**[2017] UKUT 395 (TCC)**

**Appeal number: UT/2016/0202**

***VAT – input tax – legal services provided in connection with civil claims against a director – whether supplied to the taxable person – whether direct and immediate link to taxable activities – appeal allowed***

**UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)**

**THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS** **Appellants**

**- and -**

**PRAESTO CONSULTING UK LIMITED** **Respondent**

**TRIBUNAL: JUDGE TIMOTHY HERRINGTON**
**JUDGE ASHLEY GREENBANK**

**Sitting in public at The Royal Courts of Justice, Strand, London on 8 June 2017**

**Eleni Mitrophanous, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants**

**Oliver Conolly, counsel, for the Respondent**

DECISION

## Introduction

1. This is an appeal by the Commissioners for Her Majesty's Revenue & Customs ("HMRC") from a decision (the "FTT Decision") of the First-tier Tribunal (Judge Jonathan Cannan and Mr Michael Atkinson) (the "FTT") dated 13 July 2016. The respondent is Praesto Consulting UK Limited ("Praesto"). Permission to appeal was granted by the FTT on 19 September 2016.

2. The appeal relates to a decision by HMRC that Praesto was not entitled to claim credit for input tax for VAT on legal fees charged by solicitors acting in proceedings brought by a competitor of Praesto, Customer Systems plc ("CSP"), against Mr Jeremy Ranson, a director of Praesto.

3. Praesto appealed to the FTT against that decision. The FTT allowed the appeal and found that Praesto was entitled to credit for input tax for VAT in respect of the legal fees. HMRC now appeals against the FTT Decision.

## The facts

4. The facts are set out in the FTT Decision at paragraphs [6] to [26]. We have summarized the main undisputed facts in the paragraphs below. We should note, at this point, that HMRC does challenge some of the findings of fact reached by the FTT. We have sought to identify those issues separately in the section in which we summarize the FTT Decision.

5. Praesto is in the business of installing computer software. Mr Ranson is a director of Praesto and was formally an employee of CSP.

6. On 4 November 2009, the solicitors acting for CSP wrote a letter before action to Mr Ranson alleging that Mr Ranson had breached his contract of employment with CSP by removing confidential information, had breached fiduciary duties and duties of confidentiality owed to CSP and had made defamatory comments about CSP.

7. On 6 November 2009, the solicitors for CSP wrote a letter before action to Praesto alleging that Praesto had made defamatory comments about CSP and had induced employees of CSP to breach restrictive covenants in their contracts of employment.

8. Mr Ranson and Praesto instructed Sintons, solicitors. Sintons responded to the letters before action on behalf of both Mr Ranson and Praesto. In the period between November 2009 and January 2010, further correspondence was entered into by Sintons and further advice was given by Sintons in relation to the potential claims against both Mr Ranson and Praesto. Sintons invoiced Praesto for the work done in relation to the claims in an invoice dated 4 May 2010. Praesto's claim for credit for the input tax in relation to that invoice was accepted by HMRC.

9. On 4 May 2010, CSP commenced proceedings against Mr Ranson and certain other individuals for breach of contract and breach of fiduciary duty. No proceedings were issued against Praesto.

10. The proceedings against Mr Ranson continued. CSP was successful in its claim before the High Court. However, Mr Ranson successfully appealed to the Court of Appeal, which found that Mr Ranson held no fiduciary duty to CSP. The Supreme Court refused leave to appeal. Although there was some discussion as to whether Praesto should become a party to the proceedings (to which we refer below), at no point did Praesto become a party to the proceedings.

11. Sintons issued eight invoices in relation to the legal advice that they provided in relation to the proceedings. The invoices were dated between 31 January 2011 and 24 January 2013. All of the invoices were addressed to Mr Ranson. The descriptions of the work done supporting the invoices relating to the advice refer to the steps taken in the proceedings. They do not mention Praesto.

12. There was a discussion between Mr Ranson and Sintons before the issue of the first invoice in January 2011 about whether the invoices should be addressed to Praesto as well as Mr Ranson. Sintons advised Mr Ranson that the invoices should be addressed to Mr Ranson so as to match the title of the proceedings.

