FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2020] CSIH 14
XA5/19

Lord President
Lord Drummond Young
Lord Glennie

OPINION OF THE COURT

delivered by LORD DRUMMOND YOUNG

in an appeal to the Court of Session by

NHS LOTHIAN HEALTH BOARD

Appellant

against

A decision of the Upper Tribunal dated 2 July 2018

against

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondent

for repayment of input value added tax

Appellant: Edwards; Clyde & Co (Scotland) LLP
Respondent: DM Thomson QC, Roxburgh; Office of the Advocate General

9 April 2020

Introduction

[1] The decision of the House of Lords in *Fleming (trading as Bodycraft) and Condé Nast Ltd* v *HMRC*, [2008] STC 324, and the consequential enactment of section 121 of the Finance Act 2008 have given rise to a significant number of claims for overpaid value added tax of a

historical nature. The present case involves such a claim. As in many such cases, the primary issue is not the existence of the taxpayer's claim to recover overpaid value added tax but the quantification of that claim, and in particular whether the claim can be quantified with sufficient accuracy to permit an order for repayment of tax to be made.

[2] The taxpayer is a National Health Service trust responsible for the provision of health services within the Lothian area, and is the successor to health boards that provided similar services within the same area. The taxpayer and its predecessors operated 44 scientific laboratories during the period between 1974 and 1997. Most of the work performed in the laboratories was carried out for the clinical purposes of the taxpayer and its predecessors. To that extent the work of the laboratories consisted of non-business activities for value added tax purposes. Nevertheless, the laboratories carried out work for persons outside the NHS, including local authorities and pharmaceutical companies. For value added tax purposes such work amounted to business activities. The Upper Tribunal records that such work included non-patient tests, work for the National External Quality Assessment Scheme (NEQAS), drug trials and food and water testing. It is agreed that the input tax paid by the taxpayer and its predecessors between 1974 and 1997 in respect of laboratory expenditure for such business activities was not reclaimed by the taxpayer or by any government body acting on its behalf.

[3] The taxpayer now seeks to recover such input tax. It has made a global *Fleming* claim for the whole period from 1 April 1974 to 30 April 1997 which covers, *inter alia*, the activities of its laboratories. The claim in respect of the laboratories has been reduced from its original level, and is now for £929,874.69 of what is alleged to be recoverable input tax. That claim was rejected by HMRC, and the taxpayer appealed to the First-tier Tribunal. The First-tier Tribunal heard from a number of witnesses who gave evidence on behalf of both the

taxpayer and HMRC. These included four scientists who had been employed in the taxpayer's laboratories between 1974 and 1997 and two accountants who gave evidence relating to the taxpayer's financial management. The First-tier Tribunal rejected the taxpayer's appeal on 26 June 2017. That was followed by an appeal to the Upper Tribunal, which rejected the appeal on 2 July 2018. The taxpayer has now appealed to the Court of Session against that decision.

[4] The principal argument presented to the Upper Tribunal was that the First-tier Tribunal had erroneously adopted an approach based on partial exemption instead of apportionment between business and non-business activities. The Upper Tribunal rejected that argument on an analysis of the First-tier Tribunal's reasoning. We should record at this stage that on this matter we are in full agreement with the reasoning of the Upper Tribunal. In the argument before the court, however, the taxpayer's principal criticism was directed at the First-tier Tribunal's decision to refuse the taxpayer's claim in its entirety on the basis that the evidence available was inadequate to permit proper calculation of the claim; the evidence produced, it was contended, was the best that was available, and a reasonable methodology was suggested for calculating the amount of the historical overpayments. In support of that argument the taxpayer relied on the EU law principle of effectiveness.

[5] In our opinion the argument based on the adequacy of the available evidence is well founded, for reasons that we will discuss. In order to place that argument in context, however, it is necessary for us first to discuss the scheme of value added tax, and in particular the right to deduct input tax in cases where the taxpayer carries out both business and non-business activities; secondly, to describe the history of the right of a taxpayer to recover overpaid value added tax as a matter of both EU and UK law, and in so doing to set out the present state of that right; thirdly, to set out the historical background to the

activities of the taxpayer and its predecessors; and fourthly, to describe briefly the EU law principles of effectiveness, certainty and proportionality. Thereafter we will consider the evidence led before the First-tier Tribunal and the findings of that Tribunal as to the business and non-business activities of the taxpayer and its predecessors during the period from 1974 onwards. On the basis of that evidence, we will consider the approach that a Tribunal should take to evidence available in historical claims for recovery of overpaid value added tax. In so doing, we have regard to the difficulty of obtaining detailed evidence after the lapse of many years, and to the fact that the inability of the taxpayer and other comparable bodies to adduce evidence has in large part been produced by decisions made by government within the UK, through failures to implement properly the right under EU law to recover overpaid value added tax and through decisions by the government departments responsible for the NHS that NHS boards and trusts should not reclaim input tax on their non-business activities.

[6] An appeal from the Upper Tribunal to the court is only competent on a point of law: Tribunals, Courts and Enforcement Act 2007, section 13. The primary question that arises in the appeal to the court is the approach that should be taken by the Tribunal to evidence in historical claims for recovery of overpaid value added tax. That in our opinion can be said to raise a matter of general law. Moreover, it raises a question of the application of the law to the facts as found by the First-tier Tribunal, which is also a point of law. Indeed, on its facts the present case raises the question of how the legal rules that permit the recovery of overpaid value added tax after the time when input tax would normally have been deducted apply to historical claims for such recovery. That raises general legal issues, which we discuss subsequently. The secondary argument before the court, which was the primary argument before the Upper Tribunal, relates to whether the First-tier Tribunal made a

fundamental error in its approach to the case, by asking the wrong question or by taking account of manifestly irrelevant considerations. That also raises a point of law, as the Upper Tribunal held (at paragraph 17).

The scheme of value added tax

[7] Value added tax has its origins in EU legislation; the tax is now governed by the Principal VAT Directive (Directive 2006/112/EC), although the present claim is governed by predecessors of that Directive. In the scheme of VAT a fundamental distinction is drawn between economic (or business) activities, that is to say supplies of goods and services made in a market for monetary consideration, and non-economic (or non-business) activities which are not made for monetary consideration and are therefore outside any market; the distinction is found in article 9(1) of the Principal VAT Directive and, so far as the United Kingdom is concerned, in section 4 of the Value Added Tax Act 1994. EU Directives use the expression "economic" or "non-economic", whereas the United Kingdom value added tax legislation uses the expressions "business" and "non-business", but these have the same meaning for present purposes. Most of the activities of the taxpayer in the present case are classified as non-economic or non-business activities. In respect of those activities, the taxpayer is not obliged to charge value added tax on supplies, and has no right to recover value added tax that has been incurred for the purpose of making those supplies.

[8] Nevertheless certain of the taxpayer's activities involve the making of business supplies. Those are subject to the ordinary value added tax regime. Output tax is chargeable on the consideration received for such supplies, and input tax that is attributable to the making of such supplies is recoverable. Prior to 1994 the value added tax liability of NHS boards was handled by the Scottish Office, and during that period (and until the tax year

1995/1996) it was the general practice of public bodies not to make claims to recover input tax on business activities. Consequently at that time the general practice in relation to business supplies by NHS boards and other public bodies was that value added tax was ignored. That practice changed subsequently. Nevertheless, a major factor in the failure of the taxpayer's predecessors to recover input tax during the period down to 1994 was the manner in which government had organized the activities of health boards within the NHS and decisions made by government in relation to value added tax on such activities.

The right to deduct input tax

[9] The right to deduct input tax is an important aspect of EU law. The right was enacted in earlier legislation, but it is now contained in articles 167-172 of the Principal VAT Directive. So far as material, these provide as follows:

> "Article 167
>
> A right of deduction shall arise at the time the deductible tax becomes chargeable.
>
> Article 168
>
> In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:
>
> (a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;…".

