[2019] UKFTT 502 (TC)

VALUE ADDED TAX *– input tax – pre-incorporation legal expenses – regulation 111 Value Added Tax Regulations 1995 – legal costs incurred in defence of proceedings against individual who subsequently incorporated and became director of appellant company – appeal allowed*

FIRST-TIER TRIBUNAL
TAX CHAMBER

TC07305

Appeal number: TC/2018/00238

BETWEEN

KOOLMOVE LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE GUY BRANNAN
MEMBER MARYVONNE HANDS

Sitting in public at Taylor House, London EC1 on 26 June 2019

Thomas Talbot-Ponsonby, Counsel, instructed by Blake Morgan LLP for the Appellant

Elizabeth McIntyre, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. This is an appeal by Koolmove Ltd ("**the appellant**") against the denial by HMRC of amounts of input Value Added Tax ("**VAT**") claimed in respect of pre-incorporation legal services. The legal fees were incurred by Mr Derek McKee ("**Mr McKee**") in respect of a claim against him by a third party called Jumar Solutions Ltd ("**Jumar**"). The amounts in dispute are £28,876 in relation to VAT period 08/16 and £2305 in relation to period 02/17.

2. In short, HMRC contend that the legal services in question were supplied to Mr McKee in his personal capacity in respect of Jumar's action against him, all of which occurred prior to the incorporation of the appellant. The input tax in relation to those legal services was not, therefore, allowable as input tax for VAT purposes as regards the appellant.

3. The appellant's case is that Mr McKee incurred the legal costs in successfully defending his right to use intellectual property which was subsequently (and had always been intended to be) exploited by the appellant. Therefore, it was argued that the supplies of legal services were directly connected with the business to be carried on by the appellant. The input tax was, therefore, allowable under regulation 111(1) and (2) of the Value Added Tax Regulations 1995 ("**the Regulations**")

THE EVIDENCE

4. Most of the facts were not in dispute. However, Mr McKee filed a witness statement, gave oral evidence and was cross-examined. We found Mr McKee to be an entirely straightforward and honest witness.

5. In addition, Mr McCauley, an HMRC officer, filed a witness statement but was not required for cross-examination.

THE FACTS

6. The following summary of the relevant facts has largely been taken from the skeleton arguments of Mrs McIntyre, who appeared for HMRC, and of Mr Talbot-Ponsonby, who appeared for the appellant. In addition, we have drawn on the oral and written evidence given by Mr McKee and the written evidence of Mr McCauley. In addition, part of the relevant background is summarised in the judgment of Mr John Baldwin QC (sitting as a deputy Judge of the Chancery Division of the High Court) in *Jumar Solutions Limited v Derek McKee* [2016] EWHC 1361 (Ch). None of the findings of fact in the High Court were contested before us.

7. Mr McKee is a skilled software programmer.

8. He used to work for Jumar, first as an employee of a related company (in 2012) and subsequently, in 2013/2014, directly as a consultant. His assignment with Jumar ended in 2014. In fact, Mr McKee's consultancy work was performed through a service company called APSE Consulting Limited.

9. In the period that he was working for Jumar, Mr McKee developed software ("**the McKee software**") in his spare time. The development of the McKee software was outside the scope of his responsibilities with Jumar and we accept Mr McKee's evidence that he intended to develop the McKee software once he had left Jumar.

10. In January 2015, Mr McKee contacted a competitor of Jumar, an American firm called eCube Systems, in the hope of gaining some materials which might assist with the development of the McKee software.

11. Jumar came to believe (wrongly, as it transpired) that Mr McKee was seeking to develop a product that infringed Jumar's copyright and confidential information that Mr McKee had acquired while working for Jumar.

12. Jumar then issued proceedings against Mr McKee for infringement of copyright, breach of confidence and breach of contract, seeking damages and an injunction.

13. Mr McKee defended these proceedings and instructed solicitors, Russell-Cooke LLP ("**Russell-Cooke**") who, in turn, instructed counsel. The engagement letter, dated 20 November 2014, was between Mr McKee and Russell-Cooke. It made no mention of the appellant, which was hardly surprising because the appellant had not been incorporated at that time.