13. The invoices were all paid by Praesto. Praesto claimed input tax credit for the VAT charged on the invoices. HMRC refused those claims. It is HMRC's decision to refuse Praesto's claims for input tax credit in relation to the VAT on these invoices that is at issue in these proceedings.

**The relevant legislation**

14. The law relating to the payment and recovery of VAT in the UK is contained in the Value Added Tax Act 1994 ("VATA"), which is designed to implement the provisions of relevant EU Directives, principally EU Council Directive 2006/112/EC (the "Principal VAT Directive").

15. The provision of VATA with which we are most concerned is section 24 which sets out the definition of "input tax". It provides, so far as relevant:

> (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;
>
> (b) …
>
> (c) …,
>
> 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.

16. The amount of input tax for which a taxable person is entitled to credit is so much of that input tax as attributable to supplies falling within sub-section (2) of section 26 VATA. It provides:

> (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;
>
> (b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;
>
> (c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection.

## The FTT Decision

17. There were two issues before the FTT:

> (1) first whether the supplies of legal services made by Sintons were made to Praesto (our emphasis) as required by section 24(1)(a) VATA; and
>
> (2) second, whether those supplies were supplies of services used for the purpose of any business carried on by Praesto as required by the final words of section 24(1) VATA.

18. There are various aspects of the FTT Decision to which we should refer as they become relevant to our later discussion.

19. The FTT set out a description of certain aspects of the proceedings brought by CSP against Mr Ranson in its findings of fact (FTT Decision [10] to [16]). In particular at paragraphs [13] to [15], the FTT referred to extracts from the judgment of Sir Raymond Jack in the High Court and from the transcript of the hearing in which the judge and counsel referred to the possibility of Praesto becoming a party to the proceedings or further proceedings if the question of requiring an account of profits from Praesto should become an issue.

20. In the event, of course, the question of whether an account of profits could be required of Praesto did not arise as CSP was not ultimately successful in its claim for breach of duty against Mr Ranson (as the FTT noted at paragraph [16]). However, the FTT included in its findings of fact that "it had no doubt" that if CSP had been successful in establishing a breach of duty by Mr Ranson then it would have sought to join Praesto as a party for the purposes of seeking an account of its profits. It also found that if CSP's claim had been successful, then Praesto would have been unable to continue trading (FTT Decision [19]).

21. The FTT also accepted Mr Ranson's evidence that his instructions to Sintons throughout the litigation were given on behalf of both himself and Praesto notwithstanding the absence of any engagement letter and that the vast majority of the

documentation which was disclosed for the purposes of the proceedings was documentation that belonged to Praesto (FTT Decision [18]).

22. Also in its findings of fact, the FTT referred to a letter written by Sintons to HMRC on 17 March 2014, during the course of HMRC's enquiries into the input tax claim, in which Sintons stated that the firm had acted on behalf of both Mr Ranson personally and Praesto in relation to "what was effectively litigation brought against both of them by a trade competitor" (FTT Decision [25]). The FTT accepted that evidence.

23. The FTT reviewed the various case law authorities before reaching its conclusion on the two points at issue. We have discussed the reasoning adopted by the FTT in our discussion below, but, in summary, the FTT found:

(1) that the invoices did relate to supplies made by Sintons to Praesto as required by section 24(1)(a) VATA; and

(2) that the services provided by Sintons had "a direct and immediate link" to the taxable activities of Praesto and accordingly that the services were used for the purpose of Praesto's business as required by the final words of section 24(1) VATA.

**Grounds of appeal**

24. In its Notice of Appeal, HMRC gave two grounds of appeal against the FTT Decision.

(1) the FTT erred in concluding that the relevant legal services were supplied to Praesto; and

(2) the FTT erred in concluding that there was a direct and immediate link between the legal services and the taxable activities of Praesto.

HMRC therefore challenged the conclusions of the FTT on both of the issues addressed in the FTT Decision.

