

Business/non-business and partial exemption

[St John's College, Oxford \[2010\] UKFTT 113 \(TC\)](#)

Summary

This case concerns input VAT incurred by the Appellant on refurbishing a building. The First Tier Tribunal was asked to decide on the use to which the building was put for VAT purposes; whether the Appellant's partial exemption special method (PESM) achieved a fair and reasonable apportionment of input VAT; the effect of a special method override notice (SMON); and the amount of recoverable input VAT and/or the appropriate alternative PESM for determining that amount. This decision, one of the first to consider the ECJ's decision in VNLTO, will be of interest to all organisations which have a mixture of business and non-business activities.

Background

The Appellant had agreed a PESM with HMRC in 1998 which entitled it to claim an amount of input VAT equivalent to 14.9% of the value of its taxable supplies, plus any input VAT directly attributable to taxable activities. Consequently, for the purposes of the PESM, the actual amount of residual input VAT incurred had no bearing whatsoever on the amount of recoverable input VAT.

In 2003, it decided to refurbish its Senior Combination Room (SCR) at a cost of c. £6m. The SCR was a part of a building used predominantly for the purposes of feeding the 'Fellows' of the Appellant (i.e. academic staff who were partly remunerated by the Appellant and partly by the University to carry on a mixture of teaching, research, administrative and other academic activities), and their guests (generally visiting academics). The Fellows are entitled to dine free of charge, with charges being made for alcoholic drinks, but the entitlement to dine free of charge is regarded as part of the remuneration 'package' of the Fellows. Some of the public rooms in the SCR are used for committee and other types of college meetings.

Between July 2003 and September 2005, the Appellant's representatives made four proposals for an alternative PESM to deal with the VAT incurred on the refurbishment, considering that the existing PESM would not yield fair and reasonable recovery. The various features of the proposals included treating all use except for committee meetings as taxable on a floor area basis, isolating residual VAT incurred on managing the Appellant's land interests and recovering on the basis of taxable and exempt turnover from land transactions, and apportioning all residual input VAT other than that incurred on the SCR and land interests on the basis of taxable to exempt turnover, either including or excluding funding grants.

None of the above methods was accepted by HMRC.

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In September 2004 the Appellant served a SMON and in November 2004 HMRC accepted it. However, in March 2004 when the Appellant made a voluntary disclosure on the basis of its latest proposed (and rejected) PESM and claimed £147k of additional input tax, HMRC refused to accept the disclosure.

In essence, the Appellant sought to argue that:

- the VAT incurred on the SCR could be attributed, under the Lennartz principle, to the Appellant's free supplies of catering to the Fellows, which constituted a free supply of services for the non-business use of the Fellows, who were staff (art 26(1)(b) Principal VAT Directive 2006/112/EC) and it could therefore be recovered in full as there was no direct link to exempt activities;
- the methods proposed by the Appellant had, in fact, erred in favour of HMRC by attributing an element of that input VAT to exempt activities;
- the EU legislation permitted the Appellant to treat the SCR as a 'sector', as it had proposed; and
- as HMRC had accepted the SMON but not the voluntary disclosure, the First Tier Tribunal was required to determine the recoverable amount.

HMRC sought to argue that:

- the provision of free catering was part of the business of the Appellant and therefore art 26(1)(b) and Lennartz were not in point;
- the SCR was to be used for the Appellant's business of education, from the economic perspective including source of funding of the refurbishment, from an objective view of the purpose for which it was used, i.e. to fulfil the Appellant's statutory obligation to provide a place of learning, and from the fact that attracting Fellows to the college advanced those educational purposes; and
- the Appellant's methods resulted in almost total appropriation to taxable use, which simply could not be correct from an objective standpoint.

Held

The First Tier Tribunal summarised the issues which it was asked to consider as follows:

- what were the uses to which the SCR was put, and in particular did the provision of meals to Fellows fall within art 26(1)(b) so that Lennartz was applicable:

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- the fairness and reasonableness of the college's existing PESM and its proposed PESM(s) in the context of the college's activities as a whole; and
- whether on appeal in relation to the amount of creditable input tax in circumstances where a SMON has been approved by HMRC, the First Tier Tribunal's obligation is to determine the amount of tax repayable or payable in accordance with a PESM it determines or only a method suggested by one of the parties.

On the first issue, the First Tier Tribunal considered the case of Vereniging Noordelijke Land- en Tuinbouw Organisatie (VNLTO) (C-515/07). In order for an activity such as the provision of free meals to give rise to an art 26(1)(b) output VAT charge, they had to be provided free of charge for staff or a third party otherwise than for the purposes of the taxpayer's own business activities. The First Tier Tribunal considered that providing sustenance for the Fellows fostered the Appellant's own business activities and therefore it was not subject to art 26(1)(b). Absent the output VAT charge in respect of 'private' meals, Lennartz VAT accounting could not be available to the Appellant, and the initial recovery of input VAT related to the free provision of meals, following VNLTO, (subject to a minor point regarding some non-Fellows who taught at the college and were offered free meals: these might fall under art 26(1)(b) but were not regarded as significant), must be disallowed before the remainder could be included in any PESM.

The First Tier Tribunal then considered in principle whether any of the remaining input VAT-bearing costs or areas of the building bore a sufficiently direct and immediate link to any taxable activity or to educational activities to be treated otherwise than as 'overhead' cost, but held that none did. The input VAT not disallowed as relating to the Appellant's own non-business activity was therefore residual and due to be apportioned between taxable and exempt activity.

As regards the second issue of the method of apportionment, the existing PESM was plainly unfair. That was common ground. The First Tier Tribunal considered that each of the proposed PESMs failed to disallow an amount in respect the VNLTO non-business element of the Appellant's input VAT, treated the provision of free meals as a taxable activity and sought to treat the meeting activities of the governing body as the only non-taxable use. Each was therefore fundamentally flawed and the First Tier Tribunal could not endorse any of them.

On the third point, the First Tier Tribunal held that there was insufficient evidence before it to make a determination and adjourned the case on this point for the parties to seek to resolve the matter. However it suggested that the parties might adopt an approach such as:

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- (i) determine the costs (including the relevant part of the common parts) attributable to guestrooms and treat the input tax as deductible;
- (ii) apportion the costs attributable to the kitchens on the basis of relative numbers of Fellows to non-Fellows dining, or free to paid meals;
- (iii) apportion the costs attributable to the rooms used for meetings and meals according to the total time breakfast, lunch and dinner are available in the lunchroom (weighted according to the ratio of paid meals to free meals) and the time taken for the governing body meetings; and
- (iv) reduce the costs attributable to the remaining rooms by the proportion attributable to non-economic use and treat the balance as residual.

Implications

HMRC issued Revenue & Customs Brief 02/10 in the wake of the VNLTO judgment. It appears that the First Tier Tribunal's decision in this case is an endorsement of HMRC's policy as set out in the Brief.

The First Tier Tribunal was reluctant, on the basis of the facts set out before it in evidence, to give a ruling on the amount of input VAT properly recoverable and preferred to give some guidance to the parties as to principles which might be employed, which might turn out to be a mixture of direct attribution based on floor area, head count, and time apportionment. None of these features will come as any surprise to those in the education and charities sectors who have sought to agree PESMs with HMRC in the past.

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