TC04324

Appeal number: TC/2011/08215

VAT – __Fleming__ claim – repayment of input tax relating to business activities – whether quantifiable and due – No – FA 2008, Section 121 – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

GREATER GLASGOW & CLYDE HEALTH BOARD **Appellant**

- and -

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

TRIBUNAL: JUDGE KENNETH MURE, QC
MR S A RAE, LLB, WS
MR PETER R SHEPPARD, FCIS, FCIB, CTA

Sitting in public at George House, 126 George Street, Edinburgh on 30 June, 1 to 4 July, and 21-22 October 2014

David Southern, QC, instructed by Liaison Financial Services Limited, for the Appellant

Sean Smith, QC, instructed by Douglas Pate, Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. This is a claim for repayment of input tax paid by the Greater Glasgow and Clyde Health Board. In addition to its non-business activities it has conducted to a limited extent *business* activities within the scope of the VAT system. This repayment claim is in respect of input tax incurred in relation to dining-room expenditure, residual revenue expenditure, and capital expenditure, and that over an extended period from April 1974 to April 1997. The repayment was refused by HMRC, and this appeal is directed against that refusal. It is the third in a series of appeals relating to *Fleming*-type claims at the instance of the Scottish Health Boards. In the earlier appeals at the instance of *NHS Dumfries & Galloway Health Board* and *NHS Lothian Health Board* the repayments sought related to respectively catering and capital expenditure. The subject-matter of this appeal is accordingly distinct. The appeal at the instance of *Dumfries & Galloway HB* succeeded. The other at the instance of *Lothian HB* did not, but an appeal to the Upper Tribunal is presently pending.

The Law

2. In addition to the relevant statutory provisions, particularly FA 2008 Section 121, we were referred by each party to extensive case-law. We attach as appendices their lists of authorities. Particular reference should be made to the related appeals at the instance of *Dumfries & Galloway HB* (TC/2012/06746) and *NHS Lothian* (TC/2012/00196).

Evidence

3. The Appellant's first witness was **Stephen Shaw Forsyth,** their expert witness, who had investigated the matters under review. He is an honours graduate in accountancy and finance and has qualifications in direct and indirect taxation. He is employed by Liaison as a VAT manager, working under the supervision of a more senior member of staff, Kenneth Lee. Mr Forsyth read and adopted his Witness Statement. He explained that he had revised its original form to take account of this Tribunal's decision in the earlier appeal at the instance of *NHS Lothian*.

4. In summary Mr Forsyth was responsible for the preparation of the claim and dealt also with entitlement matters. The claim covers a 23 year period from 1974/75 to 1996/97 and is in respect of direct and indirect expenditure on overheads. It seeks to recover VAT attributable to taxable business activities. The claim in original form in March 2009 was for about £3½m, £1½m directly attributable and £2m indirect. A revised version was lodged in February 2011 with the removal of the final three years of the claim. Also there was an increase in the claim in respect of capital expenditure from 40% to 80% as it was discovered that this expenditure was not just construction works but also purchases of equipment which were standard rated.

5. Mr Forsyth referred to the course of correspondence with HMRC. They had required a large amount of additional information. Obtaining this was time-consuming. Indeed the process of revising the claim, Mr Forsyth explained, had continued to date. (We would observe that Mr Forsyth produced revised calculations in April 2014 and June 2014 in the course of the hearing, which in her evidence

Miss Langley (HMRC's expert and only witness: see para 42) described as the "third" and "fourth" versions, all as noted infra.) The direct tax reclaim related wholly to taxable supplies. The indirect claim was based on an apportionment between taxable income and total income. An income-based method of apportionment was adopted. Source material included the "Blue Books", annual accounts, and related records and source materials. The Blue Books were prepared by the Scottish Health Services Common Services Agency Information & Statistics Division. They contain information relating to all the Scottish Health Boards. Various relevant records are kept in the Mitchell Library in Glasgow, where they were accessed by Mr Forsyth.

6. Mr Forsyth sought to identify firstly input tax attributable to taxable income, both standard and zero-rated, from hospital dining-rooms. Business income in the context of this taxpayer would include that arising from staff and visitor catering. Patient meals were "non-business". After investigation Mr Forsyth found about 20% of expenditure standard-rated and 80% zero-rated. Costs included foodstuffs and catering supplies and costs of running kitchens and canteens. For 2007/08 on his calculations 19.38% of expenditure was taxable at the standard rate, and for 2009/10 the percentage was 12.57%.

7. Having regard to the VAT returns produced, he continued, the Trusts were recovering only VAT under contracted-out services ("COS") and nothing relating to business activities.

8. At page 106 of the Joint Bundle of Productions Mr Forsyth sets out his approach to the calculation. Firstly, he identifies staff dining-room expenditure from the Blue Books. Then he excludes wages. While food would be zero-rated, he then identifies the non-food element, taken to be inclusive of VAT. From that the recoverable VAT can thus be calculated.

9. Mr Forsyth then addressed as a second category indirect tax recovery. Where input tax was not wholly attributable to non-business, exempt, standard-rated or zero-rated activity, it fell into residue ("the pot"). A deductible proportion can then be calculated as referable to taxable supplies. An income-based formula for apportionment had been suggested by HMRC and adopted by Liaison. A base line figure for 1999/2000 was adopted and an extrapolation made for earlier years.

10. The business percentage of total income has to be calculated and then applied to the residual (or "non-attributable") expenditure. 1999/2000 was taken as a base year as being the earliest on which accurate figures could be obtained. Income is then broken down into categories. Other than catering income the main sources of taxable income were property re-charges, selling goods and equipment, and telephone re-charges. A miscellaneous category of special treatment income eg car leasing income re-charged to staff, was added to calculate business income. Wage costs fell to be eliminated from the calculation.

11. Total income figures were taken from annual accounts and then an extrapolation was done based on the Retail Price Index. (The use of the RPI as the formula for the extrapolation exercise was hotly contested by Miss Langley.) A difficulty arose inasmuch as the numerator of the fraction to calculate the business percentage originated from a different year's figures, ie 1999/2000, from the year used to calculate the denominator, ie 1986/87.

12. The relevant expenditure has then to be quantified, subtracting that on exempt and wholly attributable supplies. VAT recovered, such as in respect of COS services, should then be identified and removed. The VAT proportion of the net amount then falls to be determined by reference to the prevailing VAT rate. The business percentage is taken for that amount, and the recoverable proportion of that is determined by the fraction of taxable supplies over total business supplies.

13. The third element of the claim is capital expenditure. Mr Forsyth relied on records contained in the Blue Books. Capital expenditure would include hospital construction, alteration and refurbishments and, also, equipment, vehicles and computers. Expenditure over £1,000 was classed as capital. Construction was zero-rated until March 1990. While HMRC had stated that all capital expenditure incurred prior to that date other than repairs was zero-rated, an apportionment was never negotiated. Mr Forsyth estimated 80% of this expenditure to have borne VAT.

14. Mr Forsyth further scrutinised the Blue Book records and a more detailed breakdown of capital expenditure has been produced. Where VAT is attributable to exempt supplies, that has been excluded from the recovery calculation. Actual VAT recoveries have been taken account of. The partial exemption percentage is then applied. It is calculated by taking taxable income as divided by total business income.

15. Mr Forsyth then noted an earlier claim submitted to HMRC in 1996, covering the period from 1974/75 to 1985/86 for a sum somewhat in excess of £½m. This had been rejected because of the three year "cap" introduced in 1997. That, Mr Forsyth suggested, confirmed the Appellant's stance that no VAT had been recovered earlier and, indeed, that the Appellant had not appreciated the potential to recover VAT. Detailed documentation in support of the claim had been submitted apparently, but he could not trace this.

16. Finally, (as indicated in para 3) Mr Forsyth summarised at the conclusion of his Witness Statement particular amendments to its original form which he had made to take account of certain observations made by the Tribunal in its decision in the related appeal at the instance of the *Lothian Health Board*.

