TC02718

Appeal number: TC/2010/1721

VALUE ADDED TAX – claims for unrecovered input tax following* Fleming *case – input tax incurred on fees comprising costs on the issue of shares – whether Appellant able to prove that input tax had not been recovered when fees incurred – no – input tax incurred in respect of staff entertainment expenses – whether Appellant able to prove that input tax had not been recovered when expenses incurred – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

KDM INTERNATIONAL LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE EDWARD SADLER
MRS GILL HUNTER

Sitting in public at Bedford Square on 14 February 2013

David Southern, counsel, instructed by Grant Thornton UK LLP, for the Appellant

Nicola Shaw QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. KDM International Limited ("the Appellant") made two retrospective claims on 23 March 2009 to recover from The Commissioners for Her Majesty's Revenue and Customs ("the Commissioners") certain amounts of value added tax which it claimed were allowable input tax on services supplied to it and for which it had received no credit against its output tax. In both cases, according to the Appellant, it had not credited the input tax in question because at the time it was incurred the understanding of both the Appellant and the Commissioners was that there was no entitlement to such a credit. Subsequent case law showed that understanding to be incorrect.

2. The Appellant's claims relate to amounts of input tax brought into account for accounting periods ending before 4 December 1996 and were made, in due time, within the window allowed by section 121, Finance Act 2008 for uncapped retrospective claims following the decision in *HMRC v Michael Fleming (t/a Bodycraft)* [2008] UKHL 2, [2008] STC 324.

3. The first of the Appellant's claims concerns input tax of £63,784 incurred in the years 1987 to 1990 and 1996 on fees and charges for supplies made to the Appellant in relation to shares issued in those years by the Appellant. (In the course of the hearing the Appellant agreed that the amount of the claim should be reduced to recognise that certain charges for supplies identified as subject to VAT were not in fact subject to VAT.) At the time it paid the input tax in question the general understanding of the law was that the issue of shares was an exempt supply; that the input tax incurred in making such a supply was directly attributable to that exempt supply; and that in consequence there was no right to recover such input tax.

4. The Court of Justice decision in the case of *Kretztechnik AG v Finanzamt Linz* (Case C-456/03) [2005] STC 1118 showed that that understanding was incorrect, since an issue of shares was held not to be a supply for VAT purposes. In the Appellant's circumstances (most, if not all, the supplies it makes in the course of its business are taxable supplies) the consequence is that the input tax incurred on supplies related to the share issues is allowed in full as a credit, as with input tax on other supplies treated as overhead costs of the business.

5. The second of the Appellant's claims concerns input tax of £1,560.30 on costs incurred between 1981 and 1996 in relation to staff entertaining at annual Christmas parties. (In the course of the hearing the claim was reduced to £656.21 as the Appellant abandoned its claim to recover input tax on such costs for the period 1981 to May 1993.) The Appellant claims it credited only 50% of such input tax, in accordance with the Commissioners' published policy at that time. The decision of the VAT and Duties Tribunal in the case of *Ernst & Young v Commissioners of Customs and Excise* [1997] VATDR 183 held that input tax on the cost of such staff entertaining is allowable in full as a credit.

6. Additionally, in its letter of 23 March 2009, the Appellant claimed simple interest on the amounts of under-recovered input tax under section 78, Value Added Tax Act 1994.

7. By its letter of 29 October 2009 the Commissioners refused all the Appellant's claims. That decision of the Commissioners was the subject of further review, but the decision was upheld. The Commissioners do not deny that if the Appellant can establish the facts of its claim then it has a right to recover the input VAT in question. However, they contend that there is evidence that the Appellant recovered the input tax as a credit at the time it was incurred and they also question the correctness of certain of the amounts claimed. On those grounds they refuse the claims.

8. The Appellant appealed to this tribunal on 5 February 2010, setting out in its grounds of appeal the basis of the two claims for the under-recovered input tax, and stating that the Commissioners have refused to accept the Appellant's evidence in support of those claims.

9. The issue we have to decide is purely one of fact to be determined from such evidence as there is about matters which occurred twenty or more years ago and the inferences which can be drawn from that evidence. The burden of proof lies on the Appellant, and we are required to determine whether, on the balance of probabilities, it can establish:

(1) that the input tax in question was not recovered when it was incurred; and (if it was not so recovered)

(2) that a reliable estimate has been made of the amount of input tax claimed as under-recovered.

10. For the reasons given below we dismiss the Appellant's appeal.

Agreed statement of facts

11. The parties agreed a statement of certain of the facts relevant to the appeal. That statement is as follows:

The Appellant

(1) The Appellant, KDM International Limited, is a specialist timber and forest products company primarily engaged in supplying a variety of market sectors, including pallet, packing, fencing, furniture, joinery, decking, shed and merchant. The Appellant also supplies a full range of manufactured garden products and timber homes. The Appellant was established and incorporated in May 1975.