**Ground 1: the FTT erred in concluding that the legal services were supplied to Praesto**

*HMRC's submissions*

25. On the first ground of appeal, Ms Mitrophanous, for HMRC, says that the correct approach for determining to whom a supply is made for VAT purposes is to consider the economic reality of the case. When doing so, the starting point should be the contractual arrangements between the parties. That contractual position should then be tested against the economic and commercial realities of the transactions. She referred to the decision of the Supreme Court in *Airtours Holidays Transport Limited v HMRC* [2016] UKSC 21 ("*Airtours*") in support of this submission and, in particular, to the judgment of Lord Neuberger, giving the opinion of the majority with particular reference to paragraphs [47] to [51] of his judgment.

26. Ms Mitrophanous says that the FTT failed to apply that approach. The FTT did not analyse the contractual position between the parties to determine whether Praesto was entitled to receive a supply of the legal services and obliged to pay for them. Instead, the FTT determined the first issue simply by reference to what it regarded as the economic reality.

27. She makes the following specific points.

28. The FTT did not make a clear finding that there was a contractual relationship between Sintons and Praesto: the FTT made no finding that Praesto was entitled to receive legal services from Sintons and no finding that Praesto was obliged to pay for them. In the absence of such a contractual relationship, there would normally be no supply to Praesto.

29. If the statements in the FTT Decision which referred to the relationship between Sintons and Praesto (in particular those in paragraphs [53], [55] and [56]) could be regarded as a finding that there was a contractual relationship under which Sintons agreed to provide services to Praesto and Praesto agreed to pay for them, that conclusion could not be justified on the evidence before the FTT.

30. Ms Mitrophanous points in particular to the lack of an engagement letter between Sintons and Praesto, the fact that all of the invoices for the legal services were addressed to Mr Ranson (not Praesto) and did not refer to Praesto and that Praesto was not a party to the litigation to which the legal services related.

31. She submits that the evidence which might suggest a continuing relationship between Sintons and Praesto - in the form of the letter from Sintons (referred to in paragraph [25] of the FTT Decision), in which Sintons refers to having acted on behalf of both Mr Ranson and Praesto, and the evidence of Mr Ranson that he gave instructions to Sintons on behalf of both himself and Praesto (paragraph [18] of the FTT Decision) – and the FTT's finding that "the substance of the relationship… continued" after the first invoice (paragraph [55] of the FTT Decision) was insufficient to support a conclusion that Praesto was legally entitled to receive the supply.

32. Ms Mitrophanous says that, if the contractual position (which suggests that there is no supply to Praesto) is tested against the economic reality (as required by *Airtours*), the economic reality supports the conclusion that there was no supply to Praesto. No claim was ever brought by CSP against Praesto itself. Although there may have been some indirect benefit to Praesto if Mr Ranson were to defend the claims against himself successfully that was not in itself sufficient to support its conclusion that a supply was made to Praesto (in this respect, Ms Mitrophanous referred to Lord Neuberger's judgment in *Airtours* at [51]).

33. In any event, the economic reality was that there was no benefit to Praesto. The claims made by CSP were only brought against Mr Ranson and related to his alleged breach of contract and fiduciary duty. Although the FTT Decision appears to suggest that, if the claims against Mr Ranson were successful, any further proceedings would

be limited to determining the quantum of its liability (at [16]) or that it was an automatic consequence that Praesto would have to make an account of profits to CSP (at [19]), that was not the case. The description of the proceedings in the FTT Decision (FTT Decision [14] and [15]) and the transcript of the High Court proceedings demonstrated that it was acknowledged at the time that further proceedings would be necessary to establish the liability of Praesto to make an account of profits. It was not simply a question of determining the quantum of Praesto's liability.

*Praesto's submissions*

34. Mr Conolly, for Praesto, says that the FTT was entitled to reach the conclusions that it reached on the facts.

35. He makes the following specific points.

36. There was no written contract (i.e. no engagement letter) between Sintons and Praesto, but there was evidence of a contractual relationship under which supplies were made to Praesto as well as Mr Ranson. That position was accepted by the FTT. Mr Conolly referred to the evidence of Mr Ranson, which was accepted by the FTT, that he gave instructions to Sintons on behalf of both himself and Praesto (paragraph [18] of the FTT Decision), to the letter from Sintons in which Sintons refers to having acted on behalf of both Mr Ranson and Praesto which was regarded by the FTT as "a fair summary of the position" (paragraphs [25] and [26] of the FTT Decision) and to the FTT's finding that both Mr Ranson and Praesto "were clients of Sintons" even though only Mr Ranson was a party to the proceedings (paragraph [53] of the FTT Decision).