17. In cross-examination Mr Forsyth acknowledged his involvement in preparing the 2009 Claim. Also he had drafted the "executive summary" (page 3). Liaison's letter at p31 was dated 30 or 31 March 2009: only one letter had been sent then.

18. Mr Forsyth then spoke to his methodology. The data available to him were the annual accounts, adjustments and workings. He acknowledged that he had used only two Years' accounts, 1986/87 and 1990/91, which gave information for the particular and preceding years. He spoke to the "division" of the former Argyll & Clyde Health Board between the Appellant and the Highland Health Board. He explained the relevance of the "Blue Books" as providing source material for the annual accounts. He accepted that the initial claim had not been based on a full calculation. Much of the archive information used was accessed at the Mitchell Library in Glasgow.

19. Mr Forsyth explained that from the four years' actual figures (viz 1985/86, 1986/87, 1989/90 and 1990/91), figures for the intervening years were calculated by a process of extrapolation, using the RPI. There were no exceptional factors in Mr Forsyth's view which might undermine this approach. He did, however, accept that he could have obtained actual information about more than four years even although

there might have been some gaps in the information available. There was no major variation apparent from the four particular years considered.

20. Mr Smith then referred Mr Forsyth to certain correspondence between Liaison and HMRC (HMRC's letters of 22 February and 23 September 2010 at p38 and 41 and Liaison's letter of 28 April 2011 at p86). Mr Forsyth conceded that certain information sought by HMRC had not been provided. More particularly he accepted that Liaison had not responded to HMRC's suggestion that actual figures be used for every fifth year with an extrapolation by way of simple averaging for the intermediate years. He had some knowledge, albeit indirect, about a "five year" agreement for catering purposes.

21. Mr Forsyth considered that the VAT Returns supported the Appellant's stance that there had been no recovery of input tax at the time when incurred. However, special considerations arose in relation to VAT on COS services which, subject to further investigation, might have been recovered when incurred.

22. On the second day of cross-examination it emerged that a paramount consideration for Liaison (and Mr Forsyth) had been the aspect of entitlement. He noted the conclusion of his letter of 18 November 2010 (p46) where he emphasises the aspect of entitlement as a preliminary issue. A complication relating to entitlement was the sharing of assets and liabilities of the old Argyll & Clyde Health Board between Highland Health Board and the Appellant. Aspects of entitlement were settled only as at January 2014. While the correspondence from HMRC did not in express terms indicate that its requests for further information might be deferred, Mr Forsyth's view was that entitlement had to be resolved as a preliminary issue.

23. Mr Forsyth was then asked by Mr Smith about the extent of the data kept at the Mitchell Library. There, Mr Forsyth examined copies of the annual accounts, statements of account, and information on board meetings. Certain of the "Blue Books" were borrowed from the Health Boards.

24. In re-examination Mr Forsyth confirmed that there was other correspondence dealing with entitlement. He did accept, however, that there was a delay in providing information sought by HMRC because he regarded the matter of entitlement as the priority. He then referred to a summary of his evidence entitled "Appellant's Note of Evidence". (Mr Smith objected to this as representing fresh evidence-in-chief. The Tribunal allowed reference to this document but on the basis that Mr Smith could further cross-examine as appropriate.)

25. Mr Forsyth was then asked about the detailed accuracy of the Blue Books in recording VAT. He conceded that they did not show whether VAT had been recovered in individual instances. He could not eliminate the possibility that "VAT might have been recovered earlier. In further cross-examination by Mr Smith he accepted that he was unable to source any further supporting documents.

26. The Appellant's next witness was **Michael Sheils** ACMA. (For convenience his evidence was interposed during the cross-examination of Mr Forsyth.) He has worked in the NHS since 1991, initially with the (former) Greater Glasgow Health Board. He is now assistant head of Financial Services with the Appellant and he is responsible for *inter alia* preparing the monthly VAT Returns.

27. Mr Sheils explained that in Scotland the individual health bodies had their own separate VAT registrations. Substantially these bodies have provided "non-business" services with a social value, but to a limited extent they conduct "business" activities on the same basis as the private sector. Where VAT is charged on taxable supplies, the income is shown *net* in the accounts. In relation to supplies to a health body, if it bears the VAT burden, the cost is shown inclusive of VAT in the accounts. If the VAT is recoverable, only the *net* cost is shown.

28. Mr Sheils indicated that the Appellant only became aware of its entitlement to reclaim input VAT in the mid-1990s. Annual reviews were then made of the accounts for this purpose. Monthly business activity reviews were undertaken from 2006. VAT Returns for the various trusts used the same accounting procedures as set down by the Health Board.

29. The VAT Returns do not show any VAT recovery under business activities as no VAT was recovered in relation to that. Only after receiving professional advice did the Appellants become aware of this opportunity. This confirmed that there was no recovery of VAT in relation to business activities previously.

30. Mr Sheils then noted the "contracted out services" (COS) rules introduced in 1983. Where VAT is recoverable there, the expenditure is recorded net of VAT. He noted instances in the Blue Books in which VAT had been recovered in respect of property maintenance: there the expense is shown as VAT exclusive. By contrast on purchases and rentals of equipment, where VAT had not been recovered, the cost was shown as inclusive of VAT.

31. Mr Sheils referred to the backdated claim for VAT repayment made in 1996. That had been rejected under the "capping" restrictions. That too confirmed that no VAT recovery had been made in respect of business activities.

32. Capital expenditure had been included for four years in the documentation viz 1975/76, 1979/80, 1982/83 and 1985/86. Capital expenditure related not merely to construction and building works but also to purchases of equipment, computers and vehicles. An item had to exceed £1,000 before being classified as capital.

33. Finally, Mr Sheils summarised the broad principles of accounting for VAT which NHS Scotland followed. This conformed to International Financial Reporting Standards. Firstly, where input VAT is wholly recoverable, output tax on the corresponding supply is not included as income and input tax is not included as expenditure. Net VAT collected has to be accounted for. However, if the taxpayer bears the VAT himself, the irrecoverable tax should be included in expenses. But if input tax is partially recoverable, the irrecoverable part should be included as part of the cost. The recoverable VAT should be left out of the expenses. Finally, turnover should exclude VAT on taxable outputs, and irrecoverable VAT should be included as a cost.

34. In the accounts and Blue Books expenditure, he explained, will be shown inclusive of VAT where the Health Board bears the total cost. If VAT is recoverable, only the net cost is recorded. Mr Sheils claimed that it was clear from the annual accounts whether or not VAT had been incurred. These accounts are audited. The annual accounts and the Blue Books are consistent: the difference between them is that the Blue Books record the information for hospitals individually. These records

can also show the nature of the costs as relating to business or non-business activity. Expenditure will be shown inclusive of VAT unless it is recoverable as relating to wholly taxable supplies, and the account code “VAT recoverable” is used. Mr Sheils indicated that there had not been any trends arising during the relevant period which might have affected the calculation of the claim.

35. In a brief cross-examination Mr Sheils confirmed that the COS rules did not restrict VAT recovery only to items of expenditure in excess of £1,000.

36. The final witness for the Appellant was **Peter Ramsay** FCCA. Since 2004 he has been Head of its Financial Services and *inter alia* supervises its monthly VAT Return. He has worked in the NHS since 1992, initially at the Victoria Infirmary, then a distinct unit which became an individual trust in 1993. From 1993 to 1999 Mr Ramsay oversaw the completion of its VAT Returns.

37. The Victoria Infirmary NHS Trust ran several other hospitals which all had staff and visitor catering facilities on which output tax was collected. VAT recovery was made only in respect of “contracted-out” services until about the mid-1990s when professional advice was received to the effect that input tax on business services could be recovered. At about that time annual reviews of business activities were carried out for three Years 1994/95, 1995/96, and 1996/97, but not further back because of “capping” rules. The Returns confirm that no VAT was recovered in respect of business activities, but only for COS services.

38. Mr Ramsay explained that he was also involved in the compilation of the “Blue Cost Books”. NHS National Services Scotland collated information supplied by every Board. Income and expenditure is recorded therein inclusive of VAT where the NHS bears the whole cost. The Blue Books contain a breakdown of information for each hospital.