Thus EU law confers a right to deduct input tax in respect of supplies of goods or services used for the purposes of taxed services, and the right to deduct arises as soon as the deductible input tax becomes chargeable.

[10] The way in which the deduction may be made is governed by articles 178-183. So far as material for present purposes, article 179 provides that the taxable person shall make the

deduction by subtracting from the total amount of VAT due in a given tax period the total amount of VAT in respect of which, during the same period, the right of deduction has arisen. Article 180 provides that

> "Member States may authorize a taxable person to make a deduction which he has not made in accordance with Articles 178 and 179".

Article 182 provides that Member States shall determine the conditions and detailed rules for applying *inter alia* article 180.

[11] Under UK legislation, the equivalent right to recover overpaid VAT is currently found in section 80 of the Value Added Tax Act 1994, a section that has been subject to extensive amendment. That right is subject to an express limitation period, currently of six years. Between 1974 and 1989, however, there was no provision in domestic law that gave any right to recover past overpayments of VAT. Section 24 of the Finance Act 1989 gave a right to recover overpaid output tax, but this was subject to a limitation period of six years. The right conferred by that section did not extend to the deduction of input tax that had not been deducted at the time when it was paid to a supplier. In *University of Sussex* v *Customs and Excise Commissioners* [2001] STC 1495, Neuberger J confirmed that interpretation, holding that failure to deduct input tax did not give rise to an overpayment of money falling within section 80. Nevertheless, the taxpayer in that case was held entitled to recover input tax over a period of 23 years on the basis of statements that had been made by the Commissioners of Customs and Excise; that right of recovery was not subject to any time limit. Section 80 of the 1994 Act was amended by the Finance Act 1996 in such a way as to permit taxpayers to recover overpaid output tax, subject to a limitation period of three years. In respect of input tax, the right to make a claim for unrecovered input tax was conferred by regulation 29(1A) of the Value Added Tax Regulations 1995 (SI 1995/2518), inserted by regulation 4(b) of the

Value Added Tax (Amendment) Regulations 1997 (SI 1997/1086). That too was subject to a limitation period of three years. Both of those time limits were made retrospective.

[12] When those time limits were imposed, no transitional provisions were made in respect of historical claims. In Case C-00/35, *Marks & Spencer PLC* v *Customs and Excise Commissioners*, [2002] STC 1036, the Court of Justice held that the lack of any transitional provision was incompatible with EU law, *inter alia* because it involved a breach of the principle of effectiveness. Thereafter, in *Fleming and Condé Nast Ltd* v *HMRC*, *supra*, the House of Lords applied a similar approach to claims for unrecovered input tax; it was permissible to impose a reasonable time limit, but if that was done retrospectively transitional provisions had to be made that accorded with the principle of effectiveness, in such a way as to allow historical claims to proceed. It is that principle that is relied on in the present case. Following the decision in *Fleming* Parliament enacted section 121 of the Finance Act 2008, which in relation to input tax enacted that claims for recovery of such tax incurred in accounting periods ending before 1 May 1997 could be made without any time limit provided that the claim was made before 1 April 2009. Those have come to be referred to as "*Fleming* claims".

[13] Numerous such claims have been made. The court was informed that 700 claims were made by NHS authorities in Great Britain, and that more than 200 of those are still unresolved. The fundamental problem in most historical claims is the availability of evidence to support a claim for repayment. Financial records may have been destroyed, in whole or in part, and the consequent lack of primary documentation may make proof of a claim difficult or impossible. That is essentially the problem that has arisen in the present case.

The history of the activities of the taxpayer and its predecessors

[14] With effect from 1 April 1974 healthcare functions in Scotland were transferred to regional health boards by virtue of the National Health Service (Scotland) Act 1972. The taxpayer is the successor of the regional health board responsible for health services in Lothian, which was established on 1 April 1974. At that time all of the health boards in Scotland had a single VAT registration, although each board managed its own finances. Claims in respect of value added tax were accordingly made by the Scottish Office on behalf of the various regional boards. To the extent that value added tax was overpaid, however, it was the regional board in question that was entitled to repayment.

[15] The registration requirements for value added tax were altered on 1 July 1992 through the creation of a divisional VAT registration for all Scottish health boards in respect of intra-NHS supplies in Scotland. Thereafter the health boards used individual VAT registration numbers. In 1994 NHS trusts were set up, and the administration of VAT returns was devolved to them. In consequence, 43 individual trusts became separately registered for VAT. That number was reduced with effect from 1 April 1999. On 1 April 2004 the trusts were replaced by health boards. The present taxpayer is a health board established on that date. It is, however, the statutory successor of a previous trust and the health board that preceded that trust. Consequently the taxpayer is entitled to make all relevant claims in respect of the VAT liabilities of its predecessors throughout the period from 1 April 1974. At this point we should note that since 1983 all NHS authorities have been able to recover "Contracted Out Services" value added tax directly from HM Treasury; that represents value added tax incurred on services obtained by them in order to carry on non-economic activities; the statutory basis for this is now found in section 41(3) of the Value Added Tax

Act 1994. The present appeal does not relate to Contracted Out Services; it is confined to input tax relating to taxable business activities.

[16] Against that background, the taxpayer has now claimed repayment of a sum representing the input tax paid by it and its predecessors in respect of the business activities carried on in its laboratories throughout the period from 1 April 1974 to 30 April 1997. In view of the material findings in fact, which we discuss subsequently, the issue is not whether the taxpayer has a claim to repayment of input tax. It is rather whether it is possible to calculate the amount of that claim with sufficient certainty to permit recovery. VAT was of course introduced in consequence of the United Kingdom's joining the European Communities, and the tax has continued to be governed by EU law and by the principles of that legal system.

EU law principles: effectiveness, certainty and proportionality

Effectiveness

[17] Effectiveness is a fundamental principle of EU law. The leading case is Case 199/82, *Amministrazione delle Finanze dello Stato* v *San Giorgio SpA*, [1983] 2 CMLR 658, in which the taxpayer sought repayment of national charges that had been levied contrary to Community law and the state imposed a requirement that any such claim must include proof that the charges had not been passed on to other persons. The taxpayer challenged that requirement of proof as contrary to Community law. The Court of Justice accepted that there would be no breach of Community law if national legislation prevented the reimbursement of taxes, charges and duties that had been levied contrary to Community law when it was established that the person paying such charges had passed them on to other persons (paragraph [13]). It then continued:

> "[14] On the other hand, any requirement of proof which has the effect of making it virtually impossible or excessively difficult to secure the repayment of charges levied contrary to Community law would be incompatible with Community law. That is so particularly in the case of presumptions or rules of evidence intended to place upon the taxpayer the burden of establishing that the charges unduly paid have not been passed on to other persons or of special limitations concerning the form of the evidence to be adduced, such as the exclusion of any kind of evidence other than documentary evidence …
>
> [15] In a market economy based on freedom of competition, the question whether, and if so to what extent, a fiscal charge imposed on an importer has actually been passed on in subsequent transactions involves a degree of uncertainty for which the person obliged to pay a charge contrary to Community law cannot be systematically held responsible".

[18] We note two particular features of this statement of law. First, the basic test of effectiveness is whether requirements of national law render enforcement of a Community right "virtually impossible or excessively difficult". The second of these elements is obviously more significant in practice; what that part of the test entails is a form of proportionality exercise in which the national court must assess the difficulty of enforcing a Community right. In doing so, the court must clearly have regard to both the evidence that is available and the reasons for any apparent deficiencies in that evidence. Secondly, in paragraph [15] the Court of Justice accepts that in some cases applying the principle of effectiveness may involve uncertainties of evidence, and it cannot automatically be assumed that the person who asserts a breach of Community law is responsible for such uncertainty. This is, we think, of some importance in the present case, where the history of the taxpayer's activities indicates that the failure to reclaim input VAT on laboratory activities prior to 2006 resulted from a number of factors, including the failure of the United Kingdom to implement systematically the EU legislation on the recovery of input tax (see paragraphs [11] and [12] above) and the practice followed within the NHS, under direction

from the Scottish Office (and its equivalents elsewhere), not to reclaim input VAT on business activities (see paragraph [8] above).

