behalf of the Commissioners, justify the making of the assessment and then decide when the last of the facts to be communicated to, or come to the knowledge of, an officer of the Commissioners was so communicated or so came to his knowledge. The period of one year runs from that date".

51. The Tribunal therefore has to look at evidence of facts which in the Commissioners' opinion justify the making of the assessment, identify those facts, and decide when the last of those facts actually came to the Commissioners' knowledge.
52. All of the Assessments were raised in reliance on the time limit set out in section 73(6)(b) VATA. Each assessment was also raised under section 77(1)(a) VATA, which permits the Commissioners to raise an assessment no more than three years after the end of the prescribed accounting period. Section 73(6)(b) VATA qualifies section 77(1)(a) by providing that an assessment cannot be raised later than one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge. The Commissioners are allowed to make protective assessments before such evidence of facts comes to their knowledge, under section 77(1)(a).
53. On 13 October 2003, the Appellant, through Glazers VAT Consultancy, applied to register for VAT with effect from 7 January 2003. Their cover letter, stated:

"SHL has purchased a listed property at 41 Montague Square, London W1. It is their intention to substantially construct the property and then sell the freehold.

I have attached a copy of the letter from the main contractors which states that 81 % of the construction work will be zero-rated for VAT purposes as approved alterations and so as SHL will be selling the property once the works are completed, this will be a zero-rated supply under Item 1, Group 6, Schedule 8, VATA 1994.

I have also attached copies of the granted planning permission, listed building consent and contract between SHL and the builders for the works as proof of their intention to trade.

...

As SHL will be a refund trader, we would like to submit monthly VAT returns so we can recover the VAT sooner".
54. The letter therefore made various representations. Further representations were made in the application for registration form (VAT1) which was attached to the letter of 13 October 2003. The Appellant confirmed that they were not currently making taxable supplies but intended to do so in the future (question 23) and that their taxable supplies would be £900,000 (question 23) and that they did not expect to make exempt supplies (question 24).
55. The Appellant provided various documentations with the VAT1 form. These included their Consent letter dated 7 January 2003 from the City of Westminster. The letter indicated conditional listed buildings consent had been granted for "Alterations including remodelling of fourth floor, small extension at rear first floor level to create access to retained existing roof terrace at rear add new garage doors to Bryanston Mews

East. The City of Westminster Permission letter permitting the development dated the same day was also enclosed.

56. The Appellant also attached to the VAT1 a letter dated 9 September 2003 from the building contractors. This explained the work to be carried out on the property. The work was laid out in the form of a list with a total price at the bottom of £585,000. The form of contract used for agreeing the building works called Agreement for Minor Building Works (1998 edition) is normally used for building works up to a value of £100,000.
57. On the face of it, the VAT1 and cover letter together with the information provided to the Commissioners, aside from the use of the wrong proforma contract, meant that the Commissioners has no reason to doubt that the work contemplated by those document would be undertaken in the manner and form explained. The Commissioners are required to process all applications for registration and to make appropriate enquiries to establish whether the application should be refused. This checking exercise will verify that the correct applications have been made, the applicants have filled in the relevant forms correctly and provided information requested on the forms.
58. On 18 November 2003, the Commissioners informed the Appellant that his application for VAT registration had been allowed. In that letter there is stated under the heading "repayment of Input Tax"

"Before you start to make taxable supplies by way of business, you may provisionally claim repayment of input tax in accordance with The Value Added Tax Regulations 1995. The Regulations concern Input Tax and Partial Exemption and the General Rules are explained in Notices 706.

Repayment is, however, subject to the condition, provided for by Section 25(6), Value Added Tax Act 1994, that the Commissioners may require you, on request, to refund all or any of the input tax claimed, if you do not make taxable supplies by way of business, or if, in respect of input tax claimed prior to a period in which taxable supplies in the course of business are made, that input tax is not commensurate with the related taxable supplies".

59. The letter goes on to state under the heading Change of Circumstances, that:

"If at any time you no longer have the intention to make taxable supplies, or there is any other change of circumstances affecting your registration (including any delay in starting to make taxable supplies), you must notify this office in writing within 30 days of the change".