39. Mr Ramsay noted also the back-dated claim for over £½m relating to 1974/75 to 1985/86. This was rejected by HMRC. That claim related only to the Glasgow Royal Infirmary NHS Trust.

40. Finally, he noted capital expenditure and its variety. It included not only construction work but also purchases of equipment and vehicles. Only items in excess of £1,000 were included as capital.

41. In cross-examination Mr Ramsay confirmed that he could not speak to the financial practices of the various Boards before 1992. In response to further enquiry by the Tribunal Mr Ramsay indicated (by a subsequent e-mail) that the “Blue Books” should record any belated recovery of input VAT in the Year of recovery.

42. The Respondents called only one witness, their expert, **Kathleen Susan Langley**, who gave evidence also in the earlier related *Dumfries & Galloway* and *Lothian* appeals. She spoke to her original and a supplementary Witness Statement. Having joined HM Customs & Excise in December 1975 she has specialised in recent years in the VAT affairs of NHS bodies, including evaluating Fleming claims. She was responsible for the decisions of 22 December 2010 and 30 March 2011 refusing payment of the Appellant’s claim. She confirmed that HMRC now acknowledges that the Appellant is entitled in principle to make a tax repayment claim for the period from April 1974 to May 1997. She noted that Liaison had submitted a Fleming claim

(doc 31/5) for approximately £1.5M in respect of dining room expenditure and for a further approximately £2M in respect of "residual expenditure". The latter element of the claim had been calculated on an "income" method. This compared taxable income with total income for each year. Liaison had set out in correspondence an explanation of the basis of claim and source materials used, including the "Blue Books", annual accounts of the Appellant, and other related materials.

43. However, Miss Langley complained that there had been no satisfactory "audit trail" and while some material from the "Blue Books" had been provided, none of the other source materials had been made available. Accordingly on 22 February 2010 (doc 38-40) HMRC had requested further detailed information and evidence. Liaison had been reminded to consider the VAT charge on capital expenditure introduced in 1989/90, the possible impact of previous claims for repayment of input tax, and the need to provide evidence of the accounting for output tax on taxable activities. Miss Langley had not received any reply.

44. HMRC wrote again to Liaison on 23 September 2010 (doc 41-3) stressing that in their calculations of recoverable VAT they had to take into account the need for direct attribution, a business/non-business apportionment, a deduction for VAT recovered in respect of "contracted out services", and more evidence of the method used in calculating direct costs for dining room expenditure. Further it was stressed that evidence was required in respect of VAT incurred on capital expenditure before March 1990. More generally evidence was sought to confirm that VAT incurred at earlier dates had not been recovered shortly after. Liaison did reply by letter dated 3 November 2010 (doc 388) but it did not deal with matters raised or provide any supporting evidence. Copy correspondence was enclosed relating to an "existing" claim purportedly outstanding. That might suggest that no business VAT had been claimed. That, Miss Langley explained, related to an earlier claim for 1973/74 to 1985/86 for £567K approximately. That had not been paid because of the three year "capping" rules then in force. That claim was resubmitted in February 2008 for the same amount but later in March 2009 was formally withdrawn. The "present" claim for in excess of £3.5M was made on 30 March 2009. There was no explanation for the increase in value of about £2M. (While Mr Southern submitted that this essentially was the present claim, Miss Langley argued that it was the first of a series of three claims – see Appellant's Closing Submissions, paras 82-84 thereof.)

45. HMRC wrote again to Liaison on 17 November 2010 (doc 44) warning that unless the information and documents requested earlier were forwarded, the validity of the claim would be determined on the basis of the information then available. There was no response and by letter dated 22 December 2010 (doc 65-7) the claim was refused. There was a dearth of supporting evidence. No reduction had been made for the pre-1989/90 period when VAT was not charged on capital. There was no reduction in respect of services performed in-house. The possibility that VAT had not been reclaimed earlier had not been disproved. Stated expenditure costs, other than those reflected in the "Blue Books", had not been evidenced. There had been no recalculation to reflect business/non-business activities or an acceptable partial exemption calculation. On request HMRC extended the time limit for further evidence to 21 February 2011. Shortly before by letter dated 18 February 2011 (doc 71) Liaison sent in a revised calculation for an amount just short of £3.5M but without further supporting evidence. Liaison explained that the taxable income and total income figures were taken from the latest accounts; that 80% of capital costs were taken as being standard-rated; that expenditure figures had been taken from the "Blue

Books" but only for three years and then extrapolated; that "in-house" services would not be recorded as an expense in the "Blue Books"; that VAT on COS services was assumed to have been recovered and deducted from the claim; that established practice was to recover input VAT only on confectionary and some provisions; that the claims for 1995/96 to 1996/97 had been removed as a claim for them had already been made; and that partial exemption was not applied to the NHS during the claim period. No further documentary evidence to support the repayment claim was provided, although the sources of the information were set out. Certain VAT Returns for two hospital trusts was submitted viz Victoria RI and West Glasgow Hospitals University NHS Trusts.

46. By letter dated 30 March 2011 (doc 83-5) HMRC indicated that there was insufficient information to support the claim. According to Miss Langley, Liaison had failed to provide for their reference any of the archive evidence used in supporting the claim. About a month later the Appellant sought a statutory review.

47. Following on the statutory review HMRC confirmed by letter dated 22 July 2011 (doc 94/8) their original decision. In their view it had not been established that the residual input tax claimed had not already been recovered. There was no evidence to support the computations, expenditure claimed, or the nature of the taxable supplies made. It was unclear why input tax had not been recovered at the correct time. It noted the need for a business/non-business apportionment and partial exemption calculation.

48. Miss Langley then considered the witness statements and other documentation lodged for the purposes of this hearing. The claim, had now been increased to £4,451,000 approximately, representing an increase of just over £1M. The calculation had been made on a wholly different basis. She regarded this as the "third version". She considered it in relation to the methodology used and the supporting evidence which was critical to its validity.

49. Firstly, she claimed that no satisfactory evidence was produced to support the figures of taxable income and total income used in calculating the taxable percentage. The extrapolation of figures from 1999/2000 had been done on an inadequate basis. She could not establish whether or not the significant amount of exempt income (over £10M) had been included in the total income figure. While the figure of taxable income had been taken from 1999/2000, the figure of total income had been taken from earlier years, from the annual accounts for 1986 and 1999/91. In effect taking the numerator (taxable income) from one year and the denominator (total income) from another year produced a meaningless result, in her view.

50. There was a need to attribute directly the VAT incurred to ensure that the claim extended only to business activities, Miss Langley continued. VAT attributable to non-business activities was not recoverable. This was important in the case of capital expenditure. There non-business use (general wards and operating theatres etc) and wholly exempt use (nurses' homes and staff accommodation) would be significant. (This aspect may have been addressed in the June 2014 calculation.) Miss Langley noted a divergence between figures of capital expenditure noted at p9 of Mr Forsyth's witness statement and extracts from the "Blue Books" at Tab 6D (doc 193). Further the implications of zero-rating of construction works until March 1990 had not been taken account of in calculating the claim. Miss Langley stressed that in her view residual expenditure should not be placed into the "pot" until there had been an

exhaustive attempt at attributing expenditure to particular headings. Miss Langley noted that originally there were 15 expenditure headings without attribution. In the June 2014 calculation there were only six expenditure headings but without explanation for the reduction. It appeared to her that very few source documents had been used even although the "Blue Books" and annual accounts were available over the Fleming period. There was only limited evidence specifically supporting this claim, she argued.

51. Miss Langley questioned the nature of the claim as being "residual … on general overheads". To be "residual" the costs require to have a direct and immediate link with taxable activities. Of the 15 costs listed by Liaison, portering, transport and uniforms did not bear to have a direct and immediate link with taxable activities. The sale of "welfare foods" seemed to distort the calculation, achieving in her view a much higher VAT recovery figure than that justifiable.