37. The economic reality supported the conclusion that services were being provided to Praesto.

> (1) Although the invoices were addressed to Mr Ranson, there was a legitimate reason why that was the case, which was accepted by the FTT (paragraph [56] of the FTT Decision).
>
> (2) Even if it was not an inevitable consequence of the proceedings against Mr Ranson that Praesto would have to make an account of profits, there was a material risk of litigation against Praesto which turned on the outcome of the litigation relating to the claims that had been brought against Mr Ranson. That potential litigation posed a real threat to Praesto's business.

*Discussion*

38. There is no question that Sintons made a supply of legal services in this case. The only question is whether that supply was made to Mr Ranson, to Praesto or to Praesto and Mr Ranson.

39. A comprehensive review of the case law in this area was conducted by Lord Neuberger in his judgement in the *Airtours* case. We do not intend to set out large tracts of that decision or of Lord Neuberger's review of the relevant case law. However, we should summarize the key principles that we take from his judgment (and in particular paragraphs [42] to [51]).

(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 (*Revenue and Customs Commissioners v Newey* (Case C-653/11) [2013] STC 2432 ("*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 affected 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 v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509 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]).

40. On that basis, we agree with Ms Mitrophanous that the correct approach is first to analyse the contractual position to determine if Praesto is legally entitled to the legal services provided by Sintons and obliged to pay for them.

41. The FTT's reasons for its conclusions on this first issue are set out at paragraphs [52] to [57] of the FTT Decision. In summary, the FTT concludes that the legal services were provided by Sintons to Praesto on the basis that:

(1) Mr Ranson and Praesto were both clients of Sintons;

(2) the relationship between Praesto and Sintons continued after the issue of the first invoice, which related to the letters before action issued to both Mr Ranson and Sintons;

(3) that Praesto was directly affected by the result of the proceedings against Mr Ranson; and

(4) that there was a material risk that CSP might join Praesto as a party or take separate proceedings against Praesto.

42. But, as Ms Mitrophanous points out, at no stage, did the FTT make a finding that Praesto was entitled to the legal services or contractually obliged to pay for them. Nor, in our view, were the findings of fact made by the FTT a sufficient basis for a finding that there was such a legal relationship in place. The fact that Praesto might benefit from the successful defence of the claim against Mr Ranson or that Praesto might, at a later stage, become a party to the proceedings is not sufficient to support a conclusion that it had a contractual entitlement to the legal services provided by Sintons in relation to the litigation against Mr Ranson. This is particularly the case when viewed against the background that all of the invoices were sent to Mr Ranson, did not refer to Praesto and that, in fact, Praesto was never a party to the litigation.

43. This was an error of approach on the part of the FTT which, in our view, amounted to an error of law. We are also of the view that the error is sufficiently material that we should set aside the FTT Decision.

44. In these circumstances, Ms Mitrophanous invited us to remake the FTT's decision on the basis of her submissions. However, we are not in a position to do so. It is clear to us, from the findings of fact made by the FTT, that there was a continuing relationship between Sintons and Praesto after the issue of the first invoice and during the conduct of the proceedings against Mr Ranson. However, as we have found those findings are not sufficient to establish whether or not there was a relevant contractual relationship between Sintons and Praesto, further findings of fact would need to be made. We are not ourselves in a position to make those findings on the basis of the evidence that is before us on this appeal.

45. Accordingly, if this were the sole ground of appeal against the FTT Decision we would find it necessary to remit this case to the FTT for further consideration. However, given the conclusions that we have reached on the second ground of appeal, we do not need to do so in this case.