60. This letter, which is given to all new businesses registered for VAT, will create a continuing obligation on the taxable person to inform the Commissioners of any relevant new facts. The Commissioners are under obligation to satisfy themselves that the intended onward supplies are taxable in order for the trader's entitlement to be registered (see para 9 Schedule 1 VATA 1994) and their internal Guidance Manual VI-28) states the following::

*Registration criteria*

1. Paragraph 9 of Schedule 1 to VATA 1994 provides (so far as is relevant):

"9. Where a person who is not liable to be registered under this Act and is not already so registered *satisfies the Commissioners* that he-

- (a) makes *taxable* supplies; or
- (b) *is carrying on a business and intends to make such supplies in the course of furtherance of that business.*

they shall, if he so requests, register him with effect from the day on which the request is made or from such earlier date as may be agreed between them and him."

(Emphasis added)

2. The Commissioners' Guidance Manual VI-28 is informative as to the steps that the Commissioners in reviewing an application should take to satisfy themselves accordingly. The relevant extracts read:

#### **"7.4 How to establish entitlement to register as an intending trader**

##### 7.4.1 General

Before you can allow registration as an intending trader *you must be satisfied that there is a business in existence, which has a firm intention to make taxable supplies ...*

...

##### 7.4.2 Requirement to provide evidence

*In order to satisfy us traders have to supply evidence to back up their application ...*

...

##### 7.4.5 Evidence required to demonstrate an applicant's *intention to make taxable supplies.*

*Here you need to gain an understanding of the business that is already in place or that is being set up. and you need to be satisfied that it is not the type of business which will be involved solely in the making of exempt supplies. In many cases, the evidence submitted in connection with the "in-business" test should also suffice as evidence of an intention to make taxable supplies so it may not always be necessary for a trader to provide (or for us to request) two sets of evidence. For example, if you are provided with a copy contract (or a copy of a bid for a competitive tender) where it is clear that the intended outcome will result in the making of taxable supplies, no other evidence will be required."*

(Emphasis added)

##### 7.6.5 *Reviews and input tax checks*

This sets out the Commissioners' policy for conducting reviews - either by a visiting officer as part of a post-registration review or by the registration section itself.

"Intending trader registrations should be reviewed at certain stages to determine whether there is still an intention to make taxable supplies, or whether the trader has already started making taxable supplies and is therefore no longer classified as intending."

4. The guidance relating to reviews of intending trader registrations is set out at section 31 of the Manual. The general aims are listed as being for the officer conducting the review, "to establish overall whether: *the registration is valid*, the registration should remain in force, the trader has ceased to be an intending trader" (emphasis added)

5. The guidance sets out the procedure relating to input tax checks at section 31.2 and provides (so far as is relevant):

"(a) Check that input tax claims have been restricted to items directly and wholly attributable to intended *taxable* supplies and that no input tax has been claimed on items attributable wholly or partly to *exempt* supplies made or to be made."

(Emphasis added)

61. There is an obligation on the Commissioners to review the information which has been provided by the taxpayer. A notification of registration to a taxable person would suggest that their papers are in order and have been checked. For HMRC purposes, should there be any matters which are not clear or they need further clarification of documents or papers provided to support information given to the various questions asked, then one would expect these to be subject to further review by an appropriate officer. It is the law that the Commissioners must be satisfied that a trader is making or intends to make taxable supplies.
62. On 18 December 2003, the Appellant's accountants provided a VAT schedule of sample invoices to the Commissioners. The invoices covered the period 11 November 2002 to 30 June 2003 showing a gross figure of £217,000 with approximately £15,000 being VAT claimed. The Commissioners allowed the VAT credit claimed for this VAT period.
63. The officer involved, Sue Sims, stated the trader was "having major refurbishment done to a listed building" and there was "no reason to doubt" the Appellant's claim. The Commissioners therefore allowed the recovery of input tax. The officer had considered the documents attaching to the VAT1 form which included Planning and Consent letters. This would have explained the scope of work proposed. The officer should have appreciated at this point that the work being undertaken did not amount to a reconstruction given that the papers were available for her to establish a credit for input tax. Her view which we now believe to be wrong, was that there was a substantial reconstruction of the Property and the Appellant was entitled to reclaim input tax.

