[2017] UKFTT 573 (TC)

TC06011

Appeal number: TC/2015/05403

VAT – apportionment of optician's income between exempt dispensing income and standard rated sales of spectacles. Whether there was a prior agreement as to the method of apportionment – no; how costs should be calculated for a costs based apportionment.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MEGJI & CO LTD **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE CHARLES HELLIER
SHAMEEM AKHTAR

Sitting in public in Birmingham on 8 June 2017

Tim Brown, instructed by Hodge Bakshi, Chartered Accountants, for the Appellant

Jane Ashworth for the Respondents

DECISION

1. Megji & Co Ltd operates an optician's business from four locations in Wales. In the course of that business it supplies eye tests and dispenses spectacles.

2. For VAT purposes the supply of an eye test is wholly exempt. But the activity of dispensing and supplying spectacles has, since the judgement of McCulloch J in *C&E Comms v Leightons Ltd* [1995] S TC 458 been treated as comprising two elements: an exempt supply of medical dispensing services and a standard rated supply of spectacles (goods).

3. The company invoices its customers separately for the eye tests but makes a single charge for the "mixed" supply of spectacles and their dispensing. This appeal concerns the manner in which that single charge should be apportioned between its standard rated (spectacles) and exempt (dispensing) elements in order to determine the value of the company's taxable supplies in relevant periods.

4. Neither party suggested that *Leightons* was wrongly decided, and we have proceeded on the basis that it was correct, but we note: (1) that, being decided in 1995 it addressed the question of whether there was a single supply or multiple supplies by reference to the test of whether one element of that provision was ancillary (or incidental) to another, rather than by reference to the broader principle enunciated by the CJEU in *Levob Verzekeringen BV and OV Bank NV v Staatccesretaris von Financien* C 41/04 [2006] STC 766 and other cases that the test was whether the two elements were so closely linked that they formed, objectively, a single, indivisible economic supply, which it would be artificial to split, and that only one example of that was the situation in which one element was ancillary to a principal element; and (2) that McCulloch J found at 465 that no practical difficulty resulted from holding that there were two separate supplies; a conclusion which, in view of some of the issues in this appeal and we found surprising.

5. Following a visit to the company in 2014 by Adrian Freestone, an officer of HMRC[1] there was correspondence between him and the company and its advisers (Hodge Bakshi ("HB")) about the apportionment between the elements of the mixed supply. The correspondence resulted in assessments made in June 2014 for the VAT periods 08/11 (the period ending on 31 August 2011) to 02/15 which totalled £41,444. These were made on the basis that in each of those periods 54% of the consideration for the mixed supply represented standard rated supplies.

6. The company makes its appeal on three alternative grounds:

   (1) that at the relevant times it had a binding agreement with HMRC that it should treat 44% of its mixed supplies is being standard rated (rather than the 54% on which the assessments were based);

[1] We use "HMRC" to encompass its predecessor HM Customs and Excise.

(2) that, given that agreement, the assessments were unreasonable and could not be said to have been made to best judgement, and

(3) the quantum of the assessments was inaccurate because the figures used in calculating the 54% were unfair.

Relevant law.

7. The effect of section 31 and Item 1 group 7 schedule 9 VAT Act 1994 is that the supply of medical services by a person on the registers of ophthalmic dispensing opticians is exempt. By virtue of this provision the supply of an eye test and the medical service of dispensing spectacles are both exempt.

8. Section 19(4) VAT Act provides that:

> (4) When a supply of goods or services is not the only matter to which a consideration in money relates the supply shall be deemed to be for such part of the consideration as is properly attributable to it."

9. That provision enables an apportionment to be made of the consideration for a mixed supply of standard rated and exempt elements (see eg *C & E Comms v Tron* [1994] STC 177 at 182).

10. Regulations 67 and 68 of the VAT Regulations 1995 provide:

> "Retail Schemes
>
> 67 (1) The Commissioners may permit the value which is to be taken as the value, in any prescribed accounting period or part thereof, of supplies by a retailer which are taxable at other than the zero rate to be determined by a method agreed with that retailer or by any method described in a notice published by the Commissioners for that purpose; and may publish any notice accordingly.
>
> (2) The Commissioners may vary the terms of any method by -
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> (a) publishing a fresh notice,
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> (b) publishing notice which amends an existing notice, or
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> (c) adapting any method by agreement with any retailer.
>
> 68 The Commissioners may refuse to permit the value of taxable supplies to be determined in accordance with a scheme if it appears to them -
>
> (a) that the use of any particular scheme does not produce a fair and reasonable valuation during the period during any period,
>
> (b) that it is necessary to do so for the protection of the revenue, or ..."

