



**TC04608**

**Appeal number: TC/2014/01111**

*VAT – input tax – legal and other professional services supplied in connection with legal proceedings to remove minority shareholder in family company – whether supplied “to” the appellant and for the “purposes” of the appellant’s business – no – appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**ROBERT WELCH DESIGNS LIMITED**

**Appellant**

**- and -**

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

**TRIBUNAL: JUDGE ZACHARY CITRON  
MRS SHAMEEM AKHTAR**

**Sitting in public at Bristol Magistrates Court on 13 April 2015**

**Mr P B Reast FCA, Chartered Accountant, for the Appellant**

**Mr L Bingham, Officer of HMRC, for the Respondents**

## DECISION

1. This case concerned VAT charged on supplies of legal and other professional  
5 services relating to legal proceedings between, on the one side, the appellant and  
individuals who were its directors and majority shareholders, and, on the other side,  
an individual who was a minority shareholder in the appellant. The appellant was a  
family company and the individual shareholders on either side of the litigation were  
siblings. The issue was whether the appellant was correct to treat the VAT charged on  
10 the supply of the services as input tax and therefore recoverable.

### **The appeal**

2. Following a visit to the appellant's business premises, HMRC wrote to the  
appellant on 8 August 2013 noting that input VAT had been claimed in respect of  
15 purchase invoices addressed to individual directors of the appellant and not to the  
appellant itself. The letter listed 21 such invoices dated between August 2011 and  
April 2013 in respect of legal services provided, charging VAT of a total of £22,024.

3. HMRC subsequently issued a VAT notice of assessment to the appellant on 1  
October 2013 in the amount of £25,452 plus interest. Of this, £22,024 related to the  
20 VAT charged on the invoices in question. HMRC later accepted that some items were  
included twice in this assessment in error – hence a corrected VAT notice of  
amendment of assessment was issued to the appellant on 8 July 2014 in the amount of  
£23,339 plus interest. Of this, the amount of tax at issue in the appeal was £19,991.

4. On 6 November 2013, the appellant's accountants wrote to HMRC requesting a  
25 review of the assessment relating to the invoices in question. On 22 January 2014  
HMRC wrote to the appellant to inform it that following review, the decision was  
upheld.

5. The appellant served a notice of appeal on 20 February 2014, claiming that  
input tax on the invoices should be allowable in full.

### 30 **Evidence**

6. We received a witness statement from Mr Alan Rupert Welch, a director of, and  
shareholder in, the appellant, whom we shall refer to here as Mr AR Welch (to  
35 distinguish him from other members of the Welch family who will be referred to in  
this judgement). Mr AR Welch did not attend the hearing; however, HMRC's  
representative, Mr Bingham, did not contest the statements of fact in Mr AR Welch's  
witness statement and did not require him to be available for cross examination.

7. We heard evidence at the hearing from Mr Reast, who was also the appellant's  
representative. Mr Reast had been the accountant to the appellant over an extended

period. We found Mr Reast’s evidence to be credible and consistent with Mr AR Welch’s witness statement.

8. We also received a bundle containing the documents and correspondence referred to above, notes from the VAT visit in August 2013, and the parties’ statements of case and skeleton arguments.

9. As the evidence was not in dispute, the following can be taken as our finding of facts

*Background to the legal proceedings in respect of which the invoiced services were provided*

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10. The appellant’s business is the design, retailing and wholesaling of cutlery and other household items such as kitchen and tableware. It was registered for VAT under registration number 275 3137 57 with effect from 1 April 1973.

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11. The background to the dispute amongst the shareholders in the appellant, which gave rise to the legal proceedings in respect of which the invoiced services were provided, is relevant to the issues in this appeal. It is as follows.

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12. The appellant was founded by Mr Robert Welch, the designer, in the 1960s. Two of Mr Robert Welch’s children, Mr AR Welch and Ms Alice Welch, joined the business and became directors of the appellant in the 1990s. In 2000, Mr Robert Welch died and the shareholdings in the appellant were thereafter held 24% by his widow (Mrs Patricia Welch), 26% by Mr AR Welch, 25% by Ms Alice Welch, and 25% by a younger son, Mr William Welch (whom we shall refer to as Mr W Welch). Together, Mr AR Welch and Ms Alice Welch had the majority of the shares in the appellant, and they were both directors (along with Mrs Patricia Welch and, until October 2005, Mr W Welch). We shall refer to Mr AR Welch and Ms Alice Welch together as the “controlling director/shareholders”.