(2) The Appellant has at all material times been registered for VAT under VRN 344 4823 54. The Appellant's accounting reference date is 31 December.

VAT on share issues

(3) The Appellant issued new shares in the years 1987, 1988, 1989, 1990 and 1996 as part of capital raising exercises incurring costs amounting to £475,362. During this period, the Commissioners were of the view, which was widely shared in practice, that the issue of shares was a transaction which was exempt from VAT, and accordingly could not give rise to a right to recover input tax charged on professional and other costs incurred in connection with share issues.

(4) Following the decision of the European Court of Justice in the *Kretztechnik* case, Business Briefs 12/05 and 21/05 were issued by the Commissioners. These announced a change in the understanding of the law as it applies to VAT on share issues.

(5) By voluntary disclosure of 23 March 2009, the Appellant sought recovery of the following amounts of VAT incurred in respect of share issues:

Accounting Period	Costs of issue	Amount of VAT claimed
1987	£28,655	£3,738
1988	£342,678	£44,697
1989	£6,251	£815
1990	£1,528	£199
1996	£96,250	£14,335
Total		**£63,784**

(6) By letter of 3 August 2009, the Commissioners rejected the Appellant's claim on the basis that the Appellant had not shown that the input tax had been incurred or that if it had, it had not already been deducted. This decision was upheld on a subsequent review by letter of 29 October 2009.

(7) As advised by the reviewing officer, further evidence was provided to the case officer in support of the claim in the form of invoices for the 1996 share issue costs. The Appellant has no records which specifically confirm whether the VAT associated with the share issues was or was not reclaimed at the time.

Staff entertaining claim

(8) Following the decision in the *Ernst & Young* case, the Commissioners accepted that VAT incurred on staff entertainment expenses was recoverable

without restriction, and was not blocked from recovery by the business entertainment rules: VAT Notice 700/65/02, para. 3.

(9) A claim was submitted by the Appellant on 23 March 2009 to recover input VAT under-recovered in respect of staff entertainment expenses before 1 May 1997 for £1,560.03.

(10) By letter of 3 August 2009, the Commissioners rejected the Appellant's claim on the basis that the 50% restriction on staff entertainment had only been applied where non-employees were in attendance, and the Appellant had supplied insufficient evidence of its claim. As in this case the events were for the benefit of employees only, no input tax restriction would – in the Commissioners' view – have been applied. This decision was confirmed on review by letter of 29 October 2009.

The evidence

12. We had in evidence two bundles of documents comprising email and letter correspondence between Grant Thornton UK LLP (acting on the Appellant's behalf) and the Commissioners; the VAT returns submitted by the Appellant between March 1988 and September 1997; various reports by officers of the Commissioners following their visits to the Appellant and VAT audit reports; extracts from the audited accounts and financial statements of the Appellant for the years ended 31 December 1987 to 1990 and 1996; listing particulars and prospectus for shares issues in 1988 and 1996; certain invoices from investment managers, accountant advisers, bankers and printers in connection with the share capital issue by the Appellant in 1996; an extract from the Appellant's staff entertainment general ledger and sample purchase invoices relating to staff entertainment; Statement of Standard Accounting Practice (SSAP) 5: Accounting for value added tax; and an extract from Accounting Standard FRS 4: Capital instruments.

13. One witness appeared for the Appellant, David John Spilling. Mr Spilling had prepared two witness statements, the second being in response to specific matters raised by the Commissioners in the course of preparing for the hearing. Mr Spilling is currently the chief financial officer and company secretary of the Appellant. He began employment with the Appellant in January 1984 as financial controller, and was also appointed company secretary in February 1988.

14. Mr Spilling gave oral evidence at the hearing, where he was cross-examined by Miss Shaw for the Commissioners. Mr Spilling's evidence covered the following matters: his involvement in the Appellant's capital restructuring and share issues; the share capital issues undertaken by the Appellant under the Business Expansion Scheme in 1987, 1988, 1989, and 1990; the advisers engaged by the Appellant for such share capital issues; the awareness of the Appellant and of its advisers at the time of the share capital issues that the Appellant would be unable to recover the VAT on the expenses relating to the share capital issues; the treatment of the expenses of the share capital issue, and the VAT on such expenses, in the accounts of the Appellant; the share capital issue by the Appellant in 1996 under the Enterprise Investment

Scheme and the treatment of the expenses of that issue in the cash flow statement and share premium account; the Appellant's compliance with VAT regulations and practice; the accounting software systems employed by the Appellant to record its transactions and the system for coding and posting purchase invoices and VAT charges in the Appellant's books of account; the treatment of VAT on share capital issue expenses in 2000 by a company associated with the Appellant; and the circumstances which gave rise to the Appellant having input VAT in excess of output VAT in certain of its quarterly VAT accounting periods.

