[2016] UKUT 278 (TCC)
Appeal number: UT/2015/0066

VAT– partial exemption– CVCP Agreement between universities and HMRC –* Fleming *claim to recover residual VAT on overheads of academic departments – whether HMRC approved a new non-CVCP retrospective partial exemption special method (PESM) from 1973 to 1994– whether a combined PESM and business/non-business method was* ultra vires *–FTT held a new non-CVCP retrospective PESM had been approved and was not* ultra vires *– HMRC appeal to the Upper Tribunal – appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS — **Appellants**

- and -

IMPERIAL COLLEGE OF SCIENCE, TECHNOLOGY AND MEDICINE — **Respondent**

TRIBUNAL: MR JUSTICE BIRSS
JUDGE ROGER BERNER

Christiaan Zwart, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Adam Rycroft of KPMG LLP for the Respondent

DECISION

Introduction

1. The Appellants (HMRC) appeal from the decision of the FTT (Judge Anne Redston and Ms Rebecca Newns) released on 22nd January 2015 with the permission of the UT, given by Judge Berner on 5th July 2015. The Respondent (Imperial) is a well known university based in London. The case relates to VAT.

2. On 31st March 2009 Imperial made a claim for repayment of residual input tax incurred between 1st April 1973 and 31st July 1994. The residual input tax relied on is VAT on overheads of its academic departments. The relevant calculations of the VAT originally paid did not take the recovery of VAT on these overheads into account. The basis of the claim for repayment is that this overhead VAT could and should have been taken into account and, if that is done, then a substantial sum is due to be repaid back to Imperial. For the whole period Imperial's repayment claim was for £626,756.77.

3. The issues have narrowed very considerably over the course of the claim and these appeals. The key dispute now is about the basis on which the net VAT originally paid for the relevant years was calculated. Imperial's case is that the relevant calculations of recoverable VAT were made pursuant to a method whose terms were agreed with HMRC as a PESM or "partial exemption special method" (see below) as part of an overall agreement with respect to the recovery of VAT incurred by Imperial. HMRC's case is that the relevant calculations were made pursuant to agreed terms which were simply a compromise of claims made by Imperial in respect of specific accounting periods. The significance of the difference is that if Imperial are right, then the correct approach to the repayment claim is to apply the agreed PESM as it was but taking into account the VAT on overheads of academic departments. Subject to disputes about evidence and detail, on that approach the claim is likely to produce a substantial payment to Imperial. However if HMRC are

right, then the correct approach is to consider the VAT for the relevant years afresh. That would involve taking into account two factors. One factor is the overhead VAT but there is another, the teaching grant (T-grant) received by Imperial in the relevant years. HMRC's case is that the T-grant should be included as consideration for an exempt supply made by Imperial and that if it is then it is likely to greatly reduce or extinguish any repayment to Imperial. Imperial's primary case is that the T-grant cannot be taken into account at all because it was expressly excluded by the PESM and the PESM is the basis on which the VAT for the relevant years is to be calculated. It is common ground that the agreed terms did exclude the T-grant.

4. HMRC rejected the claim in a decision dated 9th February 2012. Imperial appealed to the FTT. The FTT heard evidence from two witnesses both called by Imperial. They were Mr Mason and Mr Jamieson. Mr Mason was Imperial's tax manager and had worked there since 2007. He was not able to give first hand evidence since the relevant events took place before that but he collated Imperial's documentary evidence and had discussed the claim with others who had been at Imperial for longer. Mr Jamieson was the HMRC Officer who dealt with Imperial at a critical time from the point of view of this case, which was in the mid-1990s, but who was at the time of the hearing an employee of KPMG, who acted for Imperial in these appeals. The FTT found both individuals to be honest and straightforward witnesses. In its 22nd January 2015 decision the FTT found in favour of Imperial.

5. The reason the mid-1990s were critical was because in 1991 the then VAT Tribunal had issued a decision on an appeal by Edinburgh University which opened up the possibility of a university recovering a portion of the VAT borne on central administration. After the ***The University of Edinburgh v HMCE*** (VTD 6569) case, in 1992 Imperial began a succession of claims to recover that VAT for earlier years. These earlier years' claims were retrospective. The relevant discussions with HMRC took place over five years from 1992 to 1997. Overall the discussions related to the whole period starting from 1973/74. They involved not only repayments for earlier years but also payments for the years

1993/94 up to 1996/97 as time went on. Various repayments and payments were agreed over that period. Mr Jamieson was the relevant HMRC officer from 1995 to 1997. Until July 1997 the VAT on overheads of academic departments had not been included in the relevant calculations. In July 1997 Imperial sought to include that VAT in the calculations and sought to make a claim for repayment of VAT for the three years which were then open to it i.e. 1994/95, 95/96 and 96/97. HMRC accepted the inclusion of that overhead VAT for those years and paid that claim.