[19] The principle of effectiveness laid down in *San Giorgio* has been followed in numerous subsequent cases. The formulation of the principle has varied over time, and it is fair to say that some of the recent cases retreat from the more extreme statements of the principle. Nevertheless, the basic principle as stated in that case remains a fundamental part of EU law. The principle is now embodied in article 19 of the Treaty on European Union, which provides that "Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law". It is also found in article 47 of the EU Charter of Fundamental Rights, which guarantees the right to an effective remedy in all fields covered by EU law. Indeed, the principle of effectiveness can be regarded as an application of the well-known dictum *ubi jus ibi remedium*: wherever there is a right there is a remedy. As a matter of elementary common sense, it is obvious that if the law accords a right to any person that person should have a remedy that can make that right effective in practice.

[20] We were referred to a number of other cases that deal with the principle of effectiveness, but these tend to turn on their specific facts and we do not do not consider it necessary to consider them in detail. We should, however, perhaps note two subsequent cases. First, in Cases C-6/90 and 9/90, *Francovich* v *Italy* and *Bonifaci* v *Italy*, [1993] 2 CMLR 66, the Court of Justice stated (at paragraphs [32] – [34]):

> "[I]t has been consistently held that the national courts whose task it is to apply the provisions of Community law in areas within their jurisdiction must ensure that those rules take full effect and must protect the rights which they confer on individuals …
>
> The full effectiveness of Community rules would be impaired and the protection of the rights which they grant would be weakened if individuals were

> unable to obtain redress when their rights are infringed by a breach of Community law for which a Member State can be held responsible.
>
> The possibility of redress from the Member State is particularly indispensable where, as in this case, the full effectiveness of Community rules is subject to prior action on the part of the State and, consequently, in the absence of such action, individuals cannot enforce before the national courts the rights granted to them by Community law before the national courts".

Francovich is of course the leading authority on the right to obtain damages from the state for its failure to implement provisions of EU law. The fundamental principle, however, is relevant to the present case: to the extent that the state makes it excessively difficult for any person to exercise rights conferred by Community law, it is the state that must be responsible for the breach of the effectiveness principle.

Certainty

[21] The second case that we should note is *Test Claimants in the Franked Investment Income Group Litigation* v *Revenue and Customs Commissioners*, [2012] 2 AC 337; [2012] STC 1362, in the UK Supreme Court, where Lord Sumption, in a partially dissenting opinion, refers (at paragraph [146]) to:

> "... the overriding requirement derived from the Treaty… that national legal systems should provide a minimum standard of protection for EU law rights. In the case law of the Court of Justice, the standard of protection required is embodied in two principles which are restated in almost every decision on the point. First, the substantive and procedural provisions of national law must be effective to protect EU law rights (the 'principle of effectiveness'). Their enforcement in national law must not be subject to onerous collateral conditions or disproportionate procedural requirements. They must not render 'virtually impossible or excessively difficult' the exercise of rights conferred by EU law. Secondly, the relevant provisions of national law must not discriminate between the rules and procedures applying to the enforcement of EU law rights, and those applying to the enforcement of comparable national law rights (the 'principle of equivalence'). There is a third principle which features less prominently in the case law on this subject but is of considerable importance because it informs the approach of the Court of Justice to the first two. This is the principle of legal certainty, which lies at the heart of the EU legal order and entails (among other things) that those subject to EU law should be able clearly to ascertain their rights and obligations".

Counsel for HMRC placed some emphasis on the principle of certainty as described in this passage. It is undoubtedly correct to state that legal certainty is a significant feature of EU law which has been regularly restated by the Court of Justice. Indeed, it is perhaps obvious that in any developed legal system certainty as to the rules of the system is a desirable feature.

[22] Nevertheless, it is important to note that the principle in question is legal certainty. What the principle means is that the rules of a legal system should be stated with clarity, so that those affected by the system can discover their rights, obligations, powers and liabilities with a reasonable degree of certainty. The principle of certainty does not, however, extend to the facts of any particular case. It is obvious that the evidence relating to a case may vary enormously in its extent, in its cogency, in its credibility and reliability, and in its relevance to the issues that must be decided by the court. The principle of legal certainty is not relevant to the assessment of the evidence, which is a wholly separate – and very important – task for the court.

Proportionality

[23] Finally, in relation to EU law, we should note that proportionality is a fundamental feature of the system. It is mentioned in the foregoing passage from *Franked Investment Income Claimants*, in the reference to onerous collateral conditions and disproportionate procedural requirements. Applying the principle of effectiveness to a particular case will almost inevitably require an assessment of the proportionality of the procedural or evidential requirements of national law. Furthermore, the national court, in assessing whether sufficient and adequate evidence is available to establish a claim, must carry out what is in essence a proportionality exercise – determining whether the evidence available

is, taken as a whole, sufficient to establish the claim. Proportionality is also relevant to the standard used, whether that is the normal standard (at least in Scots law) of the balance of probabilities or a departure from that standard.

The findings in fact relating to the business and non-business activities of the taxpayer and its predecessors

[24] In relation to their taxable business activities, the taxpayer and its predecessors divided recovery claims for input VAT into different areas of their activities. HMRC treated the overall claim as comprising a number of "sectorized" claims, each of which related to a different area of the taxpayer's activities. The present appeal relates to the business activities of the taxpayer's laboratories, including such activities carried out by the taxpayer's predecessors. 44 such laboratories are involved. Most of their work was concerned with functions of the NHS in Scotland, and to that extent it consisted of non-business activities. Nevertheless, the laboratories also made taxable business supplies to third parties, such as local authorities, English NHS bodies and pharmaceutical companies. The input tax that related to supplies of that nature was recoverable. In so far as it was not recovered at the time when the supplies were made, it was recoverable on a historical basis, in accordance with the decision in *Fleming and Condé Nast* v *HMRC, supra*.

[25] For the purposes of the appeal to the First-tier Tribunal, and subsequent appeals, certain facts were agreed between the taxpayer and the Commissioners. These are as follows:

1) The taxpayer was entitled to make claims to recover historical input tax attributable to taxable supplies of laboratory services.
2) VAT-inclusive costs were incurred in order to make these supplies.
3) Wages and salaries had been removed from expenses to prevent distortion.

4) Contracted Out Services VAT adjustment had been made.

5) 2006/2007 was the first tax year when a recovery claim for input tax on laboratory expenses was made by the taxpayer, although laboratory claims had been made in earlier years by other Boards, which had been accepted by the Commissioners.

6) The VAT recovery fraction of 14.7% for Lothian Laboratories' business activities was derived from the 2006/2007 business activities survey.

7) In the claim period NHS Lothian carried out business activities through its laboratories.

8) The business activities included NEQAS (National External Quality Assessment Scheme), clinical trials and research, and public health and environmental health.

9) No earlier VAT reclaims had been made, save earlier claims that had been rejected as being out of time.

[26] The First-tier Tribunal heard detailed evidence from four scientists who had worked in the taxpayer's laboratories during the relevant period, which extended from 1974 to 1997. These described the work that had been carried out for external bodies, and gave varying evidence as to the amount of time that they had spent on non-NHS work. Evidence was also led from two accountants who had been employed by the taxpayer regarding its financial management during the relevant period. As already noted, the taxpayer's first claim to recover input tax on laboratory activities was for the year 2006/2007, and the recoverable amount in that year was ultimately agreed at 14.7% of the total costs of the taxpayer's laboratories. The taxpayer sought to extrapolate that percentage backwards to earlier years in order to claim deduction of input tax for the whole period from 1994 to 1997. That was rejected by HMRC on the basis that the evidence available was insufficiently reliable.

