Hey Praesto!

Indirect Tax | Management of taxes



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Keith Gordon looks at a case which considers the recoverability of input tax incurred on legal costs

Key Points

What is the issue?

As most readers will know, a VAT-registered business is required to account to HMRC for the VAT that it charges its customers (output tax), but (in most cases, at least)

can claim a credit for the VAT has incurred on its own purchases (input tax).

What does it mean to me?

Usually, there is little dispute as to what input tax may be claimed. However, one common area of difficulty is where a third party is introduced to the factual mix. This was at the heart of the recent case *Praesto Consulting UK Ltd v HRMC* [2019] EWCA Civ 353.

What can I take away?

Where supplies are made to more than one person, it might assist matters by ensuring that the invoicing accurately reflects this fact so as to reduce the possibility of dispute with HMRC. However, even when that is not the case, it is worth considering carefully whether an input tax recovery might still be appropriate.

Background

As most readers will know, a VAT-registered business is required to account to HMRC for the VAT that it charges its customers (output tax), but (in most cases, at least) can claim a credit for the VAT has incurred on its own purchases (input tax). Usually, there is little dispute as to what input tax may be claimed. However, one common area of difficulty is where a third party is introduced to the factual mix. This was at the heart of the recent case *Praesto Consulting UK Ltd v HRMC* [2019] EWCA Civ 353.

The facts of the case

Mr Ranson was an employee of a company called Customer Systems plc (CSP). He resigned and set up a company, Praesto Consulting UK Ltd (Praesto), whose business competed with CSP. CSP commenced action against Mr Ranson (and also against three former CSP employees who had taken up employment with Praesto). It was acknowledged that Mr Ranson’s actions were on behalf of the company, Praesto. Had CSP’s legal actions been successful, it was recognised that Praesto would be joined in as a party to account for any damages.

Although CSP were successful at the High Court, Mr Ranson appealed against the decision and the Court of Appeal allowed the appeal. The litigation with CSP then

came to an end. However, Praesto sought to claim the input tax charged on the invoices issued by Mr Ranson's solicitors throughout the course of the litigation. (Praesto was the addressee on the first invoice issued but, thereafter, all invoices were issued to Mr Ranson personally. This was because CSP had chosen to name Mr Ranson and not the company in the court proceedings.)

HMRC allowed the input tax claim on the first invoice (i.e. that addressed to Praesto) but refused the input tax on the subsequent invoices. Praesto appealed against the decision to the First-tier Tribunal which allowed its appeal. However, the decision was overturned by the Upper Tribunal. The company therefore appealed against the decision to the Court of Appeal.

The Court's decision

The lead judgment was given by Lord Justice Hamblen. He identified the two issues that the Court needed to address. These ultimately restated the two questions raised by the First-tier being:

- whether the invoices related to services provided by the solicitors to Praesto; and
- if so, whether those services had a direct and immediate link to Praesto's taxable activities.

In order to address these questions, his Lordship summarised the findings of fact reached by the First-tier (the First-tier hearing being the principal forum for identifying the facts in any such dispute). Although there was no express finding of a contractual relationship between Praesto and the solicitors, Lord Justice Hamblen interpreted the factual findings as 'clearly establish[ing] such a relationship'. In particular, it had been held that instructions to the solicitors were given by Mr Ranson on behalf of both himself and Praesto, that the solicitors had acted on behalf of both Mr Ranson and the company, both were clients of the solicitors and that the solicitors had supplied their services to both. In the circumstances, Lord Justice Hamblen considered that both Mr Ranson and Praesto were jointly and severally liable for the solicitors' fees (even if only one of them was referred to on the invoice).

Furthermore, the First-tier had identified 'the reality of the situation' and that the solicitors acted for both Mr Ranson and Praesto 'in relation to what was effectively

litigation brought against both of them by a trade competitor'. Similar expressions were given elsewhere by the First-tier such as 'the reality of the relationship' and 'the substance of the relationship'.

As Lord Justice Hamblen noted, Praesto (and its profits in particular) was the main target of CSP's litigation and, therefore, Praesto had 'an objectively reasonable fear of litigation by CSP'. Praesto therefore 'had a very real interest in ensuring that CPS's claim failed'.

His Lordship rejected HMRC's argument (based upon the fact that the invoices were addressed only to Mr Ranson), concluding that that provided 'no legal bar to the conclusion reached by the FTT', although he accepted that it was a fact that had to be taken into consideration when identifying the reality of the situation.