52. Miss Langley had a continuing concern with VAT already recovered under the COS rules. (This may now have been addressed satisfactorily in the latest calculations in June 2014.)

53. Miss Langley had continuing concerns about significant errors in the calculations although certain of these had been addressed in the June 2014 calculations. However, certain errors remained in her view, for example, VAT had been claimed on power bills when no VAT was charged on utilities.

54. Miss Langley then considered dining-room expenditure. The claim has been reduced by about £200K in the June 2014 calculations. While Mr Forsyth claims to have removed non-business and exempt activities in his calculation, that exercise is not evidenced. He then identified expenditure wholly related to taxable activities and uses this in the claim, but Miss Langley expressed concern that if it is "direct expenditure" a calculation to find the amount due should not be necessary. She expressed other concerns in respect of catering at Glasgow Royal Infirmary. Also, the term "production costs" is uncertain: it may include wages which would be free of VAT. It is unclear, Miss Langley claimed, whether "Blue Book" figures have been used for only 1981/82 or other years. Again no archive information has been produced. She could see no explanation for the 80:20 apportionment between zero and standard-rated expenditure. On Miss Langley's own analysis of this expenditure for 2009/10 the zero-rated percentage was just 1.67%.

55. Accordingly Miss Langley could not consider whether this element of the claim is calculated fairly and reasonably as in her view only limited information was provided, and more especially whether the VAT calculated as being due, ever existed. She found Mr Forsyth's evidence contradictory: the claim bears to be in respect of direct expenditure, wholly attributable to taxable supplies, which would be recoverable in full. However, for whatever reason a method of calculation has been introduced, the relevance of which Miss Langley said she could not understand.

56. Miss Langley then considered the methodology of the calculation used in calculating the recoverable percentage of input VAT. In her view the numerator should be the taxable income divided by the total of non-business income plus taxable income plus exempt income. These three income sources had to be reflected in the denominator. Unless exempt income were included, the input tax would be split only

between taxable and non-business income, thus overstating the recoverable input tax. In principle HMRC would accept a combined income method.

57. However, the June 2014 calculations adopt a different methodology, differing significantly from the combined income method used by the Appellant originally in 5 the appeals. Miss Langley considered the "new" method fundamentally flawed: the supposed "business percentage" reflected not only the taxable but also the exempt percentage. The exempt element has to be removed. Liaison's new formula produces a very low exempt percentage which is inappropriate. Also, the evidence supporting the methodology of the "new" calculation is lacking.

10 58. Miss Langley then considered the element of wage costs in the June 2014 calculations. Mr Forsyth deducted wages in the denominator. Miss Langley argued that if wages are taken out of non-business income, they should also be taken out of taxable and exempt income to avoid an imbalance in the taxpayer's favour. If wages for taxable and exempt activities are unquantifiable then a fair and proper calculation 15 and comparison cannot be made, she argued. She distinguished the "Standard Method Override": that, however, has applied only since April 2002.

59. In short, according to Miss Langley, the June 2014 calculations by Mr Forsyth proceed on a flawed basis: there are accounting errors and an insufficiency of evidence.

20 60. Finally, in her principal Witness Statement Miss Langley referred to partial exemption in the NHS. This affects all VAT recovery, and if there has been, say, recovery in respect of COS services, then the part of that used to generate exempt income requires to be accounted for to HMRC. Liaison, she argued, just now show a repayment of COS services in VAT over-claimed. On her calculation a repayment for 25 2009/10 of just over £31K is due. A similar calculation in respect of each of the "Fleming" years falls to be made too.

61. In conclusion Miss Langley submitted that the Appellant's claim fails in all respects, its methodology, the application of that, and the lack of supporting evidence.

62. Miss Langley spoke also to her additional witness statement dated 30 13 June 2014. There she addresses calculations presented by Mr Forsyth to the Tribunal dated 18 April 2014. (This was noted in para 35 of her first witness statement in which she views this calculation as a "third version" in the appeal.) Miss Langley considers that the calculations of Mr Forsyth dated April 2014 did not relate to the original appeal and, indeed, his arguments of June 2014 (as set out in his 35 Witness Statement of 30 May 2014) addressed calculations outwith the appeal.

63. She reminded us that the original appeal in March 2009 was for a sum slightly in excess of £3.5M. In February 2011 this was reduced to a claim just below £3.5M. A "third" claim for just under £4.5M emerged in the documents lodged with the Tribunal in April 2014. However, in Mr Forsyth's second Witness Statement of 40 30 May 2014 he now makes a claim of £4.3M, subject to a repayment to HMRC of £931K. No supporting calculations for these final figures have been produced, she complained.

64. Miss Langley considered that the many changes made to the claim were deep-seated and difficult to understand. In particular the original apportionment in respect

of capital expenditure as being taxable had been increased from 40% to 80%. In the third "version" of the claim there had been a deduction for NHS wages. This, apparently, served to increase the residual VAT from £2,070K to £3,162K. Also, the partial repayment had increased from £8,808 in "version 3" to £931,109 in the latest witness statement dated 30 May 2014 of Mr Forsyth. Miss Langley considered that other significant errors had yet to be addressed.

65. Miss Langley complained that the partial exemption adjustment, reducing the claim by £922K had been the subject of complaint by her since September 2010. It was unsatisfactory that it had taken five years for such a significant adjustment to be made, and that on the eve of the appeal hearing.

66. There were no calculations to support the exempt percentage of 30.96% noted in para 99 of Mr Forsyth's latest Witness Statement. There appeared to be confusion in the headings "income retail units" and "interests in land" where these appeared in the 1999/2000 income analyses prepared by Liaison (Tab 6B p171 *et seq*). Miss Langley questioned the reliability and accuracy of the contents of Tab 6B. The claim had been prepared carelessly, she said. The quantum and methodology had been changed. In several instances reductions had been offset by increases. All this undermined its value and reliability as evidence.

67. Miss Langley then considered the various changes to the claim as it had been revised. She considered that the methodology and calculations lodged originally differed radically from those lodged together with Mr Forsyth's revised Witness Statement. Liaison now sought just over £4,305K but the basis of the calculation was unclear. There were major differences with virtually every figure being changed. In particular, in the claim in the papers lodged with the Tribunal ("version 3") figures for not only Greater Glasgow but also Argyll & Clyde were included. There were two parts of the claim, one for Glasgow and the other for Argyll. Entitlement was finally agreed in January 2014. Also, descriptions for expenditure have been changed, with Glasgow's being different from Argyll's and also from the original descriptions for Glasgow. The COS services amount deducted for Glasgow has been reduced but without explanation. Some additional business income has been identified.

68. Moreover, Miss Langley submitted, the methodology was completely different. A partial exemption calculation had not been done for the original appeal, then was done incorrectly in the calculations lodged with the Tribunal, and then in a final form, during the actual hearing, restated as a different amount but without a corresponding calculation. A figure for NHS wages, which was not evidenced, is now deducted to achieve a taxable percentage which has more than doubled.

69. Miss Langley noted finally extensive criticisms of the evidence produced by Liaison. Very little of it was satisfactory. It was random and disjointed, she claimed. There were no clear records for one consistent period. For example, Mr Forsyth had used the 2009/2010 calculations to support the proposition that 20% of catering purchases were standard-rated. However, pages were missing in these calculations which meant that Miss Langley was unable to verify that conclusion. In May 2014 further records were produced to the Tribunal. It had not been satisfactorily referenced and Miss Langley was unable to relate these analyses to the claim at any of its stages. Indeed this further evidence was conflicting and incorrect. Income summaries for 1999/2000 were wrong. The monthly VAT returns for the Victoria Infirmary NHS Trust in 1995 indicated recovery of VAT under 28, and not merely

four "contracted out services" headings. The level of VAT recovery suggests that far more was recovered in respect of COS services then Mr Forsyth claimed. Also it was questionable whether the Victoria Infirmary NHS Trust existed during 1995.

