

Hire purchase VAT recovery
Royal Bank of Scotland plc v HM Revenue & Customs [2008] CSIH 49

The Scottish Court of Session has released its decision in the Royal Bank of Scotland (RBS) appeal, which concerned the partial exemption methodology for a hire purchase (HP) and asset finance business.

It has quashed the Tribunal's decision that a partial exemption special method giving 50% recovery for an HP business was "fair and reasonable". The Court held that the VAT Act requires an allocation of costs, and that fairness and reasonableness of the method adopted must depend upon facts found on the basis of the evidence. The Court also criticised the focus of the proposed 50% method being on the point at which an HP deal is entered into, whereas the use of costs will vary over the life of the contract and this should be reflected by the partial exemption special method adopted.

In that context, the Court did not understand how the 50% method could in any real sense be an appropriate reflection of the use of overhead expenditure, although the Court did comment that values might have been considered as a possible alternative basis of allocation.

Rather than remit the matter to Tribunal for reconsideration the Court held that if RBS wishes to pursue an alternative special method of VAT recovery to the 0% proposed by HMRC, then it must re-open the issue by serving a 'special method override' notice on HMRC under Reg 102A or 102C of the General VAT Regulations.

[Link to full decision](#)

Implications

It was always considered likely that the court would not uphold the Tribunal decision regarding the 50/50 attribution. As things stand, the guidance in this area is in Business Brief 31/07, in which HMRC are of the view that there should not be any overhead recovery.

Together with others in the leasing industry, 4 Eyes Ltd believes that whereas recovery based on a 50/50 split would not necessarily be fair and reasonable, neither is a total restriction. In Para 37 of the decision, the Court gives support to this view where it specifically addresses the possibility of attributing input tax in a way that would give rise to a suitable method of apportionment. The Court refers to activity based analysis (rather than process analysis referred to in the Tribunal) and value as two possible methods, although does not consider either in detail and this is of course not prescriptive of possible methods which could be used.

Accordingly, we advise affected businesses to review the impact of this decision on their partial exemption position as a matter of urgency. Businesses which had relied on RBS are likely to suffer from input VAT assessments to recover VAT. They will need to agree an alternative special method. Other businesses which are not currently recovering any input VAT, specifically on their HP activities, may well be able to negotiate a more favourable partial exemption special method.