**What facts became known - after 13 April 2006?**

64. On 13 April 2006 the Appellant applied to cancel their VAT registration. They stated that from 30 October 2004, they had "cease making taxable supplies in the UK and will not do so in the future".
65. On 9 May 2006, the Appellant's VAT registration was cancelled with effect from 30 October 2004. They were required to complete the Business Assets Form to ensure that VAT was correctly accounted for on the final VAT return form. The form was completed on 29 May 2006. The Appellant stated on the form that they had no stock and no capital asset. VAT input tax credits of approximately £74,000 had been repaid to the Appellant on the basis that they had intended to substantially reconstruct and sell the Property. However, the Business Assets Form indicated that there was no property owned by the Appellant and the value of the sale of the Property should have been declared on the Appellant's VAT return. Since there was no onward taxable supply declared on the VAT form a question was raised by the Respondents as to the basis of the input tax claimed and whether it should have been reclaimed at all. Further, the Appellant's annual accounts for the year ending 31 December 2004, indicated that they were involved in an exempt property rentals business and had substantial property rental income. In effect, therefore, on the face of the documents, the Appellant had a property rental business with fixed assets in that business amounting to nearly £10m.
66. The Respondents wrote to the Appellant on 1 November 2006 stating:-

"Please supply an explanation of the taxable supplies against which the VAT credits have been claimed along with an explanation and schedule of disposal or acquisition of any fixed assets since 01/01/2003. Please support explanations and documents in support of the treatment for VAT purposes whether standard or zero-rated or exempt".
67. On 20 November 2006, the Appellant wrote to the Respondents stating that the Property had been sold (for £4.725m) and been zero-rated but this amount had been omitted from Box 6 in "total sales" figure in the Appellant's VAT return.
68. The Respondents wrote to the Appellant on 21 November 2006 stating that land registry records showed that the Property has been disposed of on 4 September 2006, which was two years after the Appellant's last VAT claim.
69. Some time later, on 6 March 2007 the Appellant informed the Respondents that the Property had been acquired for use as a rental property. On 27 April 2007, the Appellant wrote to the Respondents providing a letter from Moulton Taggart quantity surveyors, stating that the Property had been "substantially reconstructed". On 3 October 2007, the Appellant provided plans of the Property before and after the refurbishment work.
70. The Respondents say that it is only after 13 April 2006 that it was evident from an examination of the plans and the work actually undertaken that the Property had not been substantially reconstructed and further it was only after that time that it became apparent that the Property was acquired and used for rental purposes.

#### 02/04 Assessments et seq

71. The question which arises is did the Respondents have sufficient information available to raise an assessment. The evidence must be evidence of facts or a basic set of facts sufficient to justify the making of an assessment. It seems that the Respondents

accepted the representations made by the Appellant that they intended to make a taxable supply rather than looking to see if the intended future supplies were taxable. The critical question is could an assessment have been made with the information in possession of the Commissioners in 2003. The answer would be yes since the Commissioners had, in their possession, the VAT registration form and the Permission and Consent letters, which provided sufficient evidence of facts to make an assessment at the earliest in October 2003 or later when making a repayment in December 2003. It would certainly seem that they had sufficient information to decide that a repayment of input tax could have been made in December 2003. Indeed a view was formed by officer Sue Sims to allow the Appellant's VAT input tax claim on the basis of the information which was available at that time. The scope of work, which was explained in the Permissions and Consent letters, would have been considered in making the repayment and there is no evidence that any more or less work was undertaken by the Appellant than was explained in those letters. It is not clear whether the words "substantial reconstruction" was used by the Appellant in the context of the VAT legislation or in a non-technical sense, in describing the scope of work being undertaken. The work itself which broadly involved the remodelling of the third and fourth floors, a widening of the garage door and some small extensions to the property did not involve the removal or alteration basic structures of the property or substantial work which could be classified as a reconstruction. A reconstruction would be similar to a major refurbishment to the Property as a whole rather than the addition of partition walls and re-decorative work. There were a number of walls which remained in place and it is clear from the information provided that the whole building was not being reconfigured and redesigned.

