IN THE HIGH COURT OF JUSTICE CO/3298/95

QUEEN'S BENCH DIVISION
(CROWN OFFICE LIST)

Royal Courts of Justice
The Strand
London WC2

Friday 14th June 1996

B E F O R E :

MR JUSTICE TURNER

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BOARD OF TRUSTEES OF THE VICTORIA & ALBERT MUSEUM

- v -

CUSTOMS & EXCISE

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MR S RICHARDS QC and MISS R HAYNES (CUSTOMS & EXCISE, New King's Beam House, 22 Upper Ground, London)

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JUDGMENT
(As Approved by the Court)

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Friday 14th June 1996

MR JUSTICE TURNER: This appeal is brought from the decision of the Value Added Tax Tribunal released on 8th August 1995. The issue before the Tribunal was as to the manner in which the Board of Trustees of the Victoria & Albert Museum was entitled to treat supplies made to it, of goods and services, for the purposes of obtaining the appropriate deduction by way of input tax when making its periodical returns for value added tax. The problem arises because of the nature of the activities conducted by the Museum which are in part business and in part (exempt) non-business use.

In June 1993, the Museum made a claim to recover additional input tax from the Commissioners on the basis that its value added tax returns had been incorrectly made during the period April 1990 to March 1993.

The relevant statutory framework is as follows, by the Value Added Tax Act 1983 it is provided, and then sections 14:

"14. (1) A taxable person shall, in respect of supplies made by him... account for and pay tax by reference to [accounting periods]...

(2) Subject to the provisions of this section, he is entitled at the end of each such period to credit for so much of his input tax as is allowable under section 15... and then to deduct that amount from any out put tax due from him.

(3) Subject to subsection (4)..., input tax, in relation to a taxable person, means...

(a) tax in the supply to him of any goods or services

(aa)

(b) being... Goods or services used or to be used for the purposes of any business carried on or to be carried on by him; and output tax means a tax on supplies which he makes...

(4) Where goods or services supplied to a taxable person...are used or to be used partly for the puroposes of a business carried on or to be carried on by him and partly for other purposes, tax on supplies... shall be apportioned so that only so much as is referable to business purposes is counted as his input tax.

(5) Where...the amount of the credit exceeds the amount of the tax, then... the excess [of the credit]... shall be paid to the taxable person by the Commissioners.

(8) No deduction shall be made under subsection (2) above nor shall any payment be made under section (5) above, except on a claim made in such manner and at such time as may be determined by or under regulations."

Section 15(1):

"The amount of input tax for which a person is entitled to credit at the end of any period shall be so much of the input tax for the period... As is allowable by or under regulations as being attributable to supplies within subsection (2)

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course of furtherance of his business-

(a) taxable supplies
(b)
(c)
(ba)
(c)

(3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2)...any such regulations may provide for

(a) determining a proportion by reference to which input tax for any prescribed accounting period is to be provisionally attributed to those supplies;

(b)

(c) the making of payments in respect of input tax, by the Commissioners to a taxable person.. Or by a taxable ... To the Commissioners, in cases where events prove inaccurate an estimate on the basis of which an attribution was made."

The other statutory provisions to which it is necessary to refer at this point are to be found in the Finance Act 1989

which provides by section 24, and the material parts of section 24:

"Where a person has paid an amount to the Commissioners by way of value added tax which was not due to them, they shall be liable to repay the amount to him.

(2) The Commissioners shall only be liable to repay an amount under this section on a claim being made for that purpose.

(3)

(4)

(5) Where an amount has been paid to the Commissioners by reason of a mistake, a claim for the repayment of the amount under this section may be at any time...

(6) A claim under this section shall be made in such form and manner and shall be supported by such documentary evidence as the Commissioners prescribe by regulations...

(7) Except as provided by this section, the Commissioners shall not be liable to repay an amount paid to them by way of value added tax by virtue of the fact that it was not tax due to them."

It can be seen that the scheme of the mechanism for repayment of value added tax, on a claim being made for that purpose, is entirely logical if it is accepted that there is an underlying assumption, (?) presumption, that a taxpayer will not have paid tax unless he was liable to make such a payment or he had made a mistake.