[27] On the basis of the evidence led, the First-tier Tribunal made a number of findings of fact that are material for present purposes:

1) The claim was not a new claim (First-tier Tribunal, paragraph 187), and was therefore not time-barred.

2) The Tribunal accepted as reliable the evidence given by officials from the various predecessor health boards as to the nature of the business activities conducted by the taxpayer and its predecessors. These included NEQAS work, food testing, water testing, non-medical testing of samples, especially for public health, and research and development. (First-tier Tribunal, paragraphs 189-190).

3) The nature of the laboratories' activities did not change during the period of the taxpayer's claims, and it was reasonable to infer that the nature of the inputs would not have changed markedly throughout that period (First-tier Tribunal, paragraph 189). The claim all along had been for unrecovered input tax attributable to taxable business supplies made throughout the period 1974 to 1997, and remained essentially the same (*ibid*).

4) The taxpayer and the Commissioners agreed that the taxable percentage of the taxpayer's outputs in the year 2006/07 was 14.7%. That was the figure attributable to the taxpayer's laboratory activities, and it was used in calculating the taxpayer's VAT liabilities for that year. That agreement, however, did not extend to other years (First-tier Tribunal, paragraph 195).

[28] Those findings in fact are in our opinion of great importance. In the first place, they establish that throughout the period of the taxpayer's claim the taxpayer and its predecessors carried out business activities which were subject to VAT and in respect of which input VAT was deductible. That inevitably means that the taxpayer has a valid *Fleming* claim for input VAT that was not recovered. The question at issue in the present proceedings is accordingly not the existence of such a claim but its quantification. We discuss subsequently the legal significance of this distinction, at paragraphs [39], [55] *et seq* and [63]-[65] below. In the second place, on the basis of the evidence led before the First-tier Tribunal, that Tribunal held that the activities of the taxpayer's laboratories did not change during the period of the claims, and that it might reasonably be inferred that the nature of the inputs (the basis for the recovery of input VAT) would not have changed either, to any significant degree. That means that, in principle at least, it should be possible to extrapolate findings of fact relating to the proportion of the taxpayer's business activities to its non-business activities throughout the period of the claim. That is a matter of elementary logic.

In the third place, agreement was reached between the taxpayer and HMRC as to the division of the taxpayer's activities between business and non-business elements for the tax year 2006/07. The critical question in the case was, put simplistically, whether that percentage could be extrapolated backwards to the period of the claim, from 1974 to 1997, and throughout that period.

The decision of the First-tier Tribunal

[29] As already indicated, the First-tier Tribunal heard extensive evidence relating to the taxpayer's claim, including evidence from persons employed in its laboratories throughout the period of the claim and two accountants with knowledge of the financial affairs of the taxpayer and its predecessors. The Tribunal accepted the evidence of the officials from the predecessor Health Boards as to the nature of the business activities conducted, and thought that it was reasonable to infer that the nature of the inputs would not have changed markedly during the period of claim. The claim would therefore have been "essentially the same" throughout the period from 1974 to 1997 (paragraph 189). The Tribunal further found that the taxpayer and its predecessors made taxable supplies throughout the period of claim (paragraph 190).

[30] The First-tier Tribunal then described the task before it (paragraph 193):

> "[T]he Tribunal has to consider whether the *business* income of the laboratories can be calculated. Whilst the evidence of the officials from the various Health Boards was helpful in determining that taxable supplies were made, that evidence fell short of facilitating its quantification. While the business income is almost certainly significant, the Tribunal does not consider that it has been quantified satisfactorily for the whole period. The Blue Books do not record income except for that arising from catering. Such other accounting information as is available is insufficient to show each element of sectorized income of each Health Board. There was for a time one common VAT return which was submitted for all Health Boards, stating only aggregate figures. No sales ledgers or copy tax invoices were produced to support the quantification of taxable supplies. Consequently the amount of output tax paid to

> HMRC in respect of the *business* income received by the laboratories and included in those common VAT returns has not been established. In the absence of those figures it is difficult to confirm the reasonableness of any input tax claim relating to that income".

On that basis, while the officials' testimony about business supplies was accepted, that evidence was "not sufficiently precise" to use as a basis for the quantification of the claim throughout the relevant period.

[31] The taxable percentage of the taxpayer's income was agreed at 14.7% in respect of the tax year 2006/07, but that agreement did not extend to other years. The taxpayer's advisers had attempted to extrapolate that figure back to the end of the relevant period (in 1997) and then further back to the start of the relevant period (in 1974). On this aspect of the claim, the Tribunal stated:

> "196. The Tribunal does not consider such an approach reasonable or acceptable. While the witnesses confirmed that there had been no changes to the general pattern of activity, there had not been any reference to reliable primary data. The time-scale involved also undermines the likely accuracy of the process of extrapolation. There is an interval of ten years between the end of the relevant period and 2006/07, and that is preceded by a taxable period of about 25 years. The value of the claim (about £900,000 as now adjusted) is substantial. The ratio of each activity might vary over an extended period: so too might profit margins. The Tribunal finds that there is no written agreement concerning the use of 14.70% for any period. It was used in calculating an agreed amount recoverable in 2006/07. All of this tends to undermine the validity of 14.70% as a *business/non-business* fraction used over an extended period. The Tribunal noted that another Health Board had used a fraction of 35%. No invoices or VAT returns were available.…
>
> 197. The Tribunal would suggest that there is a need to have a verifiable percentage, calculated by reference to prime records at regular intervals. For example, it might well be acceptable in a 25 year period to have verifiable figures every five years, and if there is not significant variation, to use extrapolated figures for the intervening four Years. The Tribunal observes that in the actual calculation of the Claim… 14.70% was not used throughout 11% was used, and also 12.15%".

On that basis the claim was refused. The Tribunal went on to consider the possible relevance of partial exemption, but for the reasons given by the judge of the Upper Tribunal we are of opinion that this played no material part in their decision to reject the claim.

The decision of the Upper Tribunal

[32] The argument for the taxpayer before the Upper Tribunal was heavily focused on the supposed failure of the First-tier Tribunal to distinguish properly between business/non-business apportionment and partial exemption. It was further contended that, largely because of that confusion, the First-tier Tribunal had failed to appreciate that the taxpayer's calculation of its claim was supported by sufficient evidence and fell within the range of acceptable methods. Those arguments were rejected by the Upper Tribunal. The Upper Tribunal's reasoning was largely concerned with the supposed failure to distinguish between business/non-business apportionment and partial exemption. It was held that, while the First-tier Tribunal's decision made reference to partial exemption (at paragraphs 200 *et seq*), its primary reasoning was concerned entirely with the business/non-business apportionment, and that was not vitiated by the later, essentially incidental, reference. On that matter we agree entirely with the reasoning and conclusion of the judge of the Upper Tribunal. The Upper Tribunal gave some consideration to the First-tier Tribunal's reasoning set out above, at paragraphs [196]-[197], and held that the extrapolation exercise put forward by the appellant did not provide a sufficiently precise and satisfactory basis for a claim for the period between 1974 and 1997. On that basis the First-tier Tribunal was entitled, on the material before it, to conclude that the appeal failed.

The taxpayer's grounds of appeal

[33] The taxpayer's first ground of appeal relates to the primary matter argued before the Upper Tribunal. It is said that the First-tier Tribunal had applied the wrong legal test to the appeal, in that it approached the appeal as if it were governed by principles of partial

exemption rather than the principles of business/non-business apportionment. The second and third grounds in effect run together. The second ground is that the First-tier Tribunal erred in law in its approach to the evidence, and in particular in its approach to the burden and standard of proof called for in a case of this nature. The third is that the First-tier Tribunal and the Upper Tribunal erred in law by failing to determine the appeal in compliance with the principle of effectiveness, which is binding as a general principle of EU law. In particular, it is said that HMRC should assist the taxpayer and the First-tier Tribunal in ascertaining a fair and just amount of under-recovered value added tax to be repaid to the taxpayer. Alternatively, the EU law principle of effectiveness required the First-tier Tribunal, or the Upper Tribunal on appeal, to find sufficient facts to enable an appropriate methodology to be determined to secure that a fair and just amount of under-recovered value added tax may be ascertained for repayment.