14. We accept Mr McKee's evidence that he defended the proceedings because, if he had not done so, he would not have been able to develop a business from the McKee software, which had always been his intention. Mr McKee said, and we accept, that if he had not intended to commercialise the McKee software in the future he was simply have conceded the proceedings. As we have noted, Jumar sought not only damages but also injunctive relief, which would have prevented Mr McKee from using the McKee software. It was clear from the hostile pre-trial correspondence that Jumar was seeking to prevent Mr McKee from attempting to exploit commercially the McKee software (see, for example, the High Court judgment at [75]).

15. Furthermore, prior to the hearing in February 2015, Jumar applied to the High Court for interim injunctive relief. Mr McKee, as part of those interim proceedings Mr McKee gave an undertaking to the Court:

> "a. Not sell, license, offer for sale, dispose of, offer to dispose of, reproduce, issue copies to the public, advertise, use or disclose in whole or in part to 3rd parties the McKee Software …."

16. Mr McKee was successful in defending Jumar's action against him. The High Court dismissed Jumar's claim in a judgment running to some 27 pages delivered on 14 June 2016, after a hearing on 14, 15, 18, 19, 20, 21, 22 April 2016.

17. Shortly after the judgment, on 8 July 2016, Mr McKee incorporated the appellant. We accept Mr McKee's evidence that he incorporated the appellant as a vehicle through which to develop the McKee software as a business. We also accept that Mr McKee did not incur the expense of incorporating the appellant until the Jumar litigation was completed, in case he was unsuccessful. However, once the litigation was complete and the outcome had been successful, Mr McKee incorporated the appellant as soon as he could so that he could exploit the McKee software through the appellant. We further accept Mr McKee's evidence that transferring the McKee software to the appellant prior to the successful outcome of the Jumar litigation may have caused difficulties as regards the undertakings given to the High Court referred to above.

18. We further accept Mr McKee's evidence that had he not defended the Jumar litigation then the appellant would not exist because he would not have been able to retain his rights in the McKee software.

19. Mr McKee is the sole director of and shareholder in the appellant.

20. Mr McKee incurred substantial legal costs in defending the Jumar litigation and was invoiced by Russell-Cooke (the invoices included, as disbursements, counsel's fees). We have reviewed the invoices in question and they clearly relate to the Jumar litigation. The invoices are as follows:

Invoice number	Date	Invoice total £	VAT
316999	22/2/2016	7,147.20	1,191.00
317445	29/2/2016	11,934.00	1,989.00
318008	11/3/2016	3,278.00	546.40
319367	8/4/2016	30,401.00	5,041.00
319480	12/4/2016	8,937.60	1,489.60
319657	18/4/2016	49,485.55	8,247.59
320279	28/4/2016	12,000.00	2,400.00
320889	12/5/2016	47,827.56	7,971.26
331517	5/1/2017	8,232.74	1,372.12
331518	5/1/2017	522.00	87.00
331519	5/1/2017	5,076.00	846.00

21. It will be noted that all the VAT invoices except the last three fall within the period of six months prior to the appellant's effective date of registration (i.e. 1 August 2016). It was clear from the narrative on the invoices (and from the supporting disbursements invoices) that the services concerned were mainly (see below at paragraph 60) supplied in the six months prior to the appellant's effective date of registration.

22. We accept that Mr McKee expects to be reimbursed by the appellant and note that the sums in question are shown in the appellant's accounts, for the period 8 July 2016 to 31 July 2017, as loans in respect of "Director's loan account".

23. Mr McKee told us that the McKee software had not yet been transferred to the appellant, but it was clear that Mr McKee intended to exploit the software through the appellant and that, by implication, the appellant (of whom Mr McKee was the sole shareholder and director) had the right to use the McKee software. Although the appellant had not yet made supplies Mr McKee indicated his intention that the appellant should make supplies in the next year. Mr McKee noted that there was a considerable amount of work already done, including due diligence, case studies etc in order to test whether the McKee software actually worked. Mr McKee also confirmed that he would transfer the software to the appellant before making supplies. We accept Mr McKee's evidence.

24. The appellant applied to be registered for VAT on 26 July 2016. On 5 August 2016, HMRC wrote to the appellant advising that the company had been registered for VAT with effect from 1 August 2016. Mr McKee was not himself registered for VAT.

25. On 27 April 2017, HMRC received VAT returns for the periods 08/16 (1 August 2016 to 31 August 2016) and 02/17 (1 September 2016 to 28 February 2017) showing amounts of VAT input tax as being due to the appellant (in the amounts respectively of £28,876.05 and £2,305.12). There was no dispute that these amounts related to the legal costs of defending the Jumar proceedings. Indeed, in May 2017 the appellant provided HMRC with copies of the Russell-Cooke invoices and a link to the High Court judgment.