72. There is no legal definition of a reconstruction. It has however been considered in various tribunal decisions and those decisions stated that broadly it involves major structural work taking place over the whole building and involving demolition, replacing and rebuilding of substantial elements of the original building and the removing or repositioning of internal walls throughout the whole of the building to enable the building to be put to a different use.
73. The Respondents are contending that the Appellant's intention expressed and relied upon by them in October 2003 to undertake a substantial reconstruction of the Property did not take place. While there was an intention by the Appellant at the start to undertake what amounts (in their view) to a reconstruction that intention changed. However, the intention of the Appellant is not a relevant consideration. What is relevant is the evidence of facts which is available to the Respondents. The Respondents are under an obligation to verify whether what was being done gives rise to an onward taxable supply in order for the trader to be entitled to reclaim the VAT.
74. The Commissioners must be probative in their work. They must look carefully at the information which has been provided and are under a duty to do so. It starts with the process of registration. The registration documents must be verified in order to ensure that the trader is entitled to be registered for VAT. Similarly, they must look carefully at the information which has been provided, in this case the Permission and Consent letters, regardless of what representations have been made by the Appellant, and see whether these satisfied the requirements for claiming input tax.

75. If the Commissioners failed to appreciate the significance of the information before them, and as was pointed out in the Tribunal case of *Mentford* (Case 16724 (2000)), "it is not a question of constructive knowledge but of actual knowledge".
76. In December 2003, the Respondents made a decision that they were satisfied there should be a repayment of input tax to the Appellant. It was duly authorised. The Respondents say however that they only became aware that the Appellant was not entitled to reclaim input tax when a Business Assets Form was completed in May 2006. It is correct that more information came to light relating to stock and assets and the type of supplies being made by the Appellant and the fact that there was rental income arising from the property as well as plans and other information provided to the Respondents, which allowed them to make a protective assessment for the 11/03 period on 6 November 2006, and further assessments, the 02/04 Assessment et seq were raised.
77. However, the Tribunal believes that there was sufficient evidence of facts in the hands of the Respondents to raise an assessment earlier than when the Business Assets Form was completed. While new facts did come to light at that time, the relevant evidence on which the Commissioners based their assessment was within their knowledge in December 2003 at the latest. The evidence which came to light in 2006, supported the fact that there was not a substantial reconstruction. However this could have been established much earlier. The further evidence which came to light, was that there was exempt rental income being supplied by the Appellant. However, Respondents have not based any of their arguments on the onward supply of exempt supplies of rental income. One can only therefore assume that the rental income point is not a relevant consideration.
78. The Respondents' main argument is that there was no entitlement to a repayment of input tax at the start since the Respondents believed that the extent of the work carried out on the property did not amount to a substantial reconstruction. In other words the credit ought never to have been paid.
79. The Appellant made clear after the purchase of the Property that it was their intention to carry out building works before selling the freehold. It was their intention to reclaim the input tax in respect of VAT incurred during the course of the construction work. They made available to the Respondents letters relating to Permissions and Consents as well as a covering letter. This was provided in October 2003. The scope of work identified in the letters of Permission and Consent did not amount to a substantial reconstruction for the purposes of the VAT legislation ("major work to the building fabric, including the replacement of much of the internal and external structure" (see Notice 708, para 10.1-10.3). This raises the question as to why the claims for repayment of input tax which was submitted by the Appellant were approved by the Respondents in December 2003. The work as outlined in the Permissions and Consent letters fell short of satisfying the HMRC's published standard for a substantial reconstruction. This would mean that there was no right, in the first instance, to recover input tax.
80. The question of the subjective sufficiency of information, had been satisfied given that Mrs Sims considered the extent of the works set out in the Permission and Consent letters and took the view that there was a "substantial reconstruction".