[34] The grounds of appeal are followed by a number of questions for the court's determination. To some extent these raise collateral issues, which it is unnecessary to consider. Two questions are significant, however. The first (question No. 2 in the appeal) is whether the fundamental right to repayment of overpaid VAT, guaranteed by EU law and the principle of effectiveness, means that even if the taxpayer's methodology for calculating the amount of repayment were rejected, HMRC, and the Tribunals, were not permitted to reject completely the taxpayer's claim for repayment of input VAT solely on the basis of difficulties with identifying a satisfactory methodology or difficulties of proof. That is followed by a supplementary question as to whether the appropriate course was for the Tribunals to make findings of fact on the basis of the evidence that was available and to rely on those in determining an appropriate amount of repayment of input VAT. The second question (question No. 4 in the appeal) is whether, having regard to the fundamental EU

law requirement that the right to recover overpaid VAT should not be rendered excessively difficult or impossible in practice under domestic law (the principle of effectiveness), HMRC and the Tribunals should adopt a flexible approach to the burden and standard of proof in connection with historical claims for repayment. We should indicate at this stage that we would answer both of those questions in the affirmative, for reasons that are discussed in detail at a later stage in this opinion.

The calculation of historical claims for recovery of input tax

[35] In historical *Fleming* claims a problem that is frequently, perhaps normally, encountered is lack of evidence. The reasons for this are obvious. Financial records for periods 20 or 30 years previously are likely to have been destroyed or filed in such a way that they cannot be traced. Notwithstanding the absence of direct records, however, some evidence will usually be available to support a historical claim. In the present case, for example, full financial records are available for the year 2006/2007, and evidence was led, and accepted by the First-tier Tribunal, that the activities of the taxpayer's laboratories had not changed significantly throughout the period from 1974 to 1997 and that the taxpayer's claim had throughout been for unrecovered input tax attributable to taxable business supplies made at the taxpayer's laboratories. In these circumstances the obvious procedure that will be relied on by a taxpayer is a backward extrapolation from the year for which full records are available, on the basis that as the nature of the business has not changed materially the inputs into the business, and the tax paid on those inputs, are unlikely to have changed materially either.

Effectiveness

[36] In assessing historical *Fleming* claims, the effectiveness principle is likely to be of great importance. As we have noted, that principle is based on the general proposition that, if a legal right exists, a remedy should be available to secure the practical availability of that right. Any requirements of proof must not make it excessively difficult to enforce the right: *San Giorgio*, *supra*, at paragraph [14]. The court indicated in that case that presumptions or rules of evidence that place an undue burden on the taxpayer will contravene the effectiveness principle. The formulation of those examples, however makes clear that they are only examples ("That is so particularly in the case of presumptions or rules of evidence": paragraph [14]). In our opinion the principle is not confined to what may be described as legal rules relating to matters such as the availability of evidence or the burden of proof. It also extends to the practical attitude taken by a court or tribunal to the evidence led in a particular case. That applies in particular to the willingness of the court or tribunal to draw inferences from such primary evidence as is available; if too strict an approach is taken to the ability to draw inferences, it may well be "excessively difficult" (or even "practically impossible") to establish a claim. In the proof of historical claims the drawing of inferences is likely to be of particular importance because of the typical restrictions in the primary evidence.

[37] As we have indicated (paragraph [18]), the application of the effectiveness test generally involves a form of proportionality exercise, in which a number of elements must be balanced. In relation to the drawing of inferences from restricted primary facts, regard must obviously be had to the deficiencies in the facts themselves and to the reasons for them. The second of these factors is likely to be important in historical *Fleming* claims, because an important reason for the taxpayer's failure to make a claim previously, and to

keep accounting and other records that would have supported such a claim, will typically be that national legislation prevented claims for the recovery of input tax, notwithstanding the existence of the right to recover input tax in EU law. That is the case in the United Kingdom, and in our opinion it is an important factor in the present case. It is also necessary to have regard to the reasoning that underlies the inference that the taxpayer seeks to draw. In a historical *Fleming* claim this will typically be an extrapolation backwards from the period when clear accounting information exists. That extrapolation must be considered critically to discover whether it is reasonable in all the circumstances. In this respect, it is to be expected that there will at least be evidence as to whether the taxpayer's business activities have changed significantly over the period in question; if they have not that obviously supports the drawing of the necessary inference. It is also to be expected that there will be evidence as to whether the level of taxable inputs in respect of those activities has changed significantly; once again if there is no significant change that supports the inference. It may also be relevant to consider the explanation given for the non-availability of any direct evidence for the period in question. If that is the fault of the taxpayer, that may justify a strict approach to the primary evidence and a restriction on the extent to which inferences may be drawn from such evidence as is available.

[38] Nevertheless, we think it important to bear in mind that in historical *Fleming* claims the responsibility for failure to make the claims when full evidence was still available lies in considerable measure with the state – in legislation that did not conform to the EU law right to recover input tax and, in the case of the United Kingdom, in the convoluted attempts to impose time limits on historical claims. In the case of NHS Boards and the Trusts that preceded them, there is the further factor that their VAT affairs were at one time under government control, and at that time, as a matter of policy, no attempt was made to recover

input VAT in respect of laboratory activities. All of these are factors that suggest that a reasonably generous approach should be taken to historical claims to recover input tax in cases such as the present.

[39] Ultimately the exercise involved is one of judgment, weighing up the strength of the evidence that is available, the reasons for the absence of other evidence, and the coherence of the reasoning that is said to support an inference as to the amount of input tax that is recoverable on the basis of the evidence that is available. The underlying question is whether the taxpayer's right to recover input tax can be made effective in practice. In this connection, we would draw attention to the fact that the Tribunal's task in cases such as the present is merely one of quantification; it is not the establishment of the right to repayment of input tax; it is a matter of agreement that such a right exists. Counsel for the taxpayer placed considerable emphasis on this element, and mentioned that in other areas of the law, notably reparation for personal injury sustained at work, the courts had been willing to take a liberal approach towards requirements of evidence and proof. Examples given included *Nimmo* v *Alexander Cowan & Sons Ltd*, 1967 SC (HL) 79, and cases such as *Fairchild* v *Glenhaven Funeral Services Ltd*, [2003] 1 AC 32 (where the logical aspect of causation was ignored to produce a result that did practical justice). We think that there is a limit to how far cases of that nature can be followed in other areas of the law. The fundamental point rather appears to us to be that the effectiveness principle, and indeed so far as domestic Scots law is concerned the principle *ubi jus ibi remedium*, require that the court should take a flexible attitude to the question of remedies, ensuring so far as possible that the parties' substantive rights are given effect.

Evidence

[40] In matters governed by EU law it is generally for the national legal system to determine what evidence is acceptable, although that is always subject to the EU principle of effectiveness and the further principle of equivalence, under which the rules applicable to a claim based on EU law should be equivalent to those that apply to a comparable claim based on wholly domestic law. The treatment of evidence in proceedings was considered by the Court of Justice in Case C- 621/15, *NW* v *Sanofi Pasteur MSD SNC*, [2018] 1 CMLR 16. The context in that case was EU-based consumer law relating to medical products; it was alleged that the administration of a vaccine had produced multiple sclerosis. Nevertheless the principles stated by the Court appear to us to be of general application. The Court noted (at paragraph 25) that "under the principle of procedural autonomy and subject to the principles of equivalency and effectiveness, it is for the national legal order of each Member State to establish the ways in which evidence is to be elicited, what evidence is to be admissible before the appropriate national court, or the principles governing that court's assessment of the probative value of the evidence adduced before it and also the level of proof required". The court then (at paragraph 26) restated the principle of effectiveness in standard terms, to the effect that the detailed procedural rules governing actions for safeguarding rights that individuals derive directly from EU law must not render "practically impossible or excessively difficult" the exercise of rights conferred by EU law.