26. Following an inspection in May 2017, Mr McCauley wrote to the appellant on 24 May 2017 stating that he was disallowing the input tax in respect of the Russell-Cooke invoices and that the VAT return for the period 08/16 would be amended to show that no tax was due either to or from the appellant. The letter also advised the appellant of HMRC's intention to raise an assessment in the amount of £2,305.12 in respect of VAT return 02/17 to recover the amounts claimed in respect of legal fees.

27. In his witness statement, Mr McCauley gave his reasons for disallowing the appellant's input tax claim. He stated as follows:

> "[The appellant] was not incorporated at the time that the legal proceedings were instigated between [Jumar] and Mr McKee. The engagement letter between Mr McKee and his solicitors do not mention the company, therefore the legal costs were provided to Mr McKee in his personal capacity as the company did not exist at the time of the litigation. The trader's agent has argued that input tax can be claimed by the company on the basis of [regulation 111] as pre-incorporation services. There has been no evidence provided of a direct and immediate link between the legal costs incurred by Mr McKee in a personal capacity and the taxable activities of [the appellant]."

28. On 22 June 2017, Sevan Associates, the appellant's new representatives, sent email to Mr McCauley seeking to appeal HMRC's decision.

29. Sevan Associates then provided HMRC with the relevant documentation.

30. Sevan Associates requested a review of HMRC's decision and on 10 November 2017 HMRC wrote to the appellant advising that the conclusion of the review was that the decision to refuse the amounts of input tax claimed in respect of legal fees was upheld.

31. The review letter stated as follows:

> "Having reviewed the relevant legislation, published guidance and also previous cases in this field I have deliberated for some time over this issue and note your agents' comments that without success in the court case [the appellant] would have been unable to utilise the 'McKee Software'. I feel however that this is one step removed from demonstrating a direct and immediate link between the court case and the supplies of the subsequently formed company known as [the appellant] given the company was not in existence at the time the expenses were incurred. It may well have proven to be beneficial for the company that the court case was successfully litigated however I am less certain that it can be said that there was a real connection or 'Nexus' with the supplies of [the appellant] when the costs were actually incurred.
>
> Having examined the facts before me, I have no evidence of a clear and stated intention to incorporate [the appellant] and utilise the McKee software in the course of its taxable supplies at the time the court action was raised. Nor that this was the stated purpose of defending the action. Taking all of the above factors into account I do not therefore feel I have sufficient information or evidence which would justify me overturning the HMRC decision in this case."

32. On 4 December 2017 a notice of appeal was lodged with this Tribunal.

THE RELEVANT LEGISLATION

33. The relevant legislation is as follows.

34. It was not disputed that input VAT, incurred on supplies to a business, can be reclaimed if it is attributable to taxable supplies made by that business (Value Added Tax Act 1994 ("VATA") sections 24-26).

35. In accordance with those provisions VAT incurred in respect of supplies of services can only be recovered by the person to whom the services are supplied.

36. However, regulation 111 of the Regulations provides for input VAT to be reclaimed in certain "exceptional" circumstances. We set out below regulation 111 in full to provide the statutory context, but note that the provisions most relevant in the present case are contained in regulation 111 (1)(b) and (2)(d). Regulation 111 provides as follows:

> "**Exceptional claims for VAT relief**
>
> 111
>
> (1) Subject to paragraphs (2) and (4) below, on a claim made in accordance with paragraph (3) below, the Commissioners may authorise a taxable person to treat as if it were input tax—
>
> (a) VAT on the supply of goods or services to the taxable person before the date with effect from which he was, or was required to be, registered, or paid by him on the importation or acquisition of goods before that date, for the purpose of a business which either was carried on or was to be carried on by him at the time of such supply or payment, and
>
> (b) in the case of a body corporate, VAT on goods obtained for it before its incorporation, or on the supply of services before that time for its benefit or in connection with its incorporation, provided that the person to whom the supply was made or who paid VAT on the importation or acquisition—
>
> (i) became a member, officer or employee of the body and was reimbursed, or has received an undertaking to be reimbursed, by the body for the whole amount of the price paid for the goods or services,
>
> (ii) was not at the time of the importation, acquisition or supply a taxable person, and
>
> (iii) imported, acquired or was supplied with the goods, or received the services, for the purpose of a business to be carried on by the body and has not used them for any purpose other than such a business.
>
> (2) No VAT may be treated as if it were input tax under paragraph (1) above—
>
> (a) in respect of—
>
> (i) goods or services which had been supplied, or
>
> (ii) save as the Commissioners may otherwise allow, goods which had been consumed,
>
> by the relevant person before the date with effect from which the taxable person was, or was required to be, registered;
>
> (b) subject to paragraph (2A), (2C) and (2D) below, in respect of goods which had been supplied to, or imported or acquired by, the relevant person more than [4 years] before the date with effect from which the taxable person was, or was required to be, registered;
>
> (c) in respect of services performed upon goods to which sub-paragraph (a) or (b) above applies; . . .
>
> (d) in respect of services which had been supplied to the relevant person more than 6 months before the date with effect from which the taxable person was, or was required to be, registered or
>
> (e) in respect of capital items of a description falling within regulation 113.

