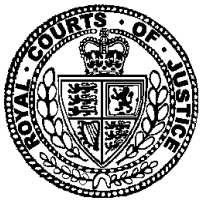

Neutral Citation Number: [2019] EWCA Civ 353

Case No: A3/2017/3450

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER
JUDGE TIMOTHY HERRINGTON &
JUDGE ASHLEY GREENBANK
[2017] UKUT 395 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 11/03/2019

Before :

THE MASTER OF THE ROLLS
LORD JUSTICE HAMBLEN
and
LORD JUSTICE HADDON-CAVE

- -

Between :

PRAESTO CONSULTING UK LIMITED	**Appellant**
- and -	
HER MAJESTY'S REVENUE AND CUSTOMS	**Respondent**

Oliver Conolly (instructed by **RG Legal Limited**) for the **Appellant**
Eleni Mitrophanous (instructed by **the General Counsel and Solicitor to HM Revenue and Customs**) for the **Respondent**

Hearing date : 14 February 2019

- -

Approved Judgment

Lord Justice Hamblen:

Introduction

1. This appeal concerns whether, on the facts as found, a company which pays the legal fees relating to the defence of civil proceedings brought against its sole director is entitled to credit for VAT input tax charged in relation to those fees.

The background facts

2. The following facts are taken from the decision of the First Tier Tribunal ("FTT", Judge Cannan and Mr Atkinson) dated 13 July 2016, with bracketed references to the relevant paragraphs of the decision.

3. Mr Ranson, was formerly an employee of the claimant in the civil proceedings, Customer Systems plc ("CSP"), which was an information technology consultancy. In 2009 Mr Ranson resigned to set up the company of which he was sole director, the appellant ("Praesto"), which thereafter carried on a consultancy business competing with CSP. Three other employees of CSP left to become employees of Praesto [6].

4. Letters before action were written by CSP's solicitors to both Mr Ranson and Praesto [7], [8]. Mr Ranson and Praesto instructed solicitors, Sintons. Solicitors' correspondence, without prejudice meetings and negotiations followed in which it was acknowledged that Mr Ranson was acting on behalf of Praesto [9]. In early 2010 there was an unsuccessful mediation. CSP then issued proceedings against Mr Ranson and the other three employees, but not against Praesto. It was alleged that Mr Ranson had breached "his terms of employment and/or fiduciary duties in setting up Praesto and competing with CSP through Praesto. Further claims were made alleging misuse of a contact list. CSP claimed damages by reference to the value of the business lost by CSP. This was estimated by reference to work done by Praesto. In the alternative CSP sought an account of profits earned by Mr Ranson in breach of his fiduciary duties" [10].

5. The claim went to a trial on liability before Sir Raymond Jack sitting as a High Court judge over nine days in November 2011 [12]. At the outset of the trial, there was a discussion between CSP's counsel and the judge about the claim for an account of profits in the light of the fact that Praesto was not a party. CSP's counsel stated that in the event that it was found that Mr Ranson owed a fiduciary duty and was in breach of that duty then CSP was likely to seek to join Praesto in relation to the account claim. In the end, the position of Praesto was left to be decided in any trial on quantum or remedy [15], [16].

6. The claim against Mr Ranson succeeded at trial but his appeal to the Court of Appeal was allowed. No further trial or hearing was therefore necessary [16].

7. Sintons issued nine invoices for their fees in connection with the litigation [20]. The first invoice was addressed to Praesto and HMRC has not challenged Praesto's claim for input tax credit on that invoice. It covered all costs up to and including the date when CSP commenced proceedings [21].

8. The other eight invoices were addressed to Mr Ranson alone and related to the conduct of the litigation from the commencement of proceedings up to and including the Court

of Appeal. There is no mention of Praesto in the description of the work done to support the invoices [22]. These are the invoices which are subject to challenge.

9. Mr Ranson had a discussion with Sintons sometime before January 2011 about whether the invoices should be addressed to Praesto as well and was told that the invoices should match the title of the proceedings [23]. The invoices were paid by Praesto [24].

The appeal proceedings

10. HMRC issued a notice of assessment to recover the input tax credit of £79,932 claimed by Praesto in relation to the VAT paid on the eight invoices in issue. That assessment was appealed to the FTT [2].

11. The FTT considered that the appeal raised two issues [51]:

    (1) Do the invoices relate to services supplied by Sintons to Praesto?

    (2) If so, did the services have a direct and immediate link to Praesto's taxable activities?

12. It answered both questions in the affirmative.

13. In relation to issue (1), the FTT found, in particular, that all the work done by Sintons was on behalf of Mr Ranson and Praesto, that CSP would have sought to join Praesto as a party if it had been successful on liability and that the services were supplied to Praesto just as much as if it had been a party [53].

14. In relation to issue (2), the FTT found, in particular, that Praesto had a direct interest in CSP's claim being dismissed, that otherwise there was a real risk it would have to account for the profits it had made in competition with CSP and that it may be viewed as a party in the proceedings in all but name [59].

15. HMRC appealed to the Upper Tribunal ("UT", Judge Herrington and Judge Greenbank). In its decision of 10 October 2017 the appeal was allowed.

16. On issue (1), the UT held that the FTT had failed to make a finding as to whether Praesto was contractually entitled to the legal services provided by Sintons, and that this failure was an "error of approach" which amounted to an error of law. It would have remitted the case the FTT for reconsideration, had it not granted HMRC's appeal on issue (2) [42]-[44].

17. On issue (2), it held that if, contrary to the above, services were supplied to Praesto, they were not used by it for the purposes of its business [73].

18. Permission to appeal from the UT decision was given by Patten LJ on 29 June 2018.

The legal framework

19. The most relevant provisions of EU law are set out in the Principal VAT Directive ("PVD"), Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, as follows:

"Article 2

1. The following transactions shall be subject to VAT:

(*a*) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such;

….