## Ground 2: the FTT erred in concluding that the legal services were used for the purpose of Praesto's business

*HMRC's submissions*

46. On the second ground, Ms Mitrophanous, for HMRC, says that the FTT also made an error of law in finding that the supplies made by Sintons were used for the purpose of Praesto's business within the meaning of section 24(1) VATA.

47. In summary, her submissions are as follows.

48. 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 (*Finanzamt Köln-Nord v Becker* Case C-104/12 ("*Becker*") at [19] and [20]).

49. There was no direct and immediate link between the supply of the legal services by Sintons in relation to the litigation against Mr Ranson and the taxable activities of Praesto.

50. The claims made by CSP were brought against Mr Ranson for breach of confidentiality and breach of fiduciary duty. They were not brought against Praesto and could not be brought against Praesto. Although there was some discussion in argument before the High Court and a reference in the judgment of Sir Raymond Jack to the possibility of Praesto becoming a party to the proceedings or further proceedings for the purpose of giving an account of profits, any successful claim against Praesto would have required CSP to overcome additional legal hurdles. It was not the case that a successful claim against Mr Ranson would automatically lead to Praesto being required to make an account of its profits.

51. The FTT therefore made an error of law when distinguishing the judgment of the Court of Justice of the European Union ("CJEU") in *Becker* (FTT Decision [59]) on the basis that Praesto could be viewed as "a party to the proceedings in all but name". Praesto was not a party to the proceedings. It may have had an interest in Mr Ranson defending the claim brought by CSP, but that is not sufficient. There was no link to Praesto's taxable activities.

52. Praesto's position was not analogous to that of the company in *P&O Ferries (Dover) Limited v Commissioners of Customs and Excise* [1992] VATTR 221 ("*P&O*") as the FTT suggested (FTT Decision [60]). In *P&O*, the company was charged with the same criminal offences as the individuals for whom it paid the legal fees; the company controlled the legal proceedings and instructed the solicitors and counsel.

*Praesto's submissions*

53. Mr Conolly for Praesto drew our attention to a number of cases in which a company had sought to obtain an input tax deduction for the payment of fees for legal services incurred in relation to proceedings against another person. Those cases included the decision of the CJEU in *Becker*, the decision of the First-tier Tribunal in *Robert Welch Designs Limited v HM Revenue & Customs* [2015] FTT 431 (TC), the judgment of Latham J in *Rosner v Customs and Excise Commissioners* [1994] STC 228, and the decision of the VAT Tribunal in *P&O*.

54. He argued that the position of Praesto in this case was analogous to the position of the company in *P&O* albeit in the context of civil rather than criminal proceedings: the civil proceedings against Mr Ranson were a necessary precursor to proceedings against Praesto; and the proceedings presented a direct threat to the on-going business of Praesto. It was not necessary for the FTT to find that the proceedings against Mr Ranson would automatically lead to proceedings against Praesto. It was sufficient for the FTT to identify a clear risk to the business of Praesto.

*Discussion*

55. The CJEU case law establishes 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.

56. The leading case is that of *Becker*. In that case, Mr Becker was a director of and the sole shareholder in a German limited company (which is referred to in the judgment of the CJEU as "A"). The case concerned a claim for recovery of VAT input tax on legal fees incurred in defending criminal proceedings brought against Mr Becker and another director for bribery in relation to a contract that was ultimately awarded to the company. Although the criminal proceedings had been brought against Mr Becker personally, the lawyers had represented both Mr Becker and the company and had issued their invoices to the company.

57. The judgment of the CJEU confirms the principles established in the CJEU case law (to which we refer at [55] above) which requires a direct and immediate link between the supply and the taxable activity of the recipient before a claim to credit for input tax can be made (*Becker*: [19] and [20]).

58. The CJEU decided that in applying the direct and immediate link test, a court should have regard only to supplies that are objectively linked to the person's taxable activity. Furthermore the requirement to consider the objective characteristics of the supply applies equally where the court or tribunal is seeking to determine a direct and immediate link between a supply and the taxable activities of the taxable person as a whole and was not inconsistent with the decisions in other CJEU cases (principally *Investrand* Case C-435/05 [2007] ECR 1-1315) to the effect that input tax recovery was not available where the pursuit of the taxable activity was not the exclusive reason for the fees or costs being incurred (*Becker*: [22] to [26]).