[41] In relation to the assessment of evidence, the Court of Justice stated (at paragraphs 30-31):

> "30 It should also be stated, particularly since, as mentioned by the referring court, medical research neither confirms nor rules out a link between the administering of the vaccine and the occurrence of multiple sclerosis, that evidentiary rules that rule out any recourse to circumstantial methods and provide that, in order to meet the burden of proof provided for in [the] Directive, the victim is

> required to produce certain proof based on medical research of the existence of a causal link between the defect attributed to the vaccine and the appearance of the disease, disregards the requirements resulting from that Directive.
>
> 31 [S]uch a high evidentiary standard, which amounts to excluding any method of proof other than certain proof based on medical research, could make it excessively difficult in many situations or, as in the present case, where it is common ground that medical research neither confirms nor rules out the existence of such a causal link, impossible to establish producer liability, thereby undermining the effectiveness of art. 1 of Directive 85/374 ...".

In our opinion that case is authority for the view that a national court or tribunal, in giving effect to EU-derived legal rights, must not apply national rules of evidence that prevent reliance on any evidence that has, in practical terms, a bearing on the claim that is made. That appears to us to accord with common sense. In general, any evidence that can reasonably be considered relevant should be taken into account.

[42] In cases such as the present which involve historical claims for the recovery of overpaid tax, it appears to us that the same approach should be taken. Evidence should only be excluded if it cannot reasonably be considered as having a bearing on whether or not the taxpayer's claim has been established. Even if a particular piece of evidence appears relatively weak, it will normally be appropriate to admit the evidence and then to take account of the overall strength or weakness of the taxpayer's case at the stage where the tribunal considers the question of whether the standard of proof on the balance of probabilities has been met. If a particular item of evidence is weak, it will obviously not carry great weight at that stage (see below).

The standard of proof

[43] In civil litigation the norm, and indeed the default position, is that proof is required on a balance of probabilities. Obvious reasons exist for that. At a practical level it treats the parties as equally as is possible given the fact that a person making a claim must establish

that claim. At a conceptual level it means that courts and tribunals proceed on the basis that if an argument is more likely than its converse it will be followed. That is elementary common sense. In some areas, notably criminal prosecution, the law departs from proof on a balance of probabilities, but that is for important policy reasons. These do not apply to reclaiming overpaid tax.

[44] Consequently we are of opinion that the standard of proof in a claim for unrecovered input tax is the ordinary civil standard, proof on a balance of probabilities. The application of that standard to the tax calculation is perhaps not entirely straightforward. Normally, a tax calculation is carried out on the basis of detailed financial records, interpreted in the light of accountancy practice, with arithmetical calculations carried out on the basis of the information in those records as so interpreted. In those circumstances something approaching certainty is perhaps achievable in a typical case. We think it likely that the First-tier Tribunal had that sort of case in mind in the approach that it took to the evidence available in the present case, and we can sympathize with the Tribunal's tendency to follow standard practice. In historical claims, however, much of the evidence is inevitably lacking, and a typical tax calculation is impossible. The Tribunal must accordingly proceed on the basis of the evidence that is available, and the critical question for it is whether on the basis of that evidence it is possible to hold that the taxpayer has proved its calculation of unrecovered input tax on a balance of probabilities – in other words, whether the taxpayer's calculation is, at a general level, more likely than the contention that no unrecovered input tax, or a much lesser amount of such tax, is due. The words "at a general level" are important; a historical claim will almost inevitably be based on evidence that is manifestly incomplete, and the Tribunal must do its best with the evidence that is available. Ultimately the question is whether, in general terms, the taxpayer's calculation is more likely to be

correct than the counter argument for HMRC that no or significantly less input tax is due to be repaid.

[45] So far as deficiencies in the evidence are concerned, it is of course material for the Tribunal to consider who is responsible. If the fault is that of the taxpayer, for example through not keeping proper records or destroying records prematurely, it might be legitimate for the Tribunal to draw the inference that the taxpayer has failed to make out its calculation of input tax. Where, on the other hand, the absence of evidence relates to a historical claim which could not have been brought earlier because of deficiencies in the UK legislation, or government practices relating to claims for input tax by public authorities, such evidence as is available should be taken into account. On this aspect of the case, the significance of deficiencies in the evidence is likely to depend on two factors: (i) whether there is an explanation for those deficiencies that is not the fault of the taxpayer; and (ii) whether the deficiencies are sufficiently serious to make the taxpayer's calculation of unrecovered input tax fail on the balance of probabilities.

[46] Finally, on this aspect of the case, we should note that in historical claims estimates will frequently be used. That is not unusual in other areas of the law, for example damages for breach of contract or personal injuries. While these differ from tax claims, we cannot see any reason that an estimate should not be used in any case where a calculation has to be carried out on the basis of incomplete information. The critical question in these cases is whether the premises on which the calculation is based appear sound, having due regard to the deficiencies in the available evidence and whether on the basis of the evidence that is available the calculation has been carried out in a manner that is objectively reasonable and in accordance with proper tax and accounting practice.

Role of the First-tier Tribunal

[47] As we propose to remit this case for reconsideration to the First-tier Tribunal, it is appropriate that we should comment briefly on the role of that Tribunal in relation to historical claims based on incomplete evidence. The Court of Justice has recognized that EU law does not require national courts to raise issues concerning the breach of provisions of such law on their own motion. In accordance with the practice followed in the domestic law of most member states, the Tribunal is entitled to adopt a passive role and to confine itself to the dispute defined by the parties themselves, relying on facts and circumstances put forward by those parties: see the joint Cases C- 430/93 and 431/93, *van Schijndel and van Veen* v *Stichting Pensioenfonds voor Fysiotherapeuten* [1996] 1 CMLR 801, at paragraphs 19-22. That accords with the domestic law of the United Kingdom, and it is an approach that the Tribunal should follow in this case.

[48] The role of the First-tier Tribunal has been further considered by the Upper Tribunal in recent cases, two of which are relevant for present purposes. First, in *Lothian NHS Health Board* v *Revenue and Customs Commissioners*, [2015] UKUT 264 (TCC), [2015] STC 2221, Lord Tyre (at paragraph [19]), held that the onus of proving that an amount of input tax had been paid and not recovered rested upon the taxpayer and that the standard of proof was the balance of probabilities. We agree with those propositions. Lord Tyre further held that it was open to the Tribunal to hold that the claim failed for either of two reasons: either because it was not satisfied on the balance of probabilities that there was any unrecovered input tax, or because the Tribunal, although satisfied that there was unrecovered input tax, was "unable to find, on a 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 case, it was observed that the Tribunal did not function as a detective with the duty to fix a

figure, even a minimum figure, for input tax paid but not recovered, regardless of the quality of the evidence. We agree with those observations, but we should observe that the evidence that was available in that case, although relating to the same Health Board as the present case, was significantly less than that before the First-tier Tribunal in the present case. For that reason the decision on the facts is distinguishable.

[49] Secondly, in *Revenue and Customs Commissioners* v *General Motors (UK) Ltd*, [2015] UKUT 605 (TCC); [2016] STC 985, the Upper Tribunal considered a submission that the First-tier Tribunal had misconceived its role as providing a solution rather than determining whether the claim advanced by the taxpayer had been proved on the balance of probabilities. The Upper Tribunal (at paragraphs [67]-[68]) accepted that the role of the First-tier Tribunal was to determine whether it was satisfied, on the basis of the evidence adduced and to the civil standard of proof on the balance of probabilities, that the taxpayer had overpaid VAT (in this case on deemed self-supplies of cars between 1987 and 1992). As a step in its reasoning, the First-tier Tribunal had required to consider and evaluate the methodology for ascertaining the ratio of the cost of production of such cars to the list price throughout the whole of the claim period. The First-tier Tribunal were not, however, confined to choosing whether to accept or reject an expert witness's model in its entirety.