(*c*) the supply of services for consideration within the territory of a Member State by a taxable person acting as such.

….

Article 14

'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner.

….

Article 24

'Supply of services' shall mean any transaction which does not constitute a supply of goods.

….

Article 73

In respect of the supply of goods or services, other than as referred to in Articles 74 to 77, the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply.

….

Article 168

In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;"

20. Article 178 of PVD provides that to exercise the right to deduct the customer must hold an invoice. Article 226 requires that the invoice show the name of the customer. These are formal rather than substantive conditions – see *Senatex GmbH v Finanzamt Hannover-Nord* (C-518/14) [2017] STC 205 at [38].

21. The most relevant provisions of UK law are set out in the Value Added Tax Act 1994 ("VATA") as follows:

> "Section 4
>
> (1) VAT shall be charged on any supply of goods or services made 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.
>
> (2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.
>
> Section 5
>
> (1) Schedule 4 shall apply for determining what is, or is to be treated as, a supply of goods or a supply of services.
>
> (2) Subject to any provision made by that Schedule and to Treasury orders under subsections (3) to (6) below—
>
> (a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration;
>
> (b) anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right) is a supply of services.
>
> ….
>
> Section 24
>
> (1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following tax, that is to say—
>
> (a) VAT on the supply to him of any goods or services….
>
> being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him. (emphasis added)
>
> (2) Subject to the following provisions of this section, "output tax", in relation to a taxable person, means VAT on supplies which he makes or on the acquisition by him from another member State of goods (including VAT which is also to be counted as input tax by virtue of subsection (1)(b) above).

> ….
>
> Section 26
>
> (1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.
>
> (2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—
>
> (a) taxable supplies…"

22. Regulation 13 of Value Added Tax Regulations 1995 requires that a taxable person must provide an invoice when supplying to another taxable person and Regulation 14 specifies that the invoice has to show the name and address of the supplier and the customer and contain a description of the goods or services supplied.

23. As made clear by the underlined passages from section 24(1) of VATA, in order to recover VAT input tax as a credit against output tax it is necessary for a taxable person to show (1) that the VAT was paid on the supply to him of goods or services and (2) that the goods or services are used or to be used for the purpose of his business.

24. As to the supply of services to a taxable person, this is a matter of autonomous EU law. In *Tolsma v Inspecteur der Omzetgelasting Leeuwarden* (Case C-16/93) [1994] STC 509 the CJEU held that a busker who receives donations from passers by does not obtain receipts for a service supplied. It was stated that:

> "14…. a supply of services is effected 'for consideration" within the meaning of Article 2 (1) of the Sixth Directive, and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient".

25. This statement has been cited and followed in a number of subsequent cases, including *Town & Country Factors Ltd v Commissioners of Customs and Excise* EU:C:2002:494 (Case C-498/99) and *Revenue and Customs Commissioners v Newey (t/a Ocean Finance)* (Case C-653/11) [2013] STC 2432. In *Town & Country,* the CJEU emphasised that it was not necessary that the legal relationship be contractual or enforceable, because of the differences that might exist in the various legal systems of Member States in this respect (at [21]).

26. The concept of a supply of goods or services is analysed by the CJEU in terms of "economic reality". In *HMRC v Loyalty Management UK Ltd and Baxi Group Ltd*

(Joined Cases C-53/09 and C55/09) EU:C:2010:590 [2010] STC 2651, the CJEU held at [39]:

> "It must also be recalled that consideration of economic realities is a fundamental criterion for the application of the common system of VAT (see, first, as regards the meaning of place of business for the purposes of VAT, *Customs and Excise Comrs v DFDS A/S* (Case C-260/95) [1997] STC 384, [1997] ECR I-1005, para 23, and *Planzer Luxembourg Sarl v Bundeszentralamt fur Steuern* (Case C-73/06) [2008] STC 1113, [2007] ECR I-5655, para 43, and, secondly, as regards the identification of the person to whom goods are supplied, by analogy, *Auto Lease Holland BV v Bundesamt für Finanzen* (Case C-185/01) [2005] STC 598, [2003] ECR I-1317, paras 35 and 36)."

27. Much of the relevant case law was considered by Supreme Court in *Revenue and Customs Commissioners v Airtours Holidays Transport Ltd* [2016] UKSC 21, [2016] 4. W.L.R 87. The UT at [39] provided a useful summary of relevant principles, as set out by Lord Neuberger in his judgment (in particular at [42]-[51]), which HMRC accepted as being correct. With minor amendments this was as follows:

(1) The consideration of the economic and commercial realities of a transaction is a fundamental criterion of the VAT system.

(2) The contractual position between the parties normally reflects the economic and commercial reality of the transactions – *Newey* at [42] to [43].

(3) The most useful starting point is therefore the contractual position between the parties - Lord Reed in *WHA Limited v Revenue and Customs Commissioners* [2013] UKSC 24, [2013] STC 943 at [27].

(4) The aim of that enquiry is to determine whether there is a supply of services effected for a consideration. This will only be the case if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient - *Tolsma* at [14]; *Newey* at [40].

(5) It is only if the contractual position does not reflect the economic reality that it is appropriate to depart from that approach. That may occur where the contractual terms constitute a "purely artificial arrangement" which does not correspond with the economic and commercial reality of the transactions - *Newey* at [45].

28. As to the use of the supply for the purposes of the taxable person's business, both parties accepted that the UT at [55] stated the correct test, as established by CJEU case law, namely that a supply will be treated as being used for the purpose of the business of a taxable person if there is "a direct and immediate link" between the supply and one or more output transactions or between the supply and the taxable person's economic activity as a whole.