15. Mr Spilling gave no evidence as to the Appellant's claim in relation to staff entertainment costs.

16. There were no witnesses for the Commissioners.

Findings of fact from the evidence – VAT on share issue expenses

17. From the documentary evidence, and the evidence of Mr Spilling, we make the following findings of fact, in addition to the facts agreed by the parties in their agreed statement, in respect of the Appellant's claim to recover VAT on the expenses of its share capital issues.

18. The Appellant's share capital issues in 1987, 1988, 1989 and 1990 were made under the Business Expansion Scheme. The 1987 issue raised £212,000, two issues in 1988 raised approximately £3.5 million, two issues in 1989 raised in aggregate £911,000 and its two issues in 1990 raised approximately £200,000.

19. In respect of each of those share issues the amount of capital raised in excess of the nominal value of the shares issued was credited to share premium account, and an amount in respect of the expenses of issue was debited to share premium account. It is not known whether the amount so debited included VAT on the invoiced expenses.

20. At the time of the 1987 share capital issue the Appellant received advice to the effect that it was not entitled to recover the VAT charged on those supplies made in respect of the share capital issue, and the investment managers, accountants, lawyers and other advisers to the Appellant involved in the share capital issue were aware this was the case.

21. In 1996 the Appellant made three further share capital issues, under the Enterprise Investment Scheme, raising in aggregate £625,777. The expenses of those issues totalled £96,250, exclusive of VAT. The amount of £96,250 is shown, as "issue expenses", as an expense or cost in the Appellant's audited cash flow statement for the year ended 31 December 1996. There is no evidence as to whether the Appellant accounted for any VAT on those expenses as a cost elsewhere in its accounts, which it would have been required to do to the extent that such VAT was irrecoverable.

22. The Appellant was consistent in its accounting treatment of share capital issue expenses in all its share issues.

23. For keeping books of account for the purpose of producing its financial statements the Appellant has used standard software systems, initially a system called "Pegasus" and from 1991 until 1999 a system called "DBFlex". Those systems were flexible and allowed users to "customise" aspects of the book-keeping, but the Appellant used the standard procedures for its VAT accounting.

24. Mr Spilling has general oversight of the maintenance of financial records by the Appellant, but there is a small team who have responsibility for entering all matters in the books of account. That team includes a person with specific responsibility for VAT entries, and she has been employed in that position since before the 1987 share capital issue.

25. The invoices rendered to the Appellant by suppliers in relation to the expenses of the 1996 share capital issues have been stamped by the Appellant's accounts department with a *pro forma* stamp on which is entered the VAT exclusive amount invoiced, a code for the account to which that amount is to be posted, the amount of VAT appearing in the invoice, and a code for the treatment or allocation of that VAT. In those cases where the VAT treatment code is visible, it is shown as "6".

26. Notwithstanding that the Appellant, in issuing shares, was making exempt supplies (that is, on the basis of the understanding and practice before the *Kretztechnik* case), it made its VAT returns on the basis of full recovery of its residual input VAT.

27. In its VAT quarterly accounting periods 03/08 and 06/08 (taken together) the total input supplies amount to £3,470,587, and the total input VAT amounts to £477,781. This total input VAT amount implies taxable input supplies totalling £3,185,206.

28. The Appellant's VAT return for 03/88 shows total output tax of £230,211 and input tax of £203,168; for 06/88 output tax of £261,207 and input tax of £272,613 (giving a repayment of VAT of £11,406); for 12/88 output tax of £321,249 and input tax of £361,637 (giving a repayment of VAT of £40,387); and for 03/89 output tax of £268,034 and input tax of £332,118 (giving a repayment of VAT of £64,084).

29. In late 1987 the Appellant moved into new office premises, and in early 1988 incurred substantial costs in fitting out and equipping those premises. Also in 1988 the Appellant acquired new warehouse premises, and office premises in Scotland, with consequent renovation, fitting out and set up costs. In 1989 the Appellant acquired a subsidiary company, and incurred professional expenses in relation to that purchase.

30. In 2000 an associated company of the Appellant, Countyweb.com PLC (previously demerged from the Appellant) issued share capital. The majority of the expenses relating to the share capital issue are coded "NOVAT", indicating that no VAT has been recovered.

