



TC07759

VAT—Input tax—Fees for legal services in pursuing litigation—Whether services used for the purposes of the business

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2018/04897

BETWEEN

T & C BAINBRIDGE FARMING PARTNERSHIP

Appellant

-and-

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

Respondents

TRIBUNAL: JUDGE CHRISTOPHER STAKER

Sitting in public at Darlington on 4 October 2019

Colin Bainbridge of the Appellant

Margaret Nkonde, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. The Appellant partnership appeals against a decision of HMRC dated 16 February 2018 refusing to allow an input tax credit requested by the Appellant. The input tax in question is the VAT on fees for legal services incurred in bringing legal proceedings in the High Court to rescind certain transfers of land to a discretionary trust.

BACKGROUND

2. The Appellant is a partnership. Its principal business activity is farming.

3. In 2011, the partners were Tom Bainbridge, his son Colin Bainbridge, and Colin Bainbridge's son Peter Bainbridge. At that time, the partnership was farming three separate pieces of land. The original core land of the farm was vested in Tom Bainbridge. The registered owner of another plot was Colin Bainbridge, and a third plot was registered to Tom Bainbridge and Colin Bainbridge.

4. In 2011, the three plots of land were moved into a discretionary trust. Title to the properties was accordingly transferred to the trustees of this new trust. The Appellant says that this was done to ensure that all of the land would remain available to the farming business: Tom Bainbridge was at the time elderly and in poor health, and there were concerns that claims on the land might be made by other family members following his death. At the time that the discretionary trust was established, it was believed by the Bainbridges that no capital gains tax (CGT) would be payable on this transaction. However, they subsequently found out that this was incorrect, and that the arrangement gave rise to CGT liability that, in the words of Colin Bainbridge, was "crushing".

5. Upon realising the true CGT implications, proceedings were brought successfully in the Chancery Division of the High Court to rescind the transfers of the properties to the trustees of the discretionary trust, and to rescind the discretionary trust. The claimants in those High Court proceedings were Tom Bainbridge and Colin Bainbridge, the previous owners of the land who had made the transfers to the discretionary trust. The only named defendant in those proceedings was Peter Bainbridge, who was one of the trustees of the discretionary trust. Two judgments were given in those proceedings by Master Matthews. The first was given on 25 September 2015, in which the transfer of the original core land of the farm was rescinded. There is no official transcript of this judgment, and the papers for the present appeal include only an unofficial note of the judgment taken by the parties' solicitor. The second judgment was given on 22 April 2016, in which the transfer of the other two plots of land was rescinded. The official transcript of this latter judgment is *Bainbridge v Bainbridge* [2016] EWHC 898 (Ch).

6. On 1 November 2015, in the period between these two judgments, Tom Bainbridge passed away.

7. There were some additional complications dealt with in the April 2016 judgment. The two plots of land dealt with in that judgment had in fact been sold by the trustees of the discretionary trust in February 2013. The sale proceeds had been used by the trustees to buy new plots of land. It was argued that the new land substantially represented the original two plots and that the court should make an order "restoring" the new land to the owners of the original properties. The judgment found that Tom Bainbridge and Colin Bainbridge were entitled to share the beneficial ownership of the new land in proportion to their interests in the original land. In fact, by a codicil to his will made in 2014, Tom Bainbridge had left all his

interest in the farming business to Colin Bainbridge, so that ultimately Colin Bainbridge became the sole registered owner of this land.

8. The April 2016 judgment did not deal with the tax consequences of the rescission. It stated at [40] that the tax issues “must be for the parties and HMRC (and in default of agreement the appropriate tax tribunal) to resolve” (see also at [19]). However, it appears to be common ground that as a result of the High Court judgments, no CGT became payable.

9. The High Court granted the equitable remedy of rescission on grounds of mistake, finding that a “causative and basic unilateral mistake” had been made by both claimants when transferring the properties to the discretionary trust, namely the mistaken belief that no CGT would be payable on the transaction. The claimants contended that they had been advised by their then solicitors that no CGT would be payable. However, the 22 April 2016 judgment makes no finding in this respect and notes at [3] that “The solicitors were and are not party to the claim, and they have not been heard, either in the original or the amended claim. But certainly in correspondence they denied both giving the advice and liability at all”.