(2A) Paragraph (2)(b) above does not apply where—

(a) the taxable person was registered before 1st May 1997; and

(b) he did not make any returns before that date.

(2B) In paragraph (2) above references to the relevant person are references to—

(a) the taxable person; or

(b) in the case of paragraph (1)(b) above, the person to whom the supply had been made, or who had imported or acquired the goods, as the case may be.

(2C) Where the relevant person was, or was required to be, registered on or before 1st April 2009, no VAT may be treated as if it were input tax under paragraph (1) above in respect of goods which were supplied to, or imported or acquired by the relevant person more than 3 years before the date with effect from which that person was, or was required to be, registered.

(2D) Where the relevant person was or was required to be registered on or before 31st March 2010 and paragraph (2C) above does not apply, no VAT may be treated as if it were input tax under paragraph (1) above in respect of goods which were supplied to, or imported or acquired by, the relevant person on or before 31st March 2006.

(3) Subject to paragraphs (3A) and (3B) below,] a claim under paragraph (1) above shall, save as the Commissioners may otherwise allow, be made on the first return the taxable person is required to make and, as the Commissioners may require, be supported by invoices and other evidence.

(3A) Where the taxable person was registered before 1st May 1997 and has not made any returns before that date paragraph (3) above shall have effect as if for the words "the first return the taxable person is required to make" there were substituted the words "the first return the taxable person makes".

(3B) Subject to paragraph (3C)] the Commissioners shall not allow a person to make any claim under paragraph (3) above in terms such that the VAT concerned would fall to be claimed as if it were input tax more than 4 years after the date by which the first return he is required to make is required to be made.

(3C) The Commissioners shall not allow a person to make any claim under paragraph (3) above in the circumstances where the first return the taxable person was required to make was required to be made on or before 31st March 2006.

(4) A taxable person making a claim under paragraph (1) above shall compile and preserve for such period as the Commissioners may require—

(a) in respect of goods, a stock account showing separately quantities purchased, quantities used in the making of other goods, date of purchase and date and manner of subsequent disposals of both such quantities, and

(b) in respect of services, a list showing their description, date of purchase and date of disposal, if any.

(5) Subject to paragraph (6) below, if a person who has been, but is no longer, a taxable person makes a claim in such manner and supported by such evidence as the Commissioners may require, they may pay to him the amount

> of any VAT on the supply of services to him after the date with effect from which he ceased to be, or to be required to be, registered and which was attributable to any taxable supply made by him in the course or furtherance of any business carried on by him when he was, or was required to be, registered.
>
> (6) Subject to paragraph (7) and (8) below, no claim under paragraph (5) above may be made more than 4 years after the date on which the supply of services was made.
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> (7) Paragraph (6) above does not apply where—
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> (a) the person ceased to be, or ceased to be required to be, registered before 1st May 1997; and
>
> (b) the supply was made before that date.
>
> (8) No claim may be made under paragraph (5) above in relation to a supply of services which was made on or before 31st March 2006.

37. In summary, therefore, as far as relevant present purposes, input tax can be claimed by a company in respect of supplies of services made prior to its date of incorporation for its benefit provided:

(1) the supplies were made for its benefit

(2) the supplies were made to a person who became a member or officer of the company;

(3) he or she was not, at the time, a taxable person;

(4) he or she has been reimbursed for the whole of the price paid (or the company has undertaken to do so);

(5) the supply was made for the purposes of the business to be carried on by the company and for its benefit or in connection with its incorporation;

(6) the supply was made within the six months before the effective date of registration.

