[2020] UKFTT 0140 (TC)

TC07621

VALUE ADDED TAX – input tax – legal costs incurred in relation to freezing order following the issue of personal liability notices - whether input tax recoverable – appeal refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/05270

BETWEEN

PARUL KESHAVLAL MALDE **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: JUDGE VICTORIA NICHOLL
MEMBER MARYYVONNE HANDS

Sitting in public at Taylor House, London on 28 October 2019

Tim Brown, Counsel, for the Appellant

Ms O Donovan, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. This an appeal by the Appellant ("Mr Malde") against the decisions of the Respondents ("HMRC") to disallow claims for input tax recovery in respect of the periods 06/17, 09/17 and 12/17. The claims relate to VAT charged on invoices for the provision of legal advice to Mr Malde in relation to a freezing order over £8.8 million of Mr Malde's assets. The freezing order was obtained following the issue of personal liability notices ("PLNs") by HMRC on Mr Malde. The PLNs were issued in July 2015 and December 2016 on the basis of Mr Malde's alleged involvement as a shadow director of, or managing, overseas companies based outside the EU which have been charged civil evasion penalties. The PLNs are the subject of appeals by Mr Malde ("the Penalties litigation").

2. Mr Malde claims that there is a direct and immediate link between the legal advice and the trading of his VAT registered sole proprietorship business. Mr Malde also claims that the legal expenses form part of his business overheads.

3. HMRC submit that the services were supplied to Mr Malde in his personal capacity in respect of the PLNs. HMRC decided that the input tax was not deductible in Mr Malde's UK VAT registered sole trader business because the amount claimed does not constitute input tax within the definition of section 24(1)(a) Value Added Tax Act 1994 ("VATA").

BACKGROUND

4. The parties referred us to documents in the Tribunal's bundle that set out the background to the Penalties litigation:

(1) HMRC allege that Sintra Global Inc and Sintra SA ("the overseas companies") have been involved in importing excise goods into the UK without payment of VAT and duty.

(2) In July 2015 HMRC issued a PLN to Mr Malde stating that he is personally liable to pay £8,698,035.42 because HMRC have charged Sintra Global Inc a civil evasion penalty in the same amount for a deliberate failure to notify which was attributable to Mr Malde.

(3) On 24 July 2015 the High Court varied and continued a freezing order made against Mr Malde on 17 July 2015 on the application of HMRC. The Freezing injunction continues until trial or further order and states that Mr Malde must not:

(i) Remove from England and Wales any of his assets which are in England and Wales up to the value of £8,800,000; or

(ii) In any way dispose of, deal with or diminish the value of any of his assets whether they are in or outside England and Wales up to the same value.

The order does not prohibit spending "a reasonable sum on legal advice and representation".

(4) In December 2016 HMRC issued a civil evasion penalty notice to Mr Malde on the basis that he is wholly responsible for the dishonest action of Sintra SA to register for and submit VAT returns. The amount of the penalty is £11,749,664.

(5) In December 2017 HMRC issued a penalty for deliberate wrongdoing for £13,830,324 to Sintra Global Inc and a PLN was issued to Mr Malde in the same amount.

(6) On 10 August 2018 the High Court varied the Freezing injunction (made on 17 July 2015 and continued on 24 July 2015) on the application of HMRC. The Freezing injunction now states that until trial or further order of the court, the prohibitions on Mr Malde extend to his assets to the value of £22,750,000.

(7) Tribunal Judge Nicholl drew the parties' attention to the fact that she had issued case management directions in relation to the Penalties litigation in September or October 2017. The parties agreed that they had no objection to Tribunal Judge Nicholl hearing this appeal.

FINDINGS OF FACT

5. We made the following findings of fact and the finding in paragraphs 15 and 17 below from the evidence in the Tribunal's bundle and the oral evidence of Mr Malde:

(1) Mr Malde is a businessman. He is the owner and/or director of a number of properties, businesses and companies. The invoices for the supplies of legal services the subject of this appeal was addressed to Mr Malde as an individual.