31. The Appellant's claim is calculated on the following basis: it is assumed that the amounts appearing in the Appellant's accounts for expenses of each share capital

issue are inclusive of VAT; the amount of VAT at the applicable rate for each year is then calculated by the relevant VAT fraction applied to that assumed VAT-inclusive amount. This method has been applied by the Appellant to the amount of £96,250 of expenses shown in its accounts for the share capital issues in 1996, notwithstanding that such amount is net of VAT, and notwithstanding that certain of the expenses (together comprising approximately one-third of the total expenses) are not subject to VAT. For 1996 the actual amount of VAT charged on the expenses of £96,250 was £11,542.86, and not £14,335 as claimed by the Appellant. If it is assumed that, for the share capital issue expenses for each of the years 1987, 1988, 1990, and 1991, one-third of the total expenses were not subject to VAT, the total VAT for which the Appellant could make a claim is reduced from £63,784 to £44,994.

32. SSAP 5 sets out the standard accounting practice for the treatment of VAT in financial statements. So far as relevant to this appeal SSAP 5 provides as follows:

> As a general principle ... the treatment of VAT in the accounts of a trader should reflect his role as a collector of the tax and VAT should not be included in income or in expenditure whether of a capital or of a revenue nature. There will however be circumstances, as noted below, in which a trader will himself bear VAT and in such circumstances the accounting treatment should reflect that fact.
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> ...
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> In the case of persons who also carry on exempted activities there will be a residue of VAT, which will fall directly on the trader and which will normally be arrived at by division of his activities as between taxable outputs (including zero-rated) and those which are exempt. In such cases, the principle that such VAT will increase the costs to which it applies and should be included in such costs will be equally applicable. Hence the appropriate portion of the VAT allocable to fixed assets should, if irrecoverable, be added to the cost of the fixed assets concerned ... .
>
> All traders will bear tax in so far as it relates to non-deductible inputs .... Such tax should therefore be included as part of the cost of those items.
>
> ...
>
> Irrecoverable VAT allocable to fixed assets and to other items disclosed separately in published accounts should be included in their cost where practicable and material.

33. FRS 4 is the accounting standard relating to capital instruments (which include shares). It defines "issue costs" as "the costs that are incurred directly in connection with the issue of a capital instrument, that is, those costs that would not have been incurred had the specific instrument in question not been issued". FRS 4 provides:

> The FRS requires issue costs, as defined, to be accounted for as a reduction in the proceeds of a capital instrument. Such costs are not assets as defined in the Board's draft Statement of Principles because they do not provide access to any future economic benefits.

Findings of fact from the evidence – VAT on staff entertaining

34. The Appellant's claim, until the hearing, was for the VAT on 50% of the estimated costs of staff entertainment provided by the Appellant for the period from 1981 to 1996 inclusive, amounting to £1,560.30.

35. The Appellant was unable to provide any documentary or accounting evidence to substantiate its claim that it had not recovered that amount of VAT or as to the quantum of the VAT paid in respect of supplies for entertainment of its staff.

36. The Appellant held a Christmas party for staff in each of the years 2000 to 2007. The methodology applied by the Appellant to formulate its claim was to take the actual costs (exclusive of VAT) of providing that Christmas party each year in the period 2000 to 2007, and divide the annual figure by the number of employees for that year, to give an amount spent per employee for each year, and then averaging that annual amount over the eight years to give an average amount spent per employee per year. That annual average amount spent per employee was then extrapolated back to each year in the period 1981 to 1996 by reference to the number of employees in the year in question, and applying a Retail Prices Index calculation to take account of the effects of inflation. That gave for each year an amount of expenditure, to which was applied the relevant rate of VAT for that year, and it was assumed the Appellant had recovered 50% of the VAT assumed to be paid in that year.

37. In VAT Leaflet 700/55/93 dated 1 July 1993 the Commissioners announced their policy, introduced in connection with the enactment of what was then section 40(3ZA) of the Value Added Tax Act 1983, of applying a "basic rule of thumb to treat 50% of the VAT incurred on [the entertainment of directors and employees] as input tax". The basis of this policy was that staff entertainment costs included an element of business entertainment. The Commissioners applied that policy from 1993 until 1997.

38. In November 1997 the Commissioners issued Business Brief 25/97 entitled "Staff and Business Entertainment", referring to the then recent decision of the VAT and Duties Tribunal in the case of *Ernst & Young*. It states: "Customs & Excise now accepts that where a business provides entertainment to its employees in order to maintain and improve staff relations it does so for wholly business purposes and any VAT incurred is input tax and recoverable, subject to the normal rules."

The parties' submissions – VAT on share issue expenses

39. For the Appellant Mr Southern pointed out that it is accepted in principle that the Appellant can make a claim to recover input tax charged on the supplies made to it in relation to the issues of share capital provided it can establish, as a matter of fact, and on the balance of probabilities, that the VAT claimed was paid and has not been recovered. The Appellant has to show that this is the case from, and by inference from, the evidence.