59. On the basis of those principles, the CJEU found that there was no direct and immediate link between the legal fees incurred and the taxable activity of the company. This was because, viewed objectively, the criminal proceedings were brought against Mr Becker in his personal capacity and the fees were therefore incurred to protect his personal interests. The facts - that the company could have become subject to similar proceedings and that the company would not have incurred the costs if it had not carried on taxable activities - were not sufficient to support a conclusion that there was a direct and immediate link with the taxable activities of the company.

60. At [30] to [32], the CJEU stated:

> **"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.

**31** Secondly, the referring court states that, since the supplies would not have been performed by the two lawyers at issue if A had not exercised an activity which produced turnover and, consequently, which was taxable, there would be a causal link between the costs relating to those services and A's economic activity as a whole. It should, however, be noted that that causal link cannot be considered to constitute a direct and immediate link within the meaning of the Court's case-law. As the referring court itself observes, there is no legal link between the criminal proceedings and A, and those services must therefore be considered to have been performed entirely outside A's taxable activities.

**32** In that regard, it should be added that the fact that domestic civil law obliges an undertaking such as that at issue in the main proceedings to incur the costs relating to the defence, in criminal proceedings, of its representatives' interests is not relevant for the interpretation and application of provisions relating to the common system of VAT. In the light of the objective scheme of VAT set up by that system, only the objective relationship between the supplies performed and the taxable economic activity of the taxable person is decisive (see, to that effect, Case C-277/09 *RBS Deutschland Holdings* [2010] ECR I-13805, paragraph 54). Otherwise the uniform application of European Union law in that area would be severely undermined."

61. The FTT sought to distinguish the decision in *Becker* on the basis that the company in that case was not "a party or a necessary party" to the proceedings, but that, in contrast, Praesto could be viewed as "a party to the proceedings [against Mr Ranson] in all but name" (FTT Decision [59]). The FTT came to that conclusion on the grounds that Praesto had a "direct interest" in CSP's claim being dismissed otherwise there was a real risk that it would have to make an account of profits (FTT Decision [59]).

62. The FTT also drew an analogy between the facts of this case and those in *P&O*. The *P&O* case involved criminal proceedings against the company and its employees following the Zeebrugge ferry disaster in 1987. The VAT Tribunal found that the company was entitled to credit for input tax on legal fees paid by the company but incurred in defending the individual employees from criminal prosecution. This was on the basis that the legal costs were incurred for the purposes of the business of the company. The VAT Tribunal ([1992] VATTR 221) summed up its conclusions in the pre-penultimate paragraph of its decision as follows.

"Of course, the tribunal recognises that the organisation and financing of legal representation, as happened here, by the Company conferred substantial benefits on the individual employees. But those features do not prevent the expenditure from having been incurred for the purposes of the Company's business. The evidence of Mr Mann, which the tribunal fully accepts, makes it clear that the board decided that the Company should incur the defence costs, amounting to £3.5m 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 vis-a-vis 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. The input tax attributable to the expenditure on those services consequently qualifies for credit under section 14."

63. The FTT concluded that the link between the supplies of legal services provided by Sintons to the taxable activities of Praesto was "at least as direct and immediate" as the link between the legal services provided to the individual employees and the business of the company in the *P&O* case. This was on the basis that "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" and that the proceedings brought the CSP commenced directly as a result of Praesto's taxable activities (FTT Decision [60]]).

64. As we have mentioned above, Mr Conolly also argued that the facts of the present case were more analogous to the facts of *P&O*. He pointed, in particular, to the alignment of the interests of the employees and the company in that case in that the company was facing similar criminal proceedings which would turn on the outcome of the criminal proceedings against the individuals. He also highlighted the evidence of the immediate threat to continuing business of the company in *P&O* and noted the finding of the FTT (FTT Decision [19]) that, if CSP's claim had been successful, Praesto would have been unable to continue trading.