(2) Mr Malde's operates a property holding business. This is referred to as his sole proprietorship. Mr Malde's sole proprietorship was registered under VAT registration number 101270969 in 2010. This VAT registration was made in connection with an 'option to tax' Mr Malde's rentals of property at Unit 18, Park Royal Metro Centre ("Unit 18"), but the sole proprietorship business now includes both commercial and residential properties.

(3) On 3 February 2017 HMRC sent an email to Mr Malde's tax advisers to explain that they were conducting routine checks on Mr Malde's VAT return for the period 12/16. The information provided by Mr Malde's tax advisers in response to these checks included the five largest sales invoices for the quarter. These were all invoices for the rental of office space at Unit 18 to companies that Mr Malde owns. Mr Malde states that he also provides his consultancy services through his sole proprietorship, but that no invoices for his services were included in the documents provided to HMRC in relation to the VAT checks because his time was taken dealing with the Penalties litigation during the relevant periods. The sole proprietorship does not have employees.

(4) The information provided in response to HMRC's checks included an invoice from Mr Malde's legal advisers, Taylor Wessing LLP, dated 19 December 2016. The covering email from Mr Malde's advisers includes the following paragraph:

> "HMRC has issued two personal liability penalty notices against Mr Malde as an individual which are linked to disputed allegations of non-disclosed trading by him in the UK, the matters are under appeal. The largest input tax claim is in respect of legal fees. The funding for this expenditure is from sources that have been disclosed to HMRC as a condition of a High Court freezing order obtained by HMRC."

(5) Mr Malde appointed Freeths LLP in place of Taylor Wessing LPP in early 2017. The input tax the subject of this appeal is on invoices from Freeths. The Freeths invoices included in the Tribunal's bundle are dated 31 March 2017, 12 April 2017, 13 April 2017, 17 May 2017, 30 May 2017, 31 May 2017, 30 June 2017, 27 July 2017, 31 July 2017, 30 August 2017, 31 August 2017, 30 September 2017, 11 October 2017, 31 October 2017and 31 November 2017. The narrative on all of the invoices included in the bundle is professional charges or fees "in relation to Freezing Injunction" or simply "Freezing Injunction".

(6) Following an extended period of correspondence between HMRC and Mr Malde's tax advisers, HMRC officer James Mangan wrote on 12 December 2017 that he had decided to disallow all input tax for solicitors' fees relating to Mr Malde's personal litigation fees "unless you are able to provide evidence to confirm that these inputs relate directly to his sole proprietorship." The invoices included the fees of Mr Malde's tax advisers, SKS(GB) Ltd, and Counsel as disbursements.

(7) Mr Malde said that the work with his legal and tax advisers that was invoiced and claimed in 2017 was to address the allegations made against him concerning trading by the overseas companies. Mr Malde told the Tribunal that he spent the bulk of his time during the relevant VAT periods in 2017 working with his solicitors and tax advisers to address HMRC's allegations and the penalties. He explained that everything that had been done by his legal teams was to show that there is no connection between him and the overseas companies, Sintra Global Inc and Sintra SA ("the overseas companies"), and that he has not traded through these companies. Mr Malde explained that he has not disclosed the narratives attached to the invoices to the Tribunal because Freeths advised him to claim legal professional privilege because of the Penalties litigation.

(8) We find that the legal services invoiced to Mr Malde in 2017 were provided to him in relation to the allegations made by HMRC concerning trading by the overseas companies and Mr Malde's connection or otherwise with this. Mr Malde is personally affected by the allegations concerning the overseas companies because HMRC have issued PLNs that make him liable for the amounts of the civil evasion penalties assessed on the overseas companies as noted in paragraph 4 above.

(9) In relation to the Freezing injunction, we noted that it was obtained by HMRC as there was a concern that Mr Malde would remove his assets in England and Wales or dispose of, deal with or diminish his assets. The Freezing injunction applies to all of Mr Malde's assets and refers in particular to his bank accounts, vehicles and properties, including Unit18. The Freezing injunction is in place over all of Mr Malde's assets as a result of PLNs the subject of the Penalties litigation, as opposed to being related to litigation concerning the assets or business of his sole proprietorship.