6. The reason why Imperial could only extend that 1997 repayment claim back three years was because of a three year limitation period then in force. However in 2008, in ***Fleming (trading as Bodycraft) v Revenue and Customs Commissioners*** [2008] STC 324, the House of Lords held that the three year limitation period for such claims had to be disapplied until an adequate transitional period was in place. So in 2009 Imperial brought this so called "*Fleming*" claim to try and extend the repayment it achieved in 1997 back until the start of VAT in 1973/74.

7. Considering all the evidence the FTT found that in 1996 Mr Jamieson on behalf of HMRC had agreed the terms as a PESM which applied to all the relevant periods, i.e. from 1973/74 up to 1996/97. In so far as the PESM applied to past years at the time it was agreed, the PESM was retrospective.

8. The FTT also found that the PESM had been approved in accordance with the formalities then necessary, that its approval was not *ultra vires* under either UK law or EU law, and that HMRC were bound by its terms today. In finding that the approval was not *ultra vires* the FTT dealt with two points. One point was whether HMRC had power to approve the method because it was a "combined method" (explained below), it being submitted by HMRC that they had no power to agree a combined method as a PESM; and the other point was whether the fact that the PESM did not include the T-grant meant it was not fair and reasonable, which would also make it *ultra vires*. The FTT held that HMRC had the power to agree the combined method as a PESM and also held that in

fact the exclusion of the T-grant did not make the PESM unfair or unreasonable. So the FTT decided that Imperial were entitled to make the repayment claim based on the PESM.

9. The evidential burden in support of a claim being on Imperial, the FTT held that the evidence in support of the repayment claim for the years 1973/74 to 1980/81 was insufficient and so rejected that part of Imperial's claim. For the period 1981/82 to 1993/94, there was more evidence but some uncertainties existed and given that the focus of the hearing had been on the fundamental legal issues rather than on the detail supporting the claim for each year, a further hearing before the FTT would be required to decide if sufficient evidence existed for each of the later periods. Sensibly the FTT decided to adjourn that matter with directions to allow the parties to try and agree quantum if they could.

10. HMRC sought permission from the FTT to appeal on a wide range of grounds. The FTT refused that application in a decision dated 21st April 2015. One of the grounds of appeal advanced before the FTT for permission appeared to that tribunal to be an attempt to revisit the findings of fact made by the FTT that Mr Jamieson had agreed a PESM for the period 1974 to 1994 and not merely compromised or agreed calculations claims. The FTT, rightly in our judgment, rejected that application for permission because it fell far short of the necessary standard.

11. As it was entitled to do, HMRC then sought permission to appeal from the UT. That application was on narrower bases than had been advanced before the FTT but like its application before the FTT, the application was discursive and not always easy to follow. Judge Berner gave permission to appeal on the first *ultra vires* point identified above but not otherwise. No further application for permission to appeal was made.

12. HMRC's case on *vires* has two dimensions but rests on a single issue. The single issue is whether HMRC had power to agree a combined method. If they did have that power then the appeal should be dismissed. If HMRC did not

have that power then that conclusion has a knock on effect on the correct construction of two letters from Mr Jamieson which played an important part in the dispute of fact about what was or was not agreed. Ultimately however the result of a conclusion of lack of *vires* is not in dispute. If HMRC are correct about *vires*, the correct conclusion is that the claims for the relevant years were agreed as compromises and so in assessing Imperial's repayment claims for those years, HMRC are entitled to contend that the T-grant should be included.

The legal background

13. Two key concepts in VAT are input tax and output tax. By way of example, in a simple case when a manufacturer sells relevant goods by way of a supply chargeable to VAT (a taxable supply) the VAT charged on those goods is called output tax. The manufacturer is obliged to pay that output tax to HMRC subject to certain deductions. The VAT paid by the manufacturer on its purchases of raw materials and for its overheads can be deducted. That VAT is called input tax. So in simple terms the tax paid by the manufacturer is called "value added" tax because the tax paid by the manufacturer is tax on the value added by that manufacturer by making the raw materials into goods and selling them. That is why, if Imperial can add further input tax into the relevant calculations, they will receive a repayment.