29. Of particular relevance in relation to the supply of legal services is the CJEU decision in of *Finanzamt Koln-Nord v Becker* EU:C:2013:99 (C-104/12) ("*Becker*"). In that case a company made an unsuccessful claim for recovery of VAT input tax on legal fees incurred in defending criminal proceedings brought against its managing director, Mr Becker, for bribery in relation to a contract that was ultimately awarded to the company.

30. The CJEU summarised the case law in relation to the requirement of a direct and immediate link as follows:

> "19. In order to answer the first question it should, first, be recalled, as the Court has previously held, that the existence of a direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct is, in principle, necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement (see *Midland Bank*, paragraph 24; Case C-408/98 *Abbey National* [2001] ECR 1-1361, paragraph 26; and *Investrand*, paragraph 23). The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them is part of the cost components of the taxable output transactions giving rise to the right to deduct (see *Midland Bank*, paragraph 30; and *Abbey National*, paragraph 28).
>
> 20. It is however also accepted that a taxable person has a right to deduct even where there is no direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do, in effect, have a direct and immediate link with the taxable person's economic activity as a whole (see, to that effect, inter alia, *Midland Bank*, paragraph 31, and Case C-465/03 *Kretztechnik* [2005] ECR 1-4357, paragraph 36).
>
> 21. It should, next, be noted, with regard to the nature of the 'direct and immediate link' which must exist between an input and an output transaction, that the Court has held that it would not be realistic to attempt to be more specific in that regard. In view of the diversity of commercial and professional transactions, it is impossible to give a more appropriate reply as to the method of determining in every case the relationship which must exist between the input and output transactions in order for input VAT to become deductible (see, to that effect, *Midland Bank*, paragraph 25).
>
> 22. Finally, it is apparent from the case-law that, in the context of the direct-link test, which the tax authorities and national courts are to apply, they should consider all the circumstances surrounding the transactions at issue (see, to that effect, *Midland*

> *Bank*, paragraph 25) and take account only of the transactions which are objectively linked to the taxable person's taxable activity.
>
> 23. The obligation to take account only of the objective content of the transaction at issue is the most compatible with the aim pursued by the common system of VAT, which seeks to ensure legal certainty and to facilitate the application of VAT (see, to that effect, *BLP Group*, paragraph 24; Case C-108/99 *Cantor Fitzgerald International* [2001] ECR 1-7257, paragraph 33; and Case C-29/08 *SKF* [2009] ECR 1-10413, paragraph 47)."

31. It concluded that there was no direct and immediate link, principally for the following reasons:

> "30. In the present case, first, according to the information provided by the referring court, the supply of services by lawyers at issue in the main proceedings sought directly and immediately to protect the private interests of the two accused who were charged with offences relating to their personal behaviour. Furthermore, as has already been pointed out in paragraph 16 of this judgment, the criminal proceedings were brought against them solely in a personal capacity, and not against A, although proceedings against A would also have been legally possible. That court correctly concludes that, in the light of their objective content, the costs relating to those supplies cannot be considered as having been incurred for the purposes of A's economic activities as a whole".

The FTT's findings

32. The FTT heard evidence from Mr Ranson and, based on his oral evidence and the documentary evidence, made various findings of fact. The most relevant findings are as follows:

(1) Mr Ranson understood throughout that CSP was "attacking" both himself and Praesto and that CSP was effectively seeking to put Praesto out of business [18].

(2) Mr Ranson's instructions to Sintons throughout the litigation were on behalf of himself and Praesto [18].

(3) Sinton's understanding was that "the reality of the situation" was that the litigation was directed at key personnel of Praesto and against the company/business, and that it acted on behalf of both Mr Ranson and Praesto in relation to what was effectively litigation brought against both of them by a trade competitor [25]. The FTT accepted this as "a fair summary of the position" and stated that they "find accordingly", thereby finding that it was the reality [26].

(4) If CSP had been successful in establishing a breach of fiduciary duty by Mr Ranson then CSP would have sought to add Praesto as a party for the purposes of an account of profits; the real value of the claim was an account of profits against Praesto; if

CSP's claim had been successful then Praesto would have been unable to continue trading [19].

(5) Both Mr Ranson and Praesto were clients of Sintons. All the work done by Sintons was on behalf of Mr Ranson and Praesto. Praesto was directly affected by the result of the trial on liability even though it was not a party. The services of Sintons were supplied to Praesto just as much as if they had been a party and that was the reality of the relationship between Sintons, Mr Ranson and Presto [53]. The substance of the relationship between Sintons, Mr Ranson and Praesto continued after the first invoice [55].

(6) Praesto was a party to the proceedings in all but name. It had a direct interest in CSP's claim being dismissed, otherwise there was a real risk that it would have to account for the profits it had made in competition with CSP [59].

(7) If the supplies had not been made to Praesto then it was at serious risk of having to account for its past and future taxable activities. Objectively, the reason Praesto obtained the services was to limit any liability arising from its taxable activities [60].

The issues on appeal

33. There are two issues to be determined:

(1) Did the FTT err in law in concluding that the invoices related to services supplied by Sintons to Praesto?

(2) Did the FTT err in law in concluding that the services supplied by Sintons had a direct and immediate link to Praesto's taxable activities?

34. These issues have to be addressed on the basis of the facts as found by the FTT.

35. It is to be noted that Issue (1) was only raised by HMRC shortly before the hearing before the FTT. It is therefore hardly surprising if the evidence before it relating to that issue was not as extensive as might otherwise have been the case. In any event, it is not for this Court to speculate as to what other evidence there might have been. Subject to a successful rationality challenge, it must take the findings made as they stand and not seek to go behind them.