> "68 ... So far as they could properly do so, it was their duty (applying their own expertise as a specialist tribunal) to ascertain the true amount of VAT (if any) which [the taxpayer] had overpaid. This result could be achieved either by the FTT performing the appropriate calculations itself, or by stating the principles by reference to which they considered the calculation should be made. In performing this task, the FTT had to act with procedural fairness, and there had to be a proper evidential foundation both for their findings of fact and for their conclusions. But their preferred solution did not have to be one for which either side had specifically contended, either before or in the course of the hearing".

We agree with the foregoing observations, and we would note that the Tribunal went on to (at paragraph [71]) approve of the observations of Lord Tyre that we have discussed in the last paragraph.

Application to the present case

[50] The First-tier Tribunal heard extensive evidence on behalf of both the taxpayer and HMRC, and on the basis of that evidence it made extensive findings in fact. We have narrated what we consider to be the critical findings at paragraph [27] above; these must obviously be read in the light of the agreed facts set out at paragraph [25]. The agreed facts disclosed that the claim for unrecovered input tax on its laboratory activities made by the taxpayer for the year 2006/2007 was accepted by HMRC, but that that agreement did not extend to earlier years. In that year the VAT recovery fraction for the taxpayer's laboratories' business activities was agreed at 14.7%; that figure was derived from a survey of the business activities in that year. It was also agreed that during the claim period the taxpayer and its predecessors carried out business activities through its laboratories; those are briefly described in the findings in fact, although a much longer description is contained in the summary of the evidence in the First-tier Tribunal's decision.

[51] In relation to the findings in fact, the first important finding was that the evidence given by officials from the taxpayer and its predecessors as to the business activities conducted in the laboratories was accepted. Secondly, it was accepted that the nature of the laboratories' activities did not change during the period of the taxpayer's claims. Thirdly, the First-tier Tribunal held that it was reasonable to infer that the nature of the inputs would not have changed markedly throughout that period. Fourthly, the claim was for unrecovered input tax, and would have remained essentially the same throughout the

period of the claim, from 1974 to 1997. Fifthly, the parties had agreed that the taxable percentage of the taxpayer's outputs in the year 2006/2007 was 14.7%, that being the figure attributable to the taxpayer's laboratory activities.

[52] The fundamental argument for the taxpayer is that in the light of the findings that the activities carried out in the taxpayer's laboratories did not change during the period of the claim to any material extent, and that the nature of the inputs would not have changed markedly throughout that period, the figure of 14.7% agreed for 2006/2007 should be extrapolated backwards to earlier years. That was supported by the specific finding by the First-tier Tribunal that the claim for unrecovered input tax would have remained essentially the same throughout the period from 1974 to 1997. Counsel for the taxpayer emphasized that all of the evidence that was now available about the activities of the taxpayer during the period from 1974 to 1997 had been provided to the First-tier Tribunal; that was not disputed by HMRC. It was submitted that in the circumstances the Tribunal should have attempted to carry out the extrapolation exercise, calculating the amount of input tax that is likely to have been paid by the taxpayer in respect of business activities in its laboratories during the claim period.

[53] The taxpayer put forward a calculation performed on this basis. It was founded on such documentary evidence as remained available. This in turn was based on the VAT incurred in each of the tax years from 1974/75 to 1996/97. Estimates were made of the amount of income that was attributable to NEQAS, clinical trials and public health and biochemistry, the three main business areas of the taxpayer's laboratory activities. On the basis of those estimates a taxable percentage of those activities was calculated; this varied from 11% to 14.7% in each of the relevant years. 14.7% was of course the figure that was accepted by HMRC for the year 2006/07. Those percentages were used to calculate the

estimated amount of input tax for each year. Obviously assumptions are made in this calculation, including the propositions that the taxpayer's business activities and the claim for unrecovered input tax would not have changed markedly over the period in question.

[54] The First-tier Tribunal rejected the taxpayer's argument. At paragraph 193, which is quoted at paragraph [30] above, it stated that it had to consider whether the *business* income of the laboratories could be calculated, and expressed the view that, while evidence of officials was helpful in determining that taxable supplies were made, it "fell short of facilitating its quantification". The Tribunal therefore concluded that the evidence did not provide satisfactory quantification for the whole period. Reference is made to the fact that no sales ledgers and copy tax invoices had been produced to support the quantification of taxable supplies. Consequently the Tribunal concluded that the amount of output tax paid to HMRC in respect of the laboratories' business income had not been established. It concluded that "In the absence of those figures it is difficult to confirm the reasonableness of any input tax claim relating to that income".

[55] In our opinion this imposes too high a test on the taxpayer. The First-tier Tribunal accepted that the evidence from witnesses helped to determine that taxable supplies were made, but held that such evidence was not enough to facilitate quantification. The fact that taxable supplies were made was not in dispute, however. The only issue in dispute was quantification. It was accepted that full accounting information was not available for the period in question; the primary reason for this was the historical nature of the claim, which was in large measure the result of the failure of the United Kingdom to implement properly the EU law right to reclaim input tax. It was also caused by the decisions made by the Scottish Office, a government ministry, to centralise the administration of VAT and not to make any claims in respect of input tax.

[56] Furthermore, it appears from a letter sent by HMRC to the taxpayer's representatives on 21 April 2015 that records held by HMRC for the period before 1997 were destroyed; in 2010 all documents older than six years were disposed of. Thus the state has to bear a major degree of responsibility for the absence of accounting records. In the foregoing circumstances the failure of the taxpayer to produce sales ledgers or copy tax invoices cannot be considered significant, as the First-tier Tribunal appears to have thought. The last two sentences of paragraph 193 suggest that the "reasonableness" of any input tax claim could not readily be confirmed in the absence of full business records such as sales ledgers or tax invoices. With respect, this appears a non sequitur. The sales ledgers and tax invoices, if available, would serve to establish the claim itself by reference to primary evidence. That is to say, they would establish the actual amount of the claim rather than the reasonableness of any amount claimed.

[57] In the present case it was plainly impossible to establish the actual amount of the claim. Consequently the question came to be whether the taxpayer could establish its claim on the balance of probabilities by reference to secondary evidence and inferences drawn from such evidence. In addressing that question, the taxpayer relied on such evidence as was available, making assumptions about the continuity of its business operations over the period of the claim. The question of reasonableness goes to the nature of the secondary evidence that was available, the reasonableness of the assumptions made about that evidence, and the cogency of the inferences drawn from that evidence to establish the final figures relied on by the taxpayer. The problem with the approach by the First-tier Tribunal at paragraph 193 is that it relies fundamentally on the absence of primary evidence, and does not address the main issues in the taxpayer's argument, namely the inevitable reliance on secondary evidence and inferences drawn from that evidence.

[58] At paragraphs 196-197, the First-tier Tribunal addressed the calculation of the taxable percentage; these paragraphs are set out at paragraph [31] above. It declined to extrapolate the figure of 14.7% for 2006/07 to earlier years. The Tribunal referred specifically to the evidence that there had been no changes to the general pattern of activity over the period of the claim (a matter that was held established in the findings in fact), but it rejected the extrapolation exercise put forward by the taxpayer on essentially five grounds. First, it was said that there was no reference to "reliable primary data". On this matter we once again observe that it was quite clear that adequate primary data, in the form of ledgers and invoices, was not available, for reasons that we have discussed. The critical question was whether it was possible to deal with that difficulty by relying on secondary data and inferences drawn from such data. That question does not appear to us to have been adequately addressed.