11. Regulation 66 provides that "scheme" means a method as referred to in regulation 67.

12. Section 73 VAT Act 1984 provides that where it appears to the Commissioners that any returns are "incomplete or incorrect, they may assess the amount of VAT due from [the taxpayer] to the best of their judgement and notify it to him".

13. Section 83 VAT Act 1984 provides that an appeal shall lie to this tribunal "with respect to any of the following matters -

(p) an assessment --

(i) under section 73 ...

or the amount of such an assessment."

1. The first ground of appeal: a binding agreement that 44% was to be treated as standard rated.

14. We make the following finding of fact.

15. On 5 February 1996 HMRC wrote to the company saying:

"I confirm that, with effect from 1 April 1996 you should account for VAT at the standard rate on 44% of your gross takings of corrective spectacles, contact lenses and accessories.

"This percentage will apply for the period shown below and will be reviewed at the time shown by the use of an agreed apportionment method. An adjustment by means of a Voluntary Disclosure should be made to pay or reclaim any balance of VAT disclosed by the review.

"At the same time you forward the revised calculations you should apply for a further provisional agreement on the new figures. Each provisional agreement will be for one year based on financial year end ...

"If revised figures are not submitted by the due date the agreement will be deemed to have lapsed and VAT will be payable on 100% of spectacle and contact lenses sales for the period covered by the provisional agreement and for future periods until revised figures are produced.

"Period of agreement 1 June 1996 to 31 August 1997

"Review period 1 September 1996 to 31 August 1997

"Review due date 28 February 1998."

16. The company submitted its VAT returns up to 2015 on the basis that 44% of the consideration received for mixed supplies represented standard rated supplies. There was no evidence that there had been a review or submission of revised figures. There was no VAT inspection by HMRC until 2014.

17. In June 1999 HMRC published VAT Information Sheet 08/99 on the apportionment of charges for the supplies of spectacles and dispensing. This Information Sheet explained that after *Leightons* in 1995 HMRC had accepted the division between the supply of exempt dispensing and the supply of standard rated frames and lenses and had agreed several methods for the computation of the apportionment. It continued:

"Customs reviewed the situation in 1997 and concluded that it was no longer appropriate for opticians to have centrally - agreed methods to establish their

liability to VAT. The application of a limited set of methods to a varied group of retailers had led to inaccuracies ... all of the agreed methods were therefore withdrawn with effect from 1 January 1988.

"From the beginning of the first VAT accounting period starting on after 1 January 1998, an optician either had to use an apportionment method that had been individually agreed with their local VAT business advice centre or make separate charges ...

"In many cases in apportionment method based upon the costs of the supplies was felt to be the most practical method to use ...

"Current position

If a single charge is being made for supplies of spectacles and dispensing, opticians should now be apportioning this in accordance with a method that has been agreed with their local VAT business advice centre

The Arguments – Discussion

18. Mr Brown says that the 1996 letter was a binding agreement between the company and HMRC that 44% of the gross mixed takings would be treated as standard rated. Such an agreement he says is permitted by regulation 67. He says that where there was such a binding agreement HMRC had no power retrospectively to raise an assessment in contradiction to it. He relies on the first-tier tribunal decision in *Mithras (Wine Bar) Ltd v HMRC* [2009] UK FTT 83 (TC) at 73 where the tribunal concluded that compliance with such an agreement meant that the appellant's return was correct with the result that HMRC could not exercise the power under section 73 to raise an assessment.

19. Mr Brown argues that, since the 5 February 1996 letter evidenced an agreement "individually agreed with the appellant's local VAT office", it was not withdrawn from 1 January 1998 and remained "agreed" for the purposes of the Information Sheet 08/99.

20. Mrs Ashworth did not contend that a binding agreement made pursuant to the power in regulation 67 did not preclude the making of an assessment in relation to returns made on the basis of that agreement, but she says:

(1) regulation 67 applies only to retail schemes and the company was not a retailer;

(2) the letter of February 1996 did not provide a method which applied after August 1987.