Issue (1) - Did the FTT err in law in concluding that the invoices related to services supplied by Sintons to Praesto?

36. Although the FTT made no express finding of a contractual relationship between Sintons and Praesto, the findings which they made clearly establish such a relationship. In particular the findings that:

(1) Mr Ranson's instructions throughout were given on behalf of both himself and Praesto [18].

(2) Sintons acted on behalf of both Mr Ranson and Praesto in relation to the litigation [26].

(3) Both Mr Ranson and Praesto were clients of Sintons [53].

(4) All the work done by Sintons was on behalf of both Mr Ranson and Praesto [53].

37. In my judgment, these findings mean that there was throughout a joint retainer whereby Sintons was being instructed by and acting on behalf of both Mr Ranson and Praesto. Under such a retainer both Mr Ranson and Praesto would be entitled to Sintons' services and both would be jointly and severally liable for Sintons' fees. That is a legal relationship involving reciprocal performance.

38. In circumstances where Mr Ranson and Praesto were jointly and severally liable for Sintons' fees there would be no particular significance in addressing invoices to only one of the parties so liable. Both would be liable for the fees unless and until that liability was discharged by payment, regardless of to whom invoices had been addressed.

39. In concluding that the findings of fact made by the FTT were insufficient to establish a contractual relationship, the UT ignored a number of critical findings made by the FTT, in particular those set out at [36] (2), (3) and (4) above. None of these findings are referred to in the paragraph in which the UT purported to set out the basis of the conclusion reached by the FTT (UT at [41]).

40. This contractual relationship also reflected the economic reality of the relationship between the parties, as found by the FTT. In particular, the FTT found that:

(1) "The reality of the situation" was that Sintons acted on behalf both Mr Ranson and Praesto "in relation to what was effectively litigation brought against both of them by a trade competitor" [25] [26].

(2) "The services of Sintons were supplied to Praesto just as much as if it had been a party. That was the reality of the relationship between Sintons, Mr Ranson and Praesto" [53].

(3) The "substance of the relationship between Sintons, Mr Ranson and Praesto continued after the first invoice" [55], when it was common ground, there was a contractual relationship.

41. HMRC laid great stress before us, as it had before the FTT, on the fact that the invoices were addressed to Mr Ranson, that they related to services provided in relation to the claim brought by CSP against him and that Praesto was never joined as a party to the proceedings. These considerations, however, provide no legal bar to the conclusion reached by the FTT. They were matters to take into account, which the FTT did when arriving at its overall conclusion.

42. As a matter of economic reality, there were good reasons for the FTT to reach the conclusion which it did. The FTT considered that Praesto was throughout a main target of the litigation. It was Praesto which had made the profits which CSP sought to claim. The real value of CSP's claim was an account of Praesto's profits. CSP was seeking to put Praesto out of business as its competitor. CSP would have sought to add Praesto as a party if it had succeeded in establishing that Mr Ranson had acted in breach of fiduciary duty. Praesto had an objectively reasonable fear of litigation by CSP. Praesto,

accordingly, had a very real interest in ensuring that CSP's claim failed at the first hurdle and to obtain and pay for Sintons' services for that purpose.

43. The FTT was satisfied and found that the litigation was effectively being brought against Mr Ranson and Praesto, even though Praesto had not been joined to the proceedings. That reflected the economic reality. It was also borne out by CSP's stated intention to join Praesto if and when Mr Ranson's liability for breach of fiduciary duty was established, and the FTT found that CSP would have sought to do so. Throughout the litigation the interests of Mr Ranson and CSP were precisely aligned.

44. In relation to the joinder of Praesto, HMRC sought to criticise the FTT for apparently assuming that a claim for an account of profits could be made against Praesto when liability against it also had to be established. It is apparent from the transcript of the discussion between CSP's counsel and the judge, referred to by the FTT, that a claim in knowing receipt was contemplated. If so, the monetary claim may have had to be put on a proprietary basis rather than as an account of profits, as contemplated in cases such as *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC and *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638, both of which were referred to in the discussion. For example, a claim could have been advanced on the basis that corporate opportunities had been diverted away from CSP to Praesto with the consequence that resulting choses in action, such as contracts with third parties, were held on trust for CSP – see *Ultraframe* at [1491]. Be that as it may, these issues do not appear to have been explored before the FTT. They involve consideration of matters of fact as well as law and the proper time to raise issues as to the viability of the claim against Praesto was before the FTT rather than this Court. On any view, it was never HMRC's case before the FTT that no claim could have been brought by CSP against Praesto.

45. HMRC further sought to contend that if, contrary to its primary case, the FTT's findings mean that there was a legal relationship under which legal services were being supplied to Praesto, then the FTT had erred in its assessment of the evidence and come to an irrational or perverse conclusion. There is, however, no proper basis for going behind or overturning any of the FTT's factual conclusions. It may be that another tribunal might not have reached the same conclusions, but the FTT was clearly entitled to reach the conclusions which it did on the material before it.

46. For all these reasons, in my judgment there was no error of law in the FTT's conclusion that the invoices related to services supplied by Sintons to Praesto and the UT was wrong so to hold. I would allow the appeal on Issue (1).

Issue (2) - Did the FTT err in law in concluding that the services supplied by Sintons had a direct and immediate link to Praesto's taxable activities as held by the UT or otherwise?

47. The UT held that the present case was indistinguishable from *Becker* and that the FTT erred in concluding otherwise.

48. In holding that a direct and immediate link was established the FTT relied in particular on the following findings:

    (1) The services it had found Sintons were supplying to Praesto as well as Mr Ranson – see findings under Issue (1).

(2) If CSP's claim for breach of fiduciary duty against Mr Ranson had succeeded it would have sought to add Praesto to the proceedings and claimed the profits it had made in competition with CSP [19].