14. VAT is derived from European Directives. For the major part of the relevant period the applicable directive was the Sixth Directive (77/388/EC). For part of the relevant time the applicable directive was the Second Directive (67/228/EC) but nothing turns on that. The only activity which is subject to VAT is economic activity. That is common ground and is clear from various articles in the Sixth Directive (including Art 2 and 4) and the decisions of the CJEU. Equally, it is also common ground (see Art 17 and Case C-437/06 ***Securenta Göttinger Immobilienanlagen v Finanzamt Göttingen*** [2008] STC 3473) that deductions can only be made for VAT incurred for goods or services which are used for the purpose of economic activities. Input VAT related to expenditure incurred in relation to activities which fall outside the scope of the Directive

because they are non-economic in nature cannot give rise to a right to deduct (***Securenta***, judgment of the CJEU, at [30]).

15. In the jargon of VAT, the distinction between economic and non-economic activity is referred to in the UK as the business/non-business distinction. The distinction is unlikely to be significant for manufacturers but it may well matter for a university. A university receives income in various ways. It might receive donations from alumni, it might receive money from the government in order to fund teaching or research and it might receive income from activities of a more overtly commercial nature such as selling drinks in a student bar and performing contract research for commercial organisations. Conversely a university will have various costs, on which it may have paid VAT, which range from those obviously directly related to a particular activity (like the cost of purchasing the drinks sold in the bar) to those obviously not related to any specific activity (like the cost of the auditor who audits the university's accounts).

16. An uncontroversial example of something which is business activity would be supplying contract research. On this a university would be obliged to account to HMRC for VAT on its supply but would be entitled to deduct appropriate input tax. The input tax would be VAT paid which can properly be attributed to that activity. Clearly the direct costs of the contract research can be attributed to the supply but for overheads some attribution or apportionment has to be made. So overheads like the auditors' costs have to be apportioned on some basis between the business and non-business activity.

17. ***Securenta*** was concerned with that sort of apportionment of input VAT. Since the Sixth Directive focusses entirely on economic activity and does not include rules for apportionment between economic and non-economic activity, the Court held (at [32] – [39]) that it was for member states to establish methods and criteria for doing that in accordance with the aims and broad logic of the Directive. A deduction should only be made for that part of VAT proportional to the amount relating to the transactions giving rise to a right to deduct.

18. In other words, ***Securenta*** is authority for the proposition that the way in which VAT should be apportioned to reflect the business/non business distinction is a matter essentially for member states' discretion. But it is equally clear that although the methods and criteria for making such an apportionment are a matter for the member states, those states do not have a discretion not to make such an apportionment. As the CJEU said, at [37], the member states must exercise their discretion in such a way to ensure that a deduction is made only for that part of the VAT proportional to the amount relating to the transactions (in other words, the economic activity) giving rise to the right to deduct. We do not accept, as was submitted for HMRC, that the apportionment of input VAT between business and non-business activity does not derive from EU law. It is an implicit part of the scheme of VAT; any failure to make provision for such an apportionment would result in a deduction for input VAT which is not permitted by the Directive.

19. The UK VAT statute applicable to this case is the Value Added Tax Act 1994 ("VATA"). In that legislation s4 limits the scope of VAT to taxable supplies made by a taxable person "in the course or furtherance of any business carried on by him" and s24(5) provides that VAT on goods or services used partly for the purposes of a business and partly for other purposes shall be apportioned so that only so much as is referable to the business is counted as input tax. Those provisions illustrate the reason the distinction is referred to domestically as the business/non-business distinction. A further linguistic problem is that, strictly so called, input tax is only VAT referable to business activities whereas VAT which is not referable to business activity is not correctly called input tax. Nevertheless the cases often use the term input tax as including VAT referable to non-business activity. Care is sometimes needed to make sure it is clear what is referred to. In this decision we use the term "input tax" to refer only to VAT referable to business activity and use the term "input VAT" to encompass both input tax and VAT paid by the taxpayer but referable to non-business activity.