21. We regard the Appellant as a retailer in relation to its supplies of spectacles and thus consider that a method agreed with a person such as the Appellant to determine the taxable amount of its standard rated supplies falls within the permission granted by regulation 67.

22. Regulation 68 permits HMRC to refuse to sanction the use of a scheme (which by regulation 66 includes an agreement under regulation 67 as well as a published retail scheme), and regulation 70 requires a retailer who uses a scheme to use it for at least one year.

23. It seems to us that the object and effect of these provisions is that once a method has been agreed HMRC are not permitted retrospectively to resile from the agreement. Not only would that infringe the principle of legal certainty which permeates EU directives but the language of the regulation indicates that the agreed method "determines" the value of the supply for the purpose of the Act although regulation 68 permits HMRC to resile prospectively from any such agreement for the reasons in that regulation.

24. On that basis we would respectfully agree with the conclusion of the First-tier tribunal in *Mithras* that unless the method has been prospectively withdrawn the value of taxable supplies computed in accordance with an agreement is the "correct" amount of tax and accordingly that section 73 does not permit an assessment to be made on the basis that the tax has been incorrectly stated under the method.

25. However, we do not consider that in the periods of account under appeal there was in force an agreement that the standard rated proportion of the Appellant's mixed supplies was 44%.That is for the following reasons:

(1) to our minds the effect of the letter is to provide that VAT returns may be made using the 44% percentage during the period of the agreement i.e. up to 31 August 1997. But there is then to be a review after the financial accounts have been produced. At that review the figure of 44% would be revisited using the figures in the financial accounts together with an "agreed apportionment method". That would give a 'better' figure for the proportion of the gross takings which were standard rated. The second paragraph, with its indication of a Voluntary Disclosure, indicates that using the revised 'better' percentage could lead to more or less VAT than the 44%. The letter then indicates that a similar regime should apply in future years. Thus in year 2 the "better" figure from year 1 could be used but that would be reviewed at the end of year 2 based on the financial figures available for that year with a corresponding payment or repayment etc. There is to our minds no indication in the letter that 44% was the correct percentage to use even for the period up to 31 August 1997;

(2) even if the letter can be construed as an agreement that 44% be used, the letter makes it plain that it applies only until 31 August 1997;

(3) the submission of VAT returns by the Appellant for periods after 31 August 1997 using 44% was not in accordance with what was agreed by the letter. That letter required the submission of revised calculations, and in their absence (and there was no evidence that they had been produced) a rate of 100%; and

(4) the fact that HMRC did not query the appellant's returns cannot in our view mean that HMRC agreed to the method being used. There had to be some

form of communication of acceptance by HMRC before it could be said that they had "agreed". Silence is not golden.

26. Whilst it may be possible to read the letter of 5 February 1996 as agreeing that a formula should be used by reference to which a percentage could be calculated, that is a long way from agreeing a percentage. There is also no evidence of the formula of by which the percentage could be calculated.

27. The terms of Information Sheet 08/99 do not affect these conclusions. Since there was no agreement to use 44% it makes no difference whether or not the methods which were withdrawn on 1 January 1998 were limited to centrally agreed methods.

28. We conclude that the Appellant's appeal does not succeed on Ground 1.

2. Ground 2: the assessment was perverse or not made to best judgement.

29. Section 83(1)(p) VATA provides that an appeal lies against both an assessment of the amount of the assessment. The tribunal's jurisdiction in relation to an appeal against the amount of an assessment is a wide one, but its jurisdiction in relation to an appeal against an assessment "is akin to a supervisory judicial review jurisdiction. The circumstances in which the FTT can decide that the assessment was not made to the best of the Commissioners' judgement, and therefore should not have been made at all, are very limited, essentially being restricted to cases where the Commissioners acted perversely or in bad faith" ([11] of the Upper Tribunal's decision in *Mithras* [2010] UK UT115 (TCC)).

30. Mr Brown argues that by failing to have regard to the 1996 agreement HMRC were perverse in deciding to assess. He relied on *Hollinger Print Ltd* [2013] UK FTT 739 (TC) in which the tribunal, having decided that HMRC had a discretion whether or not to assess, and that that discretion must be exercised properly, held that the tribunal's role was not confined solely to the question of whether the amount of an assessment was made to the best of HMRC's judgement, but included a review of the decision to assess.