The Regulations which were in force at all material times were the Value Added Tax (General) Regulations (1985) SI No. 886. Provision was made for the making of claims and returns for the purposes of traders accounting to the Commissioners for the value added tax due from, or to, them as may be appropriate. In particular, by Regulations 62 (as amended) it is provided that:

"(1) ...save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming a deduction of input tax under section 14(2) of the Act shall do so on the return furnished by him for the prescribed accounting period in which the tax became chargeable."

By Regulation 64 of the same Regulations it is provided that:

"If a person makes an error in accounting for tax or in any return furnished under these Regulations he shall correct it in such manner and within such time as the Commissioners may require."

The history of the case is set out in full in the decision of the Tribunal. In its essentials, it comes to the facts that from 1st January 1987, the Museum adopted the formula in Appendix J of Value Added Tax Notice 700 until 31st March 1993. Whereafter a method devised by Price Waterhouse, and approved by the Commissioners, was introduced which involved the application of the ratio which the input tax, incurred in relation to its wholly taxable activities, bears to the value added tax incurred on all supplies made to it, both in respect of its taxable and non-taxable (exempt) activities. On 10th June, a letter was sent to the Commissioners on behalf of the Museum in which it was claimed that the Appendix J method had never produced a fair attribution of value added tax as between the business and non-business activities of the Museum. The consequence, it was contended, was that the Museum had treated more value added tax as attributable to non-business (and therefore non-deductible) activities than it should properly have done and had thus under-claimed deduction of input tax. So, it was submitted the Museum had made an error and, subject to the Regulations, was entitled to make a recovery of under-deducted tax in the sum of £315,468. The

Commissioners' response to this claim was given by letter dated 27th January 1994 in the following terms:

"The money has been reclaimed on the basis that the method of apportionment used up to the 31st March 1993 was not fair or reasonable. If this was indeed the case then the returns submitted to that date could be considerable to be erroneous, the Museum not reclaiming all the input tax to which it was entitled.

However, the Museum applied in writing to use a particular method, which in turn, was agreed in writing by the VAT office. The method may not have been absolutely perfect, but it was considered fair and reasonable in the circumstances that pertained. The Commissioners are of the opinion that it therefore cannot, subsequently, be held to be wrong in law. If the method was not wrong in law, the returns submitted were correct and there was no entitlement for the Museum to recalculate the input tax and to reclaim this money retrospectively."

From the contents of this letter the elements of the present dispute can be distilled. It was no part of the Museum's case in this Court that it had been misled into adopting the method of apportionment employed by it in the period up to 31st March 1993. It was, however, its case that as the result of the advice which it had received, notably in Appendix J of the Notice 700, it was led to making errors in the manner of its accounting for value added tax. It is thus necessary to examine Appendix J with some care. Paragraph 8 of the Guide draws attention to the importance of the distinction between business and non-business activities. Paragraph 31 is concerned with the position where value added tax is charged on goods and services not wholly used for business purposes. In particular, it reminds taxpayers that where value added tax is charged on goods and services which are not obtained for the purposes of the business it is not "input tax" and cannot be reclaimed. This will include goods or services for private use or when supplied to the business but used in connection with a non-business activity. The paragraph goes on to provide examples of such goods and services. It comments that in such cases not all the value added tax which has been charged can be reclaimed and invites the reader to turn to Appendix J. Paragraph 3 of this Appendix J provides:

"If you use goods or services partly for non-business activities, for example if your organisation is a charity, you will not be able to treat all the value added tax as input tax.

If possible, you must always relate the value added tax on such purchases to either business or non-business use. You only apportion that part which cannot be related.

This means:
* you cannot reclaim any of the value added tax charged to you on the purchases which are used entirely for a non-business activity;
* you can reclaim all the value added tax charged to you on purchases which are used entirely for business purposes; and
* you must apportion the value added tax charged to you on purchases which are used for both business and

non-business purposes.