20. Another key distinction in VAT is between taxable and exempt transactions. All business activity is within the scope of VAT but not all supplies made in the

course of a business are taxable supplies and thus chargeable to VAT; some supplies are exempt. An example in the context of universities is the supply of teaching services. That supply is obviously in the course of the university's business, or economic, activity, but it is an exempt supply. The consequence of that is that no VAT is chargeable on the supply, and conversely no input tax attributable to that supply is deductible. This also applies in the context of the recovery of VAT paid on overheads. Such VAT attributable to an exempt supply is not recoverable as a deduction. So considering the example of auditors' costs in a university again, some portion of those auditors' costs would be attributable to exempt supplies and would not be recoverable.

21. Section 26 VATA provides that the amount of input tax which may be credited is only that which is attributable to the relevant taxable supplies and by s26(3) the Commissioners may make regulations to deal with fair and reasonable attribution. The relevant regulations which were applicable at the time are Regulations 29, 99, 101 and 102 of the Value Added Tax Regulations 1995, SI 1995/2518. Regulation 29 requires a person claiming a deduction of input tax to do so in a return for the relevant accounting period. Regulation 101 defines a method of attributing input tax to taxable supplies. This method is known as the standard method. The standard method attributes to the taxable supplies the whole of the input tax on goods or services used exclusively to make taxable supplies and none of the input tax on goods or services used exclusively to make exempt supplies. For mixed cases of input tax on goods or services used for making both taxable and exempt supplies Reg 101(1)(c) provides for apportionment of the input tax by reference to the ratio of the value of the taxable supplies. Apportionment by value in this way is clearly sensible but it is not the only way it could be done. In the ***Royal & Sun Alliance Plc*** decision of the VAT Tribunal (Decision 18842, Judge Demack, 18th November 2004) the standard method was accurately described by the judge as using value as a proxy for use (see paragraph 47).

22. Regulation 101 is subject to Reg 102 which deals with the use of other methods of attribution. Under Reg 102(1) the Commissioners may approve or direct the

use by a taxable person of a method other than that specified in Reg 101. Such a method is called a "special method" or "partial exemption special method", i.e. a PESM. By Reg 102(3), a taxable person using a method approved or directed under Reg 102(1) shall continue to use it unless the Commissioners approve or direct termination of its use. Reg 102(3) is the provision which gives rise to the difference between the parties in this case. If what has happened was or included approval of a PESM, Reg 102(3) applies and that is what makes the terms binding when Imperial seek repayment, allowing for the inclusion of academic overheads (subject to proof) but excluding the T-grant.

23. It is clear that both the standard and special methods contemplated by Reg 101 and 102 are concerned with attribution of input tax between taxable and exempt supplies. In other words they are focussed only on input tax in its strict sense. The methods of attribution are not expressed as being concerned with the attribution of input VAT between business and non-business activity. What is meant by a "combined method" in this case is a method which combines attribution as between business and non-business activity together with attribution as between taxable and exempt supplies. HMRC contend that Reg 102 only acts as a source of power to approve special methods which are exclusively concerned with input tax as separately ascertained and thus solely with the taxable/exempt distinction.

24. Aside from the power to agree a PESM under Reg 102, it was common ground before us that HMRC have a power to make agreements to compromise claims as a result of its care and management powers. For VAT those powers are provided for in paragraph 1(1) of Schedule 11 to the VATA. The utility of a power of care and management was recognised by the House of Lords in the context of direct tax in ***R (on the application of Wilkinson) v Inland Revenue Commissioners*** [2006] STC 270. On the same point, this time in a VAT context, we were also referred to the decision of Newey J in ***Revenue and Customs Commissioners v Southern Cross Employment Agency Ltd*** [2015] STC 1933, at [41] – [44] which reviewed a number of cases concerning HMRC's powers in this regard up to and including ***Wilkinson***.

25. Imperial submit and the FTT held that the power under Reg 102 together with the care and management power under para 1(1), Sch 11 VATA are sufficient to enable HMRC to agree a combined method such that the relevant terms operate as a PESM.