81. Given the reasoning in the case of *Pegasus Birds*, the Commissioners had actual, not constructive, knowledge and had sufficient information to justify the making of an assessment in December 2003. The fact that the Commissioners failed to appreciate the significance of their information would not afford them the benefit of the one year extension in section 73(6)(b) VATA 1994. There were no other relevant facts required for making an assessment. The legislation is not designed to penalise the Commissioners, however one would expect a reasonably competent officer to know the law and to be aware, especially in the light of HMRC issued guidelines, as to what constitutes a substantial reconstruction. It is clear on the face of the documents that this was not a substantial reconstruction and that should have been the end of the matter. They should not have been repayments of input tax given to the Appellant. There was no right to claim the input tax ab initio. In our view therefore the assessment with regard to 02/04 assessments et seq are out of time. Let us now turn to the assessments of 11/03.

#### The 11/03 Assessment

82. The assessment of 11/03 was made on the basis that there did not appear to exist an onward supply to which the input tax credit previously claimed could be attributed. In other words, this assessment was raised because the Business Assets Form received in May 2006 which recorded nil business assets and stock constituted last piece of evidence from which an inference could be drawn that no onward supply had taken place against which the previous claims to input tax could be attributed. For the purposes of section 73(2), this means that the credits would not have been paid had it been known that there would not in fact be any corresponding onward supply as turned out to be the case.
83. The Appellant had not declared in their VAT returns prior to their application for de-registration there were no outputs. Further the accounts for the year ending 31 December 2004 showed the accrual of exempt rental income. The last piece of evidence which came to the Commissioners' knowledge was the Business Assets Form which was in May 2006. The 11/03 assessment which was raised in November 2006 was therefore within one year from that date.
84. The Commissioners raised the assessment 11/03 on the basis explained in a letter of 1 November 2006 which stated, inter alia, "Please supply an explanation of the taxable supplies against which the VAT credits have been claimed", In other words, there was an amount of input tax which has been paid but the circumstances given rise to those payments and justifying the payments had changed. This results in a claw back of the input tax which has been paid. In this case there was no output tax declared on the Appellant's VAT returns prior to their application for deregistration and there was an accrual of rental income which was exempt. The Respondents say that the Appellant had no stock or assets which suggested that the Property had been disposed of, and therefore the value arising on sale of the Property should have been declared in the Appellant's return. Given that no onward supply had been declared, the Respondents questioned what supplies the input tax claimed by the Appellant had been attributed to, and whether the input tax had been correctly reclaimed at all.
85. In order to establish the validity of the Appellant's claim to input tax, the Respondents sought evidence that the Property had been substantially reconstructed (see paragraph 33 to 36 Respondents' arguments) and raised a protective assessment on 6 November

2006 (11/03 Assessment). It is important for the Tribunal to establish clearly the Respondents' argument - they were in asking for proof of substantial reconstruction - saying that there were no taxable supplies so there should be no recovery of input tax. Since the Respondents believed that there was no taxable supplies, they approached the recovery on a period by period (rather than global assessment) basis which is allowed under the relevant claw back provisions where there are no taxable supplies (Regulation 109, VAT Regulations and VAT Notice 706, para 11) it should be remembered that the entitlement to recover input tax arises if attributable to goods and services used in making taxable supplies or intended future taxable supplies. Since the Appellant intended onward supply was not taxable, there was no right to claim input tax credits from the outset. The original claim for input tax credit was therefore invalid. The Respondents' witness, Officer Fletcher, stated that his assessment was raised "owing to doubt over a taxable supply having taken 45 place" (paragraph 11, Fletcher's witness statement).