There is no special method of apportionment but your apportionment must be fair, and you must be able to justify them. Here is an example of how you can apportion value added tax based on your income. It can be used if you cannot directly attribute any of the supplies involved. It can also be used when, after you have directly related supplies to business and non-business activities, there are residual supplies which are used for both business and non-business purposes.

……..

Remember, you do not have to use this method. If it is not suitable you can use any other formula, but it must produce a fair result and you must have the prior agreement of your local value added tax office. Whatever formula you use, the input tax is only reclaimed provisionally at the end of each tax period. At the end of each tax year you must make the adjustment as explained above.

All methods of apportionment are subject to review to ensure that the amount treated as input tax is fair and reasonable."

It would seem to follow that the closing words of this Appendix are intended to achieve the result that a taxpayer, who will know his own business best, selects the method of apportionment he, or his advisers, consider most suitable for his business, provided that he first obtains the prior approval of his value added tax office. On 18th December 1986 the finance officer of the Museum had written to the Commissioners stating that the task of identifying those goods and services which were used for the purposes of the Museum's business activities was "very difficult" and that he "would favour the income based method of apportionment as explained Value Added Tax leaflet 700 Appendix J". The local value added tax office approved this method.

For the Museum, it was submitted that Notice 700 was defective in that it gave a clear direction that where goods and services were use or acquired for business and non-business purposes it may be impossible for the trader to claim as input tax, the entirety of the input tax incurred in obtaining such supplies. Such a direction, or requirement, conflicted with the terms of the Sixth Council Directive on value added tax (77/388/EEC) [the Sixth Directive] as interpreted and held by the European Court of justice in the case of Lennartz v. Finanzamt Munchen III [1995] STC 514. It will become necessary to refer to this case in some detail later in this judgment. It was also submitted that section 14(4) of the Act of 1983 failed properly to implement the provisions of the Sixth Directive in that the provisions of the section require an apportionment to be made whereas, in accordance with the provisions of the Directive, a taxpayer is entitled to make an

immediate and total deduction in respect of all the input tax paid by him in respect of the supplied goods and services during the relevant period.

In order to follow the argument, it becomes necessary to consider the text of those parts of the Sixth Directive to which reference was made. Article 6(2) provides that:

"The use of goods forming part of the assets of a business for private use of the taxable person or his staff or more generally for purposes other than those of his business where the value added tax is wholly or partly deductible shall be treated as supplies of services for a consideration."

Article 17 provides that:

"1. The right to deduct shall arise at the time when the deductible tax becomes chargeable.

2. Insofar as the goods or services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay: (a) value added tax due or to be paid in respect of goods or services supplied or to be supplied to him by another taxable person....

5. As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which (VAT) is not deductible, only such proportion of the (VAT) shall be deductible, as is attributable to the former transactions. This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person."

Article 19 then sets out how the deductible proportion is to be determined. As a simple statement of fact, it may be recorded here that, the Museum has not accepted any liability to account for output tax on non-business use of goods supplied to it, nor was there any evidence that it had ever done so. This may make it difficult for the Museum to pursue its primary argument that section 14(4) is non-compliant with the Directive. More importantly, if an apportionment is made between business and non-business use, the latter use is not treated as a notional supply and the taxable person does not become liable for output tax.

The argument for the Museum is, in my judgment, mistaken. Article 6(2) of the Directive is concerned with the liability of a trader to pay output tax in respect of the use of goods which have been used for non-taxable purposes and in respect of which input tax has been deducted. It is not concerned with apportionment, the need for which only arises in cases in which the trader is unable to determine when or the extent to which the goods or services have been used for business or non-business purposes. In making its submission, the Museum argued that the effect of the decision in

Lennartz requires that when a taxable person acquires goods which are intended partly for business and partly for non-business purposes the right to deduct is not only immediate but also total. For the Commissioners it was argued that while the decision in Lennartz may produce this result, it is not the necessary consequence. The trader may either apportion at the input stage, in which case Article 6(2) does not come into play. Or he may claim deduction in respect of the whole of his supplies, in which case he has then to pay output tax in respect of notional supplies of goods or services. In paragraph 26 of the judgment of the European Court, it was stated that:

"It is apparent from the combined provisions of Article 6(2) and 11A(1)(c) that, where a taxable person acquires goods which he employs partly for private use, he is deemed to effect the consideration a supply of services taxed on the basis of the cost of providing services. Consequently, a person who uses goods partly for the purposes of taxable business transactions and partly for private use and who, [these words emphasised] upon acquiring the goods recovered all or part of the input VAT, is deemed to use the goods entirely for the purposes of his taxable transactions within the meaning of Article 17(2). Consequently, such a person is in principle entitled to a right of total and immediate deduction of the input tax paid on purchasing the goods."