The CVCP Guidelines

26. Although not directly in issue in this appeal, we should say a few words, by way of background, about the way in which the university sector and HMRC have traditionally approached the question of attribution of VAT incurred by the universities. It has been recognised from the outset that VAT presents some special difficulties for universities and colleges. A set of guidelines called the CVCP Guidelines were agreed with HMRC in 1973 and were updated a number of times before being withdrawn in 1997. CVCP stands for the Committee of Vice Chancellors and Principals. The Guidelines allowed for separate taxable activities to be dealt with distinctly by the university in a method referred to as "tunnelling". The input tax for three particular activities was agreed to be dealt with partly or completely by formulae. These were called "formulaic tunnels". Those activities were external catering, conferences and bar sales. For each of external catering and conferences the relevant formula allowed the university simply to claim as input tax a sum equal to 20% of the output tax attributable to that activity. For bar sales VAT could be reclaimed on directly attributable inputs such as the purchase of alcohol and tobacco but then 5% of the output could be claimed as input tax in addition. These approaches based on formulae reduced the need to keep records, which was one of the objectives of the Guidelines. Until 1990 the Guidelines include a grid or worksheet with entries for various activities which a university might undertake and boxes to complete for dealing with input tax to be attributed to those activities.

27. It is clear that in agreeing the Guidelines HMRC were acting pursuant to its power under Reg 102. Either the Guidelines as a whole could be regarded as a special method or, probably more accurately, the three specific formulae were

each special methods and HMRC were, by the Guidelines, expressing a willingness to agree further special methods on a case by case basis.

28. We were referred to two cases in which the CVCP Guidelines were considered by the VAT Tribunal: ***The University of Sussex*** (VTD 16221) 1999 and ***Wadham College Oxford*** (VTD 20233) 2007. The major significance of the CVCP Guidelines in this case is as the background against which the relevant events took place.

Power to agree combined methods

29. The authorities are addressed below. Before doing so we will consider the issue as a matter of principle.

30. The care and management powers on their own are sufficient to give authority to HMRC to enter into an agreement which caters for both attribution of VAT as between taxable and exempt supplies as well as attribution of VAT as between business and non-business activity. However, as HMRC emphasise in this case, such an agreement would not benefit from the automatic continuing binding effect provided for in Reg 102(3). For that to apply the agreement has to be agreed as a special method within Reg 102 (which is what the FTT found as a fact HMRC had done) and HMRC have to have had the power to do so (which is the issue on this appeal).

31. Absent authority, we would hold that there is nothing in principle or in the legislation to prevent a single agreement which is entered into between HMRC and a taxpayer being both an agreement for a special method under the regulations and also an agreement under the general powers of care and management. There may be sensible pragmatic reasons why an agreement of that kind is entered into. Since HMRC clearly have power to agree each thing individually, there does not appear to us to be any reason why those powers could not be exercised together to support entering into one agreement. Insofar as it provides a method for attributing input tax to taxable supplies, it would be a special method within Reg 102, and it would be binding as such.

32. The argument before the FTT and before us seems to have assumed that the power in Reg 102 on its own is not sufficient to provide a basis for agreeing a combined method. Considering the issue on pragmatic grounds, one of the advantages of agreeing a PESM is likely to be simplification of record keeping. That advantage would be undermined if the demands of allocating VAT between business/non-business supplies demanded the very record keeping which was intended to be simplified. Considering the power itself, in circumstances where a taxpayer's overall activity involves the need to make both the business/ non-business distinction as well as the taxable/ exempt distinction in order to properly attribute overhead VAT, it is necessary, and we consider necessary as a matter of EU law, to deal with both distinctions in order to correctly allocate VAT to a taxable supply.

33. In order to agree a method to allocate input tax between taxable and exempt supplies (which is expressly what Reg 102 is concerned with) one needs to have a method or criteria to determine the amount of input tax in the first place. Regulation 100 is directed to ensuring that input VAT which is not properly input tax, because it is not used in making supplies in the course or furtherance of a business, is not to be deductible. That regulation, which recognises the necessity for an apportionment between business and non-business activities, is a provision which has effect in relation to the whole of Part XIV of the 1995 Regulations. The power to agree a special method under Reg 102 falls accordingly to be construed by reference to Reg 100. In consequence it is not difficult to envisage the power given by Reg 102 being construed as sufficient to enable HMRC, as well as agreeing a method of attribution of input tax, also to agree how that input tax is to be determined as between business and non-business activity. We do not have to decide this question and did not hear argument directed to it. All the same we do not think it is clear that the power in Reg 102 would not have been sufficient on their own to agree a combined method or at least some combined methods, even before the introduction, in 2011, of an express power to do so in Reg 102ZA.