40. The essence of the Appellant's case is that its consistent understanding of the law at the time the VAT in question was charged to it, and the understanding of its

advisers at that time, was that the VAT was not recoverable. That understanding accorded with standard practice, and the practice of the Commissioners, at the relevant time. It is a reasonable inference that it was more probable than not that the Appellant, in all respects a company which complied with its VAT obligations, did not seek to recover VAT which it was advised at the time was not recoverable.

41. Mr Southern relied on the evidence of Mr Spilling, who was involved in all the share issues, and who during that period had oversight of the keeping of the books of account of the Appellant. The tenor of that evidence is that the Appellant believed, upon advice, that it could not recover the input VAT, and that it would have followed that advice by not seeking to recover it. It is highly improbable, as the Commissioners' case would have it, that the Appellant in some way inadvertently and unknowingly recovered the VAT. Its book-keeping methods were to a high standard using established software systems, and it was audited by leading firms of accountants over the relevant period.

42. It is also a reasonable inference, the Appellant submitted, that the Appellant complied with SSAP 5, debiting share premium account with the amount of irrecoverable VAT as an expense of issuing the shares. It should therefore be assumed that in the case of the share capital issues in 1987, 1988, 1989, 1990, and 1991 the figures shown as such expense in the share premium accounts in those years are the VAT-inclusive amounts. The Appellant's claim has been made on that basis.

43. The Appellant accepts, however, that the corresponding amount appearing in the Appellant's cash flow statement in its 1996 accounts is the amount of expenses of the share capital issues in that year exclusive of VAT. The tribunal should not infer from that that the VAT in question was regarded by the Appellant in that year as recoverable – the Appellant may have charged the irrecoverable VAT as an expense of administration in its profit and loss account, which would not have infringed SSAP 5.

44. In support of the Appellant's case it should be noted that the invoices for the 1996 expenses were stamped with an "06" code in respect of the VAT charged in those invoices, which Mr Spilling recalled as a coding to indicate abnormal or special treatment. The Appellant also referred to the share capital issue expenses incurred by Countyweb.com PLC, where it is clear from the "NOVAT" posting of such expenses in its books of account that the input VAT in respect of such expenses was not recovered.

45. The Appellant now accepted that the methodology of its claim required adjustment to allow for the fact that a portion of the expenses were exempt from VAT, and if the proportion of taxable inputs in the case of the 1996 expenses (68.5%) is applied to all the earlier issues the total claim is reduced to £44,994. The Appellant accepted that its claim should be reduced in this manner. That adjustment to the quantum of the claim should not in any way impugn the principle that the Appellant has a right to recover the VAT which it mistakenly treated as irrecoverable.

46. For the Commissioners Miss Shaw pointed out that although in "Fleming" cases the tribunal was usually required to look back to distant events where documentary evidence may be sparse (and that is the case in relation to the Appellant's claims), it is nevertheless the case that the taxpayer making a claim in such circumstances has to establish that claim on the balance of probabilities in the normal way: as expressed in the case of *Guide Dogs for the Blind Association v HMRC* [2012] UKFTT 687 (TC) the passage of time does not reduce the burden on the taxpayer of proving its case.

47. Miss Shaw encouraged us to view Mr Spilling's evidence in the light of such documentary evidence as the Appellant has provided. His evidence speaks largely to his recollection of certain matters, but to the extent it is inconsistent with the contemporary documentary evidence, Mr Spilling's evidence, though no doubt truthfully and honestly given, is of little assistance to the tribunal.

48. The only documentary evidence of substance relates to the expenses of the share capital issues in 1996, and their treatment in the books of account of the Appellant. There the expenses are shown net of the VAT charged. If the Appellant had treated the VAT as irrecoverable that VAT also should have been treated as an expense of the share capital issue, in accordance with SSAP 5. There is no evidence that it was charged as an expense to the profit and loss account which in any event the Commissioners would regard as not in compliance with SSAP 5. The invoices for the supplies in question show that the VAT was coded for some purpose, but there was no clear evidence (and certainly no evidence from the person in Mr Spilling's team who dealt with VAT matters) as to what that signified. There is a serious question, therefore, as to the way in which the Appellant dealt with the VAT charged on the expenses – such evidence as there is suggests that it was accounted for on the basis that it was recoverable.

49. In view of Mr Spilling's evidence that there were no material differences in the treatment of all the share capital issues and the expenses of making those issues, it is reasonable to assume that the accounting for VAT proceeded on the same basis, that is, the amount debited to share premium account in respect of issue expenses excluded VAT on the grounds that the VAT would be recovered.