31. In *J&B Hopkins* [2017] UKFTT 0410 (TC) the tribunal disagreed with the analysis in *Hollinger,* holding that there was a two-stage process: a decision to assess and then the making of the assessment (see [92]) and that consideration of the decision to assess was outside the jurisdiction of the FTT.

32. We doubt this conclusion: because we can see no warrant for it in the words of section 83, because it seems at variance with the judgement of Chadwick LJ *Rahman (No2*) [2003] STC 150 at [7], and because, if the making of an assessment vindictively or capriciously may justify setting excess it aside (as Carnwath J indicated *Rahman* (Number 1) [1998]), it is difficult to see how that differs from setting aside a perverse decision to assess.

33. Had we found that there was an agreement permitted by regulation 67 for the determination of the standard rated percentage at 44% we would have found that the assessment was perverse. But we did not, and so we do not.

34. The 1996 letter does not describe any formulaic method by which the relevant percentage may be calculated (indeed the letter's reference to "*an* agreed apportionment method" indicates the reverse). If there had been evidence that in 1996 there had been an agreement on a formula then it would have been perverse to ignore it and to use a different formula in making the assessments if the terms of the original formula were not proscribed by revocation in 08/99. However there was no evidence which indicated that there was any difference between the formula method underlying the 44%, or that which would later be used in making the adjustments, and that underlying the compilation of the assessments.

35. As a result we do not find that the assessments should be set aside on the basis of Ground 2.

3. Ground 3: The Quantum of the assessment.

36. Both parties accept that an apportionment should be made between the standard rated supply of spectacles and the exempt supply of dispensing services on the basis of the cost of the various elements of the mixed supply. It was also accepted that the standard rated element consisted of the supplying of lenses (or contact lenses), the frames, a case and other physical accessories, and that the exempt element consisted of the service of dispensing the prescription).

37. Thus, so long as there was agreement about the quantification of the relevant costs the parties agreed that the proportion of the consideration for the mixed supply which related to the standards rated supply was

(cost of spectacles etc ("COS")) / (COS + cost of dispensing ("COD").

38. There was agreement about the numerator of this fraction. The parties agreed that it should be taken from the company's accounts with the addition of VAT and the relevant employment costs of the member of staff who prepared the lenses. The disagreement between the parties related to the determination of the cost of dispensing, although they were in agreement that COD should comprise the employment costs of the company's staff that were attributable to dispensing.

39. It might be argued that this concurrence was agreement under Regulation 67 between HMRC and the Appellant of a formulaic method to be used in the apportionment. If that were the case then our role would be limited to determining the amounts to be put into the formula. However, we do not consider that there is such an agreement. That is because for there to be such an agreement there must be consensus as to the meaning of the terms used, and in this case there is disagreement and uncertainty about the conception and computation of the relevant "costs".

40. The exercise we undertake is therefore to make a determination in accordance with section 19 of the consideration properly attributable to standard rated supplies. It will be seen in due course that this might have the same result as the divination of what might have been agreed to be the meaning of "costs", but the nature of our decision is different.

41. We should start by considering what activities constitute dispensing. That is because we need to determine what part of the consideration is attributable to that activity. It is clear that the activities which are not part of the "supply of medical care" cannot be treated as relevant to the cost of the exempt part of the mixed service, and that medical care must have a therapeutic aim - the diagnosis, treatment and as far as possible cure of diseases or health disorders.

42. In *Leightons* McCullough J described nine agreed stages in the sale of a pair of corrective spectacles:

> "It is agreed that the stages in the sale of a pair of corrective spectacles can be summarised as follows:
>
> (i) The patient is first seen by a dispensing optician who examines the patient's existing spectacles (if any), prepares a record card and decides on the appropriate next step.
>
> (ii) Usually the patient has his eyes tested by an ophthalmologist (who is a registered medical practitioner) or an ophthalmic optician who writes out a prescription.
>
> (iii) The patient takes the prescription to the dispensing optician who then or later may discuss matters with the prescriber.
>
> (iv) The dispensing optician takes detailed measurements of the patient's eyes and other features and prepares detailed notes.
>
> (v) The dispensing optician advises the patient on the options available in respect of lenses and frames.
>
> (vi) The dispensing optician draws up a specification for the lenses and frames from the measurements which he has taken.
>
> (vii) The specification is sent to a laboratory which produces the lenses and frames to specification.
>
> (viii) When the spectacles are returned the dispensing optician will check whether they conform to the specifications sent.
>
> (ix) And finally the dispensing optician will fit the spectacles with the patient and make any minor modifications required."