34. Turning to the cases, in its decision on *vires* the FTT placed reliance on ***The Labour Party v Customs and Excise Commissioners*** (VTD 17034, 9th January 2001). In that decision the tribunal had to decide essentially the same question (see paragraph 54) as came before the FTT in this case. HMRC had agreed with the taxpayer a method for calculating "deductible input tax" which was a single composite formula for apportioning "input tax" as between business and non-business supplies and also for attributing input tax as between taxable and exempt supplies (paragraphs 64 and 69). In the decision the tribunal explains that it uses the term "input tax" loosely to include tax on non-business supplies (paragraph 5). HMRC argued that the method was agreed but only under the care and management power in para 1(1), Sch 11 VATA and was not an agreement for a PESM under the predecessor of Reg 102. The tribunal considered ***GUS Merchandise Corp Ltd v Customs and Excise Commissioners* (No 2)** [1995] STC 279 (Court of Appeal) and ***R v Customs and Excise Commissioners ex parte Kay & Co Ltd*** [1996] STC 1500 (High Court) and held, in paragraphs 57 to 59, that HMRC had power both to agree a special method under regulations and also to reach agreement under their general power of care and management. The tribunal concluded that there was nothing to prevent one agreement from being both an agreement for a special method and also an agreement under general powers of care and management to deal with apportionment between business and non-business (paragraph 59, last sentence).

35. The reasoning in ***The Labour Party*** decision makes sense, but since it is not binding on us we have considered the matter afresh.

36. In ***GUS Merchandise*** the Court of Appeal was considering retail schemes and goods sold by mail order via agents. The relevant regulations were similar to Regs 101 and 102 in this case in the sense that they allowed HMRC to permit a retailer to have the value of supplies determined by a published method and also to adapt any retail scheme by agreement with the retailer. However the actual agreement in issue in that case, while it contained an element which operated as a modified version of a retail scheme to differentiate between standard-rated and zero-rated supplies, also contained another element which was not a

modification of a retail scheme. That other element was a distinction drawn between agents' own purchases and customers' purchases. The court held that HMRC had the power both to agree a special method under the regulations and also to reach agreement under the general care and management powers. Thus in ***GUS Merchandise*** the only question the court then had to decide was the factual question of whether an agreement had been reached.

37. In our judgment ***GUS Merchandise*** supports the view that there is nothing in principle to prevent one agreement being both an agreement for a special method and also an agreement under the general powers of care and management to deal with an aspect which does not form part of the special method.

38. Although ***Kay*** was cited on this appeal, it is only relevant in the sense that there is nothing in that case to indicate that it is not possible for an agreement to cover both a special method dealing with the taxable/exempt distinction and also the business/non-business distinction.

39. ***GUS Merchandise*** was considered by Sales J (as he then was) in ***Oxfam v Revenue and Customs Commissioners*** [2010] STC 686. In that case the charity Oxfam contended that they had a binding agreement with HMRC concerning the attribution of input VAT as between business and non-business activity. To deal with input VAT in mixed cases, the method apportioned the mixed input VAT by the ratio of the value of business expenditure to the sum of business and non-business expenditure. Applying the method, Oxfam had included expenditure on fundraising as non-business expenditure. In another case it had been decided that voluntary donations were outside the scope of VAT altogether. Oxfam argued that the fundraising expenditure was therefore to be regarded as relating to non-supplies and not to either business or non-business expenditure. If that was right the result would remove that expenditure from the ratio and produce a higher recovery of input tax. The tribunal decided that no agreement had been entered into. On appeal Sales J dismissed the appeal as well as the appellant's challenge made on public law grounds. The

tribunal below had distinguished ***GUS Merchandise*** on the basis that there was no legislative framework for agreeing a method of business/non-business apportionment equivalent to the legislative framework to agree modified retail schemes (see Sales J, at [31]). However the judge held, at [36], that ***GUS Merchandise*** did demonstrate that a binding contract of that kind could be entered into. In other words ***Oxfam*** supports a point which was common ground before us, i.e. that an agreement on a method of apportionment between business and non-business input VAT is something can be reached between HMRC and a taxpayer.

40. No other cases were cited to us which bear on the question of combined agreements. Based on principle and the authorities, in our judgment HMRC have the power, as a result of Reg 102 and paragraph 1(1) of Sch 11 of the 1994 Act, to enter into a single agreement which is both an agreement for a special method under the regulations and also an agreement under the general powers of care and management. To the extent that such an agreement comprises a method of attributing input tax to taxable supplies it will be a special method within Reg 102 and Reg 102(3) will apply to it.