70. In conclusion Miss Langley indicated that HMRC does still not accept the claim. Over a period of five years questions of principle had not been addressed and errors and concerns remain. In particular a Partial Exemption Special Method ("PESM") has been used (under deduction of NHS wages) in a form which HMRC would never approve. The partial exemption calculation does not take into account repayment of VAT on exempt supplies wrongly claimed. Various aspects relating to direct attribution remain to be addressed. It was still maintained incorrectly that services before 1984 had been contracted out, therefore incurring recoverable VAT. That was not supported by the "Blue Book" evidence, and a VAT reclaim was being made where the tax had never been charged.

71. In the course of reading her Witness Statements, Miss Langley elaborated and emphasised certain salient points. These may be summarised as follows. She explained that in addition to correspondence in her own name, she was responsible for drafting correspondence in name of colleagues, including a Miss Squires and Rita Moss. She had asked Liaison to provide actual figures every ten years, but then it had been agreed with them (at a meeting with Mr Lee) that actual figures could be provided every five years and that "averaging" could be made in respect of intervening years. She did not approve of the use of the Retail Prices Index for the purposes of extrapolation: in England there was a distinct NHS Price Index. A straightforward averaging for intermediate years was preferable.

72. Miss Langley acknowledged the distinction between entitlement issues and quantification of the claim. She explained that she had been anxious to advance both aspects and did not consider entitlement a preliminary matter inasmuch as HMRC viewed it as peripheral, and not as ruling out an entire claim. She complained that between July 2011 and 2014, Liaison had produced no information to assist quantification of the claim. She insisted that matters of quantification had not been deferred until the matter of entitlement was resolved.

73. Miss Langley complained that in its extrapolated figures for intermediate years Liaison was relying on actual figures outwith the *Fleming* period. In particular the actual and extrapolated figures for 1985/86 did not match. In relation to matters of attribution (paras 49 and 50 of her WS) Miss Langley agreed in response to a question from the Tribunal that if exact information was not available on particular points, she would have to "form a view".

74. In relation to dining-room expenditure Miss Langley complained that certain pages in the records provided by Liaison were missing. That perhaps explained her low zero rate percentage calculation of 1.67% whereas Mr Forsyth had suggested a figure between 15% and 12.67%. In the case of capital expenditure direct attribution was easier to establish with accurate records. However, she considered that certain overheads, which could not be directly attributable, fell to be included in the "pot" of residual expenditure.

75. In response to the Tribunal's questions Miss Langley acknowledged that she believed that there were full records available when a calculation on the basis of five year intervals between actual figures was agreed. She admitted that she had no

recollection of the NHS index in England being mentioned in discussions with Mr Lee. “Blue books” or equivalent records do not exist in England apparently.

76. Miss Langley was then cross-examined by Mr Southern. Helpfully this laid emphasis on the points in controversy. Miss Langley accepted that there was *business* income arising in the Years in question. Also, there would be recoverable input tax when purchases were directly attributable to taxable activities and, also, “residual” tax recoverable similarly. VAT on capital expenditure could be recoverable as directly attributable or “residual” where partly attributable. Miss Langley explained that she was unaware of any recoveries of residual input tax pre-1994/95. She agreed with Mr Southern that in order to recover residual business VAT you had to know the ratio of *business* and *non-business* activities and the amount of *exempt* activities. She was unable to confirm Mr Ramsay’s evidence that there had been no recovery of residual VAT pre-1994/95. She considered this unproven.

77. Miss Langley considered that there was no evidence confirming that the VAT reclaimed had originally been incurred. Even if so incurred, it could have been recovered before the present claim was lodged, she considered. There was, in Miss Langley’s view, insufficient evidence one way or the other. The Appellant’s computations were undermined accordingly, and problems of quantification remained even if not insuperable.

78. Miss Langley accepted that since 2009 there had been changes in the Appellant’s calculations including changes to the type of expenditure, type of exempt income, and amount of VAT on capital expenditure. Certain of these, she accepted, were in response to HMRC’s criticisms. She noted that in correspondence she had listed various concerns about the calculations. She explained that in certain instances letters which she had drafted, were typed, signed, and issued by administrative assistants, hence the variety of signatories in correspondence. Miss Langley was unaware of any claims for residual VAT by Scottish Health Boards having been accepted. She could not comment on any claims by English Health Boards. She was unaware of any departmental policy on the principle of recoverability of such claims. Miss Langley explained that in her correspondence she did not describe what evidence might be acceptable: the *onus* was on the claimant.

79. Miss Langley accepted that 11 months had elapsed before HMRC had responded to the 2009 claim, and that initially it was rejected in its entirety on the basis of non-entitlement. However, shortly after, she explained, she sought further information. There was no suggestion, she insisted, that quantification might not continue to be considered and negotiated with HMRC pending the resolution of entitlement issues. However, information sought by HMRC, had not been supplied, including annual accounts, VAT returns and workings etc.

80. Miss Langley insisted that actual figures should always be used in preference to extrapolations by the use of indices in calculating a claim.

81. Miss Langley considered that the revisal of the original claim created a “new” claim. The inclusion of the Argyll & Clyde elements supported this view. Also, where there were major errors and consequential corrections, sourced documents to support the corrections should be produced. She remained concerned that in calculating a recoverable percentage of residual expenditure, it was not satisfactory to take the numerator and denominator from different sources. Even a small difference

in percentages, where it occasioned a substantial further recovery, could validly be objected to, she maintained. In relation to the direct attribution of capital expenditure, Miss Langley considered that fundamental issues remained unresolved.

5 82. There was some consideration then of the inclusion of wages in the partial exemption formula. Wages, in Miss Langley's view, should be included in the denominator. (Later in response to the Tribunal she agreed that wages costs as reflecting income should be included in both numerator and denominator.) She noted with approval that Mr Forsyth now accepted that double-recovery of VAT on contracted out services had to be eliminated. Any earlier recovery had to be added 10 back.

83. In a brief re-examination Miss Langley indicated that she would have one weekly contact with her supervisor. In relation to partial exemption methods she had consulted with specialist teams in London and Nottingham and policy branch. Finally, she explained the sense of "special treatment income". This covered catering 15 income and car lease income where the Health Board charged staff for personal use of cars leased by the Board.

84. Mr Forsyth, we consider, is a professional witness with expertise in VAT accounting. Each of the other witnesses is a senior officer serving in a public authority. Perhaps not surprisingly matters of their credibility and reliability in a 20 straightforward sense did not arise. The evidence of the Appellant's witnesses, Michael Sheils and Peter Ramsay, was fairly brief and uncontroversial. We were somewhat surprised, however, that the Appellant did not call Kenneth Lee of Liaison as an additional witness. Mr Forsyth, of course, worked under his supervision and carried out the detailed research in support of the claim. However, Mr Lee, (but not 25 Mr Forsyth) did attend meetings with Miss Langley about this and other Health Board negotiations, the subject matter of which he might have dealt with in evidence as a matter of personal familiarity. In particular in Miss Squire's letter of 23 September 2010 (approved and authorised by Miss Langley) to Mr Forsyth there is reference to an agreement made with Mr Lee that in calculating the basis of claim actual figures 30 need to be taken only every five years (doc 42 and para 71 *supra*). Mr Forsyth and Miss Langley were the principal witnesses for each party. While we considered them both credible and reliable, their interpretations of the various Regulations applicable to the claim contrasted somewhat. In particular we would observe that Miss Langley's expectation of progressing quantification of the claim while entitlement to 35 it was unresolved, was somewhat unrealistic. We sympathise with the reluctance of the Appellant's representative to expend undue time, effort, and expenses on the quantification of the claim while the prior issue of entitlement was unresolved.

Submissions

85. We heard in turn from Mr Southern and Mr Smith. Each had obliged the 40 Tribunal by providing in advance their Written Submissions, which had been revised to take account of each other's arguments. At the conclusion of the hearing they simply adopted their respective documents and in their oral submissions sought to highlight the main points of difference remaining. In view of that we propose in our narrative to focus largely on their oral submissions. Reference should, of course, be 45 made in conjunction to their Written Submissions. There are, of course, three heads of claim as noted in our preliminary remarks, viz the recovery of input tax on dining room expenditure, residual revenue expenditure, and capital expenditure.