10. In a letter to HMRC dated 29 June 2017, the Appellant’s agent requested that the Appellant be repaid the VAT that it had paid on the legal fees incurred in connection with those High Court proceedings. The letter stated as follows. The Appellant had not claimed the input tax in its quarterly VAT returns. However, the agent had advised the Appellant that the VAT was recoverable. Solicitors previously acting for the Appellant had advised that it would be wise to transfer the partnership land into a discretionary trust and that there would be no CGT to pay on the transfer. The advice that no CGT was payable was wrong. The applications to the High Court had been complex, and significant legal fees had been incurred. The insurers of the solicitors who had advised on the transaction had denied liability and refused to reimburse these legal costs, as a result of which legal proceedings had been taken against them, which were eventually settled.

11. In subsequent correspondence with HMRC, the Appellant’s agent clarified as follows. The claim for input tax now being made by the Appellant was for the amount of VAT paid on the legal fees for the High Court proceedings to rescind the discretionary trust. The amount recovered from the insurers of the former solicitors significantly exceeded the amount of these legal fees and the VAT thereon. This is because the amount recovered from the insurers related also to various other claims that had been made against the former solicitors, and the sum recovered from the insurers was significantly less than the total amount of all of the claims. The other claims included the costs of the proceedings against the solicitors themselves, certain business losses, and amounts for stamp duty land tax, conveyancing costs, accountancy costs and other items. The correspondence from the agent said that there had been no apportionment of the agreed compensation figure, and that it could not be said that the VAT on the legal fees had already been recovered.

12. Following further correspondence between HMRC and the Appellant’s agent, HMRC issued a decision dated 16 February 2018 denying the claim to input tax.

13. This decision was upheld in a review decision dated 20 April 2018.

14. On 10 July 2018, the Appellant commenced the present Tribunal appeal.

APPLICABLE LAW

15. Section 24 VATA relevantly provides:

- (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 ... goods or services used or to be used for the purpose of any business carried on or to be carried on by him. ...
- (5) Where goods or services supplied to a taxable person ... are used or to be used partly for the purposes of a business carried on or to be carried on by him and partly for other purposes —
 - (a) VAT on supplies, acquisitions and importations shall be apportioned so that so much as is referable to the taxable person's business purposes is counted as that person's input tax, ...
- (5A) For the purposes of subsections (1) and (5), a relevant asset held for the purposes of a business carried on or to be carried on by a taxable person is not, in any circumstances, to be regarded as used or to be used for the purposes of the business if, and to the extent that, it is used or to be used for that person's private use or the private use of that person's staff.

16. A supply will be treated as being used for the purpose of the business, within the meaning of s 24(1) VATA, if there is “a direct and immediate link” between the supply and one or more output transactions or between the supply and the Appellant’s economic activity as a whole (*Praesto Consulting UK Ltd v HM Revenue and Customs* [2019] EWCA Civ 353 (“*Praesto*”) at [28]).

17. The right to claim input tax presupposes that the expenditure incurred by the Appellant in acquiring the goods or services on which the input tax was charged was part of the cost components of the taxable output transactions giving rise to the right to deduct, that is to say, components of the price of the goods or services which the Appellant supplies (*Praesto* at [30], quoting *Finanzamt Koln-Nord v Wolfram Becker*, C-104/12, EU:C:2013:99 at [19]-[20]).

18. A supply will not be treated as being used for the purpose of the business, within the meaning of s 24(1) VATA merely because the business will benefit from the expenditure. There must be a real connection, or nexus, between the expenditure and the business that is directly referable to what the business is in fact doing. (*Customs and Excise Commissioners v Rosner* [1994] STC 228 (“*Rosner*”).)