(10) Mr Malde's witness statement includes the claim that the Freezing injunction impacts on his sole proprietorship as "it cannot be operated or expanded without a variation". We do not accept the first part of this statement as Mr Malde's sole proprietorship has clearly continued to operate. He has continued to collect rental income from his properties, including those listed in the Freezing injunction, after it was made in July 2015.

(11)We accept that Mr Malde has not been able to expand the property rental business by acquiring further properties. In August 2015 Mr Malde had to abort the purchase of two properties that he was in the process of acquiring because the Freezing order did not allow him to enter into the necessary arrangements.

(12)In April 2018 Mr Malde made an application to the High Court to have the Freezing order lifted or varied in relation to his house as he had moved out to have works carried out shortly before the Freezing order was imposed, and had not been able to progress the works since then because of the order. The relevant application documents and outcome are not included in the Tribunal's bundle. Mr Malde has not claimed that there was another application in respect of the Freezing order in 2017. In the absence of the narratives attached to the invoices or further evidence, beyond that noted or the wording on the invoices, it is not possible to determine that any advice in 2017 concerned, for example, the terms, effect or possible variation of the Freezing injunction.

(13) HMRC allowed Mr Malde's claims to recover input tax on legal fees in 2016, but Mr Brown conceded that his client was not relying on this fact to support his claim in this appeal.

(14) Officer Mangan opened an enquiry into Mr Malde's VAT returns in order to verify his claims for repayment of VAT for the periods 06/17 onwards.

(15) On 9 May 2018 HMRC notified Mr Malde of three decisions ("the decisions"). These were to restrict the input tax that had been claimed under section 25(3) VATA and to make the resulting assessments under section 73 VATA as follows:

Period	Input tax restricted	Assessment
06/17	£7114.40	£2111.40
09/17	£13,671.00	£2226.00
12/17	£8,646.21	£6055.21

(16) An independent review of the decisions was requested by Mr Malde's representatives on 8 June 2018.

(17) On 20 July 2018 HMRC sent notification that the independent review had upheld the decisions. The letter commented that "[the] fact you are VAT registered as a sole trader and legal costs are charged to you personally does not necessarily entitle you to claim the VAT incurred as input tax. In order to claim VAT as input tax the costs incurred must be for the purposes of your business."

(18) On 13 August 2018 Mr Malde lodged an appeal under section 83 VATA with the Tribunal.

RELEVANT LAW

6. The relevant legislation is set in the Appendix to this decision.

7. The parties referred us to *Customs and Excise Commissioners v Rosner* [1994] BVC 31 ("*Rosner*"), *Praesto Consulting UK Limited V HMRC* [2019] EWCA Civ 353 ("*Praesto*"), *Finanzamt Koln-Nord v Becker* Case C -104/12 ("*Becker*") *and Kretztechnik (Taxation)* [2005] EUECJ C-465/03 ("*Kretztechnik*") at the hearing. These cases are referred to in context below.

8. The parties agree that the burden of proof is on Mr Malde.

DISCUSSION

9. This appeal is to determine whether the VAT charged on invoices from Freeths to Mr Malde constitutes deductible input tax. The question is whether it is input tax for the purposes of section 24(1) VATA so that Mr Malde can deduct it from the output tax due for the relevant accounting periods and claim the VAT credits.

10. Section 24 VATA provides that input tax is VAT charged on the supply to a person of services that are "used or to be used for the purpose of any business carried on or to be carried by him". As Latham J commented in *Rosner*, this is a "deceptively simple phrase". He continued:

> "But the thread, it is said, which allows one to keep control of a phrase which could otherwise be used to cover a wide variety of circumstances is that there must be a clear nexus between the matter in relation to which the expenditure has been incurred and the business itself. The nexus cannot merely be the fact that the business will benefit from the expenditure."
>
> "One only has to state that proposition to appreciate that there can be no question of describing sensibly the legal expenses of a person who has been

> charged with an offence wholly unrelated to his business as being expenses incurred for the purposes of the business. Benefit, therefore, cannot be the test. There must be some real connection, a nexus, between the expenditure and the business. It seems to me that the nexus, if it is not to be benefit, must be directly referable to the purpose of the business. By purpose of the business in this context I mean by reference to an analysis of what the business is in fact doing."