50. The Appellant at no time accounted for VAT as a partially exempt trader (partially restricting its recovery of residual input tax), notwithstanding that (in the pre-*Kretztechnik* era) an issue of shares was treated as an exempt supply, and in some years (1988 and 1989 in particular) the supply comprised by share issues was very significant relative to its taxable supplies. This indicates that the Appellant could fail to apply the proper VAT treatment when it was dealing with matters outside its normal trading activities.

51. Miss Shaw also referred to the 03/88 and 06/88 VAT returns which would reflect the expenses for the substantial share capital issues in 1988. They show that the aggregate amount of input supplies in respect of which no input tax was claimed amount to £285,380. That is less than the expenses of the share capital issues (£342,678, assuming this to be the VAT exclusive figure, as per the 1996 treatment). That is an indicator that, at the least, some of the VAT charged on those expenses was

recovered, or that the Appellant's treatment of such VAT cannot be relied upon as correct.

52. On the question of quantum, the Appellant had been compelled to accept at the hearing, when the individual invoices were examined, that its claim in relation to 1996 must be reduced to take account of those supplies where no VAT was charged, and had then conceded that its claims for the earlier years should be reduced by the corresponding proportion. That indicated the unsubstantiated nature of the Appellant's claim generally.

The parties' submissions - VAT on staff entertaining

53. Mr Southern conceded at the hearing that the Commissioners' policy restricting recovery of VAT charged on the cost of staff entertaining to 50% of such VAT was introduced only in 1993. He said that the practice in the period prior to that was not clear, but the Appellant now withdrew its claim in respect of that prior period. Accordingly its claim related to the years 1993 to 1996, and amounted to £656.21.

54. The Appellant argued, on the authority of the case of *Guide Dogs for the Blind* and the case of *Morrison Bowmore Distillers Ltd v HMRC* [2010] UKFTT (TC) that as long as the methodology is logical and based on all the relevant known facts (even if they relate to a later period), and is consistently applied, that is sufficient to establish a claim in the absence of any other evidence. The method of calculating the claim for each year met these requirements.

55. For the Commissioners Miss Shaw argued that the Appellant's claim was self-evidently wrong: for the period from 1981 until 1993 the Commissioners had no policy restricting recovery of input VAT in relation to the costs of staff entertaining and the Appellant could not therefore have failed to recover all such input VAT. The Appellant claimed to have operated on the same basis throughout the period 1981 to 1996, and if that was so it followed that for the years 1993 to 1996 it must have recovered all the relevant input VAT, notwithstanding the Commissioners' policy during this period.

56. As to the method used for calculating the amount of the claim, the Appellant offered no evidence that it held a staff Christmas party every year, nor was the amount calculated in any way related to the profitability of the Appellant from year to year, which for many businesses is a factor in determining whether to provide staff entertainment, and the scale on which to provide it.

Discussion and conclusions – VAT on share issue expenses

57. There is no difference on any point of law between the parties. It is common ground that if, and to the extent that, the Appellant can establish that it did not recover the VAT charged to it on the supplies made in relation to the sequence of share capital issues it undertook in the years 1987 to 1990 and again in 1996, then it is entitled to recover those amounts of VAT now, together with simple interest from when it could have recovered those amounts by way of credit in the relevant VAT returns it made.

58. The only question we have to decide is whether the Appellant has shown from the evidence that, on the balance of probabilities, it did not recover the VAT which it now claims was charged on those expenses of issuing share capital.

59. In the case of the share issues in the years 1987 to 1990 the Appellant, quite understandably, has no documentary evidence other than an entry in its accounts for each year showing an amount debited to share premium account with the narrative "expenses relating to share issue". There are no invoices to establish the amount of VAT charged, and no internal book-keeping papers to indicate how any VAT was treated. The Appellant therefore cannot establish how the VAT was treated in its VAT returns, or even whether the amount so debited to share premium account included or excluded the VAT charged on the expenses relating to the issues of share capital (if that amount included the VAT such accounting treatment would be strong evidence that the Appellant treated the VAT as irrecoverable).

60. In the case of the share issues in 1996 there is the advantage that we have in evidence the invoices in respect of the relevant supplies relating to the share capital issues in that year. We can therefore see the amount of VAT charged to the Appellant. We can also see that the Appellant stamped the invoices with a code which appears to relate to VAT. The cash flow statement in the Appellant's 1996 financial statement shows that the Appellant accounted for those invoiced expenses on a VAT-exclusive basis. (The Appellant offered no explanation as to why the amount of those expenses did not appear as a debit item in the share premium account – that account simply shows a figure for "net premium on shares issued", which may or may not mean net of the expenses of issue.)