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13. Mr W Welch was appointed as a director in 2000 and came to work for the appellant full time as a designer in 2001. Conflict over the affairs of the appellant between Mr W Welch and the controlling director/shareholders began from this time. The controlling director/shareholders considered that, in this period, Mr W Welch did not create enough designs (and did not want other designers to be hired). According to the appellant, only three new designs were created between 2000 and 2005 (when Mr W Welch left the appellant’s employment). In the appellant’s view, this hindered the development of the appellant’s business. The controlling director/shareholders came to suspect that Mr W Welch wanted to develop his own name and brand. Efforts were made to remedy the situation: in 2003 a mediator was used and an offer was made to purchase Mr W Welch’s shares, but the offer was not taken up. In October 2005, Mr W Welch resigned as a director and employee of the appellant.

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14. The appellant asserted that in the three months following his resignation, Mr W Welch created and registered 12 cutlery patterns in the name of his own company, as

well as creating a new website. It was said by the appellant that Mr W Welch approached one of its important customers during the three month period after he resigned, to win its business. The appellant asserted that Mr W Welch, in the period since leaving the appellant's employment, approached almost of its customers, both in the UK and US, and was a serious competitor.

15. The appellant asserted that, prior to his departure in 2005, Mr W Welch had wanted to weaken the appellant by producing few designs, and then set himself up in direct competition with the appellant, using the "Welch" name. The controlling director/shareholders considered taking legal action against Mr W Welch at this time in respect of the ownership of the intellectual property in the 12 cutlery patterns, but did not, preferring to focus on the business of the appellant.

16. After October 2005, as a minority shareholder in the appellant, Mr W Welch came into conflict with the controlling director/shareholders over matters such as dividends paid by the appellant and remuneration of the directors of the appellant. The appellant asserted that Mr W Welch refused to attend annual general meetings, and his solicitor was antagonistic. It was asserted that dealing with Mr W Welch and his solicitor caused a considerable strain on the creativity of both the controlling director/shareholders.

17. An offer was made to purchase Mr W Welch's shares in 2006 but was not taken up.

*The legal proceedings in respect of which the invoiced services were provided*

18. In October 2011, Mr W Welch issued a petition under section 994 of the Companies Act 2006 in respect of the appellant.

19. The appellant did not address us on the details of this provision of the Companies Act. In brief, it allows a shareholder in a company to petition the court for an order on the ground that the company's affairs are being conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least the petitioner).

20. Under section 996 of the Companies Act 2006, if the court is satisfied that the petition is well founded, it may make such order as it thinks fit for giving relief in respect of the matters complained of. Amongst the things the court's order may do are:

- (1) regulate the conduct of the company's affairs in the future;
- (2) require the company--
  - (a) to refrain from doing or continuing an act complained of, or
  - (b) to do an act that the petitioner has complained it has omitted to do;

(3) provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, the reduction of the company's capital accordingly.

5 21. The respondents named in Mr W Welch's unfair prejudice petition were the controlling director/shareholders and the appellant. Mr Reast told us that the conduct of the appellant of which Mr W Welch complained in the legal proceedings included its payment of dividends, the remuneration given to Mr AR Welch, and its treatment of Mr W Welch when he worked for the appellant prior to October 2005.

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22. Mr AR Welch's evidence was that Mr W Welch was trying to force a purchase of his shares and inflict as much damage on the appellant as possible. Mr AR Welch considered that in defending the unfair prejudice proceedings, he was defending the appellant, which could have been put into financial difficulties.

15 23. After Mr W Welch issued the unfair prejudice petition, the appellant brought a counter claim against Mr W Welch in respect of the ownership of the intellectual property in the 12 cutlery patterns produced in 2005-2006 referred to above.