86. Mr Southern explained at the outset that while two organs of government were involved, they had their distinct interests. He considered that a degree of disproportionality had emerged in relation to the dispute. Liaison had suggested that HMRC were unreasonable, while HMRC seemed to argue that a satisfactory evidential basis was lacking. It was, he continued, the role of the Tribunal to balance these approaches.

87. Public Law, Mr Southern considered, laid emphasis on three principles, viz efficiency, effectiveness, and economy, which the Appellant Health Board sought to achieve. In the present claim there were three stages which required to be satisfied, viz that VAT had been incurred; that while recoverable, it had not to date been recovered; and finally (and here most controversially) that the VAT recoverable had been satisfactorily quantified.

88. Mr Southern then addressed us on four main topics. The first was the *jurisdiction of the Tribunal*. Essentially, he argued, its role was to make a determination in principle, from which both parties' accountants could then calculate a properly recoverable sum. The *Ramsay* decision (*W T Ramsay Ltd v IRC* [1982] AC 300) had stressed a *purposive* approach when construing legislation. That principle could, he suggested, be appropriately grafted onto the Tribunal's function. He noted remarks of Lady Hale in *AH (Sudan)* at para 30 which gave weight to the specialist role and function of this (and other) Tribunals.

89. The role of the Tribunal should mirror the "nature of the decision appealed against", Mr Southern continued, noting the opinion of Neill LJ in *John Dee Limited* at p952. The Tribunal in the present case, he submitted, had not a review power but a full appellate jurisdiction, enabling it to substitute its own decision. Such an approach had been approved by Etherton J in *Banbury Vision Plus* at paras 46-48, and followed by this Tribunal in several instances of PESM cases. Here he noted *St Helen's School, D C M Optical,* and *McInroy & Wood*.

90. Mr Southern's conclusion was that these decisions demonstrated that the Tribunal's role was to find a just solution. That view was consistent with the Tribunal's approach in *GMUK* where, rather than calculate a sum for repayment, it directed a formula to be applied by parties. In effect the decision depended on whether in the case of a self-supply for VAT purposes, the purchase price or cost of motor vehicles was to apply. Mr Southern noted too in this context *Pegasus Birds* in which an assessment to "best judgement" had been made.

91. In relation to jurisdiction Mr Southern concluded that the Tribunal had full appellate jurisdiction; it should follow a two-stage approach, viz determining principle first, then calculation; while an exact sum must be sought, its calculation could be referred to parties once the principles of calculation had been determined. This Tribunal should be conscious of its specialist role, as described by Lady Hale, *supra*. Moreover, the two-stage approach recommended seemed to be supported by HMRC's guidance in its Business Brief (para 4.2) of 17 September 2010.

92. The next topic considered by Mr Southern was identifying the *governing legal principles*. In *Pegasus Birds* Lord Carnwath seemed to emphasise *effectiveness* and *proportionality*, which suggested that recovery of tax due should not be made excessively difficult. The Appellant was seeking a remedy allowed by legislation and which was in accordance with EU law. He submitted that it was a breach of EU law

if an effective remedy were denied. Moreover, it would be a breach of proportionality.

93. He commented also on the developing form of the Appellant's repayment claim, which had been the subject of criticism by HMRC and by Miss Langley in her evidence. He noted with approval the approach in *Reed* and *GMUK*. He referred to the guidance in paras 3 and 4 of the Business Brief of September 2010 which, he considered, set out the correct approach. It depended on fact and degree. He endorsed his comment at paras 80-91 of his Written Submissions. Essentially re-computation of an existing claim does not represent a new claim or a material amendment of an existing claim. Here, the facts on which the claim is based had not changed.

94. So far as the *onus* of proof is concerned Mr Southern agreed with Mr Smith: it rests on the Appellant (paras 36-38 of his Written Submission) and that to prove a specific amount. This, he continued, seems consistent with HMRC's guidance on *Fleming* claims. Mr Southern notes at para 40(3) "… To take the place of such evidence claims may be based on notional figures, assumptions, extrapolation and interpolation; …" in relation to Section 121FA 2008. (We would observe with respect that this is not part of the wording of the Section). However, he notes (para 42 of Written Submissions) that HMRC's *Fleming* guidance indicates that estimates based on assumptions which are *reasonable and sustainable* are acceptable, and that there was no definitive list of what evidence would or would not be acceptable.

95. Thirdly, Mr Southern addressed the issue of <u>methodology and evidence</u>. HMRC seemed to suggest that if the claim were defective in parts, the whole should be rejected. Mr Southern submitted that in that event, only the defective parts should be excised.

96. Mr Southern considered that the elements in the claim of VAT on catering and capital expenditure had been properly addressed. Full information and figures relating to them had been recovered from the Blue Books. So far as residual VAT was concerned, Mr Southern referred us to *dicta* of Lord Carnwath in *Mayflower Theatre*. Residual and direct expenditure had to be contrasted. In some instances input VAT may be directly attributable to taxable and exempt supplies. But if it is not directly attributable, it should not disappear from the calculation: it may still be available as residual input tax and the subject of partial recovery. By contrast HMRC seemed to argue that VAT insofar as not directly attributable to outputs, should not be allowed. The Appellant's claim, Mr Southern stressed, had been constructed on a conservative basis to exclude possible double-recovery. The Appellant's suggested PESM had to be "fair and reasonable", while its calculation of claim required to be correct, albeit in the whole context of proportionality.

97. Mr Southern acknowledged that there were difficulties in relation to the sufficiency of evidence. The scale of the evidence was extensive and the analysis of it, complex. A form of extrapolation was an acceptable basis for calculating the claim, he continued. Estimates, also, had to be made. This approach had been endorsed in *GMUK* [but see paras 147/148] and other cases.

98. A key aspect of quantification of the claim was estimating business income as a percentage of total income and apportioning that between taxable and exempt supplies. Mr Southern accepted that there had been no evidence presented as to the

NHS's accounting systems. They were expenditure-based, which was a special factor. The Blue Books had provided accurate figures for 1999/2000, which had been used for retrospective extrapolation. This, Mr Southern argued, enabled satisfactory figures to be produced. There was, however, some controversy about the elimination of wages and salaries in the suggested PESM calculation.

99. Mr Southern noted that Miss Langley had favoured the use of the Consumer Prices Index to the RPI for purposes of extrapolation. The CPI, however, had not been introduced until 1996, late in the period of claim.

100. Fourthly and finally Mr Southern encouraged us to make the following Findings in Fact, viz the methodology was reliable; the methods of extrapolation were correct and conservative, the use of the Blue Books as a direct source had been extensive and provided correct information; the Appellant and its predecessors were conducting both taxable and exempt business activities and its taxable business activities generated recoverable VAT; during the claim period the Appellant had incurred considerable capital expenditure which could be estimated accurately; VAT recovery had been limited to direct catering costs and COS services.

101. Further, and critically, there had been no business activity review before 1994/95. Miss Langley had accepted that without that it would be impossible to make a precise calculation of a residual VAT claim. It followed that Blue Books figures for expenditure were largely inclusive of VAT where it had been payable. And in conclusion the claim represented a serious, informed and evidence-based approximation of the recoverable VAT, which on the balance of probabilities was due and repayable to the Appellant.

102. In reply on behalf of HMRC Mr Smith adopted his Written Submission, which had been adjusted in response to the Appellant's arguments, and then made an additional oral submission replying in turn to the aspects raised by Mr Southern.

103. He agreed with Mr Southern that the Tribunal had a full appellate jurisdiction rather than merely a supervisory one. Under the appellate jurisdiction the Tribunal could substitute its own decision whereas under a supervisory one, say in respect of the exercise of a discretionary power, it had to confine itself to confirming or rejecting the decision. In the present appeal Section 83(1)(c) VATA governed its power viz to calculate the amount of tax to be repaid. "Best judgement" was not incorporated as a criterion to be observed in the present case.