61. We then have the evidence of Mr Spilling. Mr Spilling was himself involved with all the share issues. He was quite clear in his evidence that the senior management of the Appellant was advised at the time, and understood, that the VAT charged on the share capital issue expenses was irrecoverable. We accept Mr Spilling's evidence to that effect. Where we have concerns, however, is with the question of whether the Appellant went on to implement, in its accounts and its VAT returns, that understanding which the senior management had. Under cross-examination Mr Spilling was unable to explain, by reference to the 1996 claim, why the accounts recorded the expenses on a net-of-VAT basis (which in itself implies that the VAT was not considered to be irrecoverable), or how the VAT may have been accounted for, or even the exact significance of the "06" code stamped on the invoices in respect of VAT. Of course, we fully understand that Mr Spilling, rightly, did not wish to give evidence of matters outside his knowledge, but in his responses we felt that at times he was distancing himself from the evidence one might have expected the Appellant to put forward to substantiate its claim.

62. Mr Southern's answer to the question of why the 1996 accounts recorded the expenses on a VAT-exclusive basis if that VAT was irrecoverable was that the VAT must have been charged as an expense to profit and loss account. That would seem to us to be at odds with the terms of SSAP 5 and FRS 4, which requires issue costs to be accounted for as a reduction in the proceeds of the share capital raised. However, we can accept that if the cost of irrecoverable VAT arising on an issue of capital is

instead charged against profits, there is, in the result, nothing which would give concern to an auditor required to give the standard audit certificate. We had no evidence, however, as to why the Appellant should have chosen this unusual course (nor, indeed, did we have anything other than Mr Southern's assertion that it was an acceptable course in accounting terms).

63. Taking these matters into account, we do not feel that the Appellant establishes its claim to the required standard of proof in relation to the 1996 expenses. To the extent that there is documentary evidence of what actually happened – the entries in the Appellant's audited accounts for that year – it tells against the Appellant's case in that the inference to be drawn is that the Appellant accounted for the VAT in question on the basis that it would not be a cost to the Appellant, that is, because it was, or would be, recovered.

64. As to the issues in each of the years 1987 to 1990, the Appellant argues – as it must if its case is to be credible – that the amounts debited to share premium as costs of the share capital issues are VAT-inclusive. The Appellant cannot explain, however, why the accounting treatment of such costs in those years should be different in that regard from the accounting treatment in 1996 (where they are treated as VAT-exclusive). Mr Spilling could offer no explanation for this, other than that the Appellant had different accountant advisers at the time of the 1987 to 1990 issues. That we did not regard as dealing with the point.

65. The Commissioners, as we have recorded, challenged the Appellant's case with regard to the 1988 issues (where the expenses of the issues, at £342,678 as appearing in the accounts, form the basis of by far the greater part of the Appellant's total claim) by an analysis of the VAT returns for the two VAT quarterly periods in which the Appellant might be expected to have taken account of the invoiced expenses. Their submission was that the aggregate amount of inputs in those two periods in respect of which no input tax was claimed is significantly less than the expenses of the share issues, which is inconsistent with the claim that the VAT charged on those expenses was treated as irrecoverable.

66. The Commissioners also called into question the Appellant's claim that its VAT compliance record was beyond reproach, pointing out that in 1988 it did not appear to have claimed its residual input tax on the basis that it was partially exempt by reason of the very sizeable share issue at that time.

67. For completeness we mention that the Commissioners also questioned the unusually high proportion of input tax to output tax in some VAT quarters (leading to VAT repayments on some occasions), but we consider that Mr Spilling dealt satisfactorily with that point in his evidence on significant fitting-out and related expenses consequent upon the Appellant's expansion of its business following its substantial raising of share capital.

68. Mr Southern was dismissive of these matters of analysis, describing them as reverse engineering designed to bolster a particular hypothesis. Whilst we agree that we should treat these submissions with a degree of circumspection, they do at the

least raise a case for the Appellant to explain in the circumstances of its claim, and that the Appellant was unable to do.

69. The Appellant's case in relation to the VAT on the expenses for the issues in 1987 to 1990 is based solely on Mr Spilling's evidence. Mr Southern asks us to accept the tenor of that evidence, that the Appellant believed, on the basis of advice which conformed with the general understanding at the time, that the VAT in question was irrecoverable. He asks us accept that it was therefore highly improbable that the Appellant should then proceed to recover the VAT, whether by design or accident.

70. We have already mentioned the limitations of Mr Spilling's evidence. We do not consider that it goes to the heart of the matter, which is what the Appellant actually did, rather than what it knew to be the right thing to do. Looking back to the earlier years with the knowledge of the way the Appellant accounted for VAT in relation to the expenses for the 1996 share capital issues undermines, rather than supports, the Appellant's case. That case is further undermined by the Commissioners' observations upon the actual VAT returns made by the Appellant at times crucial to the issues in this case.