43. McCullough J did not expressly hold that each of those stages had a therapeutic aim, but it seemed to us that that conclusion was implicit in the judgement. We consider that, with the addition of a discussion between the optometrist and the patient about his or her vision at the start of the consultation, they describe the extent of the therapeutic function. On this basis we would exclude from activities which constituted medical care the activities of most of the administration, and in particular the activity of assisting with a customer's choice of frames, save to the extent the nature of the frame is relevant to the prescription or type of use of the spectacles. The care provided in helping a customer find the colour and style of frame he or she likes is care, but is not medical care.

44. McCullough J's description was of course in the context of Leighton's business. The Appellant's business was different and many of the activities described in this passage as conducted by assistants, were, in the Appellant's business, conducted by the optometrists but it is the nature of the activity rather than the person by whom it is conducted (so long as they are appropriately qualified or supervised) which is relevant.

The Evidence and Our findings of fact in relation to the activities of the OOs, the D0, and the OAs.

45. We received no formal oral evidence but had before us a letter describing features of the business to HMRC from Mr Shiraz Megji, the managing Director of the company, and copies of correspondence from HB to HMRC. Mr Megji was in court and answered our questions.

46. In our findings in this section we give consideration to the time spent by the relevant members of the Appellant's staff in dispensing. That is because one method for determining the cost of dispensing which had been discussed by the parties (a method which we consider may contribute to the computation of a proper attribution) was to determine that cost as the proportion of the employment costs attributable to dispensing on the basis of the proportion of the employees' time at work spent in that activity.

47. The Appellant employs 15 staff members who together with Mr Megji and J Megji operate at four sites. The company had three categories of staff who took part in dispensing to some extent:

(1) ophthalmic opticians (OOs) who conducted eye tests but were also involved in dispensing; and

(2) a dispensing optician (the "DO)" who did not conduct eye tests but spent some time in dispensing; and

(3) optical assistants ("OA"s) who were not qualified, but operated under the supervision of an ophthalmic optician and played a role in helping with some part of the dispensing activity.

48. Five members of staff, including Mr Megji, are OOs. One is a qualified dispensing optician and the remainder are not qualified.

49. Not all eye examinations results in a purchase, or an immediate purchase, of spectacles. Section 26 Opticians Act 1989 requires the patient to be given a prescription. Some patients take the prescription elsewhere. Some may have a preliminary discussion about a style of frames and then return later to make a final decision. Mr Freestone analysed daily sales records in the year to 31 August 2013 and concluded that 48.02% of those having eye tests ordered spectacles following the examination. Mr Megji analysed the dispensing figures for a four-week period in 2015 and showed that 12.06% of the total dispensing related purchases by customers who had not had an eye examination on the day of their purchase. We accept these figures as resulting from accurate calculations.

(i) The activities of the OOs.

50. In the Appellant's business, unlike some other opticians' chains, the majority of the work on the fitting and selection of spectacles and lenses after an eye test is done by the OO who carried out the examination. Mr Megji saw the involvement in the optometrists in the specification of the spectacles as a particular selling point of the business and noted that the economics of the business were affected by the conversion rate. The optometrist's were given targets in terms of conversion. This was one of the reasons for which we broadly accepted Mr Megji's evidence in relation to the split time spent by the OOs.

51. Eye examinations are booked as 30 minute appointments with an OO. At the beginning of the appointment patients may fill in a short questionnaire about their activities and their use of spectacles. There is then a detailed discussion with the OO about the patient's vision and the benefits of, and the needs they may have for, particular types of spectacles. This phase takes some 10 minutes on average. The next phase is the clinical eye test which takes on average a further 10 minutes and will generally result in a lens prescription or a new lens prescription. In the final 10 minutes the OO will discuss the best form of eyewear and give advice on frames, lens types and coatings, and then assist with the selection of lenses and frames and the measurement of facial features to produce a specification for the particular spectacles.