11. Mr Brown noted the passages set out above from *Rosner*, but suggested that the Court of Appeal's decision in *Praesto* is the relevant authority in this case. *Praesto* concerned the question of whether 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 civil proceedings in that case were taken against the sole director by his former employer for breach by setting up in competition. Mr Brown noted that the Court of Appeal found that the Upper Tribunal had been wrong to conclude that the case was indistinguishable from *Becker* because the FTT had found that Praesto had a direct interest in the claim being dismissed and the benefit was not merely incidental. The Court of Appeal allowed the appeal, referring [at para 57] to the importance of the 'economic reality' in this case as follows:

> "[The] proceedings were effectively being brought against both [the director] and Praesto, targeting the profits made by Praesto with the aim of putting it out of business"

and they observed that, objectively, if the claim had been established,

> "[it] would have meant [Praesto] accounting for the profits of its taxable activities with the consequence that it would have been unable to continue to trade"

12. Mr Brown submits that the decision in *Praesto* means that, rather than looking for a 'nexus', the Tribunal should follow the Court of Appeal's guidance and consider the 'economic reality' of the circumstances. In *Praesto* it was found that the company had a direct and immediate interest in the legal fees as it had more than an incidental benefit from the outcome. Mr Brown submits that the facts of this case should be looked at in the round, and that the fact that the Freezing order covers all of Mr Malde's assets illustrates that there is a more than an incidental benefit in the outcome concerning the Freezing order for Mr Malde's sole proprietorship.

13. Mr Brown's second basis of claim is that, as in *Kretztechnik*, the expenditure on the legal fees was incurred in order to increase the capital available for the economic activity of the business as a whole. In *Kretztechnik*, the ECJ decided that, in view of the fact that a share issue was carried out "in order to increase its capital for the benefit of its economic activity in general", the supply of services acquired in connection with the share issue formed part of its overheads and are therefore component parts of the price of its products. Mr Brown suggests that the fact that the Freezing order is over the all of Mr Malde's assets means that the resolution of the Penalties litigation and the removal of the Freezing order will allow Mr Malde to invest in and grow the sole proprietorship, creating a direct and immediate link between the supply and the economic activity as a whole.

14. HMRC submit that there is no direct and immediate link between Mr Malde's discussions with his advisers and the sole proprietorship. Ms Donovan said that it is clear from Mr Malde's oral evidence that the legal fees were incurred to establish that the activities of overseas companies were not his business and that there is no connection with him. Mr Malde's sole proprietorship continues notwithstanding the Freezing order because there is no direct link. It is not sufficient that Mr Malde is the common denominator between the Freezing order and the

sole proprietorship for advice given to him in connection with the Freezing order to be the input tax of the sole proprietorship.

15. We agree with Ms Donovan that Mr Malde's evidence is that the legal fees were incurred to establish that he has no connection with the overseas companies or their trading. Other than the application to exclude his house from the Freezing order in April 2018, Mr Malde has not established that the legal advice related to the Freezing order itself, let alone to the effect of the Freezing order on his sole proprietorship. The advice was to challenge the PLNs and establish that alleged trading by other businesses, the overseas companies, was not connected with Mr Malde. The time spent with advisers working on these issues has meant that Mr Malde has not had time to provide and invoice his consultancy services, but the sole proprietorship has continued to invoice the rentals of the properties.

16. We followed the guidance provided by the Court of Appeal in *Praesto*. The decision records [at para 28] that the parties had agreed that the correct test as to the use of a supply for the purposes of a taxable person's business as established by CJEU case law is:

> "[A] supply will be treated as being used for the purposes 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."