20 24. During 2011, the appellant provided financial information to share valuers appointed by solicitors acting for Mr W Welch, to enable them to arrive at a valuation of Mr W Welch's shares. This did not go further and later, a further valuer was appointed by Mr W Welch.

25 25. Both the unfair prejudice proceedings, and the proceedings relating to the intellectual property in the 12 cutlery patterns created in 2005-06, were settled by a court order dated 30 April 2013 for the payment by the respondents to Mr W Welch of £1,875,000 in three instalments, the last of which was to be on 24 June 2014; and the transfer by Mr W Welch of his shares in the appellant, to the respondents' order, upon completion of all payments. In the event, it was the appellant which both made the payments and acquired Mr W Welch's shares (which were consequently cancelled). The sum paid represented £900,000 for Mr W Welch's shares and  
30 £975,000 in respect of his costs.

#### *The invoiced services*

35 26. The VAT in question arose on the legal and other professional services provided in connection with the legal proceedings (the "invoiced services"). For all but two of the invoices listed in HMRC's letter of 8 August 2013, the named supplier was Davies Murray-White, a firm of solicitors (the "solicitors"). We were shown some of the underlying invoices at the hearing: some of these represented charges from barristers and experts in valuation and strategic remuneration. The two remaining invoices listed in the HMRC letter were described as "miscellaneous invoices", but  
40 the references were to the same valuation and remuneration experts referred to in the other invoices.

27. The solicitors' invoices were addressed to Mr AR Welch and Ms Alice Welch (and not to the appellant). They were expressed in generic terms: "to professional charges for services in connection with advising you generally". We saw an invoice from Bruce Sutherland & Co addressed to the solicitors and referring to the parties to the unfair prejudice proceedings, in respect of advice in relation to the value of the appellant; we saw an invoice from "Alan M Judes Strategic Remuneration", addressed to the solicitors, in respect of "consultancy services to your clients Rupert Welch and Alice Welch".

28. Mr Reast told us that the reason the solicitors invoiced the controlling director/shareholders (and not the appellant) was that the initial expectation had been that Mr AR Welch and Ms Alice Welch (only) would be parties to the unfair prejudice proceedings. Mr Reast also told us that following the HMRC visit in August 2013 that gave rise to the assessment under appeal, the appellant had asked the solicitors to re-invoice in the name of the appellant, but they had not been prepared to do so.

29. The solicitors did not divide their advice or bills between the unfair prejudice proceedings and the appellant's claim in respect of the intellectual property in the 12 cutlery patterns created in 2005-06; we understood from Mr Reast it would have been practically impossible to do so, as they were effectively advising on a single matter, being the dispute between the appellant and the controlling director/shareholders on one side, and Mr W Welch on the other. To underline this point, we understood from Mr Reast that certain discrete intellectual property advice had been taken by the appellant in relation to the intellectual property dispute from a different service provider, but the VAT charged on this was not within the assessment under appeal.

30. Similarly, the solicitors did not divide their advice or bills between the three respondents (the controlling director/shareholders and the appellant).

### **Further findings of fact**

31. We make the following further findings of fact which are significant to the issues in this appeal, some made by inference from the evidence outlined above:

(1) The conflict with Mr W Welch over the period 2001-2013, as described above, caused some degree of disruption and distraction for the controlling director/shareholders as regards their management of the appellant's business, in the sense that it absorbed some amount of their time and energies which would otherwise have been devoted to the business. We cannot quantify this with any exactitude, although, for the period from October 2005 when Mr W Welch ceased to be an employee, we infer from Mr W Welch's position as a minority shareholder and from the examples of disruption that were given to us,

that the disruption principally arose from Mr W Welch's exercise of powers of a minority shareholder, including at general meetings.

5 (2) We accept the evidence of Mr AR Welch, and likewise infer from the pattern of earlier unsuccessful attempts to value Mr W Welch's shares, as well as from the ultimate outcome of the legal proceedings, that the object of the legal proceedings was to resolve a longstanding conflict amongst the shareholders in the appellant by buying out Mr W Welch for a sum determined by the court. The invoiced services were geared to achieving this result, through the provision of legal and other professional advice. Consistent with this, we  
10 accept Mr Reast's evidence that it would have been a difficult and artificial exercise to try to divide the legal advice as between the part pertaining to the unfair prejudice proceedings, and that pertaining to the proceedings in respect of the intellectual property in the 12 cutlery designs created in 2005-06. We find that the invoiced services had the same single object as the legal proceedings to which they were directed: to bring about the removal of Mr W Welch as a  
15 shareholder in the appellant.