52. The OOs' professional guidelines require that all dispensing, fitting and collection of spectacles for children must be carried out by a qualified optometrist or dispenser. Thus almost all children's work is carried out by OOs.

53. We thought it likely that, apart from children's spectacles, the collection of spectacles once made up to prescription and specification was not generally carried out by OOs.

54. We concluded that some part of the initial 10 minutes would relate to the clinical aspects of the eye test – gathering information which would alert the optician to matters which required further investigation or attention, but that a larger part would relate to matters relating to the types of spectacles a patient would need. We concluded that of a 30 minute appointment on average some 12 minutes would generally relate to the clinical eye test and the remainder to advice and assistance in relation to the nature of the spectacles required.

55. Given Mr Megji's position in the business we thought it likely that some of his time related to the direction and administration of the company.

56. HMRC argued that only 50% of the cost of each OO's should be treated as a cost of dispensing. Mr Freestone arrived at this figure by taking two thirds of the OO's time as spent in activity other than the optical test. Of the remaining non eye test activity he then treated:

(1) 50% of it as leading to an immediate order for spectacles and therefore as being exempt dispensing;

(2) 20% of it as advice which did not lead to an immediate order but led to a later order (when for example the customer, having made up his or her mind on the type of frames came back to make an order) ; and

(3) 5% of it as time spent with individuals who already had a prescription.

57. These he regarded as activities of dispensing. The percentages totalled 75%. As a result he calculated that time spent on dispensing was

75% x 2/3 = 50% of the OO's time.

58. The Appellant argues that 67% of an OO's time related to dispensing.

59. We return to this issue towards the end of the decision.

(ii) The Activities of the DO

60. The practice has one dispenser, whom we understood to be a registered dispensing optician. The dispenser took part in customers' selection of spectacles and and the preparation of the specification for spectacles, and would on occasion do so instead of an OO; but there was only one dispenser and four sites. The DO also did a multitude of other tasks: frame ordering, checking on deliveries, pricing frames, putting the frames into stock, arranging the window display at each location, seeing reps and ordering, doing repairs, helping with collections and adjustments, organising marketing materials, updating the website and ordering stationary.

61. Mr Freestone made the assessments under appeal on the basis that the Dispenser spent 20% of her time in dispensing.

62. The Appellant notes that her contract described her role as dispensing and says that this suggests that other work was ancillary. On this basis HB suggested in their letter of 12 May 2015 to HMRC that 60% of her cost be allocated to dispensing.

63. There was no evidence as to the split of the time spent by the Dispenser between actually advising on hand drawing up specifications for the delivery of a pair of spectacles. The list of activities ascribed by Mr Megji to her was long. We do not consider that the description in her contract is strong evidence of what she did. In the absence of any other evidence of what she did when it seems to us that there is nothing to cause us to doubt HMRC's figure of 20%. We find that the Appellant did not discharge the burden of showing that the figure was too low.

(iii) The Activities of the Optical Assistants (OAs).

64. The optical assistants man reception, help with people coming in to browse, assist with repairs and adjustments and help with the collection of spectacles by customers.

65. It seems to us to be likely when a customer came to a shop who already had a prescription, whether from the company's practice or otherwise, and ordered spectacles, the work on selection and specification would on many occasions be

carried out to a large extent by one of the optical assistants since the OOs would be engaged in eye tests.

66. HMRC's assessment was made on the basis that 50% of the OA.'s time was not dispensing.

67. An earlier estimate of this percentage by HMRC had been 70%. Mr Freestone changed his mind after receipt of the letter from Mr Megji in which Mr Megji had he had explained that the OOs (and sometimes Dispenser) did the bulk of the dispensing of the prescription, and that the optical assistants helped with those who came to browse, repairs, adjustments and (non - childrens') collections.

68. No further evidence was offered to us of the activities of the OAs or of the amount of time they spent in particular activities. In our view the fitting and making of minor adjustments on collection would be the provision of medical care but work on reception and with browsers would not be. The evidence therefore did not indicate that 50% (or either of the lower figures used for D Morrissey and J Megji) was wrong. We find that the Appellant did not discharge the burden of showing that the figures were too low

The rival contentions.