(3) There was a real risk of that claim succeeding [59], [60].

(4) If the claim had succeeded Praesto would have had to account for the profits of its past and future taxable activities [60] and would have been unable to continue trading [19].

(5) Praesto accordingly had a direct interest in CSP's claim being dismissed [59].

(6) Objectively the reason Praesto obtained Sintons' services was to limit any liability arising from its taxable activities [60].

49. As the FTT found, this was effectively litigation brought against both Mr Ranson and Praesto. Phase 1 of the litigation was to establish that Mr Ranson acted in breach of fiduciary duty. Phase 2 was to pursue Praesto for all profits made as a result of that breach of duty. If the claim could be defeated at phase 1 then the "real risk" of Praesto having to account for its profits and being put out of business would be avoided. Phase 1 was the intended first step towards the destruction of Praesto's trading activities and eliminating Praesto as a competitor. The services supplied enabled the claim against Mr Ranson at phase 1, and thereby the claim against Praesto at phase 2, to be defeated, thus avoiding the real risk of the destruction of Praesto's business.

50. These knock-on effects for Praesto of a finding of liability against Mr Ranson were not present in *Becker*.

51. There was no suggestion in *Becker* that a finding of criminal liability on the part of Mr Becker might lead to proceedings being brought against the company. Whilst it might have been legally possible to bring proceedings against the company, no such proceedings had been brought and it was not suggested that they would be brought, still less that the prospect of doing so was linked to the proceedings against Mr Becker. Any benefit to the company from the successful defence by Mr Becker of the criminal proceedings was necessarily indirect.

52. There was equally no suggestion in *Becker* that there was a real risk that consequential proceedings brought against the company would severely impact the company's taxable activities or put it out of business.

53. As the FTT held, the factual circumstances of the present case bear some similarity to the case of *P&O Ferries (Dover) Ltd v Commissioners of Customs & Excise* [1992] VATTR 221. In that case criminal proceedings were brought against various P&O employees and the company itself arising out of the "Herald of Free Enterprise" Zeebrugge disaster. As a result of legal advice, P&O formed the view that the success or otherwise of the possible prosecution of the company depended largely on the success of the prosecution in relation to the charges against the individual employees. In those circumstances the company undertook to pay for the legal representation of all the individual defendants and then claimed the VAT input tax on the costs of so doing. The Tribunal (Mr Stephen Oliver and Mr Ring) held that the costs had been incurred for the purpose of the company's business. It found that:

> "…the board decided that the Company should incur the defence costs….so far as the defences of the seven individual employers was concerned, to protect its own business. If it had not engaged the solicitors for the seven individual members of staff the Company would have been at risk of their defences being conducted ineffectively, with a consequently greater likelihood of conviction. Convictions of the individual employees would have placed the Company itself in danger of being convicted of corporate manslaughter. The conviction of even one of the individual employees would have caused severe damage to the public perception of the Company's business and could have jeopardised the Company's negotiating position viz a viz the Union. Conviction of the Company would have had dire consequences as far as cargo claims, sought to be recovered from it by insurers, were concerned; it would have ruined the name of P&O, a name used both for cross-Channel ferry activities and for numerous other transportation activities in different parts of the P&O Group. To mitigate the real risk of being driven out of business the board reasonably, the Tribunal accepts, took the view that the Company had to take every step available to it to guard against the successful prosecution of each of the individual employees. The legal services in question were, therefore, used for the purpose of the Company's business."

54. That too was therefore a case in which the consequence of a finding of liability on the part of the individual was a real risk of proceedings being successfully brought against the company with disastrous consequences for its business activities.

55. Further, there was no finding in *Becker* that the services were being supplied to both Mr Becker and the company, as a matter of contract and economic reality. In *Becker* the objective content of the supply was said to be "the activity of a criminal defence lawyer with a view to preventing the conviction of a natural person". Here, on the FTT's findings, it was the activity of civil lawyers with a view to preventing Mr Ransom and Praesto being found liable to CSP and Praesto having to account for all the profits from its taxable activities.

56. In my judgment the FTT was accordingly correct to conclude that the *Becker* decision was distinguishable and the UT was wrong to conclude otherwise. As the FTT found, Praesto had a direct interest in CSP's claim being dismissed [59] and the benefit was not merely "incidental" as the UT found (UT at [71]).

57. In those circumstances the only remaining question is whether the FTT erred in law in concluding, on the basis of the findings made, that the services supplied by Sintons had a direct and immediate link to Praesto's taxable activities. Whether or not there is a direct and immediate link is a fact sensitive question. The FTT applied the right legal test. It had regard to "all the circumstances surrounding the transactions at issue", looked for an objective link and found that "objectively the reason Praesto obtained Sintons' services was to limit any liability arising from its taxable activities" [60]. In particular:

(1) As found in relation to Issue (1), the services Sintons were supplying to both Mr Ranson and Praesto under the joint retainer.

(2) The finding that the supply acquired reflected the economic reality. The proceedings were effectively being brought against both Mr Ranson and Praesto, targeting the profits made by Praesto with the aim of putting it out of business – see [40], [42]-[43] above.

(3) There was a real risk of the claim against Praesto being brought by CSP and succeeding if breach of fiduciary duty by Mr Ranson was first established. This was not a mere contingency.

(4) Objectively the reason Praesto retained Sintons' services was to avoid the real risk of liability to CSP which, if established, would have meant accounting for the profits of its taxable activities with the consequence that it would have been unable to continue to trade – see [48]-[49] above.

58. In my judgment, in all the circumstances, it was open to the FTT to conclude that the services supplied by Sintons had a direct and immediate link to Praesto's taxable activities in the light of the findings it had made. It made no error of law. I would accordingly allow the appeal on Issue (2).