(3) The controlling director/shareholders believed that the conduct of the legal proceedings was in the interests of, and provided a benefit to, the appellant, by removing a source of distraction and disruption.

20 (4) Mr W Welch was a competitor to the appellant, following his departure at the end of 2005; and in the appellant's view, this gave Mr W Welch an added incentive to cause distraction and disruption to the controlling director/shareholders. However, we find that the legal proceedings and their settlement did not affect Mr W Welch's position as a competitor to the appellant – they affected only his position as a shareholder in the appellant.  
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(5) The solicitors considered their clients to be the controlling director/shareholders, not the appellant, and for this reason were not prepared to re-issue invoices in the name of the appellant after the event.

## 30 **The law**

### *UK statute*

32. The UK statutory provision at issue is section 24(1) of the Value Added Tax Act 1994, the relevant part of which provides that:

35 “‘input tax’, in relation to a taxable person, means ... VAT on the supply to him of any goods or services... being ... goods or services used or to be used for the purposes of any business carried on or to be carried on by him.”

40 33. It was accepted by the parties that the appeal turned on whether the VAT charged on the invoiced services fell within this definition of “input tax” (as the supplies made by the appellant in its business were taxable supplies).

34. We note the two requirements of section 24(1): that the supplies in question be made to the taxpayer (the “to whom” requirement); and that they be used for the purposes of the taxpayer’s business (the “purpose” requirement).

5 35. We also note section 24(5), the relevant part of which provides:

10 “Where goods and 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 ... VAT on supplies ... 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; ...”

#### *Case law on the “purpose” requirement*

15 36. HMRC referred us to *Finanzamt Köln-Nord v Becker* ([2013] EUECJ C-104/12), which contains a summary of the case law of the Court of Justice of the European Communities (“CJEU”) requiring a “direct and immediate link” between the services provided and the taxpayer’s taxable business, in order to satisfy the “purpose” requirement. The case concerned an individual, Mr Becker, who was both a  
20 majority shareholder in, and a director of, a German limited company. The German company carried out taxable supplies of construction works. Criminal proceedings were brought against Mr Becker on allegations that the German company had made payments which under criminal law were likely to be regarded as bribery or aiding and abetting on the part of Mr Becker. The lawyers, who represented both Mr Becker  
25 and the German company, addressed their invoices to the German company. The question was whether the VAT on the invoices was deductible by the German company.

30 37. The CJEU reiterated the requirement of a direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct input VAT. It also recognised that a taxable person has a right to deduct even where there is no direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs  
35 do, in effect, have a direct and immediate link with the taxable person’s economic activity as a whole.

40 38. The CJEU held that the direct and immediate link test needs to be applied to supplies in the light of their objective content. On the facts in *Becker*, the court found that the legal services sought directly and immediately to protect the private interests of the accused director; and criminal proceedings were brought against the individuals in a private capacity. The costs relating to those supplies could not be considered as having been incurred for the purposes of the German company’s economic activities

as a whole. In particular, the fact that the legal supplies would not have been made if the German company had not carried on activity which produced taxable turnover, did not constitute a direct and immediate link.

*Case law on the “to whom” requirement*

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39. The parties did not address us on the case law regarding “to whom” supplies are made. In the recent *Airtours* case ([2015] STC 61), the taxpayer was in a position of financial distress and engaged a professional services firm to review its restructuring strategy; HMRC refused its claim to deduct input tax on the fees of the services provider, on the grounds that the services had been provided not to it, but to the creditor banks. The Court of Appeal (by a majority) found that the taxpayer, who paid for the services, was not the recipient of those services for VAT purposes, based on a close reading of the terms of engagement. Leave to appeal has been granted by the Supreme Court.