86. What does this mean? It means that the Assessment of 11/03 was made on the basis that an onward supply did not take place (rather than an exempt supply having taken place) and therefore the point in time at which the Respondents had sufficient information to make an assessment was, at the latest December 2003 when they had sufficient information to know that taxable supplies would not be made. This means that the Respondents should not be accorded an extension of time under section 73(6)(b) VATA in respect of the 11/03 Assessment. The fact that there were later exempt lettings activities, which would have precluded the recovery of input tax, was not the basis of the Respondents' argument. Their argument, as clearly outlined (para 36 of the Respondents' submissions) was that "after the Appellant applied for deregistration that the Commissioners came to know that no taxable supplies had been made". The Business Assets Form did not contribute any operative facts which substantiated the assessment. The basis of the 11/03 Assessment was that there was no taxable supply and not that there was no onward supply. The Respondents' knowledge that there was no taxable supply arose at the latest in December 2003. The Assessment 11/03 is therefore out of time.

### **Written Submissions of Appellant after hearing**

87. The Appellant made written submissions after the end of the hearing. Their main point is that the Respondents raised arguments at the hearing which was confusing. The confusion arises from the Respondents' argument that the Appellant had made exempt supplies which prevented recovery of input tax, when as a matter of law no supplies had been made at all. Given the inconsistency, the Appellant says that the two arguments are mutually inconsistent and evidence of the latter cannot be used to justify the former. Further, if there were exempt supplies then a single assessment for the total amount of input tax claim would have to be made whereas if there were no taxable supplies made, then a period by period assessments would be made. The latter was made in this case.
88. The Appellant says that an intending trader completing an application for registration seeks registration on the basis either of making taxable supplies or intending to make such supplies (paragraph 9 Schedule 1 VATA 1994). The statute provides that input tax arises where a person makes taxable supplies in the course or furtherance of a business (section 26 VATA 1994), and the amount of input tax recoverable by a taxable person is so much of the input tax as is attributable to taxable supplies (Regulation 101, VAT

Regs 1995). The entitlement to input tax is subject to clawback provisions (Regulation 108 VAT Regs 1995). The clawback arises if intended taxable supplies are no longer to be made or if exempt supplies are made. Where no taxable supplies are to be made then a clawback arises at the start but where exempt supplies are made then the clawback would arise when the exempt supplies are made. In the former, an assessment would be on a period by period basis and the latter a single assessment for the total amount (VAT Notice 706, para 11 and Regulation 101 and 108, VAT Regs 1995). The manner of the clawback in this case indicates that no taxable supplies were made at the start.

89. The Appellant says that the Respondents' argument is that a substantial reconstruction was not undertaken and therefore credits for input tax were invalid since there was no right to reclaim the input tax from the outset. The Appellant says that the Respondents cannot "raise an assessment on the basis of objection to original intention yet seek to support the timing of those assessments with evidence going to eventual fulfilment". In other words, we need to look at what happened at the start not what happened at the time exempt supplies were made. Two arguments are inconsistent in that sense.
90. The Tribunal agrees. The Tribunal's decision was made on the basis that the Respondents had sufficient evidence to make an assessment in December 2003 and to this extent, the further arguments raised by the Appellant are not directly relevant.
91. In conclusion, the Tribunal feels that the Respondents had sufficient evidence to raise an assessment, at the latest, in December 2003 since it was obvious from the Permission and Consent letters and supporting documentation provided by the Appellant that the Inland Revenue's published statement on substantial reconstruction were not being satisfied. The Commissioners appeared to have failed to appreciate the significance of the information and therefore would not have the benefit of the extension provided under section 73(6)(b) VATA. It is clear that the Respondents were not relying on the Business Assets Form as evidence of facts on which the assessments were based. The assessments were based on the fact that there were no taxable supplies made by the Appellant or a disagreement as to the classification of onward supplies. Further, the officers looking at the proposed work to be undertaken by the Appellant had different views as to what constituted a substantial reconstruction. The Business Assets Form did not provide any evidence of any operative facts which substantiated the assessments which were made.
92. The Tribunal feels that the Respondents should have presented further arguments to rebut the written submissions of the Appellant presented after the hearing.
93. The appeal is therefore allowed. Reasonable cost is allowed to the Appellant.