[2016] UKFTT 829 (TC)

TC05554

Appeal number: TC/2016/01770

VALUE ADDED TAX – input tax – whether expenditure for the purposes of the business – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

DORAN BROS (LONDON) LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JANE BAILEY
MR CHARLES BAKER FCA

Sitting in public at Fox Court, London on 13 October 2016

Mr Martin Kaney, tax consultant, for the Appellant

Mr Anharul Qureshi, presenting officer, for the Respondents

DECISION

Introduction

1. The Appellant appeals against the Respondents' refusal, expressed in a review letter dated 2 March 2016, to allow a claim for input tax in the sum of £10,000 for the period ended 09/15, and also against the Respondents' subsequent assessment to give effect to their decision. The Respondents refused the Appellant's claim on the basis that the invoice supplied was a pro forma invoice, and that there was insufficient evidence to show that this invoice related to a business expense of the Appellant.

Background

2. The background to this appeal is set out in more detail in our findings of fact, below. In brief, the Appellant entered into an engagement with a firm of tax consultants, Qubic Tax. After taking the advice offered by Qubic Tax, the Appellant implemented certain measures, including buying a large quantity of investment gold to put into an employee benefit trust for the benefit of the Appellant's sole director and employee. Qubic Tax invoiced the Appellant in the sum of £50,000 plus £10,000 VAT. The Appellant paid Qubic Tax's invoice.

3. The Appellant sought to deduct the input tax of £10,000 in its VAT return for the period ended 09/15. After enquiring into this return, the Respondents refused the Appellant's claim to be entitled to deduct the £10,000 as input tax. This refusal was upheld on review. The Appellant appealed.

The parties' submissions before us

4. On behalf of the Appellant, Mr Kaney submitted that the Appellant was entitled to deduct the £10,000 in dispute as this was VAT incurred on expenditure related to advice taken by the Appellant to enable it to provide employee rewards, and it was not attributable to the Appellant's subsequent purchase of gold. Mr Kaney argued that the provision of rewards for employees was a residual cost of running a business, and it was normal for companies to remunerate their directors, and so the expense was referable to the Appellant's taxable supplies. It followed that the VAT incurred in paying for the advice was deductible by the Appellant.

5. Mr Kaney also submitted that it was the taxpayer's state of mind which largely determined the purpose for which a fee is incurred, and that the Respondents were looking too far ahead in linking the advice given to the Appellant with its subsequent purchase of gold. Mr Kaney submitted that the advice could have related to other matters, such as tax in respect of residential lettings, and that at the time the advice was given it was not known what consequences might follow. Mr Kaney submitted that if the advice had related to payroll matters then the VAT would have been allowed and that this was an analogous expense.

6. The Respondents' case was put on a different basis in the original decision and in the review decision. Before us the Respondents accepted there was no longer a dispute about whether the invoice was a proforma invoice; instead Mr Qureshi argued that the Appellant had failed to demonstrate a sufficient link between the expenditure and the taxable supplies it made. The Respondents' view was that expenditure was in respect of advice given to achieve the tax efficient extraction of funds from the Appellant and so it was for the personal benefit of the Appellant's sole director. It followed that it was not deductible. This description – advice on a tax efficient extraction method – was that used by the Appellant's accountants to explain what the expenditure was for.

Onus and burden of proof

7. In an appeal to the Tribunal against an assessment to input tax under Section 73(1) of the Value Added Tax Act 1994 ("VATA 1994"), the onus of proof is upon the Appellant to displace the assessment raised. The burden of proof is the civil standard of the balance of probabilities.

Findings of fact

8. We heard oral evidence from Mr Thomas Doran and were shown the documents in the bundle consisting of correspondence between the parties, an engagement letter and various invoices. On the basis of the documents in the bundles before us and the oral evidence of Mr Doran, we find the following facts:

a. Mr Doran is a builder. He began in the building trade in the UK with his uncle in the early 1990s and then worked alone albeit with the involvement of members of his family. Mr Doran set up the Appellant as the vehicle through which he could conduct his trade, and (at all relevant times) he was the Appellant's sole employee and sole director. Through Mr Doran's efforts over time, the Appellant built up a good reputation for the high standard of work it delivered and for delivering that work on time. This reputation ensured a steady stream of work for the Appellant.

