[2015] UKUT 0264 (TCC)

Appeal number: FTC/92/2014

VAT – Input tax – Claim for recovery of input tax under-claimed between 1974 and 1997 – Quantification and substantiation of claim – Whether the First-tier Tribunal erred in refusing appeal because evidence insufficient to establish a "tolerably acceptable calculation" – VATA 1994, section 83(1)(c) – Finance Act 2008, section 121 – appeal refused.

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

ON APPEAL FROM THE
FIRST-TIER TRIBUNAL (TAX CHAMBER)

LOTHIAN NHS HEALTH BOARD

Appellant

v

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: LORD TYRE

Sitting in public at George House, 126 George Street, Edinburgh on 16 and 17 March 2015

David Southern QC for the Appellant (Lothian NHS Health Board)

Sean Smith QC, instructed by the Office of the Advocate General for Scotland, for the Respondents (HMRC)

DECISION

LORD TYRE

Introduction

1. As a consequence of the decision of the House of Lords in *Fleming (t/a Bodycraft) v HMRC* [2008] STC 324 and the subsequent amendment to the law made by the Finance Act 2008, section 121, the entitlement of traders to recover underclaimed input VAT for periods going back as far as 1973, which had been removed in 1997, was restored. Claims required to be submitted by 31 March 2009.

2. Among the many VAT-registered bodies who made claims to recover historic input tax were public authorities carrying on mainly non-business activities and/or making predominantly exempt supplies, such as universities and health boards. In the early years of VAT, public bodies had been slow off the mark in reclaiming such input tax as they were able to attribute wholly or partly to taxable supplies. Budgetary pressures forced a change of approach, and by the 1990s public authorities were entering into partial exemption special methods and making claims for recovery of input VAT alleged to have been under-recovered in past years. The latter process was interrupted by the retrospective introduction in 1997 of the three-year cap which was ultimately held by the House of Lords in *Fleming* to have breached the EU principle of effectiveness. After the enactment of the Finance Act 2008, section 121, a large number of claims were submitted by public authorities, including health boards, prior to the 31 March 2009 deadline.

3. Making a claim to recover input tax allegedly under-recovered so many years ago gives rise to obvious practical difficulties. These were succinctly summarised by the First-tier Tribunal in *Perenco Holdings* [2015] UKFTT 65 (TC) as follows:

> "It is a characteristic of many *Fleming* claims that, because the claims relate to VAT periods many years and sometimes decades ago, documentary evidence tends to be sparse. Often the relevant tax invoices and VAT returns will no longer exist or, as in this case as regards VAT returns, are no longer retrievable. The personnel involved in the original transactions may have long since moved on and, in any event, after so many years memories will have faded."

In the case of public bodies there may be a further problem in that some of the relevant documentary evidence may never have existed at all, because little attention was paid at the time to recovery of what would probably only have been a very small fraction of the total input tax incurred by the body in question.

4. The onus of establishing a claim for recovery of historic input tax rests upon the claimant. However, the judgment of the Court of Justice in *Amministrazione delle Finanze dello*

Stato v SpA San Giorgio [1983] ECR 3595 makes clear that any requirement of proof which has the effect of making it virtually impossible or excessively difficult to secure the repayment of recoverable input tax would be incompatible with community law. This is an application of the principle of effectiveness. In *Test Claimants in the FII Group Litigation v HMRC* [2012] STC 1362, Lord Sumption (at paragraph 146) construed this principle as prohibiting the imposition of "onerous collateral conditions or disproportionate procedural requirements" for the enforcement of community law rights. It is accordingly necessary to bear in mind the principle of effectiveness when applying any rule of substantive law or procedure concerning the quality of evidence required to substantiate a claim for recovery of input tax relating to a period many years into the past.

5. The present appeal concerns a claim by the appellant health board to recover input tax paid on capital expenditure during a 23-year period from 1974 to 1997. It is one of a number of similar appeals by health authorities in Scotland and the first, I was informed, to come before the Upper Tribunal. The sum claimed in March 2009 was £1,354,031.36, which sum was later increased to £1,416,737.87. The claim was rejected by the respondents, and the appellant appealed to the First-tier Tribunal ("FtT"). The appeal was refused on the ground that the appellant had failed to prove, to an acceptable standard, what amount, if any, of unrecovered input VAT had been paid by it on capital expenditure over the 23-year period. The appellant now appeals, with the leave of the FtT, to this tribunal on the basis that the FtT erred in law in refusing the appeal on that ground.