17. We considered whether there is a "direct and immediate link" between the advice to Mr Malde on the one hand, and the output transactions of his sole proprietorship, or its economic activity as a whole, on the other. We find that it is clear that the purpose of the legal fees is not in order to allow Mr Malde to continue to rent the properties that he owns or to invest in more rental properties. There is no nexus with what the sole proprietorship continues to invoice, to adopt the terminology used in *Rosner*. Looking in the round at the legal supplies to Mr Malde and the economic reality of the sole proprietorship illustrates that the advice is in respect of the alleged activities of others, as opposed to those of the sole proprietorship. The economic reality of the circumstances is not of the nature that the Court of Appeal in *Praesto* considered to be necessary to give rise to a right to deduct the VAT charged, and it does not make the legal fees overheads as described in *Kretztechnik*.

18. Mr Malde has not satisfied us that the VAT charged by Freeths and claimed as input tax of the sole proprietorship in the accounting periods 06/17, 09/17 and 12/17 is deductible input tax. We conclude that, applying the test in section 24 to our findings of fact, the legal advice was not "used or to be used for the purpose of [the sole proprietorship] carried on or to be carried by [Mr Malde]" and so the VAT charged is not input tax of the sole proprietorship.

DECISION

19. The appeal is dismissed, and the assessments set out in paragraph 5(15) above are confirmed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

20. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

VICTORIA NICHOLL
TRIBUNAL JUDGE
Release date: 4 March 2020

APPENDIX

Article 168 Council Directive 2006/112/EC

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;

(b) the VAT due in respect of transactions treated as supplies of goods or services pursuant to Article 18(a) and Article 27;

(c) the VAT due in respect of intra-Community acquisitions of goods pursuant to Article 2(1)(b)(i);

(d) the VAT due on transactions treated as intra-Community acquisitions in accordance with Articles 21 and 22;

(e) the VAT due or paid in respect of the importation of goods into that Member State.

Section 24 Value Added Tax Act 1994 - Input tax and output tax

(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.

Section 25 Value Added Tax Act 1994 - Payment by reference to accounting periods and credit for input tax against output tax

(1) A taxable person shall—

(a) in respect of supplies made by him,

…

account for and pay VAT by reference to such periods (in this Act referred to as "prescribed accounting periods") at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances.

(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.

(3) If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then, subject to subsections (4) and (5) below, the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the Commissioners; and an amount which is due under this subsection is referred to in this Act as a "VAT credit".

(4) The whole or any part of the credit may, subject to and in accordance with regulations, be held over to be credited in and for a subsequent period; and the regulations may allow for it to be so held over either on the taxable person's own application or in accordance with general or special directions given by the Commissioners from time to time.

(5) Where at the end of any period a VAT credit is due to a taxable person who has failed to submit returns for any earlier period as required by this Act, the Commissioners may withhold payment of the credit until he has complied with that requirement.

(6) A deduction under subsection (2) above and payment of a VAT credit shall not be made or paid except on a claim made in such manner and at such time as may be determined by or under regulations; and, in the case of a person who has made no taxable supplies in the period concerned or any previous period, payment of a VAT credit shall be made subject to

such conditions (if any) as the Commissioners think fit to impose, including conditions as to repayment in specified circumstances.
…

Section 73 Value Added Tax Act 1994 - Failure to make returns etc
(1) Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.
(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.
…

(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.
(6A) In the case of an assessment under subsection (2), the prescribed accounting period referred to in subsection (6)(a) and in section 77(1)(a) is the prescribed accounting period in which the repayment or refund of VAT, or the VAT credit, was paid or credited.

…

(9) Where an amount has been assessed and notified to any person under subsection (1), (2), (3) [, (7), (7A) or (7B)] above it shall, subject to the provisions of this Act as to appeals, be deemed to be an amount of VAT due from him and may be recovered accordingly, unless, or except to the extent that, the assessment has subsequently been withdrawn or reduced.