b. In late 2014, the Appellant sold a large property, formerly a church, which it had converted into residential properties. As a result of this sale the Appellant had a considerable amount of funds at its disposal.

c. At about the same time as the sale of the former church, the Appellant undertook some general repairs on a property in south London. The owner of this property was a director of Qubic Tax, a firm of tax consultants, and at some point during the repairs there was a brief conversation between that director and Mr Doran about whether the Appellant was receiving tax advice. After that conversation, Mr Doran gave the telephone number of the Appellant's accountants, Riddingtons, to the Qubic Tax director. At that point Riddingtons had been engaged by the Appellant for about 20 years.

d. Thereafter there was an initial meeting at Riddingtons' offices between the Appellant (in the person of Mr Doran), Riddingtons and Qubic Tax. This meeting took place in about March or April of 2015. Mr Doran told us, and we accept, that he had no idea, prior to that initial meeting, of the nature of the advice Qubic Tax would give. We also accept Mr Doran's evidence that he had his own personal advisor, Mr Dixon at BKD Wealth Management, and he would have gone to Mr Dixon for any personal tax advice.

e. There were about five or six months between the initial meeting and the Appellant entering into the various transactions as a result of the advice given by Qubic Tax. One or two further meetings took place between the Appellant, Ridingtons and Qubic Tax in this five or six month period.

f. On 12 August 2015, Qubic Tax issued an engagement letter to the Appellant. This engagement letter sets out, amongst other things, the services Qubic Tax would provide and the fees it would charge. (We set out the terms of the engagement in more detail, and our interpretation of the engagement letter, below.)

g. Although we did not have a signed copy of the engagement letter in our bundle it appeared to be common ground that Mr Doran had signed the engagement letter on behalf of the Appellant. We were not told the date on which the engagement letter was signed but, in considering this point, we noted from the terms of the engagement letter that once a signed copy had been returned to Qubic Tax, the Appellant became liable to pay a Primary Fee of £2,750 plus VAT to Qubic Tax and that Qubic Tax would also make a request for a payment of £50,000 on account in respect of the Secondary Fee. Although we did not see an invoice for the Primary Fee, amongst the documents in our bundle was a proforma invoice dated 20 August 2015 from Qubic Tax, addressed to the Appellant, in the sum of £50,000. On the balance of probabilities we find that this proforma invoice was issued once the engagement letter had been signed, to seek payment on account of the Secondary Fee. It follows that we find that Mr Doran signed the engagement letter on behalf of the Appellant on a date between 12 and 20 August 2015.

h. There was very limited evidence before us about the specific advice given by Qubic Tax to the Appellant once the engagement letter had been signed, or about the transactions which then took place. However, on the basis of comments in Mr Doran's evidence and from references in the Qubic Tax engagement letter, we find that, after deciding to proceed with the advice given by Qubic Tax, the Appellant instructed lawyers to set up an employee benefit trust. We consider that an experienced and successful businessman such as Mr Doran would not sign an engagement letter on behalf of the Appellant without understanding the essential elements (if not the finer detail) of the transactions proposed. We find that by the time he signed the engagement letter Mr Doran was aware that the Appellant was being

advised on ways that he, Mr Doran, as the Appellant's only director, could be rewarded.

i. There are references in the engagement letter to the preparation of a trust deed, and also to the fees of professional Trustees appointed in relation to the Trust. We find that by the time he signed the engagement letter, Mr Doran understood that the advice was that an employee benefit trust should be set up and the Appellant should purchase an asset to put into that trust.

j. We also find that, on the advice of Qubic Tax, the Appellant decided to purchase gold to put into the employee benefit trust. Mr Doran's evidence was that, when he signed the engagement letter, he did not know what specifically what asset the Appellant would be advised to purchase. This was challenged by Mr Qureshi. Mr Doran did not tell us when the Appellant did decide to buy gold or why it was selected. We accept that there was a point in time when Mr Doran understood the essential elements of the advice Qubic Tax was giving but that he did not know specifically which type of asset the Appellant would be advised to purchase. We make no findings as to whether the Appellant's decision to buy gold to put into the employee benefit trust was taken before or after the engagement letter was signed.