Evidence led before the First-tier Tribunal

6. The appellant's first task was to satisfy the FtT that the input tax forming the basis of the claim had been paid, and that it had not already been recovered. The second task was to persuade the FtT that the appellant's proposed method of attribution of residual input tax to taxable business supplies was fair and reasonable. Evidence was led on behalf of the appellant from four witnesses to fact, namely:

    - Mr Robert Martin, the appellant's head of corporate reporting and governance, who explained that until 1994 there had been one collective VAT registration for Scottish health boards and confirmed, under reference to documentation, that the health trusts to whom NHS financial matters were subsequently devolved had not regularly reclaimed input tax. Mr Martin explained that where an NHS body bore the cost of VAT, the practice was to record the cost inclusive of VAT;

    - Mr Michael Shiels, assistant head of financial services at NHS Greater Glasgow & Clyde, who stated that the practice within the NHS was to attribute input tax directly where possible, and otherwise to treat it as irrecoverable;

- Mr Derrick Douglas, assistant director of finance with NHS Forth Valley, who had experience of VAT recovery in relation to capital projects and who was familiar with recovery of VAT under contracted-out services ("COS") rules, but was unaware of any proportional recovery of VAT incurred on capital schemes;

- Mr George Curley, a chartered engineer and currently the appellant's director of operations, who was not aware of VAT recovery in respect of capital schemes other than a small element of professional fees under COS.

References to "COS" are to rules introduced in 1985 by a Treasury Direction under VATA 1994, section 41(3), which allowed NHS bodies to recover input tax incurred on certain services received for the purpose of non-business activities, thereby removing a disincentive to the contracting-out of services. The Treasury Direction lists various services in respect of which VAT refunds may be claimed.

7. The FtT found all of these witnesses credible and reliable but observed that their evidence was in very general terms and fell short of supporting the value of the claim or the manner of its calculation.

8. The appellant also led evidence from Mr Ross Muir, a VAT consultant with experience in advising NHS bodies, who had been responsible for quantifying the appellant's claim. In the absence of records retained by the appellant, Mr Muir used information relating to Lothian Health Board, including its annual accounts and cost record books, obtained from Edinburgh University Library. He made allowance in his calculation for VAT on professional fees and for VAT recovered in respect of works done under COS. The FtT commented on Mr Muir's evidence as follows:

> "These are historical records not spoken to by those processing them or recording them. Critically, we did not hear any satisfactory evidence as to the manner and practice of their compilation and the crucial aspect of the inclusion or exclusion of VAT and any interim recovery of VAT under COS, for instance."

9. Evidence was led on behalf of the respondents from Miss Kathleen Langley, the officer responsible for the decision to refuse the repayment claim. She expressed reservations about various aspects of the claim: for example whether account had been taken of VAT already recovered; whether VAT had been recovered in respect of contracted-out services under COS and, in particular, whether such recovery would have been restricted to professional fees; whether the input tax sought in the repayment claim had ever been incurred; and whether or not any input tax incurred was directly attributable to taxable supplies. There was no audit trail linking the source documents relied on by the appellant to the claim. In her view, the value of the claim had not been satisfactorily vouched.

10. The FtT also heard evidence and submissions regarding the second contentious aspect of the appellant's claim, namely the appropriate method of apportionment of residual input tax attributable to business activities but not directly attributable to taxable or,

alternatively, to exempt supplies. Mr Muir on behalf of the appellant had proposed an inputs, i.e. cost-based method of apportionment of VAT as between non-business activities and taxable and exempt supplies. Miss Langley disagreed with the use of an inputs method and advocated the use of an outputs, i.e. income-based method which produced a lower rate of recovery.

11. The appellant invited the FtT to make the following findings in fact:

    (i) During the lengthy period of the claim there had been very limited recovery of residual input tax on capital expenditure;

    (ii) The reason for this was that the default position was for non-recovery and that, accordingly, the figures recorded for capital expenditure were VAT-inclusive; and

    (iii) While VAT was recoverable on COS operations, it had been recovered only to a limited extent. That recovery had been far more restricted than the respondents had suggested.

    There was no doubt, it was submitted, that there had been an under-recovery of VAT on capital expenditure. The respondents had acted unreasonably by rejecting the claim in full.

The first-tier Tribunal's decision

12. The FtT decided that the appellant had failed to prove that an amount of recoverable input tax had not been recovered, and stated as follows:

    "53. "...We feel a sense of frustration in that we cannot deal satisfactorily with the technical issue of the recoverable percentage of input tax (a mixed question of fact and law and as such appropriate for the Tribunal's determination) which is in dispute in this and perhaps some other of these related appeals.