104. Mr Smith did not consider that this Tribunal's power had been extended. While higher courts might be hesitant to interfere with the factual findings of a specialist tribunal, that did not assist in defining the Tribunal's jurisdiction. He did not consider that there was a two-stage process: while the Tribunal might "encourage" parties to a particular resolution, it could not direct it. He distinguished the *GMUK* case: there the only question was whether cost or purchase price should be adopted in relation to the taxation of the self-supply. That did not represent a direction to negotiate.

105. Mr Smith then turned to the essential principles applicable to the dispute. Firstly, the *onus* of proof fell on the Appellant, and the standard of proof was the balance of probabilities. More particularly there was no lesser standard where a claim was historic. It was not the Tribunal's task, Mr Smith continued, to find a particular sum due if the claim were not established (see KDM International Ltd). It was not

inconsistent with EU law or "disproportionate" to require the taxpayer to prove his case.

106. Next, Mr Smith considered whether there was now a "new claim" before the Tribunal. He submitted at the outset that the extra element originating from the Argyll & Clyde HB was new matter, relating to a different geographical area, and rendering the "revised" form of the claim in effect a "new" claim. The new elements could not be excised to validate the balance of the claim. Also, they could not be regarded as *de minimis*. Mr Smith founded on *Reed Employment Ltd.*

107. Moreover the claim was defective in form having regard to Regulation 37. It should state the sum due and the manner of its calculation, according to Mr Smith. These were mandatory requirements. The form of a claim before this Tribunal differed from that in an arbitration, where a demand alone was sufficient. There was a significant change of method too.

108. Then Mr Smith criticised the <u>methodology and evidence</u>. The necessary exercise of direct attribution had not been carried out. It had not been shown that this failure was exclusively to the benefit of HMRC. There was no evidence to show the relative percentages of "business" and "non-business" income. (Mr Smith was prepared to concede that there was a small element of business income.) So far as possible input VAT should be directly attributed to "business" and "non-business" activities before apportioning what is left in the "pot". (See *Mayflower Theatre Trust Ltd)*.

109. Mr Smith then considered the manner of extrapolation. In principle he had no objection to that where there is a dearth of documentary evidence (see *Morrison Bowmore Distillers Ltd*.) He accepted the Blue Books as good records, but other documentation available was less reliable. A check every five years would have been more satisfactory. There has not been an attempt to set out the main cost-bearing activities of the Appellant and check for consistencies over the years. For instance at p176 of the Joint Bundle, while the main sources of income are identified, the costs are not. He emphasised that the substantial figures stated there for "other direct creditors" were not further specified. Continuity could not be presumed. There was reference in the claim to a PESM, but this would have had to have been approved by HMRC. There had been no such approval granted.

110. Mr Smith was content with Mr Southern's suggested Finding in Fact that the Appellant was conducting both taxable and exempt activities, and that the taxable business activities generated recoverable VAT. However, he could not accept a Finding in Fact to the effect that there had been no business review conducted before 1994/95. Quite simply the circumstances were unclear. He relied on *KDM International Ltd* and *WMG Acquisition Co UK Ltd* as supporting the primacy of documentary evidence. Documents were preferable to the evidence of witnesses, and the burden of proof was not eased in "historic" cases. In the present case substantial sums were in issue and there was a sparsity of documentary evidence.

111. The credibility of the claim (rather than that of the individual witnesses) had been eroded here. Its form had varied several times, and, ultimately, in the course of the hearing, all as Miss Langley had noted. The Blue Books did not show satisfactorily whether VAT had been claimed or not.

112. Finally, Mr Smith commented on the lack of documentary evidence. He adopted paras 58-73 of his Written Submission to the effect that there was not a claim in a valid, acceptable form and that in the context of Regulation 37 of the VAT Regulations 1995. There were available annual accounts and Blue Books for the Appellant's reference. It had failed to use these, Mr Smith submitted. Not all the Blue Book information had been used. The Claim should have been supported by reference to the available documentation. Reliance had been placed on the RPI in calculating figures for "intermediate" years which was unsatisfactory. The Blue Books should have been used as the best contemporaneous record. Mr Smith submitted that the appeal should be dismissed primarily because of the unsatisfactory documentary base.

113. Finally, Mr Southern's comments in response should be noted. As he interpreted HMRC's argument, it was to the effect that there was either no valid claim or the stance taken in April 2014 represented a new claim. He acknowledged the requirements of Rule 37 and the need to refer to such documentation as the claimant had in his possession. This was a complex case and there had to be a proper evidential base. However, there was a vast amount of documentation for Mr Forsyth to research. For practical purposes much of it was stored at a public library.

114. Mr Southern stressed that the claim for input tax remained essentially the same. It was in respect of input tax on catering costs, on other general hospital costs, and capital expenditure. These three elements remained as constants. Any changes represented amendments to an existing claim.

115. Mr Southern appreciated that the re-formulated claim related to a different geographical area. This, however, arose out of *entitlement* issues. The Scottish NHS Trusts had been reorganised and substantially reduced in number. Rights had been transferred by Statutory Instrument. While the claim might seem "untidy", there had been a dispute about entitlement, which was ultimately settled by negotiation. It was not a new claim, he maintained.

116. Mr Southern then turned to jurisdiction. The key issue was whether the Tribunal had investigative powers. Was the hearing adversarial or inquisitorial? There was, Mr Southern suggested, always a fact-finding role for the Tribunal. This was best exemplified in the FTT decisions in relation to PESM's. While the Tribunal could not "direct", it could – in an influential sense – "hint". This was a clear case of under-recovery. Apart from accepting or rejecting the claim in full, the Tribunal could identify and distinguish the stronger from the weaker elements in it, and it could delineate a basis for agreement. There was appropriately scope for investigation by the Tribunal, varying according to the individual case.

117. Mr Southern distinguished the global claims in construction cases cited by Mr Smith. If elements in the present claim were unsatisfactory, only these should be excised. The balance of the claim should remain extant. There was no reason why it should be prejudiced in its entirety by inadmissible elements.

118. He then turned to the *onus* and burden of proof. The Appellant's case, he protested, was not constantly shifting as the Respondents had suggested. The form of the claim had been improved, but the basis and reasons for it remained unchanged. Miss Langley's comments he dismissed as intemperate.

119. Mr Southern referred next to the need for direct attribution. This had two senses, *viz* apportionment between *business* and *non-business*, and then between *taxable* and *exempt* supplies and services. The Appellant's calculation took account of both these aspects. Mr Southern adopted *dicta* in *Mayflower Theatre Trust Ltd* to the effect that where VAT was directly attributable to particular supplies, but had not actually been so attributed, it all should fall into the "pot" of residual input tax. The fact that a sum of VAT had not been attributed, did not render it non-attributable and irrecoverable. Non-attributed VAT, he continued, should not disappear from the calculations. Rather, it falls into residue and so becomes (at least partially) recoverable. That procedure did not disadvantage HMRC. Indeed, it was a mathematical impossibility that excess VAT would thus become recoverable.

120. Finally, Mr Southern commented on the sufficiency of the documentary evidence available. There was an abundance of evidence in his view. Admittedly there was a practical difficulty inasmuch as the Blue Books showed only expenditure, and that while individual Health Boards had their own accounts, those of the Appellant Health Board existed only since 2004. The final form of the claim was a matter of balance, and he submitted that the present form represented a sound balance between the evidence available, a correct analysis, and conclusions.

Conclusion

121. We consider that the appeal must be dismissed. We have misgivings in so deciding, and this echoes our remarks in our decision in the related NHS Lothian Health Board appeal (TC/2012/00196 para 53). Both parties acknowledge that a substantial sum of input VAT is repayable. The difficulty is computational. Two problems confront us in addressing this, the first being the nature of our jurisdiction, the second being the proper martialling of voluminous records and other information. Here, we note that the process of calculation and revisal of the claim continued into the course of the hearing itself, which is unsatisfactory from the viewpoint of the Tribunal. Miss Langley complained of having to address four versions, but to some extent these revisals were made to meet HMRC's criticisms.