k. We have very limited evidence in respect of the Appellant's purchase of gold. We find that on 10 September 2015, Asset Hound Limited issued an invoice to the Appellant in the sum of £865,000. This invoice was in respect of the deposit required for the Appellant's purchase of gold. On the basis of this invoice we find that the total amount to be spent by the Appellant on purchasing gold was £6.1million, of which £773,500 represented a fee to Asset Hound Limited.

l. On 29 September 2015, Qubic Tax issued an invoice to the Appellant, replacing the earlier proforma invoice. The description on the invoice is:

> Professional Charges
>
> Incentives and Rewards – Providing Assets – Secondary Fee

m. Both parties were keen to elicit Mr Doran's view as to what he had understood this fee was for. Mr Doran told us that he considered the secondary fee charged to the Appellant was for the tax advice the Appellant received. On being pressed by Mr Qureshi, Mr Doran said that the advice related to general schemes and that the asset which the Appellant bought could have been cars or property; he did not know the asset would be gold. We make no findings as to Mr Doran's understanding of the Secondary Fee.

n. In response to a series of questions from Mr Qureshi about the benefit the Appellant received as a result of the advice, Mr Doran told us that the benefit to the Appellant was that it would put money into a trust which

would come back to the directors. Mr Doran accepted that he was the Appellant's only director. In re-examination Mr Doran told us that the benefits to the Appellant were in reduced Inheritance tax – Mr Doran then corrected this to corporation tax – and that the Appellant could borrow back from the employee benefit trust the funds which it had invested. This would enable the Appellant to continue to use the funds it had invested in the gold it put into the employee benefit trust for its renovation and building work. We find that the advice given to the Appellant by Qubic Tax related to minimising the tax and NICs which was payable by the Appellant if it chose to reward Mr Doran. We find that the Appellant would not have implemented the advice given by Qubic Tax if it had not been able to borrow back funds from the trustees of the employee benefit trust in order to continue its building and renovation work.

o. We find that, if the Appellant implemented the advice given by Qubic Tax, this implementation could result in a benefit Mr Doran personally.

p. It was common ground that the Secondary Fee of £50,000 plus £10,000 VAT was paid by the Appellant to Qubic Tax. The Appellant deducted the input tax of £10,000 in its VAT return for the period ending 09/15.

q. An officer of the Respondents visited the Appellant's accountants on 16 November 2015 in order to verify the Appellant's VAT return for the period 09/15. There was subsequently correspondence between the Respondents and Riddingtons in relation to the deduction of £10,000 in respect of the invoice issued by Qubic Tax.

r. On 4 January 2016, the Respondents refused the Appellant's claim to deduct the £10,000, on the basis that the fee related to the purchase of investment gold and, as investment gold is exempt from VAT, the fee related to the making of an exempt supply. The Appellant sought a statutory review of this decision.

s. By letter dated 2 March 2016, the Respondents refused the Appellant's claim on the basis that the invoice of 20 August 2015 was a pro-forma invoice (the invoice of 29 September 2015 had apparently been supplied to the Respondents by this time but seems to have been overlooked), and that there was insufficient evidence to show that the expenditure related to the taxable supplies of the Appellant. The Appellant appealed to this Tribunal.

Decision

9. We start by looking at the relevant parts of the European and domestic legislation.

European legislation

10. Article 168 of Council Directive 2006/112/EC on the common system of value added tax provides:

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;

Domestic legislation

11. The rights set out in Article 168 are enacted in domestic legislation, in Sections 24 – 26 VATA 1994. Section 24 VATA 1994 defines "input tax", Section 26 VATA 1994 gives taxable persons an entitlement to credit in respect of input tax, and Section 25 VATA 1994 gives a taxable person the right to deduct input tax paid from any output tax due.

12. Section 24(1) provides:

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.

13. The relevant parts of Section 26 provide:

(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;

Case law

14. This legislation has been interpreted in a number of cases, some of which we were referred to by the parties. Our review of the authorities confirms the general principle that the legislation requires a nexus between the expenditure in question and the taxable transactions carried out by the business for the input tax incurred to be deducted. It is not sufficient for the expenditure to provide a general benefit to the business, the expenditure must be referable to the purpose of the business.

15. This principle explains the distinction between *Customs and Excise Commissioners v Rosner* [1994] STC 228 (where legal expenses incurred defending a sole trader in respect of criminal charges not sufficiently related to the school he ran were not deductible) and *Praesto Consulting UK Limited v HMRC* [2016] UKFTT 495 (TC) (where invoices addressed to the taxpayer's director, but inherently related to the legal fees incurred in defending both the taxpayer and its director in a legal proceedings brought by a trade competitor, were deductible). In the latter case there was a direct and immediate link between the expense incurred and the business of the taxpayer.