(Regulation 111(1)(b) and 111(2)(d) the Regulations).

38. It was common ground that jurisdiction to hear the appeal was provided by section 83 VATA.

SUBMISSIONS

39. Mrs McIntyre, for HMRC, noted that there was no evidence that the McKee software was owned by the appellant but rather by Mr McKee. Secondly, the contract with Russell-Cooke for the provision of legal services had been between that firm and Mr McKee, not with the appellant. Therefore, in Mrs McIntyre's submission, the legal fees incurred had been for the benefit of Mr McKee and not for the appellant. Furthermore, the appellant had not yet made any taxable supplies, although we did not understand Mrs McIntyre to be submitting that the appellant was not carrying on a business. Therefore, Mrs McIntyre submitted that the appeal should be dismissed.

40. Mr Talbot-Ponsonby, for the appellant, submitted that although regulation 111(1) stated that HMRC "may" authorise an amount to be treated as input tax, HMRC would need to have a good reason to disallow input tax if the conditions in regulation 111(1) were met. HMRC had a discretion but the regulations set out the circumstances in which it was to be exercised. In

any event, as Mr Talbot-Ponsonby correctly observed, HMRC's submissions were to the effect that the conditions had not been met.

41. Mr Talbot-Ponsonby referred to the decisions in *Customs & Excise v Rosner* [1994] STC 228, *Oldfield v Customs & Excise* (VAT Tribunal decision 12233) and *Finanzamt K'ln- Nord v Becker* (CJEU C-104.12). He submitted this in all these cases the services supplied were personal to the recipient. In addition, Mr Talbot-Ponsonby referred to the decision in *Morgan Automation v Customs & Excise* (VAT Tribunal 5539). In that case, a director sought to escape from a restrictive covenant, and the Tribunal held that, because the supply was made to the director and not the company, the input tax could not be recovered. However, that decision predated the introduction of regulation 111.

42. In the present case, Mr McKee always intended to set up a company to exploit or commercialise the McKee software.

43. Mr Talbot-Ponsonby also referred to the decision of the Court of Appeal in *Praesto Consulting UK Ltd v HMRC* [2019] STC 724. Praesto had been established by its sole director (R). Proceedings had been issued by R's former employers, claiming that he had been in breach of fiduciary duties in setting up Paesto. Praesto had not been joined to those proceedings, however the former employer had indicated that, if the claim succeeded against R, it was likely that Praesto would be joined as a party in relation to the part of the claim that related to an account of profits. R had instructed solicitors to act in the defence of the action. The action was unsuccessful. Praesto claimed that it had been entitled to credit for VAT input tax charged by the solicitors. The claim was refused HMRC and Praesto appealed that decision to the FTT. The FTT made a number of findings of fact, upon which it held that all the work carried out by the solicitors had been on behalf of R and Praesto, and that Praesto had had a direct interest in the claim being dismissed because otherwise there had been a real risk that it would have had to account for the profits it had made. Accordingly, the FTT upheld the challenge. The Upper Tribunal (Tax and Chancery Chamber) (the UT) held that the FTT had erred by failing to make findings as to whether Praesto had been contractually entitled to the legal services provided by the solicitors and that the services supplied by the solicitors to Praesto had not been used for the purposes of its business. Praesto appealed.

44. The Court of Appeal held that the FTT had been entitled to reach the conclusion that it did. As Mr Talbot-Ponsonby noted, in that case the company, Praesto, already existed in this decision did not involve the interpretation or application of regulation 111.

45. Mr Talbot-Ponsonby argued that the undertakings given in the context of Jumar's application for an interim injunction prevented Mr McKee establishing and transferring (or licensing) the McKee software to the appellant. It would have been possible for Mr McKee to incorporate the appellant and left it dormant, but this would have been a waste of time if he had lost the Jumar action. Instead, the appellant had been incorporated as soon as reasonably practicable after the Jumar action was settled in Mr McKee's favour Mr McKee had given evidence of his intention to commercialise the McKee software through the appellant.

46. Furthermore, Mr Talbot-Ponsonby distinguished the decision of the VAT and Duties Tribunal (Mr Howard Nowlan) In *Oaks Pavilion Limited v HMRC* (TC00145) ("*Oaks Pavilion*"). This was a case where the expenditure had been incurred in the services supplied before the individual who formed the company decided that the company would conduct the development business. Therefore, the expenditure was not incurred "for the company". Nonetheless, it was clear from this decision that once a definite intention to incorporate had

been formed expenditure could be incurred and services received "for" the benefit of the company.

