For whom the bill tolls

Indirect Tax | Management of taxes



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Keith Gordon considers a recent VAT case concerning the identity of the person to whom services were provided

Key Points

What is the issue?

In the real world, supplies can benefit more than one person. Who (if anyone) can recover the VAT element on any invoice?

What does it mean to me?

Where there are two or more recipients of a supply, it is important to ensure that the paperwork properly reflects this.

What can I take away?

Paperwork alone will not entitle a person to the VAT recovery. The facts have to show that the claimant was the recipient of the relevant supply.

The fundamental principle of VAT (so much so that it is the basis of the name of the tax) is that each party in a chain of supplies is required to hand over the tax in relation to the extent to which that party has added value. This is achieved by the provision in the Value Added Tax Act 1994 ('VATA'), section 25 which provides that a taxpayer must pay to HMRC the VAT it has charged ('output tax') but is entitled to a credit for the VAT it has been charged ('input tax').

One of the key conditions for a sum to constitute input tax is that it represents the 'VAT on the supply to [the taxpayer] of any goods or services' (VATA, section 24(1)(a)). As the case law shows, however, a single supply could be said to be made to more than one party. A good example is the supply of an estate agent's services which were made to the customers of the Redrow Group but where the cost was borne by Redrow itself (see the House of Lords' decision in *HMCE v Redrow Group plc* [1999] STC 161, although that case must now be considered in the light of more recent cases such as the Supreme Court's decision in *Airtours Holidays Transport Ltd v HMRC* [2016] UKSC 21).

Furthermore, European case law has identified that there must be a direct and immediate link between the supplies made to the taxpayer and the taxable supplies being made by the taxpayer (*BLP Group plc v HMCE* [1995] STC 424). Thus, if a business makes both taxable and exempt supplies and a particular supply to the business relates only to the exempt supplies, then there cannot be any input tax recovery (except to the extent that the *de minimis* rule applies).

The importance of identifying the correct recipients of any supply and the direct and immediate link test were at the heart of a recent decision of the Upper Tribunal in *HMRC v Praesto Consulting UK Ltd* [2017] UKUT 395 (TCC).

Facts of the case

Praesto Consulting UK Ltd (‘Praesto’) is a company of which a Mr Jeremy Ranson is a director. Previously, Mr Ranson had been an employee of a company called Customer Systems plc (‘CS’). Following his departure from CS, Mr Ranson is alleged to have breached terms of his employment contract with CS and legal proceedings followed. Both Mr Ranson and Praesto engaged the same solicitors because it was clear that any breaches by Mr Ranson would have a direct impact upon Praesto in due course. Praesto paid for the initial legal services and HMRC accepted its claim for the input tax credit.

However, formal proceedings were initially taken against only Mr Ranson although it was readily recognised that Praesto were likely to be joined as a further defendant. Consequently, in subsequent invoices, the solicitors issued subsequent invoices to Mr Ranson alone, so as to reflect the title of the case now proceeding in the courts. Praesto nevertheless paid the fee and duly claimed the input tax credit. However, HMRC refused the credit on this occasion leading to Praesto’s appeal to the First-tier Tribunal.

The First-tier allowed the company’s appeal. HMRC then appealed against the decision to the Upper Tribunal.

The Upper Tribunal’s decision

The Upper Tribunal had to consider two grounds of appeal by HMRC. First, HMRC contended that the legal supplies had not been made to Praesto. Secondly, HMRC argued that there was not a direct and immediate link between the services supplied and Praesto’s taxable activities.

The Upper Tribunal (Judges Timothy Herrington and Ashley Greenbank) allowed HMRC’s appeal on both grounds.

In respect of the first, the Judges noted that the findings of fact in the First-tier did not include any finding that Praesto was an actual recipient of the legal supplies for which it had paid. Nor could such a finding be inferred from the other findings of fact. The Upper Tribunal recognised that Praesto might well have benefited from a successful defence by Mr Ranson and also that Praesto might well have been joined in the proceedings. But those facts were not sufficient.