    54. We agree with Mr Smith that satisfactory calculations of the amount of unrecovered tax – at least fair and reasonable ones given the context of Section 121 – have to be established by the appellant as the preliminary stage in the appeal. Mr Southern accepted that a "best judgement" approach, adopted for assessment purposes in certain contexts in VAT legislation, had no place in the present appeal. It did not seem to be in dispute that the onus of proof lay on the appellant. We note the approach of the Tribunal in *General Motors UK Ltd v HMRC* [2013] UKFTT 443 (TC) (paras 60 and 61), where a somewhat comparable evidential difficulty was encountered. There a rigid stance was adopted by the Tribunal. In fairness given the context of Section 121 claims we consider that the appellant still has to show on the balance of probabilities a reasonably precise figure for unrecovered input tax on capital expenditure over the *Fleming* period. In the present appeal there remain too many imponderable factors which preclude us making such a finding. Moreover, there is in our view logical force in Mr Smith's submission that the appellant's

argument is inferential. There remain uncertainties such as isolated repayments of significance and possible recoveries in relation to Contracted Out Services.

55. …In *St George's Healthcare NHS Trust v HMRC* [2014] UKFTT 170 (TC) there was a significant measure of agreement between the parties, and the amount at issue was comparatively small. Parties also sought a decision in principle. Here, by comparison, each party proposes a different total sum, and these are substantially divergent. The correct figure most probably is somewhere in between, but the evidence, even viewed sympathetically, does not guide us towards an approximate, far less a precise, figure. The decision in *St George's Healthcare* does not cause us to review our initial opinion, set out in the preceding paragraph.

56. In general terms we do agree with the suggested Findings-in-Fact (i), (ii) and (iii) proposed by Mr Southern and as set out by us in para 33 *supra*. In relation to (ii) we consider that generally, if not invariably, the figures included for capital expenditure were VAT inclusive. In any event it seems to be common ground between the parties that in principle a substantial repayment of input tax on capital expenditure is due. Bookkeeping practices seem to have been far from ideal in identifying whether expenditure was recorded as being VAT inclusive or exclusive, and in recording any occasional recoveries of input tax. There are also uncertainties in relation to recovery in respect of COS schemes. The four witnesses led by Mr Southern as to general NHS authorities' financial practice, while credible, were not all immediately involved in relation to the maintenance of the financial records of the appellant. They did not speak in particular to the records relied on by Mr Muir. All that, accordingly, falls far short of establishing, if not a precise value of unrecovered VAT, a tolerably acceptable calculation. Accordingly no Finding-in-Fact thereanent is made. Even if it were appropriate for the Tribunal to adopt an investigative role, we do not consider that the source material available would prove sufficient in the context of the evidence led."

I should note that it was agreed before me that, contrary to what is said in paragraph 56 above, it was *not* common ground between the parties that in principle a substantial repayment of input tax on capital expenditure was due; the respondents did not concede that any repayment had been proved to be due.

13. For these reasons, the FtT refused the appeal. However, in an effort to assist the parties in any further negotiations, the Tribunal went on to set out its views on what would constitute a fair and reasonable partial exemption special method. Having examined the parties' respective contentions in some detail, the Tribunal concluded that a fair and reasonable result would be achieved by attributing 1.87% of residual input tax to taxable business supplies. That part of the decision was clearly *obiter* and I was not asked to express any opinion upon it.

The issue

14. The issue in the appeal to this Tribunal is whether, having in effect made the above findings in fact in favour of the appellant, the FtT erred in law in holding that the claim failed because a tolerably acceptable calculation of the amount of input VAT paid and not recovered could not be carried out.

Contentions for the appellant

15. It was contended on behalf of the appellant that the FtT had erred in law in holding that the claim failed in its entirety because of difficulties of methodology and quantification. The Tribunal's decision was not reasonable, proportionate or consistent with the principle of effectiveness. The appellant had a directly effective community law right to recover overpaid input tax. National law could not make the exercise of that right virtually impossible or excessively difficult. Given the nature of historic VAT claims, the evidence would rarely be such that a precise figure could be ascertained. The courts had to adopt a broad brush approach using extrapolation, estimates and assumptions. Parliament must have intended such an approach to be taken in historic claims stretching back for up to 35 years. In the present case, there was abundant evidence to establish under-recovery: the issues related to data, methodology and therefore quantification. The FtT ought to have adopted a two-stage approach analogous to the approach used in "best judgement" cases, asking (i) is there a claim? and (ii) if so, how much? Where, as here, the answer to the first question was in the affirmative, it was an error of law to hold that the claim failed entirely.