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40. We found of particular assistance the Court of Appeal’s articulation (at paragraph 37) of the principles governing whether or not a service, paid for by the taxpayer, is supplied to the taxpayer. Of these, the more relevant to this appeal, in brief summary, are:

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(1) consideration of economic realities is a fundamental criterion as regards the identification of the person to whom services are supplied;

(2) decisions about the application of the VAT system are highly dependent upon the factual situations involved;

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(3) when determining the relevant supply in which a taxable person engages, regard must be had to all the circumstances in which the transaction or combination of transactions takes place;

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(4) the terms of any contract between the parties, whilst an important factor to be taken into account in deciding whether a supply of services has been made, are not necessarily determinative of whether as a matter of 'economic reality' taxable supplies are being made as between any particular participants in the arrangements. However, the contractual position is generally the most useful starting point for the VAT analysis. That may be particularly so where certain contractual terms do not wholly reflect the economic and commercial reality of the transactions;

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(5) there may, as a matter of analysis, be two or more distinct supplies within the same transaction. A single course of conduct by one party may constitute two or more supplies to different persons;

(6) the mere fact that the taxpayer has paid for the service does not necessarily mean that it has been supplied to him.

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41. The majority opinions in the case laid some stress on the requirement of reciprocity between the payment of consideration and the supply of the service – as Moore-Bick LJ put it (at paragraph 92):

“the critical question in relation to the present transaction is whether [the service provider] entered into an obligation to the [taxpayer] to provide the banks with a report on its financial position”.

### **Appellant’s arguments**

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42. Although neither party clearly divided its arguments between the two requirements (“to whom” and “purpose”) of section 24(1), we have done so in the summary that follows.

43. Regarding the “to whom” requirement, the appellant emphasised the fact that it was itself a party to the legal proceedings to which the invoiced services related; as a respondent in those proceedings, the appellant had rights and obligations, alongside the controlling director/shareholders, set out in the court order concluding the proceedings; and it was the appellant itself which made the payments, and repurchased the shares, pursuant to the court order.

44. As to the “purpose” requirement, the appellant stressed the fact that Mr W Welch was perceived by the controlling director/shareholders as a source of distraction to the controlling director/shareholders in their management of the appellant, and as a business competitor to the appellant. By achieving the removal of Mr W Welch as a minority shareholder, the legal proceedings enabled the controlling director/shareholders to concentrate more fully on their management of the appellant’s business; and so (in the appellant’s argument) benefitted the appellant and its business.

45. In particular, the appellant contended that the dispute between Mr W Welch and the controlling director/shareholders stunted the growth of the appellant’s business during the period 2001-2013; that if the settlement price had been much in excess of £1,875,000 it is unlikely the appellant would have been able to continue to trade and therefore there would have been no future sales; and that the invoiced services in this way had a direct effect on the turnover of the business.

46. In connection with these contentions, Mr AR Welch’s witness statement stated that the appellant’s turnover increased from £6 million in the year to 30 April 2010 to £11 million in the year ended 30 April 2014

47. The appellant argued that *Becker* was not directly relevant because it related to a criminal matter involving just the directors in their personal capacities; the taxpayer itself was not included as a defendant in the proceedings in *Becker*.

48. The appellant further contended that the respondent’s arguments, if accepted, would imply that input tax would only be able to be claimed on the purchase of goods – it would be difficult to show that VAT on any professional fees of accountants or lawyers had sufficiently close linkage to the business, to be allowed as input tax.

### **Respondent’s arguments**

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49. Regarding the “to whom” requirement, HMRC argued that the VAT in question related to supplies made to directors of the appellant and not to the appellant itself. They contended that the appellant had not incurred the invoiced services, nor been invoiced for them.

5 50. As to the “purpose” requirement, HMRC argued that there was no direct and  
immediate link between the invoiced services and the taxable supplies made by the  
appellant. HMRC viewed the appellant’s situation as analogous to that in *Becker*,  
where the legal services supplied sought directly and immediately to protect the  
private interests of the accused individual directors; and the criminal charges were  
10 brought against the directors individually, not the employer company. They contended  
that *Becker* is clear authority that legal services provided to individuals do not have a  
direct and immediate link to the taxable transactions of a business, even when the  
legal representation is required as a result of that person’s involvement in the  
activities of the business. HMRC submitted that this was the case even if the business  
15 instructed the solicitors, received the invoices and paid them.