THE EVIDENCE OF COLIN BAINBRIDGE

19. In his evidence in chief, Mr Bainbridge said amongst other matters as follows. He has five children. His son Peter became a partner in the business about 8 years ago, and another son became a partner recently. He believed that at the time that his father had purchased the farm, his father had made a will leaving the farm to all four of his children. His father had always said that he would make a new will leaving the farm to Colin Bainbridge, who was the only one of his father’s four children working in the business. However, by 2011 it was feared that his father due to his health condition was not capable of making a will. On advice of solicitors, the discretionary trust was therefore set up, the whole point of which was to keep the family business going by ensuring that the land used by the farming business would remain part of the business, and not be subject to claims by other family members after his father’s death. It was only after the discretionary trust had been set up that he discovered that his father had made a new will in any event (compare paragraph 7 above).

THE APPELLANT'S ARGUMENTS

20. Although the three plots of land were owned by individual partners, the land was held by them beneficially for the partnership, and was partnership property. The Appellant relies on s 20 of the Partnership Act 1890.

21. The land was shown on the partnership accounts. All of the expenses of maintaining the land were borne by the partnership. The loan for the land purchase was shown as a partnership liability, and the servicing of the loan was a partnership expense. No rent was paid by the partnership to individual partners. It is irrelevant that the capital accounts of the partners reflect the value of the land held in the partnership. They must do so because the partners own the partnership.

22. Had the discretionary trust not been set aside by the High Court, the disposal of the land to the discretionary trust would have been a disposal by the partnership for CGT purposes, and liability for payment of the CGT would have fallen on the Appellant partnership.

23. The input VAT was incurred by the Appellant partnership, for the purposes of the partnership.

HMRC ARGUMENTS

24. The legal services were supplied to the claimants in the High Court proceedings as individuals, rather than to the VAT registered partnership. The legal costs were incurred in taking action as a result of individual concerns about the land being split up in the event of a member of the partnership dying.

25. At best, the legal proceedings provided merely an incidental benefit to the business. The legal fees did not relate directly to the function and carrying on of the business, and there is no clear link between the expenditure and the actual sales carried out by the business. The expenditure is not directly referable to the purpose of the business. Reliance is placed on *Rosner*.

26. There is a direct link between the expenditure and the owners of the land, but not with the actual farming business. The services related to a personal matter, namely which individuals would get what inheritance. The land was in the names of individuals.

27. The burden is on the Appellant to demonstrate that the legal services purchased were in connection with the business. The Appellant has not discharged this burden.

THE TRIBUNAL'S FINDINGS

28. The 16 February 2018 HMRC decision found that the land belonged to the registered owners individually, and was not a partnership asset.

29. An internal HMRC minute dated 17 April 2018 questions the correctness of this conclusion, expressing the view at page 6 that the partnership in maintaining and exploiting the land had a beneficial interest in it. However, that minute did not itself take a decision on the question, stating that "I recommend that the decision maker seeks further input on this point".

30. The 20 April 2018 review decision appears not to address the question directly. Rather, it concludes (apparently irrespective of whether or not the land was a partnership asset) that the amounts spent on legal fees for the High Court proceedings were not incurred in furtherance of the partnership's business. This was also the position taken by HMRC at the hearing.

31. The Tribunal notes that even if it were the case that Tom Bainbridge and Colin Bainbridge each held their legal interests in the land for the benefit of the partnership immediately before the transfers to the discretionary trust, this would not mean that the land would have continued to be a partnership asset even after the death of one of them.

32. In the absence of any partnership agreement stipulating otherwise, on the death of any partner, the partnership would have been dissolved (Partnership Act 1890, s 33), and all partnership assets would have been distributed equally between the living partners and the estate of the deceased partner.

33. No partnership agreement for the Appellant partnership has been produced in evidence in the present case, although Colin Bainbridge said in his evidence that a formal partnership agreement was prepared by their accountants before the discretionary trust was set up.

34. It is necessarily implicit in the Appellant's case that the partnership would continue to exist following the death of Tom Bainbridge, and it seems that this is what has occurred. This would seem to confirm that there must have been a partnership agreement providing for this.