71. We then turn to the question of quantum. The claim made by the Appellant in respect of the 1996 issues is undoubtedly wrong, since it is clear from the invoices that not all the supplies were subject to VAT. Yet the Appellant persisted with that claim until the hearing. It conceded that point, and conceded further at the hearing that certain of the invoices for the earlier issues must also have been free of VAT (supplies of a corresponding nature would have been made for each share capital issue). Mr Southern asked us, in effect, to decide the principle that the VAT was not recovered, and to leave it to the parties to finalise the figures.

72. In our judgment the way in which the Appellant has framed its claim, and persisted with its claim, without careful regard to its accuracy further undermines the credibility of its case – as to the principle as well as the quantum. The Appellant is making a claim that it has not recovered certain VAT, and now seeks its repayment. It is incumbent upon the Appellant to make such a claim with careful regard to the facts as it knows them to be and then with regard to any reasonable inferences which can be drawn from those facts. If the Appellant is careless as to the facts it knows or ought to have known, that calls into question the basis of the assertions as to the facts it would have us infer.

73. There is some support for the Appellant's case from the way in which, some years after the occasions on which the Appellant issued share capital, Countyweb.com PLC accounted for VAT on the expenses of its share capital issue. Mr Spilling's evidence is that he approved the invoices rendered to Countyweb.com PLC, but there was no evidence as to why that company applied a different coding system from the Appellant, or what other similarities or differences there were between its circumstances and those of the Appellant. We do not regard this evidence as concluding the matter in the Appellant's favour.

74. Taking account of all these matters we conclude that the Appellant has not established that it is more probable than not that the Appellant did not recover the VAT charged to it on the supplies it received in connection with the issues of share capital.

Discussion and conclusions – VAT on staff entertaining

75. Again, with regard to this part of the Appellant's claim, there is no dispute between the parties as to the law. Once more the question we have to decide is whether the Appellant has shown from the evidence that, on the balance of probabilities, it did not recover 50% of the VAT which it now claims was charged on the supplies it received in respect of the expenses relating to staff entertaining.

76. The claim which the Appellant made, and in which it persisted until the hearing, was for 50% of such input VAT for the years 1981 to 1996. As we have explained, at the hearing the Appellant conceded that it could not sustain a case for such a claim for the years prior to 1993.

77. The only evidence before us was that the Appellant provided Christmas parties for its staff in the years 2000 to 2007, the cost per employee of which was known for each of those years. The Appellant also had records of the number of employees in each year of claim, and by that means, with an adjustment for inflation, the amount of VAT charged to the Appellant was calculated.

78. It will often be the case that a "Fleming" claim will be based on assumptions made from later circumstances rather than direct evidence of what happened at the time, and as long as those assumptions are reasonable, and take account of all – or what are likely to be the most significant – factors, that should be sufficient to establish the claim on the basis of reasonable inferences to be drawn from such assumptions. In this respect we have no difficulty in accepting the method applied by the Appellant to calculate what has to be an estimate of the costs of staff entertaining, and the VAT charged on such costs, for each of the years of the claim.

79. The further requirement of a "Fleming" claim is that the taxpayer must demonstrate that in principle its claim is credible – is made on the basis of a rational and careful assessment of what was most likely to have happened. We do not consider that this has been the Appellant's approach in making its claim. The claim made by the Appellant was purportedly made by reference to an alleged policy of the Commissioners which, for the greater part of the period to which the claim related, simply did not exist. The Appellant's response at the hearing was to jettison its claim for that period when there was no such policy. That, however, does not salvage the credibility of the claim, even for that reduced period. If the Appellant claims that it recovered only 50% of the relevant input VAT for a period when there was no restriction on its right to recover 100%, and therefore when it is fair to assume it did in fact recover 100%, is it any more credible that it reflected in its VAT returns the new policy introduced in 1993? As the Commissioners put it, if in making its claim it was unaware of the policy change in 1993, is it probable that it was in 1993 aware of

that policy change and at that time changed its VAT treatment of input tax on staff entertainment costs?

80. We see the force of that point. The indication is that the Appellant's claim was opportunistic and made without careful regard to what, on the balance of probabilities, the Appellant actually did. Therefore we do not consider that the Appellant has demonstrated that it was more likely than not that it recovered only 50% of the relevant input VAT, even for the years 1993 to 1996.

81. For these reasons we dismiss the Appellant's appeal with regard to both the VAT on the expenses of share capital issues and the VAT on the expenses of staff entertainment.

Right to apply for permission to appeal

82. 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.

EDWARD SADLER
TRIBUNAL JUDGE

RELEASE DATE: 20 May 2013