51. In HMRC’s view, the directors of the appellant wanted to remove the minority  
shareholder and the legal services were incurred by them as individuals in a family  
dispute. Whilst HMRC accepted what it called a peripheral benefit to the appellant of  
resolving the dispute with Mr W Welch (so the directors could concentrate on running  
20 the business), this was insufficient to create a direct and immediate link with the  
supplies made by the appellant.

52. HMRC also contended that references (made in the appellant’s statement of  
case but not repeated in its skeleton argument, nor in its submissions at the hearing) to  
paragraph 6 of, and Appendix 2 to, HMRC’s statement of practice of March 2007  
25 entitled “VAT strategy: Input tax deduction without a valid invoice” were not  
relevant.

## Discussion

53. This appeal turns on the application of the two requirements (“to whom” and  
30 “purpose”) of section 24. We agree with HMRC that its March 2007 statement of  
practice is not relevant to the resolution of the issues in this appeal.

### *The “to whom” requirement*

54. Applying the Court of Appeal’s guidance to deciding whether the party that  
paid for services was the recipient of them, we start with the contractual position and  
35 then consider if this analysis should be varied or dislodged in light of the economic  
reality of the situation.

55. Unlike the court in *Airtours*, we were given no written terms of engagement  
governing the provision of the invoiced services; but the facts we do have regarding  
the contractual position here favour HMRC’s contentions. First, the solicitors  
40 consistently invoiced the controlling director/shareholders (only); second, the

references to clients in the invoices are consistently to the controlling director/shareholders (only); and third, the solicitors were not prepared to re-invoice in the name of the appellant. From this we have made the finding of fact, by inference, that the solicitors considered the controlling director/shareholders (only) to be their clients. All this indicates to us that the contractual relationship was between the solicitors and the controlling director/shareholders (only). The appellant was not able to demonstrate the required reciprocity between itself, as the payer for the services, and the solicitors, as the provider of the services, upon which the majority opinions in *Airtours* put particular stress.

56. How does this analysis sit with the economic reality of the situation? It is clearly consistent with economic reality to regard the services as provided to the controlling director/shareholders: they were respondents in the legal proceedings and had an economic stake in its outcome, as shareholders in the appellant. The question is whether we would be ignoring economic reality if we followed the contractual relationships and regarded only the controlling director/shareholders as the recipients of the services – and did not include the appellant as a further recipient of the services.

57. We think not. The controlling director/shareholders had effective control of the appellant; their economic interests were closely intertwined, if not identical. Indeed, we note that the court, in resolving the legal proceedings, appeared to regard the appellant and the controlling director/shareholders as, in effect, a single party with one common interest. The courts have stressed economic reality in order to avoid outcomes that give undue weight to formal contractual arrangements that ignore economic reality. That is not the position with the contractual arrangements here: in our view, they well reflect the economic reality of the situation.

58. There are therefore no grounds, on our view of the law, to depart from the contractual arrangements and find that the appellant was a recipient of the services, either solely or along with the controlling director/shareholders.

59. Our conclusion on the “to whom” requirement resolves this appeal in HMRC’s favour. We shall, nevertheless, go on to consider the “purpose” requirement of section 24(1).

#### *The “purpose” requirement*

60. Whilst we have accepted the appellant’s evidence that it considered the legal proceedings (and the invoiced services in respect of them) to be in the interests of the appellant and its business, this is not sufficient to satisfy the “purpose” requirement. The law requires us to apply the “purpose” requirement consistently with the CJEU’s requirement of a direct and immediate link between the services provided and the taxable outputs of the appellant.

61. Whilst we have been assisted by the summary of the relevant legal principles found in *Becker*, we agree with the appellant that its facts are materially different

from those in the case. Here, the appellant was itself party to the legal proceedings – it cannot therefore be said that the legal proceedings here involved only the controlling director/shareholders in a personal capacity.