69. HMRC's assessments were made on the basis that the cost of dispensing was the aggregate of the products of the fraction of the time each employee spent dispensing and the employment costs for that employee. On that basis they made the assessments on the basis that dispensing costs were the aggregate of respectively 50%, 20%, and 50% of the employment costs of the OOs, the DO and the OAs (with slightly different figures for two particular OAs).

70. There was no dispute about the quantum of the employment costs which included: in the case of Mr Megji the dividends he took from the company, training costs and motoring costs for the DO. The figures used were those for one particular year, but HMRC were not given, and we did not see, figures for any other year.

71. HB had most recently contended that the respective percentages for the proportion of the time spent dispensing should be: OOs: 67%; DO: 67% and OAs: 70%.

72. So far as the proportion of the time spent by the DO and the OAs we have already set out our conclusion above. What remains is the determination of the proportion of their work time spent by the OOs in dispensing.

73. The appellant argues that 63% (or in the alternative 67%) of the OO's time was referable to exempt dispensing and therefore that about two thirds or so of the costs of the OO should be treated as dispensing costs. It so argues on two different bases.

74. On the first basis they say that two thirds of each appointment relates to a dispensing activity. That results in conversion to an order for spectacles in about 50% of cases. Then 25% should be added for dispensing advice when there was no

conversion into an order for spectacles, together with 10% for final collection, 5% for adjustments and 5% for individuals who already have a prescription. Thus the proportion of their time of the time spent in dispensing was:

95% x 2/3 = 63.33%.

75. On the second basis they argue that since any time not spent by the OO in sight testing must have been spent dispensing, 67% of the OO's costs related to dispensing. They support that by noting that the eye test fees form one third of the sales figures for the year 2013 as shown in the company's accounts.

Discussion - Quantum

76. Section 19 requires the ascertaining of the consideration which is properly attributable to the standard rated supply. That requires some method of attribution. Regulation 68, which permits HMRC to refuse permission to use a method which is not fair and reasonable indicates that the method of attribution must be fair and reasonable.

77. The determination of the value of the consideration for a supply requires in principle a determination of the subjective value of the consideration to the supplier. In the absence of any factors which suggest that from the perspective of the supplier the attribution should be different, it seems to us that, because a supplier would normally have regard to the comparison between cost and income, and generally hope for an equivalent margin, an attribution based on the cost of the various elements of a supply is capable of producing a fair and proper attribution.

78. That is easy to state but less easy to apply. It hides a morass of questions about which costs are relevant and how they should be ascertained, and it is difficult to find a secure principled framework for guidance in their resolution. In this appeal two particular questions arise: (i) whether the costs of the OO's (or employees generally) should be apportioned between eye testing and other work on the basis of the time spent by the employees in those activities, or on the basis of the company's income from those activities; and (2) if on the basis of time spent, how time spent by OOs in giving dispensing advice in relation to customers who do not purchase glasses should be treated.

(i) apportionment by reference to accounting income or time spent?

79. In their correspondence with HMRC, HB suggest using the split between eye test fees and other income in the company's accounts as a basis either (i) for splitting all the employment costs, or (ii) for apportioning the OOs' employment costs between eye tests and dispensing (and apportioning other employees' employment costs on a time basis).

80. If the first of these contentions is applied the result is as follows. The figures taken from the August 2013 accounts in HB's letter of 17 April 2015 show that about 1/3rd of the company's income derives from eye tests. Thus one might attribute 2/3rd of all the salary costs to non eye tests. Those costs are about £360k, so 2/3rds would

be £240k. The cost of the glasses is shown as £215k. On this basis, assuming that almost all the service costs relates to dispensing activity 215/(215+240) = 47% of the non eye test income would be attributable to the standard rated supply of the spectacles.

81. However such an attribution assumes that all of the 2/3rds of employees' salary are the direct costs of dispensing rather than being associated with the provision, display and choice of frames. Further, whereas it may be that about 2/3rds of an OO's costs should be regarded as dispensing it makes no allowance for the non dispensing activities of the other staff members and thus overstates the costs attributable to the dispensing activity. It does not seem to us to give a fair cost attribution.

82. In relation to the second of these contentions, we find that an apportionment of an OO's costs by reference to the split of eye test and other income in the company's accounts does not produce a fair and reasonable result because the company's income does not derive solely from the OOs' activity but also from the activity of selling frames, part of which is carried out by the OAs.