Conclusion

59. In the light of the *Becker* decision, it is likely that in many cases a company which pays the legal fees relating to the defence of proceedings brought against its director will be held not be entitled to credit for VAT input tax charged in relation to those fees. In the present case, however, I consider that the FTT was entitled to decide otherwise in the light of the factual findings it made in the particular circumstances of this case.

60. Those factual circumstances are unusual. Ordinarily where a claim is brought against a former employee or director who has left to set up a competitor company, the claim will be made against both the individual and the company. In such a case there would likely be no issue as to the entitlement of the company to claim recovery of VAT. CSP, for reasons best known to itself, decided to bring proceedings against the individual only, although the target of its claim was the company's profits and business and its stated intention was to seek to join the company at a later stage of the proceedings. The FTT understandably focused on substance and reality and reached an overall conclusion which was open to it on the facts as found.

61. I do not consider that the FTT decision establishes any general proposition, still less a proposition of law, as to the circumstances in which a company will or will not be able to claim VAT in comparable factual circumstances. The decision turns on the findings of fact made by the FTT in this specific case.

62. I would allow the appeal.

Lord Justice Haddon-Cave:

63. I agree that this appeal should be allowed for the reasons given in the judgment of Hamblen LJ.

64. The FTT have made a number of crucial findings of fact in this case which, in my view, are effectively determinative of both issues under appeal. These are succinctly summarised by Hamblen LJ in paragraphs [36], [37] and [40] above (which relate to the 'supply of services' issue, Issue (1)) and in paragraphs [48], [49] and [56] (which related to the 'direct and immediate link' issue, Issue (2)).

65. The FTT findings of fact are clear, unequivocal and directly relevant to the issues in question. It is useful to have regard to the trenchant terms in which they are expressed. I cite four paragraphs from the FTT judgment by way of illustration:

i) As to Issue (1), the FTT found:

> "53. We are satisfied that both Mr Ranson and Praesto were clients of Sintons. All the work done by Sintons was on behalf of Mr Ranson and Praesto. The fact that Praesto was not a party in the trial on liability does not affect that conclusion. Praesto was directly affected by the result. That was the reality of the relationship between Sintons, Mr Ranson and Praesto. It is clear that CSP would have sought to join Praesto as a party if it had been successful on liability. Indeed it considered applying to join Praesto as a party during the course of the trial on lability and it appears only to have been procedural difficulties which prevented it from making any such application at that time.
>
> …
>
> 55. In our view the substance of the relationship between Sintons, Mr Ranson and Praesto continued after the first invoice. For some reason, not entirely clear, CSP chose to name only Mr Ranson as a defendant together with the other individuals, and not Praesto. It was Praesto who made the profits from any breach of duty by Mr Ranson and all parties appeared to recognise that it was Praesto's profits that would have to be accounted for either by Mr Ranson or by Praesto itself."

ii) As to Issue (2), the FTT found:

> "59. In Becker, the company was not a party or a necessary party to the proceedings. Plainly there would be some benefit to the company if Mr Becker was acquitted of the criminal charges. But benefit is not the test, as held by Latham LJ in Rosner. There must be something more than a benefit. In the present case Praesto may be viewed a party to the proceedings in all but name. it had a direct interest in CSP's claim being dismissed, otherwise there was a real risk that it would have to account for the profits it had made in competition with CSP.
>
> 60. In that sense Praesto's position was similar to that of P&O. Whilst P&O is a decision of the VAT Tribunal and not binding on us, the decision was consistent with the subsequent case of Rosner and Becker. It seems to us that the link in the present

> case was at least as direct and immediate as it was in P&O. If the supplies had not been made to Praesto then it was at serious risk of having to account for the profits of its past and future taxable activities. In one sense it is more direct and immediate. CSP commenced the proceedings directly as a result of Praesto's taxable activities. Objectively, the reason Praesto obtained the services was to limit any liability arising from its taxable activities."

66. It is not open to this Court to go behind, or ignore, these clear findings of fact by the FTT. The FTT findings were not seriously challenged by the Respondent, nor could they have been.

67. As Hamblen LJ says (at paragraphs [37] and [49] above):

    i) the FTT's findings on Issue (1) mean that there was throughout a joint retainer whereby Sintons was being instructed by and acting on behalf of *both* Mr Ranson and Praesto; and

    ii) the FTT's findings on Issue (2) means that this was effectively litigation brought by CSP against *both* Mr Ranson and Praesto.

68. The FTT's findings are determinative of both legal issues:

    i) As to Issue (1), the FTT findings are determinative of the "economic realities" of the relationship between Sintons, Mr Ranson and Praeto (*c.f. HMRC v Loyalty Management UK Ltd and Baxi Group Ltd (Joined Cases C-53/09 and C55/09)* EU:C:2010:590 [2010] STC 2651, at [39]). The FTT concluded "the invoices do relate to services supplied by Sintons to Praesto" (FTT, paragraph 57)

    ii) As to Issue (2), the FTT findings are determinative of the "direct and immediate link" between the services supplied by Sintons and Praesto's taxable activities (*c.f. Finanzamt Koln-Nord v Becker* EU:C:2013:99 (C-104/12). The FTT concluded "the supplies were… made to Praesto for the purposes of its business" (FTT, paragraph 61)

69. I have read with care the judgment of the Master of the Rolls but respectfully disagree with it. His analysis seems to me inevitably to draw this Court into seeking to go behind the findings of fact of the first instance tribunal.