122. This is a *Fleming* type claim, calculated by reference to an extended period of 20 years, from April 1974 to March 1994. It is enabled by FA 2008, Section 121, and there is published guidance issued by HMRC as to its implementation. We would refer to their *Fleming Guidance* issued in both March and September 2010. So far as we understand, there is no statutory relaxation of the standard of proof to be applied and the *onus* remains on a claimant. We were advised by Mr Southern that para 2.6 of the "March" Guidance encouraged an expectation that "reasonable and sustainable" estimates are acceptable. We note in the "September" Guidance similar wording at para 4.9 but with cautionary emphasis about the sufficiency of evidence. However, a practical difficulty which has emerged in parties' negotiations has been that marginal alterations of arithmetical formulae (say, in respect of a PESM) can result in very substantial changes in the net amounts calculated as repayable.

123. In short, the parties are both public bodies with corresponding responsibilities; it seems accepted in principle that a substantial amount of input VAT is repayable; the areas of dispute appear to be limited and can be identified; but their consequences in value are significant.

124. A process of mediation might be ideally suited to resolving the dispute inasmuch as each stage could be addressed in turn and a decision or compromise on each stage then be made, but the nature of the jurisdiction of this Tribunal, which must focus on calculating an exact or even approximate final sum due, is not.

125. We consider firstly the nature and consequences of our ***jurisdiction***. Parties agree (correctly in our view) that it is a "full" jurisdiction. We accept that jurisdiction is determined according to the question at issue: see *John Dee Ltd* (p952). Here, we consider, it is the determination of a due sum repayable by HMRC and that on the basis of evidence led, not the monitoring of the individual stages of its calculation, their manner and accuracy.

126. As we understand Mr Southern's arguments, he seemed almost to concede shortcomings in the Appellant's calculations by suggesting in his "reserve" argument that we should review in principle each stage of the calculations and their "mechanics", leaving aside the arithmetical aspects for finalisation. Here Regulation 37 of the 1995 VAT Regulations falls to be considered. It provides in respect of claims for repayment of overpaid VAT that:-

"Any claim under Section 80 of the Act shall be made in writing to the Commissioners and shall, by reference to such documentary evidence as is in the possession of the claimant, state the amount of the claim and the method by which that amount was calculated."

That implies, we consider, that where primary records are available to a claimant, they must be used.

127. Another preliminary aspect which arises is whether the claim in its present form represents a ***new claim*** and is accordingly time-barred. Here we would distinguish between the adjustment and amendment of an initial claim, and its enlargement or enhancement by introducing extra distinct elements. In the context of the present appeal the practical issue is whether or not repayments of VAT due to the former *Argyll and Clyde Health Board* have been introduced after the time-bar, which expired on 31 March 2009. It was explained to us that questions of *entitlement* to claims of former Scottish Health Boards had been resolved. Entitlement had been passed to their successors. The geographical area of the now defunct *Argyll and Clyde Health Board* and its responsibilities had been divided between this Appellant and the *Highland Health Board*. While the statutory reorganisation of the Scottish Health Boards may have resolved questions of succession and entitlement, it would not have restored potential claims of the defunct Board which had already been time-barred.

128. While we consider that such additional elements which were in themselves time-barred cannot be introduced into the present claim, they do not, once excised, contaminate it in its entirety. In short revisals and refinements are permissible: additions and extensions are not. While the original claim stands, additional elements must be excluded.

129. We indicated *supra* our misgivings about the **sufficiency of the evidence** supporting the Appellant's calculations. Evidence was led over five days: clearly each and every item could not be spoken to even indirectly, and sensibly each of the parties did not seem to expect such a standard of proof. Matters of **computation and**

methodology were addressed in a broad manner. A sympathetic approach in *Fleming* cases is suggested: see Moses J in *Marks & Spencer v HMRC* (p241).

130. Annual accounts are prepared for the Appellant and the other Health Boards. There are also the Blue Books recording expenditure (only) of all the Scottish Health Boards. It is likely that these figures are inclusive of VAT where this has been charged. These two sources of information are in our view relied upon and represent a satisfactory starting point for the necessary calculations.

131. The first stage of the necessary calculations is the *attribution* of inputs and VAT paid thereon. This process involves several stages. It is accepted that certain *business* supplies were made by the Appellant, and these, of course, come within the VAT system. Firstly, therefore, an apportionment of the taxpayer's activities must be made between *business* and *non-business* supplies. This does not seem to have been fully resolved.

132. There are two elements in the present form of the claim, viz about £1.5M in respect of dining-room expenditure and about £2M in respect of "residual" expenditure. The *business* activities in each of these two elements has to be calculated to ensure that the repayment claimed does not exceed the relative input VAT. Input VAT can be reclaimed only insofar as it is attributable to taxable supplies, whether standard or zero-rated, but not in relation to exempt supplies.

133. Where input VAT on *business* supplies cannot be more particularly attributed between taxable and exempt supplies, it then falls into the "pot" of residual expenditure. This is then attributed by means of a partial exemption method. The standard formula can be superseded by a special method ("PESM"), if agreed, which apportions input tax, so allowing the deduction of that proportion of it as is reflected in taxable outputs (see Regulations 101/102 of the 1995 VAT Regulations). In the present case a PESM has not been agreed with HMRC. Indeed, the attribution process of the "pot" of residual expenditure remains the subject of dispute between the Parties.

134. Another disputed aspect of the computations was how frequently annual calculations should be verified by reference to actual figures. Here Regulation 37 is surely relevant in encouraging the use of such documentation as is available. It seems that there was an agreement that verification be made for every fifth year, and for intervening years extrapolated figures could be used. The manner of extrapolation was more controversial. It seems to us that a simple "straight line" increment could be added most satisfactorily and that, particularly, where verification by reference to actual figures was impossible or impracticable. HMRC seemed content with such a technique. The introduction of the RPI or other indexation would seem an unnecessary complication for a few intervening years. HMRC's misgivings on this aspect seem justifiable.

135. Mr Forsyth explained that he had used only two years' accounts as the basis for his calculations. These would record also the previous years corresponding figures, so providing an actual four year "base" record. From that, figures for the other intervening years were computed by a process of extrapolation. We would question the validity of the chosen method of extrapolation used by the Appellant for an extended period of 20 years, particularly when the four "base" years do not fall at even intervals in it.

136. The **calculation of a PESM** was also controversial. Here, a formula for use had not been agreed. The numerator and denominator, as calculated for the Appellant, were derived from different original Years' figures. We agree with Miss Langley that this is unsatisfactory.

137. Finally, we were uncertain that **COS VAT** had been identified satisfactorily in its entirety.

138. For all of these reasons we dismiss the Appeal.

139. 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.

KENNETH MURE
TRIBUNAL JUDGE

RELEASE DATE: 13 March 2015

APPENDIX

GREATER GLASGOW AND CLYDE HEALTH BOARD

Appellant

- and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

JOINT LIST OF AUTHORITIES

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2. VATA 1983, Schedule 5, Group 1
3. VATA 1994, section 41, 78, 80, 83-83G
4. VAT Regulations (SI 1995/2518), regulation 37
5. Finance Act 2008, section 121

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7. *John Doyle Construction Ltd v Laing Management (Scotland) Ltd* [2004] SLT 678
8. *John Doyle Construction Ltd v Laing Management (Scotland) Ltd* [2004] SC 713

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31. *R v C & E Comrs* ex parte *Building Societies Ombudsman Co Ltd* [2000] STC 892

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33. *St Helen's School Northwood Ltd v R & C Comrs* [2007] STC 633

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36. *DCM (Optical Holdings) Ltd v R & C Comrs* UK FTT 28 September 2009

37. *R & C Comrs v London Clubs Management Ltd* [2012] STC 388

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41. *Market & Opinion Research International Ltd v R & C Comrs* [2013] UKFTT 779