The precondition to the operation of Article 6(2) in a mixed business is, in my judgment, the prior decision of the taxable person to have treated the whole of his supplies as having been for a business purpose. If he has not done that, then apportionment becomes the only permissible alternative.

It was then submitted for the Museum that the Commissioners required the Museum to operate the method "laid down by (them) in... Appendix J". Such a submission involves a complete misreading of the Notice and the Appendix. It requires no great effort to discover that the Appendix is expressed in permissive and not mandatory terms as to the method to be employed subject only to the conditions that it (a) must produce a result which is fair and reasonable and (b) has been agreed by the local value added tax office. It was submitted that the Appendix J method was impermissible within the terms of the Statute since it was income rather than use based. As a statement of general application this cannot be regarded as a sound proposition. There may very well be cases in which just such a method will produce a result which is both "fair and reasonable". That it may not have done for the Museum's particular basis of operation cannot make such a method "impermissible". It may not have been appropriate for, or in the best interests of, the Museum. To argue, as it was, that the method was impermissible is, in my judgment, untenable. It was, of course, a necessary argument if the proposition that the Museum had made an error was to be successful.

While it is well established that "error" within Regulation 64 has to be accorded a wide meaning, the question

remains for consideration whether the Museum in making returns using the income based method of apportionment made any error. If it had been compelled to make its returns on this basis, when in law it could not be so compelled, there would be a convincing argument to the effect that the Museum had made an error. All that has in fact happened is that the Museum, having sought independent advice, has been able to devise a basis for its returns which produces a more favourable result. The Tribunal concluded on this part of the case (see page 17, line 43):

"We cannot accept that the meaning (of error) is as wide as Mr. Thomas contends. In our judgment a taxpayer who has adopted a method which is an acceptable method of apportionment, and has not made a mistake in the way in which he has applied that method, cannot sensibly be regarded as having made an 'error' simply because he could have chosen another acceptable method which would have produced a different amount."

The Tribunal was correct in reaching this conclusion. No error of fact or law had been made, simply an incorrect assessment of what would have been most advantageous to the Museum. I did not understand that the argument for the Museum to compel a different result. It was to the effect that the word "error" was to be given a broad common sense meaning. Such that a trader who had made an error of law or error of fact should be permitted to rectify his returns and, thus, obtain repayment of sums overpaid. The problem which, as it seems to me, the Museum is unable to surmount is in demonstrating of what the error consisted, that is of fact, law or otherwise. As my holding in relation to Appendix J shows, there was no error of law. No error of fact is asserted other than that a method of assessment was chosen which did not provide the most favourable outcome. It was nevertheless not one which involved any intrinsic error of fact or law.

For the reasons already identified, the Tribunal was, in my judgment, correct in the decision at which it arrived, and this appeal must be dismissed.

MISS HAYNES: The Commissioners seeks their cost.

MR JUSTICE TURNER: You cannot resist, Mr. Thomas..

MR THOMAS: I preserve the appellant's position. Might I seek leave to the Court of Appeal from your Lordship, the Appendix J question is a matter of some great interest to a considerable number of Museum's and charities.

MR JUSTICE TURNER: Miss Haynes, what do you say?

MISS HAYNES: In view of the decision of the tribunal and the decision I oppose leave to appeal.

MR JUSTICE TURNER: Mr. Thomas, I have come to a clear conclusion, and it would be inconsistent with that conclusion if I were to encourage you by giving you leave to the Court of Appeal. You must seek leave there. Thank you.