16. As was made clear by the Supreme Court in *HMRC v Airtours Holiday Transport Limited* [2016] UKSC 21, in considering whether the VAT on an amount paid under a contract is deductible as input tax, the first step is to consider the contractual relationship which gave rise to the expenditure and then to consider whether the contract reflects economic reality.

17. Therefore the questions we must ask ourselves are:

- having regard first to the contract and then economic reality, to whom were Qubic Tax's services supplied, and
- is there a link between the expenditure incurred by the Appellant and the taxable supplies of the Appellant?

18. In looking at the issues in this way it follows that we reject Mr Kaney's submission that the Appellant's state of mind determines the purpose for which the expenditure is incurred. Following the Judgment of the CJEU in *Newey (trading as Ocean Finance) v. HMRC (Case C-653/11)* [2013] All ER (D) 254, we consider that the analysis is not of why a particular taxable person chose to enter a transaction, but what transaction a taxable person has entered into and whether there is a link between the expenditure and that taxable person's supplies.

To whom were Qubic Tax's services supplied?

19. Looking first at the relevant contract, the Qubic Tax engagement letter was addressed to, and signed on behalf of, the Appellant. It is clear that Qubic Tax were under an obligation to provide their services to the Appellant. The contractual relationship is between the Appellant and Qubic Tax. Mr Doran has no rights under the contract, and Qubic Tax is under no obligation to provide any services to anyone at the behest of Mr Doran. Although we have very limited evidence of the parties' behaviour, the fact that Qubic Tax dealt with Riddingtons rather than Mr Doran's advisor, is consistent with this analysis.

20. The Respondents argued that Mr Doran benefits personally from the arrangements but Mr Qureshi did not suggest that the engagement letter did not reflect economic reality. We agree that the implementation of the advice given may result in considerable benefit to Mr Doran as well as benefitting the Appellant, but we do not consider that the benefits obtained by the Appellant and Mr Doran from the resulting

transactions are such as to suggest that the contractual arrangement is artificial or that it does not reflect economic reality.

21. We conclude that, as a matter of contract and of economic reality, Qubic Tax's services were supplied to the Appellant.

Is there a link between the expenditure incurred and the Appellant's taxable supplies?

22. In considering this second question we note it was common ground that the Appellant's taxable supplies are in the field of building, renovation and construction. The parties were not agreed about whether the Appellant's expenditure was sufficiently linked to the Appellant's taxable supplies.

23. Before we consider whether there is a direct and immediate link between the expenditure and the Appellant's taxable supplies, given the reasons set out in the Respondents' original and review decision letters, we should be clear about our conclusions in relation to what the expenditure was incurred upon.

What was the expenditure incurred on?

24. The Respondents' original position was that the Secondary Fee at the heart of this dispute was a cost component of the gold for which the Appellant paid a deposit in September 2015. Much of the Appellant's arguments before us appeared to be in a response to this stance, although by the date of the hearing the Respondents' position had moved to a submission that the expenditure was incurred on advice to mitigate tax and NICs. In moving to this position the Respondents adopted the description provided by the Appellant's accountants of the service supplied as being "to advise on a tax efficient extraction method".

25. As noted above, Mr Doran gave evidence as to his understanding of what the Secondary Fee was paid for, and that evidence was challenged by Mr Qureshi. However, construction of a contract is a question of law, and so the parties own understanding of the terms is not relevant. Mr Doran's view of the engagement letter does not determine the services for which the Appellant paid the Secondary Fee. In order to determine what the Secondary Fee was paid for, we need to consider the terms of the engagement letter.

26. Clause 1.1.1 of the engagement letter set out that the "Initial Services" were the provision of:

> tax advice on the implications of UK tax law relating to corporation tax, income tax, NICs and VAT in respect of Incentives and Rewards – Providing Assets, where appropriate and relevant

27. There were also "Enquiry Support Services" which related to the assistance Qubic Tax would provide to the Appellant in respect of any enquiry by HMRC into the advice given. Clause 1.6 anticipated that the "Initial Services" would be complete within four weeks of the date of the engagement letter.