In respect of the second ground, the Judges noted the key principles as set out in BLP, as restated more recently in *Becker v Finanzamt Köln-Nord* Case C-104/12). Becker concerned criminal proceedings taken against Mr Becker personally rather than the company of which he was a majority shareholder. The CJEU ruled that ascertaining whether there is a direct and immediate link depends on the objective content of the goods or services acquired by the taxpayer. Where criminal proceedings were being taken against a shareholder of the company (rather than the company itself) then the company would not be entitled to recover the input tax on those fees. The Upper Tribunal ruled that *Praesto* could not be distinguished from *Becker* and concluded that, therefore, there was not the requisite direct and immediate link between the legal services supplied to Mr Ranson and the company's taxable supplies.

Commentary

In relation to the first point, one might criticise the Upper Tribunal's approach as unnecessarily legalistic. However, on the facts before it, I think that the decision was undoubtedly correct. In particular, one should note how the Tribunal explained its decision: 'when viewed against the background that all of the invoices [eight in total] were sent to Mr Ranson, did not refer to Praesto and that, in fact, Praesto was never a party to the litigation'. It is therefore possible that any one change of these facts (most likely the terms of the invoice) would have been sufficient to lead to a different outcome on that ground.

In respect of the second, the Upper Tribunal recognised (albeit briefly) that the phrase 'direct and immediate link' does not require a supply made to the taxpayer to be identified with any specific supply (or supplies) made by the taxpayer. It is sufficient that one can identify the supply with the taxpayer's overall (taxable) business (i.e. representing an overhead), as made clear by the CJEU in *Sveda* Case C-126/14. Indeed, as recognised by the First-tier in *Durham Cathedral v HMRC* [2016] UKFTT 750 (TC), the costs of an overhead do not have to be incorporated into the taxpayer's pricing structure and such a fact would not preclude the recovery of input tax.

At the heart of the *Praesto* case (as in Becker itself) was the fact that the individual and the company were separate legal persons – the legal proceedings were being taken against the individual and that precluded the company from claiming the input

tax. A variation of the theme is where the legal proceedings concern an individual (say) where that individual is also a VAT-registered person. In those circumstances, the *Praesto* scenario cannot apply and one must go back to basics. As the CJEU said in *Becker*, 'the existence of a direct and immediate link depends on objective factors'. Thus, there will be a difference between the legal costs incurred by an individual defending an action taken by a disgruntled former employee and those incurred by the individual in suing a health insurance company for non-payment of medical fees. Another variant concerns the situation where the legal fees relate to civil (rather than criminal) proceedings where the impact on the company is potentially more immediate.

The point is in fact emphasised further in the *Becker* judgment – one should 'consider all the circumstances of the transactions at issue and take account only of the transactions which are objectively linked to the taxable person's activity'.

Arguably, the Upper Tribunal has perhaps followed the decision in Becker slightly too closely without noticing a subtle (but possibly fundamental) factual distinction between the cases. In *Becker*, the CJEU noted that the legal proceedings were taken against Mr Becker and that 'proceedings against [his company] would also have been legally possible'. In *Praesto*, legal proceedings against the company were not only legally possible but a realistic and likely prospect. Given the Tribunal's decision in relation to the first issue, however, its decision on the second is, for all practical purposes, irrelevant.

What to do next

This case is a good reminder of the need to check the contractual and invoicing arrangements where supplies are simultaneously made to more than one person. Alternatively, where matters are already proceeding to litigation, it is essential to obtain clear evidence to the fact that supplies are being made to the party which is intending to recover the input tax.

On a more basic level, one should also remember that payments made by a VAT-registered taxpayer will not necessarily give rise to an input tax credit: one has to establish the link between the services provided and the taxpayer's own taxable supplies.