

**Partial exemption apportionment
The University Court of the University Of Dundee (20728)**

Summary

A recent Tribunal case concerned HMRC's investigations into the university's previously agreed method for business/non-business apportionment of input tax, and its assessment, which sought to adjust retrospectively the outcome of that method. The Tribunal set aside HMRC's assessment for a variety of reasons and expressed concerns about certain aspects of HMRC's approach, some of which may be familiar to other taxpayers.

While the setting aside of the assessment must be viewed on the particular facts of the case, in the Editors' opinion, the criticisms which the Tribunal has raised of HMRC's approach to and conduct of the dispute may be significant in a wider context. Businesses finding themselves in a similar position may wish to discuss the issues arising from this decision with their usual VAT advisor.

Background

The Appellant, in common with other universities, is required to apportion the VAT which it incurs on costs between its business activities and its non-business activities. As the UK VAT legislation does not prescribe the manner of such an apportionment, it is for HMRC and the taxpayer to agree a method of apportionment. In the Appellant's case, the method was agreed by letter of January 2000. The Tribunal acknowledged that the method, if examined in close detail, left some room for improvement. However, it commented that both the Appellant and HMRC had, in 2000, sensibly taken the view that a method which was clear and easy to operate was appropriate, even if it did involve some compromise on both sides.

In 2004, HMRC allocated a new officer to control the Appellant. The officer formed the view that the method, and also the partial exemption method which applied after the business/non-business method had been applied, did not properly appropriate input VAT to those of the Appellant's activities which attracted input VAT recovery. Consequently, the officer issued assessments which, HMRC considered, corrected the amounts of input VAT recoverable to the best of HMRC's judgment. The assessments included periods during the Appellant's tax year ending in March 2004, ten months of which had elapsed when the officer's concerns were first raised. The assessments were subsequently withdrawn in respect of tax years ending in 2002 and 2003, when HMRC accepted that the Appellant had been entitled to use the agreed method, but maintained in respect of year ending 2004.

This was the underlying subject of the dispute, the Appellant essentially contending that the assessments were not in HMRC's best judgment, and that they sought to retrospectively withdraw the agreement with HMRC. HMRC contended that it had withdrawn the agreed method by letter of June 2004.

Held

The Tribunal upheld the appeal against HMRC's assessment on the basis that the assessment was not made to best judgment. The decision was critical of HMRC's approach and it is worthwhile setting out the main findings of the Tribunal in some detail.

The VAT position of a university is complex and a simplistic approach may not be either appropriate, fair or reasonable. The dispute came to a head as a result of an "ill-considered" letter which, the Tribunal understood, had been sent by HMRC to the Appellant and other universities. It demanded a lot of information and acknowledged that it was "onerous", but still required a prompt response.

Following a meeting, HMRC's haste to issue assessments was evident from the fact that they had to be modified and HMRC had to attempt to justify them. HMRC threatened to assess if the Appellant was unable to justify the use of the method, which had been agreed by HMRC. The Tribunal found that the Appellant was justified in using the method which had been agreed and need go no further until the dispute was resolved.

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The manner of the assessment sought to put the onus of determining the amount due to HMRC on the Appellant, by seeking to persuade HMRC to modify those amounts. The inspection by HMRC was conducted in a manner which was almost obsessive as regards detail (as opposed to the sensible approach adopted when the method was agreed), with some 600 purchase invoices being requested and queried. At the time of the enquiries and the assessments HMRC had not considered, in principle, whether it was appropriate in the context of the 2000 agreement to revisit the earlier tax years and seek to amend the method retrospectively.

The Appellant's proposals for an alternative method all "fell on stony ground".

When HMRC issued the letter of June 2004 withdrawing the use of the method, the calculations required to adjust the provisional recovery for the tax year ending in March 2004 had not yet been performed. At that time, the Appellant was reasonably and legitimately operating, and placing reliance on, the agreed method in costing, budgeting and conducting its affairs.

For the assessment to fail on the basis of 'best judgment', the Appellant would have to show that "it was produced as part of something other than a genuine and honest attempt to calculate the amount of VAT". The Tribunal did not consider that it was such a genuine and honest attempt. Rather, it was an attempt to circumvent the agreed method, not concerned with accuracy or appropriateness but driven by HMRC's perceptible exasperation that the Appellant was not providing information within timescales imposed by HMRC, without proper consideration of the Appellant's particular circumstances and conducted as if the Appellant were a dishonest trader rather than an education institution seeking to regularise its VAT position.

The Tribunal could not determine whether any of the methods proposed by the Appellant would have yielded a fair and reasonable result, and commented that HMRC's approach had been to reject the Appellant's proposals on the basis of seeking to maximise the VAT due to the Revenue.