47. By contrast, in the present case, Mr Talbot-Ponsonby argued that Mr McKee's clear evidence was that he always intended to incorporate the appellant and would have done so in February 2016 but for the Jumar proceedings – Mr McKee's evidence on this point had not been challenged in cross-examination. Mr McKee then incorporated the appellant as soon as he could.

48. The Jumar litigation, if Mr McKee had been unsuccessful, would have stopped the appellant from carrying on business. There was, therefore, a direct and immediate link between the services supplied and the business to be carried on by the appellant.

DISCUSSION

49. We have come to the clear conclusion that the appellant is entitled for the VAT respect of the services rendered by Russell-Cooke to be treated as input tax under regulation 111.

50. In the first place, it is necessary for the appellant to show that there was a direct and immediate link between the services supplied by Russell-Cooke and the business to be carried on by the appellant.[1]

51. In *Oaks Pavilion* the VAT and Duties Tribunal summarised the provisions of regulation 111 as follows:

> "21. In the case addressed by Regulation 111(1)(a), where it is the taxable person who is later registered that is claiming an input deduction for earlier expenditure, that person first has to demonstrate that the acquisition of goods or services was for the **purpose of a business which either was or was to be carried on by him at the time of supply or payment.** There are then two very obvious exceptions. If some of the goods bought as mentioned have already been sold or supplied prior to the person being registered, or being required to be registered (so that the onwards supply has occasioned no liability to VAT) then obviously an input deduction cannot later be claimed because the input VAT would have nothing to do with the later taxable supplies. Similarly with consumables, if petrol, gas, electricity or other consumables have been supplied in the period prior to registration, then broadly the same rule applies. Since consumables that have been consumed will self-evidently not be the subject of an onwards supply either before or after the date of registration, the deductibility of the input tax will depend on the facts. If the cost of the consumables all related to activity and supplies made prior to registration, then logically the input deduction should be denied. If however the consumables related for instance to factory manufacturing costs, and no stock had been supplied at all by the point of registration, the cost of the consumables would obviously be a cost referable to later supplies that would only be made once the factory started to sell its products, all in taxable transactions for VAT purposes. Thus, as the paragraph indicates, it would then be appropriate for an input deduction to be allowed for the earlier consumables.

[1] See, for example, *Finanzamt K'ln- Nord v Becker* (CJEU C-104.12). In that case Mr Becker was prosecuted for criminal behaviour arising out of the activities of his company. The CJEU found that there was no direct and immediate link between the services supplied to Mr Becker and the supplies made by his company: "In this case, the supplies of lawyers' services, whose purpose is to avoid criminal penalties against natural persons, managing directors of a taxable undertaking, do not give that undertaking the right to deduct as input tax the VAT due on the services supplied."

> 22. Where expenditure is incurred for a company, prior to its incorporation, the contention on behalf of HMRC that both paragraphs 111(1)(a) and (b) have to be satisfied cannot be right. Satisfying sub-paragraph (1)(a) would in all cases of "pre-incorporation" expenditure be impossible, so the contention on behalf of the Respondents would lead to a complete absurdity. Furthermore Regulation 111(1)(b) itself contains all the relevant requirements.
>
> 23. Where expenditure is incurred by another person prior to the incorporation of a company, the company can claim an input deduction for the expenditure if:
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> - the expenditure was incurred "for the company"[2];
> - on or after incorporation the company reimburses or undertakes to reimburse the person who incurred the expenditure for those costs;
> - the person who originally incurred the expenditure became a member, officer or employee of the company, and had not ranked himself as a "taxable person" when he incurred the expenditure; and
> - the person who incurred the expenditure incurred it for the purpose of a business to be carried on by the company, and has not used the acquired goods or services for any purpose other than the intended business of the company.
>
> 24. The most material of those requirements, at least in the context of this case is the one that I have listed first in paragraph 23. It is not remotely sufficient that an individual incurs costs, and then later decides to form a company. The situation contemplated by this Regulation is that one of the people likely to be involved with the formation of a company incurs the costs on the basis that it is incurring costs "for the company" which is about to be incorporated. It is not sufficient for an individual to be incurring building costs with a view to selling a house or to letting it, and then later to form the intention to put the property development role into a company."