70. It is not open (or relevant) for this Court to speculate *post hoc* as to the chances of Praesto being sued by CSP successfully. To do so would cut across the FTT's clear findings as to the objective realities at the time, *viz. e.g.* (i) "We have no doubt that if CSP had been successful in establishing a breach of fiduciary duty by Mr Ranson then CSP would have sought to join Praesto as party"; (ii) "all parties appeared to recognise that it was Praesto's profits that would have to be accounted for"; and (iii) there was a "real risk" that Praesto would have to account for its profits (see FTT, paragraphs 19, 55 and 59 respectively).

71. For all these reasons, I have concluded that the appeal should be allowed.

Sir Terence Etherton MR:

72. I have the misfortune to disagree with the decision of the majority of the Court.

73. I am very grateful to Lord Justice Hamblen for setting out so clearly the legal principles and his analysis.

74. I can explain quite briefly the reasons for my dissent.

75. The critical legal principles which inform the analysis are that, for an entitlement to credit for VAT input tax on a transaction, (1) there must be a "direct and immediate" link between the particular input transaction and one or more output transactions giving rise to the right to deduct or (2) the costs of the services are part of the taxpayer's general costs and have a direct and immediate link with the taxpayer's economic activity as a whole and are, as such, components of the price of the goods and services supplied by the taxpayer; and (3) that direct and immediate link must be established objectively, that is to say in the light of the objective content of the supply: *Finanzamt Köln-Nord v Becker* at paragraphs 16, 19-23 and 30.

76. Looking at the matter objectively, those conditions were not satisfied in the present case. The relevant invoices were addressed to Mr Ranson alone. It was a deliberate decision, on advice from the solicitors who had previously acted for both Mr Ranson and Praesto, that they should be addressed to him alone. He, and not Praesto was a defendant in the proceedings. The services specified in each of the invoices – the relevant supply for the purposes of VAT - were for specific matters relating to the conduct of Mr Ranson's defence in the action. None of the invoices specified anything done for Praesto. It is an obvious inference that the reason the invoices were addressed to Mr Ranson was so that, if he was successful in the litigation, he could recover his costs from CSP. The effect of the decision of the FTT is that services supplied for the conduct of Mr Ranson's defence in the litigation and deliberately invoiced to him alone so that he could recover costs from CSP, if he was successful in the litigation, can be deployed by Praesto to reduce Praesto's output tax on its general business receipts for the relevant periods.

77. The decision of the FTT amounts to a finding that a company, whose director or employee is being sued, and, if he or she is successfully sued, is itself likely to be sued successfully in due course, either in the same proceedings or in fresh proceedings, and for that reason whose economic interests are best served if the proceedings against the employee or the director fail, can offset against its own liability for output tax on its business income the input tax on invoices addressed to that employee and director alone, for legal services provided solely in connection with the defence of that employee or director, but which are paid by the company. I do not consider that such a decision is correct in law.

78. It should be noted that the objective facts of the present case are not even as favourable to Praesto as that characterisation of the legal issue. That characterisation assumes that, if the liability of the director or employee is established, the company is likely to be sued successfully in due course. In the present case, allegations having been originally made against both Mr Ranson and Praesto, a deliberate decision was taken by CSP not to commence and then continue proceedings against Praesto. In the proceedings, which were commenced in May 2010, the claim for an account of profits was limited to an account from Mr Ranson. It was not until the trial of Mr Ranson's liability in November 2011 that any suggestion was made that an application might be made to join Praesto.

That suggestion, which was that Praesto might be added in due course as a defendant for the trial on quantum should CSP succeed on liability against Mr Ranson, was made by CSP's counsel in the course of the hearing on liability before Sir Raymond Jack, sitting as a High Court judge, in November 2011. Yet, even after judgment on liability was given in favour of CSP on 6 December 2011 and the hearing on quantification of loss and damage had been fixed for 14 May 2012, no application was ever made to join Praesto, notwithstanding that points of claim for the quantum hearing had been directed and had been served. In fact, after the commencement of the proceedings there was never any application to join Praesto from the beginning to the end of the proceedings, nor even a letter from CSP's solicitors threatening, or reserving the right, to join Praesto.

79. I would regard it as, at best, highly speculative whether any application to join Praesto in the existing proceedings, alleging a different cause of action against Praesto from the causes of action for breach of contract and breach of fiduciary duty alleged against Mr Ranson, could possibly have succeeded after a nine day trial on liability against the existing defendants and some 18 months since the commencement of the proceedings. I would also regard it as uncertain whether, after a trial against Mr Ranson, any new proceedings subsequently commenced against Praesto could have withstood a strike out application on the ground of abuse of process.

80. Further, on the only occasion after commencement of the proceedings in May 2010 that the suggestion was made that Praesto might be joined, namely by CSP's counsel at the trial of Mr Ranson's liability in November 2011, the possible cause of action against Praesto articulated by counsel was for "knowing receipt". That was a quite different cause of action from those alleged against Mr Ranson. It could only succeed by showing that Praesto had received an asset procured by breach of fiduciary duty in circumstances in which Praesto's knowledge was such as to make it unconscionable for Praesto to retain the benefit of it: *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437, 455. The asset in question was never articulated by counsel. It was plainly not money or any tangible asset as there was no suggestion to that effect in the proceedings against Mr Ranson. It is to be noted that in *Ultraframe (UK) Ltd v Fielding* [2006] EWHC 1638 (Ch) at [1547] Lewison J said that he accepted the submission that (in the context of breach of a fiduciary duty) a proprietary remedy is not available in the case of an alleged misappropriation of a business (as opposed to a proprietary claim to shares in a company or to a specific business asset), and he also accepted the submission that a proprietary claim does not apply to profits.

81. The FTT never attempted to analyse the likelihood of a claim for an account of profits succeeding against Praesto, bearing in mind the relevant legal principles applicable to such a claim, and also Praesto's separate legal personality and the absence of any findings of fact by the FTT about Praesto's ownership and, indeed, the way its affairs were conducted either generally or in relation to particular transactions. Mr Conolly declined to articulate in his oral submissions how such a claim would have been made out.