35. However, there would have been no need to create the discretionary trust in the first place, if the partnership would in any event have had the right to continue using the land belonging to Tom Bainbridge after his death. The very fact that the discretionary trust was created is evidence that all or some part of Tom Bainbridge's interest in the land would not otherwise have been a partnership asset after his death. The purpose of setting up the discretionary trust was to create new rights for the beneficiaries of the discretionary trust that they previously did not have (the right to use the land belonging to Tom Bainbridge after his death), rather than to preserve for the partnership rights that the partnership already held.

36. Furthermore, there is no evidence before the Tribunal that the partnership was the beneficiary of the discretionary trust. The trust deed of this discretionary trust was not produced in evidence. However, the details of claim in the High Court proceedings contained the following paragraph:

On 28 October 2010, [a solicitor] wrote a letter to both Tom and Colin. This stated that: "We consider the best way forward would be as follows: 1. Tom and Colin both transfer their interest in the whole farm into a Discretionary Trust for the benefit of Tom, Rita, Colin, and his children." (Rita is the wife of Tom.)

37. This suggests that the beneficiary of the discretionary trust was not the partnership, but rather, that the beneficiaries of the discretionary trust were specific individuals, some of whom (Rita, and at the time at least 4 of Colin Bainbridge's five children) were not partners in the partnership. Not only is the trust deed establishing the discretionary trust not before the Tribunal, but there is no other documentary evidence before the Tribunal that establishes that there was any legal obligation on the beneficiaries of the discretionary trust to make the land available to the partnership for its business purposes, even if it may have been envisaged that in practice they would do so.

38. For these reasons, the Tribunal finds on a balance of probability that (1) regardless of whether or not Tom Bainbridge's interest in the land was a partnership asset immediately before the discretionary trust was created, some or all of that interest would not have been a partnership asset after his death if the discretionary trust had not been created; (2) the purpose of the discretionary trust was to ensure that the beneficiaries of the discretionary trust would have a beneficial interest in Tom Bainbridge's land after his death, at a time when it would otherwise no longer have been a partnership asset; and (3) the beneficiaries of the discretionary trust were individuals in their individual capacity, so that assets within the discretionary trust were not partnership assets.

39. On that basis, the Tribunal finds that the creation of the discretionary trust was for the purpose of determining which individuals would get what benefits from land previously belonging to Tom Bainbridge after his death. The business may arguably have benefitted from the creation of the discretionary trust, if its practical effect was intended to be to prevent a diminution of the assets available for use by the business following the death of one the partners. However, there was no real connection, or nexus, between the expenditure on establishing the discretionary trust and the business, that was directly referable to what the business was in fact doing.

40. For that reason, the Appellant partnership would not have been entitled to claim as input tax the VAT paid on the legal fees incurred in setting up the discretionary trust and transferring the properties to the discretionary trust. It is unclear from the evidence whether or not the Appellant partnership did claim this VAT as input tax.

41. The purpose of the High Court proceedings to rescind the discretionary trust is to be characterised by reference to the purpose for which the discretionary trust was set up in the first place. Even if it were the case that the partnership, rather than the registered owners of the land, became liable to the CGT when the land was transferred to the discretionary trust (and the Tribunal makes no finding in this respect), that liability to CGT arose from a transaction having no real connection with the business. The undoing of that transaction therefore also has no real connection with the business.

42. For these reasons, the Appellant partnership is not entitled to claim as input tax the VAT paid on the legal fees for the High Court proceedings.

43. Having reached that conclusion, it is unnecessary to consider whether this VAT has in any event already been recovered by the Appellant or by Colin Bainbridge through the payment made by the insurers of the former solicitors (see paragraph 11 above). Documentation relating to this settlement with the insurers has not been put before the Tribunal. The Tribunal makes no findings in relation to the Appellant's claims against its former solicitors, or the settlement reached.

CONCLUSION

44. The appeal is dismissed.

45. 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.

DR CHRISTOPHER STAKER

TRIBUNAL JUDGE

RELEASE DATE: 26 JUNE 2020