83. We find that, on the available evidence, an apportionment on the basis of the proportion of each employee's time spent in dispensing is just and reasonable because it most nearly reflects the cost of providing the dispensing service and thus the related part of the consideration the supplier might expect to receive.

(ii) dispensing activity which does not result in the sale of a pair of spectacles

84. Mr Freestone had suggested that this time be left out of account – see [57 and 58] above.

85. Mr Brown said that the effect of eliminating the cost of the time spent in abortive dispensing was in effect unfairly to increase the proportion of cost attributable to the sale of glasses; and that was unfair because there was no standard rated sale to which the time was attributable. At best that time should be treated as attributable to both dispensing and spectacle sales.

86. In our view, the basis of a costs based apportionment is that the supplier would receive consideration for the various elements in the proportions of his costs in providing those elements (so that each element of his business was, in the absence of evidence to the contrary in relation to its management, equally profitable). The cost of providing a dispensing service must in our view include the cost of providing it when it is not used – that will be a cost which is built into the economics of the practice. As a result it seems to us that the cost of time spent by a member of staff in dispensing activity which does not in the end result in a pair of spectacles should be treated as part of the cost of the occasion on which there is a conversion.

87. The debate over the cost of time spent in (commercially) abortive dispensing by the OOs has a counterpart in the question of what should be taken into consideration in the computation of cost, and in particular the extent to which overheads should be included. If particular overhead costs can be identified as being attributable to particular activities, then it seems to us, again on the basis that the supplier would

expect to make an equal margin on each limb of its sales, that such overheads should be taken into the computation of the relevant cost. If an overhead cost cannot be fairly allocated to a particular type of sales then if it is allocated pro rata to other costs it makes no difference to the end fraction whether or not it is included. The effect of our decision in the preceding paragraph is to treat the cost of abortive dispensing as an overhead attributable only to dispensing. The evidence before us indicated that employment costs and the costs of materials were major costs of the business and we heard nothing to suggest that there were other significant overhead costs which should or could be properly allocated only one activity. As a result the only reasonable approach on the evidence before us was to treat other overhead costs as arising pro rata to the costs of eye test, dispensing and frames, and therefore to make no further adjustment for them.

88. We have concluded that an OO would, on average, spend 12 minutes of the 30 minute appointment on the sight test and 18 on dispensing activity. Thus on the basis outlined above, and for OO who did nothing other than eye tests and dispensing, 18/30= 60% of his or her time would be attributable to the dispensing activity, and accordingly 60% of his or her costs of employment.

89. We heard no evidence as to the other activities of the OOs but can accept that all but Mr Megji spent practically all of their time in testing and advising, the administration being provided by the Dispensing Optician and the assistants. But we consider that a lower proportion should be used in relation to Mr Megji as it was his business, and running it would inevitably take up some of his time. We would allocate only 50% of his costs to dispensing activity.

90. We have noted at [57 and 58] above Mr Freestone's calculation which results in a percentage of 50% for the time an OO spent dispensing. The effect of that calculation is that 17% of an OO's time was to be regarded, on average, as spent neither in eye testing nor dispensing. Given Mr Megji's evidence of the activities of the OOs and the number of OAs we thought it unlikely that OOs other than Mr Megji would spend any significant amount of their time in administration or other non front line activities. We therefore concluded that the assumptions underlying that calculation meant that it did not yield a fair and reasonable apportionment.

Conclusion

91. The parties did not ask us to determine the assessments, but to provide decisions on the matters which divided them. We have decided that:

(1) A proper basis for attribution is one which is fair and reasonable;

(2) A costs attribution can be fair and reasonable and therefore proper;

(3) An attribution of by reference to the ratio of relevant employment costs and the costs of glasses etc is in this case a reasonable basis for the determination of cost;

(4) In this case it is fair to attribute employment costs on the basis of the time spent by employees in the relevant activities;

(5) The proportion of an OO's time spent in dispensing activity is to be taken as 60% (except for Mr Megji when 50% is fairer)

(6) The proportion ofthe Dispenser's time spent in dispensing is to be taken as 20%

(7) The proportion of the optical assistants' time spent dispensing is 50% save in the case of D Morrissey and J Megji.

92. Formally we adjourn the appeal for the parties to agree the numbers. They may apply for the hearing to be resumed if they cannot agree.

Rights of Appeal

93. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 26 JULY 2017