52. We respectfully agree with and adopt the Tribunal's analysis.

53. We find that Mr McKee always intended to exploit the McKee software through a limited company and that he incorporated the appellant as soon as reasonably practicable after the Jumar litigation was concluded in his favour. We accept Mr McKee's evidence that there was no point in incorporating the appellant before Jumar's claim had been defeated. We further accept that unless the Jumar claim was defeated by Mr McKee it would have been impossible for the appellant to carry on the business of exploiting the software. The purpose of Jumar's claim was to prevent the McKee software being exploited commercially. If that litigation had been successful neither Mr McKee nor the appellant would have been able to commercialise the McKee software.

54. We must confess we have found HMRC's case somewhat confused. HMRC's Statement of Case states:

> "37. HMRC consider the VAT incurred on supplies of services can only be recovered by the entity to whom it is supplied when it is used to be used for the purposes of making taxable supplies….

[2] We note the exact statutory expression is "for its [i.e. the company's] benefit"(regulation 111(1)(b)) but the Tribunal's meaning is clear.

> 39. HMRC consider that it is for the appellant to demonstrate that the supply of services was made to the limited company for the purposes of making taxable supplies.
>
> 40. HMRC consider that the supply of services was made to Mr McKee as an individual not to the limited company.
>
> 41. HMRC consider that the letter of engagement supplied to HMRC support [sic] HMRC's position that the supply of services was made to Mr McKee.
>
> 42. HMRC consider that there is no direct and immediate link between the amounts expended on legal services, instructed by Mr McKee and the taxable supplies of the limited company."

55. Uppermost in HMRC's mind appears to be the fact that the supplies of Russell-Cooke's services were made to Mr McKee and not the appellant. Indeed they were. HMRC, however, appear to have lost sight of the fact that the whole point of regulation 111 (2) is to allow VAT on services supplied, in broad terms, to the incorporator prior to the incorporation of (but for the benefit of) the limited company and for the purposes of the business *to be* carried on by it to be allowed as input tax. Certainly, the relevant conditions have to be satisfied but in this case we have come to the conclusion that they are indeed satisfied.

56. First, we are satisfied that the supply of Russell-Cooke's services was for the benefit of the appellant. It was always Mr McKee's intention to incorporate the appellant in order for the McKee software to be exploited. The wisdom of using a limited liability company to exploit the McKee software would, in any event, have been self-evident in the light of Mr McKee's experiences at the hands of Jumar and in an industry sector where, as we take notice, claims for breach of copyright etc are commonplace.

57. Secondly, we are satisfied that the appellant has undertaken to reimburse Mr McKee – the legal fees incurred by Mr McKee are shown as a director's loan in the appellant's accounts.

58. Thirdly, Mr McKee was not registered for VAT.

59. Fourthly, Mr McKee incurred the expenditure on Russell-Cooke's services for the purpose of a business to be carried on by the appellant. As we have already concluded, Mr McKee always intended that the McKee software should be exploited through a company owned by him. Unless he successfully defended the Jumar litigation, there would have been no business for the appellant to carry on. There was no evidence that Russell-Cooke's services had been used for any purpose other than the intended business of the company.

60. As regards the six-month rule contained in regulation 111(2)(d), we are satisfied that, with one exception, all the services were provided prior to the effective date of registration (1 August 2016) and also before the date of incorporation of the appellant and within the requisite six months. Therefore, in accordance with the normal rules (VAT Notice 700) in relation to the basic tax point in respect of the supply of services of solicitors, those services were supplied within the six-month period prior to the effective date of registration of the appellant. The one exception related to the disbursements invoice from Russell-Cooke in respect of Mr McKee's barrister (which was included on invoice number 00331518 dated 05/01/2017). This indicated that some of the services were supplied after the date of incorporation of the appellant and indeed some appear to have been supplied after the effective date of registration. Accordingly, these amounts are not eligible for credit as input tax under regulation 111. The copy of the invoice with which we were supplied was not, however, fully legible and we leave it to the

parties to apportion the qualifying input tax accordingly. The amount of VAT concerned is relatively small, but the parties have permission to reapply to this Tribunal for further guidance on this point in default of agreement.

CONCLUSION

61. For the reasons given above, we allow this appeal, save to the extent indicated in paragraph 60 above in relation to invoice number 00331518.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

62. 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.

GUY BRANNAN
TRIBUNAL JUDGE

Release date: 02 August 2019