The combined method in this case

41. A formula is set out in paragraph [83] of the FTT's decision. While the combined method is summed up by that formula, it is not on its own a complete statement of the method. The terms need to be explained and the exclusion of the T-grant is not mentioned in the formula. The formula produces the input tax to be attributed to the university's taxable income as a proportion of a value called "residual VAT". The residual VAT is Imperial's total VAT incurred for certain cost centres. That VAT figure did not split out non-business VAT. The formula is:

$$\frac{\text{taxable income}}{\text{total income (business and non-business)}} \times \text{residual VAT}$$

42. The "taxable income" is calculated by grossing up Imperial's output VAT for the relevant year and after making certain adjustments. The "total income (business and non-business)" was based on the statutory accounts but excludes the T-grant.

43. The simple point, which is not disputed, is that in this single formula both the business/non-business and taxable/exempt distinctions are combined.

44. Imperial argued that algebraically the single formula could be divided into two formulae and that this illustrated the artificiality of HMRC's arguments. The two formulae have been represented in different ways at different times but before us Imperial put it as follows. There is a business/non-business calculation and a partial exemption special method calculation. They are:

Business/non-business calculation

$$\frac{\text{business income}}{\text{total income (business and non-business)}} \times \text{residual VAT} = \text{residual input tax}$$

Partial exemption special method calculation

$$\frac{\text{taxable income}}{\text{taxable income + exempt income}} \times \text{residual input tax}$$

45. The business/non-business calculation apportions the same starting residual VAT figure between business and non-business activity by value and produces an answer which is the residual input tax. The partial exemption special method calculation then takes the residual input tax and apportions it between taxable and exempt supplies by value and produces an answer which is the input tax to be attributed to the university's taxable income. Since "business income", which is the numerator in the first ratio, is the same quantity as the sum of "taxable income + exempt income", which is the denominator in the second ratio, and since the first calculation can be substituted for "residual input tax" into the second calculation, the result is mathematically equivalent to the earlier

single formula. That is Imperial's point. However the FTT did not accept it in the Decision and HMRC argued it was not correct.

46. There is in our view nothing wrong with the mathematics and we agree with Imperial at least to the extent that the two calculations show how the single formula works to combine the two distinctions. However in real cases things may not be so simple. One difference is the effect of rounding. Imperial's accountants made the same point which Imperial now seek to make in correspondence in a letter on 23rd November 1999. The letter compares the result using the single formula with one based on two calculations (expressed slightly differently but in substance the same). Due to rounding the two calculations produced a result which showed at least for the particular numbers that the single formula was slightly (very slightly) disadvantageous to Imperial. The other difference is with the quality of information. If the agreed method actually did contain the two calculations and required each to be computed distinctly it would be necessary to determine a figure for the "business income" and a figure for "taxable income + exempt income". Although in principle they should be the same HMRC submitted that in practice they could end up with different answers.

47. We believe HMRC makes a legitimate point in that if the agreed method actually did require carrying out two calculations then for these sorts of practical reasons the answers might be different, albeit we doubt the differences would ever be very large. Nevertheless the point does illustrate that what needs to be considered is the method actually agreed and not some other method. Splitting the formula shows how it works in principle but nothing more.

Did HMRC have the vires to agree this combined method as a PESM?

48. The method which was agreed is a single formula which combines attribution of input VAT between business and non-business activity with attribution of input tax between taxable and exempt supplies. It does so in a convenient and pragmatic manner. It was in fact agreed as a PESM. Insofar as the method is a

means for the latter attribution it is clearly a PESM and HMRC had vires to approve it. Although, as we have explained, we have our own reservations on this point, insofar as the method is a means for the attribution between business and non-business we have taken it for the purpose of this appeal that it is not a PESM but we have found that HMRC had vires to agree that under their care and management powers. These powers can be used together to agree a single combined method and so we hold that HMRC had the authority to do what they did, and that what they agreed as regards the attribution of input tax was a special method.

Conclusion

49. The FTT was right, essentially for the reasons it gave. The appeal is dismissed.

MR JUSTICE BIRSS

JUDGE ROGER BERNER

RELEASE DATE: 24 JUNE 2016