5 62. Nonetheless, *Becker* makes clear that, in applying the direct and immediate linkage test, we need to make an objective assessment of the content of the services provided; here, it is not enough to say that the invoiced services would never have been required, were it not for the business activity of the appellant.

10 63. We have found as facts that the object of the legal proceedings was to resolve a longstanding conflict amongst the shareholders in the appellant by buying out Mr W Welch for a sum determined by the court; and that the invoiced services were geared to achieving this end, through providing legal and other professional advice relevant to the legal proceedings. These findings of fact means that it is not necessary, or appropriate, for us to consider the elements of the advice relating to the unfair prejudice proceedings, separately from the elements relating to the proceedings  
15 concerning the intellectual property in the 12 cutlery patterns created in 2005-06. Had the facts been different, we might have had to consider the apportionment provisions in section 24(5).

20 64. It is clear to us that services geared to achieving the buyout of Mr W Welch’s minority shareholding do not have a direct and immediate link to particular taxable outputs of the appellant - sales of the cutlery and other household goods it designed. Rather, the question is whether services of this kind fall into the category, recognised in the summary of the law in *Becker*, of “overhead” costs that have a direct and immediate link with the taxpayer’s economic activities as a whole. (It is this category of “overhead” costs that answers the appellant’s contention that, on HMRC’s  
25 arguments, virtually all legal and accounting costs would be excluded as input tax.)

30 65. We accept the appellant’s submissions that removing a minority shareholder perceived as disruptive by the controlling director/shareholders (and who, as a business competitor, may have had an interest in distracting the appellant’s directors in this way) freed up a certain amount of time and personal energy for the controlling director/shareholders to devote to managing the appellant’s business. However, in our view, a company director having more time, energy and concentration to run the business is a step removed from the economic activity of the business itself. We accept as plausible the appellant’s submissions that the directors’ ability to devote themselves more to the business after the removal of Mr W Welch as shareholder did  
35 help the business’ fortunes; but they have not persuaded us of a direct and immediate link. In between the removal of Mr W Welch as a shareholder and the results of the appellant’s business lie a number of links in the chain – principally, the management decisions the directors made with their increased time and resources, and the impact of those management decisions on the business’ results. Even assuming the linkage to  
40 the success of the business could be proved (and we would observe that the appellant asserted a linkage between the removal of Mr W Welch and the greater success of the business, but did not attempt to prove it), we would expect the linkage, by its nature, to be indirect and gradual.

5 66. In our judgement, the only matter to which the invoiced services were directly and immediately linked was the removal of Mr W Welch as a shareholder. We have therefore considered whether this in particular could be said to be part of the appellant's economic activity as a whole, such the VAT on the invoiced services should be treated as an "overhead" cost.

10 67. Mr W Welch's removal as a shareholder was achieved through a buy back of the appellant's own shares – effectively, a return of capital from a company to a shareholder. We are aware of authority that the raising of capital by way of an issue of new shares can be part of overhead costs (*Kretztechnik AG v Finanzamt Linz* [2005] STC 1118); but in our view there is a vital difference between raising new capital to be deployed in the business, and taking capital out of a business to return it to a shareholder. The latter does not in our view come within the ambit of the appellant's overall economic activity. We are reinforced in this view by the fact that, in this particular case, the court order could equally have been satisfied by a transfer of Mr W Welch's shares to one of the controlling director/shareholders – which would not have involved the appellant at all (other than to formally approve the transfer) and so, in our view, even more clearly would have had no linkage to the appellant's overall economic activity. The fact that the same overall result was achieved by a different legal means – repurchase by the appellant of its own shares – should not (and in our view does not) change the analysis as to whether the removal of Mr W Welch as a shareholder formed part of the appellant's overall economic activity.

68. We therefore find that the "purpose" requirement of section 24(1) is not satisfied, as the appellant was unable to demonstrate a direct and immediate link between the invoiced services and the appellant's business.

25 **Conclusion**

69. The appeal is dismissed; and the VAT notice of amendment of assessment issued on 8 July 2014 in the amount of £23,339 plus interest is upheld.

30 70. 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.

40 **ZACHARY CITRON**  
**TRIBUNAL JUDGE**

**RELEASE DATE: 17 JULY 2015**