In the Upper Tribunal, HMRC had successfully argued that the First-tier had failed to make an express finding as to whether Praesto was entitled to the legal services provided by the solicitors. Had HMRC not won their appeal on the second issue, the Upper Tribunal would have remitted this specific question to the First-tier for further findings of fact. However, Lord Justice Hamblen concluded that (whilst another Tribunal might have interpreted the facts differently) the First-tier considered the material before it and reached a permissible decision.

Accordingly, his Lordship answered the first question in Praesto's favour.

The second question focused more on working one's way through various cases which have considered legal costs. The Upper Tribunal decided that this case fell down on the '*Becker*' side of the line. In *Finanzamt Köln-Nord v Becker* (C-104/ 12), a company was unsuccessful in its attempt to recover the input tax on legal fees it had paid for the defence of criminal proceedings taken against its managing director. The CJEU had concluded that there was no direct and immediate link between the expenditure and the company's taxable supplies because the legal proceedings related to the protection of the private interests of the accused in relation to his personal behaviour. In Becker, there was no reasonable likelihood of the company being joined in the criminal proceedings. Nor was there any suggestion that the prosecution of the managing director would have a major impact on the company's business.

However, Lord Justice Hamblen considered that the Upper Tribunal had erred in this regard. In particular, there were clear factual distinctions between the *Becker* and

Praesto cases. He considered that the *P&O* case (*P&O Ferries (Dover) Ltd v Commissioners of Customs & Excise* [1992] VATTR 221) was more alike the present. That was a case arising from the tragic events in 1987 when the ferry, The Herald of Free Enterprise, overturned near Zeebrugge. The company and a number of employees were subject to criminal prosecution and the company paid for the legal representation of all defendants. P&O was entitled to the input tax credit.

Given the First-tier's findings of fact, Lord Justice Hamblen concluded that the First-tier was fully entitled to consider that there was a sufficient link between the expenditure and Praesto's taxable supplies.

Lord Justice Haddon-Cave gave a concurring judgment emphasising the 'crucial findings of fact' made by the First-tier which 'are effectively determinative of both issues under appeal'. Indeed, he proceeded to describe those findings of fact as 'clear, unequivocal and directly relevant to the issues in question' and as having been expressed in 'trenchant terms'.

Interestingly, however, the Court was not unanimous. The Master of the Rolls (Sir Terence Etherton) gave a dissenting judgment. This focused on the second test – the direct and immediate link. At the risk of sacrificing accuracy for the sake of brevity, his Lordship's concerns centred on the speculative nature of the link between Praesto's business and the legal costs it had incurred. He also noted that the P&O case was not binding on the First-tier (let alone the Court of Appeal) and pre-dated the case law which adopted the 'direct and immediate link' test.

On the basis of the majority verdicts, however, Praesto's appeal was allowed.

Commentary

The final four paragraphs of Lord Justice Hamblen's judgment are worth reading. They make it clear that the case was ultimately one determined on its own facts rather than one identifying any new proposition of law. However, within that message, there is the important point that the facts need to be brought to the attention of the First-tier Tribunal. Where HMRC went wrong before the Upper Tribunal was in their attempt to retry the case and reargue the facts of the case. That is why it is very relevant that (whilst HMRC's approach succeeded in the Upper Tribunal) the Court of Appeal's decision is based solely on the facts as found by the First-tier.

So far as the ‘direct and immediate link’ test is concerned, it should also be remembered that this terminology can be somewhat misleading. Indeed, in *Becker* itself, it was acknowledged by the CJEU that ‘a taxable person has a right to deduct [input tax] even where there is no direct and immediate link between a particular input transaction and one or more transactions’. This is because the right to deduct exists if the expenses are ‘part of [the trader’s] general costs and are, as such, components of the price of the goods or services’. For a later confirmation of this broader test, see *Sveda* (*‘Sveda’ UAB v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* Case C-126/ 14).

What to do next

Where supplies are made to more than one person, it might assist matters by ensuring that the invoicing accurately reflects this fact so as to reduce the possibility of dispute with HMRC. However, even when that is not the case, it is worth considering carefully whether an input tax recovery might be appropriate – particularly in any case where a decision to the contrary was made in the light of the Upper Tribunal’s decision.

However, it should be remembered that this case does not set any precedent and therefore each case will turn on its own facts. Nevertheless, this emphasises the need to ensure that all the relevant facts are brought to the First-tier’s attention in the form of admissible evidence.