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Case alert

First-tier Tax Tribunal – Melford Capital General Partner Ltd

31 December 2019

Summary

This is a significant decision from the First-tier Tax Tribunal (FTT). The case concerns the recovery of input tax by a VAT group on costs incurred setting up and maintaining an investment fund.

HMRC disallowed the Appellant's claim for input VAT on the basis that most of the activities carried on by the appellant were not to be regarded for VAT purposes as economic activities. Whilst HMRC acknowledged that the Appellant made some taxable supplies (the supply of management services), it argued that, in essence, the Appellant provided investment capital in return for dividends which was a non-economic activity which precluded recovery of related input VAT.

Advised by Grant Thornton UK LLP, the Appellant challenged that view. It argued that the UK VAT group (of which the Appellant was a member) was a fully taxable entity which only made taxable supplies of management services. As such, it contended that it was entitled to reclaim all the input VAT incurred on both setting up the fund structure and the ongoing costs.

The FTT agreed with the Appellant and allowed its appeal.

First-tier Tax Tribunal

Melford Capital General Partner Ltd (MCGP) is the General Partner of Melford Special Situations LP (MSS) - an English Limited Partnership (the 'fund'). MCGP holds shares in a separate holding company - Hyde Park Hayes Ltd – (HPH) which, in turn, holds the shares in separate special purpose vehicle companies (SPVs). MCGP is, in turn, owned by Melford Capital Partners LLP (MCP). Both MCGP and MCP are members of a UK VAT group.

MCP is contracted to provide management and advisory services to the fund including the provision of advisory services to MSS, HPH and the SPV's. As the SPV's and neither HPH or MSS are within the same VAT group as MCGP and MCP, the provision of these services are liable to VAT at the standard rate. From a VAT perspective, these are the only supplies that are made by the VAT group and, as such, the Appellant argued that, being taxable supplies, it was entitled to reclaim in full the input VAT it had incurred on both set-up costs and on the ongoing costs associated with running the fund structure.

HMRC considered that the UK VAT group should, essentially, be ignored. It contended that the provision of investment capital by MCGP in return for dividends was a non-business (or non-economic) activity and, as such, whilst some input VAT may be reclaimed to reflect the level of taxable supplies of management services made by MCP, the vast majority of the input VAT could not be reclaimed as it related to the non-business investment activity of MCGP.

The Appellant argued that HMRC's contentions were out of line with established case law. Firstly, HMRC should not focus on the activities of an individual member of the VAT group. In the case of Skandia, the Court of Justice determined that it is the VAT group (and not the individual members) that should be regarded as the taxable person. Therefore, instead of viewing the LLP as providing taxable management services and the Appellant as holding investments, for VAT purposes one must see a single taxable person, the Group, that both held investments and provided taxable management services.

Secondly, in the case of Larentia and Minerva, the Court of Justice determined that where a holding company has both business (economic) activities and non-business activities any VAT incurred on general costs should be attributed to its economic activities. The Appellant argued in this case that, whilst it was not a holding company, the VAT group was analogous to a holding company and, as such, it should, similarly, treat VAT incurred on its general costs as being attributable to its economic activities. Accordingly, as the VAT group's economic activities were wholly taxable supplies of management and advisory services it should, as a holding company would, be entitled to reclaim all of the input VAT incurred on its general costs. The FTT agreed with both of the Appellant's contentions and allowed the appeal.

Comment – this is a substantial victory for the Appellant. By allowing the appeal, the Tribunal has, once again, found that HMRC's policy in relation to UK VAT groups is flawed. Whilst this decision does not set a binding principle, it does provide an opportunity for other funds structured in a similar way to challenge HMRC's policy in relation to the recovery of input VAT and, in some cases, funds may be able to revisit earlier VAT periods and claim substantial sums of previously disallowed input VAT.

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