16. In the course of the oral hearing before me, the appellant disclaimed any intention to put forward an argument based upon *Edwards v Bairstow* [1956] AC 14, i.e. that the FtT could not reasonably have reached the conclusion it did on the facts found. Apart from anything else, that was not the ground upon which leave to appeal had been granted. The Tribunal appeared to have been under the impression that it was common ground between the parties that a substantial repayment of input tax on capital expenditure was due; it could be inferred that the Tribunal itself was of this view. That being so, it was an error of law to refuse the appeal entirely on the ground that no "reasonably precise figure" (see paragraph 54 of the FtT's decision quoted above) could be ascertained for under-recovered input tax. Having in effect made findings in fact in the appellant's favour, the Tribunal failed to carry through the logic of its decision. The fact that it went on to consider in detail what partial exemption method would produce a fair and reasonable result presupposed that the appellant had a valid claim. It was the duty of the Tribunal to decide the quantum of the claim in absence of agreement between the parties. It had taken too restrictive a view of its jurisdiction. In the event that the FtT had felt unable to put a figure to the amount under-recovered, the appropriate course would have been to adjourn the appeal to allow the parties to agree a figure, with the possibility of applying to

reconvene the hearing if necessary, as was done in *General Motors UK Ltd v HMRC* [2013] UKFTT 443 (TC) at paragraph 383.

Contentions for the respondents

17. On behalf of the respondents it was submitted that the appellant had failed to identify any error of law in the decision of the FtT. The jurisdiction of the Tribunal in respect of underclaimed input tax was derived from VATA 1994, section 83(1)(c) which provided that an appeal lay with respect to *the amount of* any input tax which might be credited to a person. In other words, the Tribunal was empowered and obliged to consider the particular question of what "amount" should be credited to the appellant. It was bound to ask itself whether it was satisfied that the amount claimed by the appellant, or some lesser amount, had been shown not merely to have been underclaimed but also previously unrecovered. It did not, on the other hand, have jurisdiction to give a decision in principle, leaving it to parties to agree quantification. There was no two-stage process; that proposition had been rejected by the Tribunal in *General Motors UK Ltd v HMRC* (above).

18. It was incorrect to assert that the FtT had found that the appellant had a substantial claim to recover input VAT. On the contrary, the Tribunal had expressly disavowed making any finding in fact as to whether VAT that had been paid on capital expenditure remained unrecovered. There was nothing special about historic input tax repayment claims to justify a different approach to assessment of the quality of evidence presented in support of the claim, or to necessitate a "broad brush" approach. If a *Fleming* claim had become stale due to the lapse of time, the claimant had no-one to blame but itself. The principle of effectiveness was not infringed; there would have been nothing to prevent the claim being made contemporaneously. The difficulty experienced by the appellant in quantifying its claim was caused by lapse of time and not by any rule of law. The onus of proof remained on the person seeking to establish its claim, and the FtT was under no obligation to "solve" the problem of quantification if the appellant had failed to prove the critical facts to the requisite standard. It would serve no purpose to remit the case to the Tribunal with a direction to determine figures, because the Tribunal had already stated clearly that it found that task impossible.

Decision

19. In my opinion the FtT committed no error of law. The Tribunal was not bound, in an appeal against the refusal of a claim to recover input tax, to adopt a two-stage approach in terms of which it addressed, firstly, the question whether input tax was likely to have been paid but not recovered and, secondly, if so, the question of how much input tax had been paid and not recovered. There is no warrant in section 83(1)(c) for such an approach, and the situation is not, in my view, analogous to a "best judgement"

assessment where a two-stage approach may be appropriate. The onus of proving that "an amount" of input tax has been paid and not recovered rests upon the claimant. The standard of proof is the balance of probabilities. At the conclusion of a hearing, it is open to a Tribunal to hold that the claim fails for either of two reasons: (a) because the Tribunal is not satisfied, on the balance of probabilities, that there is any unrecovered input tax; or (b) because the Tribunal, although satisfied that there is unrecovered input tax, is unable to find, on balance of probabilities, that any particular – even a minimum – amount of input tax can be ascertained as having been paid and not recovered. In the latter alternative the Tribunal does not function as a detective with a duty to fix a figure – even a minimum figure – for input tax paid but not recovered, regardless of the quality of the evidence placed before it by the claimant.