65. The CJEU case law requires us to identify a direct and immediate link between the supply of the legal services and either one or more output transactions of Praesto or between supply of the legal services and Praesto's economic activity as a whole. This is not a case where there is a link to particular transactions. The question is whether there is a direct and immediate link to Praesto's taxable activity as a whole.

66. That case law requires us to have regard only to supplies that are objectively linked to Praesto's taxable activity. The legal fees in this case were incurred in respect of proceedings brought against Mr Ranson in his personal capacity. Our starting point is therefore that, viewed objectively, those costs were not part of the general costs of the taxable activities of Praesto – and accordingly there was no direct and immediate link between the supply made by Sintons and the taxable activites of Praesto. In this respect, there are clear similarities between the facts of this case and those in *Becker*.

67. There are other similarities with the *Becker* case: as with the company in *Becker*, Praesto was not a party to the proceedings; as in *Becker*, there was a risk that Praesto might become a party to other proceedings; and, as in *Becker*, the legal costs would not have been incurred but for the fact that Praesto carried on taxable activities.

68. As we have described above, the FTT sought to distinguish the decision in *Becker* on various grounds.

69. The first ground was that Praesto could be viewed as party to the proceedings "in all but name". This was principally on the basis that if CSP's claim was not dismissed, there was a real risk that it would have to make an account of profits. A similar point was made by Mr Conolly. However, the fact remains that Praesto was not a party. There was a risk that it might become a party to subsequent proceedings, but that is not materially different from the position in *Becker*, where the company could have become subject to criminal proceedings. Indeed, it is arguable that the risk in *Becker* was more direct in that the proceedings against the company would have been similar in nature to those brought against Mr Becker.

70. The second ground on which the FTT sought to distinguish the decision in *Becker* was that the proceedings against Mr Ranson represented a serious risk to the business of Praesto. Again, a similar point was made by Mr Conolly. However, as Mr Conolly accepted, the proceedings against Mr Ranson would not lead automatically to Praesto having to make an account of profits. The proceedings against Mr Ranson represented a risk that further proceedings might be brought against Praesto. There may well have been an incidental benefit to Praesto's business from the removal of that threat. However that does not amount to a direct and immediate link between the costs of defending CSP's claim against Mr Ranson and Praesto's taxable activities. This is evident from the decision of the CJEU in *Becker* and also from the judgment of Latham J in *Rosner* at page 230 (d)-(g) (to which the FTT referred at FTT Decision [35]).

71. The FTT also relies on the fact that CSP commenced the proceedings as a result of the activities of Praesto. However, the fact that the legal fees would not have been incurred if Praesto had not undertaken its taxable activities is not in itself sufficient to support the conclusion that there is a direct and immediate link between the supply of the services by Sintons and the taxable activity of Praesto (see *Becker* [31]). Once again, we cannot perceive any material difference between this case and *Becker* in this respect: in *Becker*, the company potentially earned profits from its taxable activities as a result of the alleged illegal activities of Mr Becker; in this case, Praesto potentially earned profits from its taxable activities as a result of the alleged unlawful activities of Mr Ranson in breaching his fiduciary duty.

72. It follows that we do not find any basis on which to distinguish this case from the decision of the CJEU in *Becker*. We are bound to follow that decision. We do not need to decide if, as a result, the decision of the VAT Tribunal in *P&O* is consistent with *Becker* and the other CJEU cases. We acknowledge that there were some particular facts and circumstances in that case - for example, the company was also

subject to criminal prosecution - which may justify a different conclusion. However, we do not need to decide that issue now.

73. For these reasons, in our view, the FTT made an error of law in distinguishing the facts of this case from those in *Becker*. There was no direct and immediate link between the supplies of legal services made by Sintons in relation to the proceedings against Mr Ranson and the taxable activity of Praesto. Accordingly the legal services were not used for the purpose of Praesto's business within the meaning of section 24(1) VATA.

**Conclusion**

74. For these reasons, we allow HMRC's appeal.

**Timothy Herrington**
**Upper Tribunal Judge**

**Ashley Greenbank**
**Upper Tribunal Judge**

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