82. It is to be observed, when assessing the matter objectively, that Praesto has not disclosed in these proceedings, and Mr Conolly was clear and firm in his oral submissions that Praesto has not been and is not now prepared to disclose, any documents as to the legal advice given to it about the prospects of success of any claim against Praesto and of the likely success of an application for the joinder of Praesto to

the proceedings against Mr Ranson or the commencement of fresh proceedings against Praesto. Nor has our attention been drawn to a single minute of the board of Praesto addressing the conduct of the litigation against Mr Ranson or its significance for the economic interests of the company.

83. Turning to the relevant principles which, as I have mentioned above, were laid down by the CJEU in *Becker*, it cannot be said, and I do not understand Praesto to contend, that there was any direct link between the supply of the litigation services in the invoices addressed to Mr Ranson and one or more particular output transactions of Praesto giving rise to the right to deduct. Nor can it be said that, objectively, there was a direct and immediate link between the supply of the litigation services in the invoices addressed to Mr Ranson and Praesto's economic activity as a whole. There would have been such a direct and immediate link if Praesto itself had been sued, either in the proceedings against Mr Ranson or in separate proceedings or if the invoices concerned advice given to Praesto on the prospect of it being successfully sued, but those things did not happen. The fact that the board of directors of Praesto may have thought subjectively that it would be generally in Praesto's best future economic interests if the claim against Mr Ranson failed is not of itself sufficient to satisfy the condition of an objective direct and immediate link.

84. The majority of this court consider that such a conclusion was not open to the UT and is not open to this court in view of the findings of fact made by the FTT. I do not agree. In the first place, what is in issue is one of law, as I have articulated it above. In the second place, on proper analysis, I do not consider that any of the findings of fact of the FTT, taken singly or together, preclude the UT's finding in favour of the Revenue. The relevant findings are summarised by Hamblen LJ in paragraphs [32], [36], [40], [43] and [48] above. My observations on them are as follows.

85. The FTT's description of Praesto as "a party to the proceedings in all but name" (at [59]) is not a term of art or a legal expression or a meaningful statement of fact. The objective facts were that Praesto was never a party to the proceedings against Mr Ranson, had never intervened in them, had never been the subject of an application to be joined to them, and had never received from CSP's solicitors any letter threatening to, or reserving the right to, apply to add Praesto as a party to the proceedings after their commencement. It has not been suggested that the separate legal personality of Praesto can be ignored and that the company must be treated as being the same as Mr Ranson. With respect to the FTT, the description - "a party to the proceedings in all but name" - is not a statement of fact at all but, in the circumstances, a legally meaningless characterisation.

86. The personal belief of Mr Ranson and the understanding of Sintons that CSP was "attacking" Praesto, as well as Mr Ranson, and seeking to put Praesto out of business do not establish the requisite objective direct and immediate link to Praesto's economic activity as a whole. The fact that Mr Ranson's instructions to Sintons throughout the litigation were on behalf of himself and Praesto, and that Sintons regarded themselves as acting for both and that both were clients, is consistent with a belief on the part of Mr Ranson and Praesto that it was in Praesto's general future economic interests for CSP's claim against Mr Ranson to fail, but that is not the same as an objective direct and immediate link to Praesto's economic activity. It is a link to a contingent future claim against Praesto, which might or might not materialise, and for the prevention of which it was perfectly legitimate for Praesto to be willing to retain Sintons and to pay

Sintons. That is not the same as a direct and immediate link for the purpose of giving credit for the input tax for Sintons' services for Mr Ranson's personal defence in the litigation against him by CSP.

87. That is why it is also irrelevant that, if CSP had been successful in establishing a breach of fiduciary by Mr Ranson, CSP would have sought to add Praesto as a party for the purposes of an account of profits, and, if such an application for joinder was successful and an account of profits was successful against Praesto, Praesto would have been unable to continue trading. Those were all future contingencies, which might or might not occur. They do, of course, establish a link between the cost of conducting Mr Ranson's defence in the litigation and Praesto's economic general wellbeing. They are not, however, a direct and immediate link, any more (as is accepted by Praesto) than the fact, mentioned in paragraph [19] of the FTT judgment, that an award of damages against Mr Ranson personally would have led to his bankruptcy, that is to say the bankruptcy of the sole director of Praesto.

88. It is, of course, trite that the possible occurrence or non-occurrence of future events may be highly relevant to a company's business. The cost of advising the company on them and the cost of bringing them about or ensuring they do not occur may, in appropriate circumstances, properly be considered general costs of the company and, as such, components of the price of the goods and services supplied by the company for the purposes of credit for VAT input tax. The present case, however, concerns the supply of services specifically and solely for the conduct of the defence of a third party, Mr Ranson, in proceedings against him, in the belief that judgment against him might be consequentially beneficial in staving off possible subsequent proceedings against Praesto. The objective link between those services and the success of Praesto's business was not direct but indirect and was not immediate but consequential. It is well established that payment of costs by the taxpayer for a service provided to a third party instructed by the taxpayer, which is in the economic interests of the taxpayer, may not satisfy the objective direct and immediate link test: *Airtours Holiday Transport Ltd v Revenue and Customs Commissioners* [2016] UKSC 21, [2016] 4 WLR 87.

89. The FTT, like the majority in this court, considered that a useful analogy is provided by the *P&O Ferries* case, a decision of the VAT Tribunal and so not a binding precedent. Not only were the facts very different but, critically, it was decided many years before *Becker* and did not purport to apply the objective direct and immediate link test.

90. For those reasons, I would have dismissed this appeal.