20. In the present appeal, the FtT found against the appellant for the second of those two possible reasons. It proceeded on the basis that there had probably been an under-recovery by the appellant of input tax on capital expenditure. However, the Tribunal went on to hold that the evidence placed before it was insufficient to enable it to carry out even a "tolerably acceptable calculation" of the amount paid and not recovered, let alone a precise figure. The Tribunal gave reasons why, with obvious reluctance, it reached that conclusion. Those reasons included the following: contemporaneous book-keeping practices failed to identify whether expenditure was VAT-inclusive or exclusive; there were no reliable records of input tax recoveries contemporaneously made; the manner in which the COS scheme had been operated was uncertain; the publicly available records upon which Mr Muir's quantification proceeded could not be linked to the evidence of the other witnesses of a very general nature regarding VAT recovery practices during the years to which the claim related. On that state of the evidence, I consider that the Tribunal was entitled to say, in effect: "We are sorry, but you have failed to prove your case", and was not guilty of any error of law in holding itself unable to put a figure on the amount of unrecovered tax.

21. The appellant placed emphasis on the FtT's use of the phrase "a reasonably precise figure" for unrecovered input tax on capital expenditure, which appears in paragraph 54 of its decision. Taken on its own, the Tribunal's use of this phrase might suggest that it set too high a bar for the appellant, by requiring an unreasonable and perhaps unattainable precision in the computation of a claim made for a period stretching back many years. Reading the decision as a whole, however, I am satisfied that the Tribunal did not regard itself as requiring an unreasonably high standard of accuracy in the computation of the appellant's claim. At paragraph 55, the Tribunal observed that "…the evidence, even viewed sympathetically, does not guide us towards an approximate, far less a precise, figure". This observation appears to me to make clear that the Tribunal did not regard itself as requiring precision, and that approximation could have been sufficient to discharge the onus of proof. The appeal failed because, as the Tribunal subsequently put it in paragraph 56, nothing placed before it enabled it to arrive at a figure that was even "tolerably acceptable".

22. Such an approach does not, in my view, constitute an infringement of the principle of effectiveness. I have already noted that the principle, as enunciated by the Court of Justice in the *San Giorgio* case, reiterated in many subsequent decisions of the Court and applied by the UK national courts, is concerned with the practical effect of national rules of substantive law and procedure. The appellant did not identify any provision of substantive law or procedure which, following the legislative changes made in response to *Fleming*, rendered the appellant's community law right to recover input tax "virtually impossible or excessively difficult". It was submitted rather that the infringement of the effectiveness principle lay in the approach adopted by the respondents, and by the FtT, to the substantiation of historic VAT claims. As the appellant put the matter in its written argument:

> "Section 121 was designed to implement the effectiveness principle. Parliament conferred the right to make repayment claims going back 24 years. Parliament must be taken to have intended that overpaid tax should be recoverable, even though the normal documentary evidence required for tax claims would not have been preserved or available."

Senior counsel confirmed that it was not contended that there was a different, more relaxed standard of proof for historic VAT claims. But, he submitted, in contrast to a current claim for which full documentation was required, different forms of proof such as estimates, assumptions and extrapolations had to be used.

23. I do not consider that such a distinction can or ought to be drawn. In all cases the standard of proof remains the balance of probabilities: that applies equally to historic claims for unrecovered input tax. There is no rule of law or procedure restricting the exercise of the right of recovery in such cases; proof by means of estimates, assumptions and extrapolations was open to it as it is in all cases. The problem for the appellant was that the Tribunal was not satisfied that the material placed before it was of sufficient value to enable any reliable conclusions to be drawn, whether by way of estimation, assumption, extrapolation or otherwise. Section 121 re-opened entitlement to make repayment claims potentially going back to 1973, but it did not purport to address any of the practical difficulties that might be encountered in attempting to substantiate old claims. Responsibility for such difficulties must ultimately rest with those who, for whatever reasons, failed to make the claims when they first arose.

24. Nor, in my opinion, can the appellant derive any support for its argument from the fact that the FtT went on, in a part of the decision that is clearly *obiter*, to set out its views on the second aspect of the appeal, namely the ascertainment of a fair and reasonable partial exemption special method. The Tribunal stated expressly that it did so with a view to being helpful to the parties in any further negotiations. No doubt the Tribunal regarded this as appropriate in view of the considerable amount of work that had been carried out by both parties on this aspect of the appeal, and in my view the members of the Tribunal are to be commended for taking such trouble to be of assistance. But the fact that the Tribunal felt able to conclude that it would be fair and reasonable for 1.87% of the

appellant's residual input VAT to be recoverable affords no assistance with the prior questions of whether as a matter of fact there was unrecovered residual input VAT and, if so, how much.

25. For these reasons, the appeal is refused.

LORD TYRE

JUDGE OF THE UPPER TRIBUNAL

RELEASE DATE: 28 MAY 2015