[59] Secondly, it was said that the time-scale involved undermined the likely accuracy of the process of extrapolation, with intervals of 10 years between 2006/07 and the end of the claim period and nearly 25 years before that. That is undoubtedly a relevant factor. The taxpayer sought to address it by relying on the evidence of its witnesses to the effect that the nature of its laboratory activities did not change during the claim period; that evidence was accepted by the First-tier Tribunal. The taxpayer further relied on an inference, again accepted by the Tribunal, that the nature of the inputs would not have changed markedly throughout the period. It also relied on the fact, again accepted by the Tribunal, that the claim all along had been for unrecovered input tax attributable to taxable business supplies made throughout the period, and that the claim remained essentially the same throughout that period. (The findings in fact are set out at paragraph of [27] above). These are matters

that the First-tier Tribunal required to address in considering the materiality the timescale involved, but it is not apparent that it did so.

[60] Thirdly, the Tribunal refers at paragraph 196 to the fact that the ratio of each activity might vary over an extended period, as might profit margins. That is no doubt correct so far as it goes, at a hypothetical level, but the task of the Tribunal was rather to examine the evidence from the taxpayer's witnesses to the effect that laboratory activities and inputs would not have changed markedly over that period. With all due respect, the fact that in theory the ratio of the various activities might vary, together with profit margins, is not a complete answer to the taxpayer's methodology; it is merely a factor that may be taken into account in assessing that methodology, and there is no indication that the First-tier Tribunal performed that task. Furthermore, while the factors referred to might vary, there is obviously the possibility that the variations might to a substantial extent cancel one another out.

[61] Fourthly, the Tribunal criticize reliance on the figure of 14.7% as a business/non-business fraction over an extended period. This is essentially a development of the last point; it is a relevant factor, but it must be set against the evidence that the taxpayer's business activities and inputs were broadly constant over the period in question. Fifthly, the Tribunal noted that no invoices or VAT returns were available. This of course results primarily from the historical nature of the claim. The taxpayer's case accepts the absence of primary evidence, but seeks to quantify the amount of unrecovered input tax by reference to secondary evidence and inferences drawn from that evidence.

[62] The First-tier Tribunal continued, at paragraph 197 (set out at paragraph [31] above) by suggesting that "there is a need to have a verifiable percentage, calculated by reference to prime records at regular intervals". It was suggested that verifiable figures might be

provided every five years, and if there were no significant variation it might be acceptable to use extrapolated figures for the intervening four years. The fundamental point here appears to be that without primary records such as invoices or ledgers it is impossible to verify a claim, and if the claim extends over a period such documentation must be available at regular intervals, possibly every five years. Once again this fails to address the fundamental problem that, largely as a result of matters for which the United Kingdom government was responsible, such primary evidence did not exist for the claim period. What was material, therefore, was whether the taxpayer's alternative methodology was sufficient to quantify its claim on a balance of probabilities test. That question is not addressed.

[63] In all of the above, we would stress two particular matters. The first is that the existence of a claim to recover input tax on business activities is not in issue; all that is in dispute is the quantification of that claim. That means that some amount of input tax must be due to the taxpayer. If the First-tier Tribunal were correct, none of that would be recovered. In a case where it is clear that some repayment of tax is due by HMRC, it should normally be possible to reach some sort of quantification of the amount due. Indeed, it can be said that exceptional circumstances would be required to render such quantification impossible. If necessary the Tribunal should perform the appropriate calculations itself, or at least state the principles by reference to which it is thought that the calculation should be made; in this connection we would refer to the decision of the Upper Tribunal in *Revenue and Customs Commissioners* v *General Motors (UK) Ltd*, *supra*, discussed at paragraph [49] above. We would also add that in a case where it is accepted that a repayment of input tax is due but the final amount appears uncertain, it is always possible as a last resort to discount the resulting figure to reflect that element of uncertainty. We emphasize that this is a last

resort, and that it is necessarily a very approximate procedure, but it is a technique that can be used to ensure that a claim that undoubtedly exists does not fail entirely.

[64] The second matter that we would emphasize is the principle of effectiveness, which as we have observed is a fundamental principle of EU law, and has parallels in domestic law. This is a case where it is accepted that input tax was not claimed during the relevant period for reasons that are not the fault of the taxpayer. In view of the lapse of time, only very limited records are available, but the taxpayer has produced all of the evidence that is now available. It is on the basis of that information, with the extrapolation from the figure for 2006/07, that it is sought to quantify the claim. The principle of effectiveness appears in our opinion to demand that if at all possible that claim should be quantified.

[65] The critical question is accordingly whether, in the light of the absence of primary evidence, the taxpayer has succeeded in proving the quantification of its claim on the balance of probabilities by using such secondary evidence as exists and drawing inferences from that evidence. The secondary evidence includes the quantification of the claim that the taxpayer has produced, and also the testimony of the witnesses who gave evidence. This is not a test of certainty or near certainty: the critical question is whether the taxpayer's calculation of the amount due is more likely to amount to a proper quantification of its claim than the alternative, which appears to be that no input tax is repayable because of the impossibility of quantification. That question has not in our opinion been properly addressed by the First-tier Tribunal.

[66] For the foregoing reasons we are of opinion that the first of the two questions referred to at paragraph [34] above should be answered in the affirmative. The right to repayment of overpaid VAT is guaranteed by EU law and the principle of effectiveness. That means that the Tribunal (and HMRC) should make findings of fact on the basis of the

evidence led and to use those to draw appropriate inferences as to the level of VAT that is due. In this connection we would refer to the principles put forward in the cases cited at paragraphs [47]-[49] above, in which the role of the Tribunal is discussed. Ultimately, the difficulties of proof are not sufficient to reject the possibility of quantification. Even if such difficulties exist, the First-tier Tribunal must attempt to identify a satisfactory methodology to permit quantification of the amount of input tax that is due, it being accepted that the taxpayer is entitled to some repayment of input tax.

[67] We are further of opinion that the second of the questions referred to at paragraph [34] should be answered in the affirmative. We consider that the Tribunals and HMRC should adopt a flexible approach to the burden and standard of proof in connection with historical claims for repayment. The fundamental problem in such cases is that primary evidence does not exist owing to the lapse of time. The absence of such evidence, at least in cases such as the present, is not the fault of the taxpayer, and the lack of evidence should not be held against the taxpayer. In this connection we would refer to our previous discussion of evidence (at paragraphs [40]-[42]) and the standard of proof (at paragraphs [43]-[46]). It is also relevant to bear in mind the importance of the overriding principle of effectiveness, which we have discussed at paragraphs [36]-[39].

[68] Finally, we should note the argument presented by the taxpayer to the effect that the decision of the First-tier Tribunal was erroneous because it confused business/non-business apportionment with partial exemption. We agree entirely that those concepts should not be confused. Nevertheless, in view of our decision on the other aspects of the case, it is unnecessary to consider this matter further. We would merely state that that we agree with the decision of the Upper Tribunal to the effect that, although there is reference to partial

exemption in the decision of the First-tier Tribunal, it did not play a material part in the fundamental reasoning of that Tribunal.

The court's order

[69] We will accordingly allow the appeal, answering the two questions referred to above (questions of law Nos. 2 and 4 in the Appeal) in the affirmative. We do not find it necessary to answer the other questions.

[70] We consider that the appropriate procedure thereafter is to set aside the decisions of the First-tier and Upper Tribunals and to remit the case to a differently constituted First-tier Tribunal for reconsideration. Extensive evidence has been led, and it may well be possible for the Tribunal to make use of that evidence in coming to a decision on the case. We would not, however, seek to dictate the procedure that should be followed in this respect; details of procedure are generally best left to the court or tribunal that requires to carry them out. The fundamental task for the First-tier Tribunal is to reconsider the claim presented by the taxpayer and the arguments for both parties. In doing so it should obviously have regard to the considerations that we have set out in the earlier parts of this opinion.