28. Clause 5 set out the fees chargeable. A "Primary Fee" of £2,750 plus VAT was chargeable upon provision of the "Services". Clause 5.2.2 provided that an invoice in respect of the "Primary Fee" would be issued upon receipt by Qubic Tax of a copy of the engagement letter signed by Mr Doran.

29. Clause 5.3 set out the provisions relating to the "Secondary Fees". The relevant parts of this provide:

> 5.3.1 Upon the purchase of assets to incentivise employees, we shall charge you a Secondary Fee which will be £50,000 plus VAT (the **Secondary** Fee). This Secondary Fee is quoted on the advice and information provided by the Company to date. Should this information change then our fees may be revised accordingly. At all times, the minimum aggregate Secondary Fee during any 12 month consecutive period (commencing on the date of this Engagement Letter) shall be £10,000 plus VAT (the **Minimum** Fee) and payable in accordance with clause 5.5. *A request for payment on account in respect of the Secondary Fee will be issued on receipt of a signed copy of this Engagement Letter*.
>
> 5.3.2 In the event of no purchase being made within 6 months from the date of this Engagement Letter, the Minimum Fee shall be immediately payable by the Company within 14 days of the date 6 months following the date of this Engagement Letter.

30. The Secondary Fee became payable upon "the purchase of assets to incentivise employees". The Appellant's purchase of gold triggered the Secondary Fee but this does not mean that the Secondary Fee was payable as part of the fee for the gold or was referable to the gold. Clause 5.3.1 explains when the fee is incurred, not what the Appellant is paying for. In our opinion the Secondary Fee was part of the fee paid for the "Services" supplied under the engagement letter, namely the initial advice and any enquiry support services required.

31. As set out in Clause 1.1.1, the Initial Advice was in relation to the UK tax implications in respect of the provision of rewards and incentives. At one point Mr Kaney submitted that the Appellant was taking general advice and that the tax advice could have related to other matters, such as the taxation of residential lettings. Mr Doran might have thought that before the Appellant's meetings with Qubic Tax but he clearly could not have thought that by the time he signed the engagement letter on behalf of the Appellant. The advice given by Qubic Tax was on ways in which the Appellant could reward Mr Doran without incurring the liability to tax and NICs which would have been incurred had £6.1m been paid by way of salary.

32. We conclude that that the Secondary Fee incurred by the Appellant was for advice on how to reward its sole employee with the least possible liability to tax and NICs.

Is there sufficient link to the Appellant's taxable supplies?

33. Mr Qureshi submitted that there was insufficient link between the services provided and the Appellant's own taxable supplies as the services provided were for

the benefit of Mr Doran rather than the Appellant. The Respondents' submission was that the Appellant's intention was to ensure that Mr Doran paid the least amount of tax possible in respect of the reward he received.

34. Mr Kaney submitted that the supply to the Appellant was not linked to a specific supply but was an overhead, and was analogous to payroll services.

35. We consider that there may have been some benefit to Mr Doran in advice being given to the Appellant on methods by which Mr Doran might be rewarded with only minimal payment of tax and NICs by the Appellant. There may also be benefits arising to Mr Doran from any structuring which the Appellant chose to adopt as a result of the advice given by Qubic Tax. However, the fact that there are benefits to Mr Doran does not prevent the services provided to the Appellant being for the purposes of the business.

36. Mr Qureshi accepted that expenditure incurred by the Appellant on payroll services would be an overhead of the business but sought to distinguish the tax advice given by Qubic Tax on the basis that it was "outside the norm". We do not agree that this is a valid distinction; a service can be used for the purposes of the business irrespective of how common it is for that service to be used.

37. We conclude that advice given to a taxable person on how it can reduce its tax and NICs liabilities in rewarding its employee is advice given for the purpose of the business. The advice directly relates to the Appellant's own tax and NICs liabilities, and the reduction of these liabilities will increase the Appellant's profits. The additional benefit which Mr Doran may derive personally, even if it is considerable, does not enable us to draw a distinction between this type of advice and advice which might be given to the Appellant in respect of operating its payroll or the mitigation of any other business expense.

Conclusion

38. For the reasons set out above, we allow the Appellant's appeal.

39. 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.

JANE BAILEY
TRIBUNAL JUDGE

RELEASE DATE: 23 DECEMBER 2016