TC03308

Appeal number: TC/2012/02647

VAT –input tax – Fleming claim.

FIRST-TIER TRIBUNAL
TAX CHAMBER

ST GEORGE'S HEALTHCARE NHS TRUST **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD BARLOW
MARK BUFFERY

Sitting in public at London on 2 and 3 July 2013.

Mr David Southern of counsel for the Appellant

Mr Richard Mansell of the office of the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns claims made by the appellant for input tax it contends it did not claim in the period 1 April 1973 to 31 March 1997. The claims relate to the supplies of drugs, medicines and prosthetics the appellant claims to have made to private out patients in that period. The claims total £179,191.95 and are what are called 'Fleming claims' which means they depend upon section 121 of the Finance Act 2008 and regulation 29(1) of the VAT General Regulations 1995 because, were it not for those provisions, the claims would have been out of time.

2. The parties have asked us to make some preliminary findings at this stage which it is hoped may enable them to agree the actual sums recoverable, if any.

3. In fact, during the hearing HMRC indicated a good many points on which they now agree the appellant has produced sufficient evidence to recover some of the amount claimed. However, as we are being asked, in effect, to endorse the methodology of the claim we think it appropriate to record our findings in full even where the Commissioners have agreed with the appellant's contentions.

4. The appellant is now a National Health Service Trust and has been since 5 March 1993 when the property, rights and liabilities of a predecessor body, which had been a Health Authority, were transferred to it by the Secretary of State. We hold that the right to claim input tax was transferred at that time. The case of *Midlands Co-operative Society Ltd –v- HMRC* [2008] STC 1803 is authority for the proposition that an assignment under a statutory scheme can pass such rights to a successor. In the period since 1973 the hospital had been the subject of several such re-constitutions.

5. Initially, HMRC had denied the claim for the period 1 April 1973 to 31 March 1982 because of a lack of formal evidence of transfer of rights between predecessor bodies. We find that the hospital had been operated without interruption throughout the period in question. Several witnesses were called who were able to confirm that the hospital had been operated continuously and indeed HMRC do not dispute that fact. It is overwhelmingly likely that proper formal steps would have been taken and overseen by the Government to transfer the rights and liabilities such that we can make a presumption of regularity and hold that the rights and liabilities were transferred at each stage when that became necessary. At the hearing HMRC agreed that was the case.

6. The background to this appeal is the changing understanding of the correct treatment of the supply of medicines and drugs over the years since the introduction of VAT.

7. It was not appreciated that a supply of medicines could give rise to a claim for input tax until the Court of Appeal decided the case of *Customs and Excise Commissioners –v- Wellington Private Hospital* [1997] STC 445 but that judgment was questioned following the case of *Card Protection Plan –v- Customs and Excise*

Commissioners [1999] STC 270. The *Wellington* case was then superseded by the VAT (Drugs, Medicines and Aids for the Handicapped) Order 1997.

8. The commissioners held the view that the supply of medicines could only be zero rated, and therefore could only give rise to an input tax claim, if the supply was by an independent pharmacist; with the consequence that a supply by a hospital would not be zero rated. They promulgated that opinion in December 1992 and January 1993 but acknowledged that it was wrong in March 2005.

9. The position now, so far as is relevant to this appeal, is that medicines and drugs are zero rated if they are supplied to outpatients by hospitals and the patients are paying for them.

10. A National Health Service Trust has functions which mostly fall outside the scope of VAT because they are not the making of supplies by way of business. Equally, such a body has some functions that are business in the normal sense of that word such as providing a cafeteria or restaurant for visitors or parking facilities. The provision of private health care is also a supply by way of business but much of that activity is exempt from VAT. The appellant was registered for those purposes at times material to this appeal and recovered some input tax in respect of the taxable supplies it was making. As already explained, the claim in this case relates to the zero-rated supply of medicines, drugs and prosthetics to private out patients where input tax was incurred but not claimed at the relevant time. One of the aspects of the claim that needs to be considered is whether or not the appellant has been able to show that the amounts now being claimed had not previously been claimed.

11. In addition, there is a special scheme, under section 41 of the VAT Act 1994, which applies, amongst others, to bodies exercising functions on behalf of a Minister of the Crown by which they can claim recovery of sums that would have been input tax had they been in business. We need not describe the details of that scheme but again a question arises as to whether any recovery may already have been made under it which is being duplicated under the present claim. That scheme is known as the Contracted Out Services Rules and we will refer to it as the COS scheme.

12. We heard evidence from three witnesses for the appellant. They were Dominic Sharp ACA, currently the deputy finance director of the hospital, Scott Harwood MIIT VAT consultant and Simon Merry VAT consultant. The consultants are from the Berthold Bauer consultancy. The respondents' witness was Gary Kennedy Higher Officer Tax Specialist of HMRC who was in charge of examining NHS Fleming claims. We accept that the evidence of all the witnesses was truthful. The appellant's witnesses had not been involved with the Trust or its predecessors for the whole period and much of their evidence was based on hearsay or assumptions about how things may have been dealt with in the past. They did have a close knowledge of the Trust's current operations and methods and although we will have to consider the validity of their assumptions we do regard their evidence as both credible and helpful. Mr Kennedy had no direct knowledge of the operation of the Trust and his evidence was mainly concerned with the methodology of the claim.

13. Mr Sharp told us that he had worked for the Hospital for four years. He deals with payroll, payment for supplies and VAT. He had talked to current private patient managers and an accountant who had worked in the Hospital since 1986 and all stated their belief that the Hospital had catered for private patients throughout the period from 1973 and he concluded that that had been the case. Although detailed figures for private patient income are now only available from 1993/4 we are satisfied and find that private patients were treated at all material times.

14. Mr Sharp was questioned by Mr Mansell about whether the proportion of private patient income attributable to outpatient drugs may have risen in the later years of the claim because of the cost of drugs for newer treatments such as those for IVF and HIV. He said that he doubted that would be the case and that the Hospital's particular specialisations were cardiac and neuroscience rather than IVF and HIV.

15. Mr Sharp also said that he doubted if the Hospital would have used an outside pharmacy at any relevant time and would always have had its own internal pharmacy.

16. The rest of the evidence deals with the method adopted to calculate the claim and to justify it. We will make some observations about the nature of such a claim before we consider the evidence.

17. The Fleming claims arose because of misunderstandings about recoverable input tax and claims made within a certain period of time, including the claim in this appeal, are allowed to be made for the whole period in which VAT applied, rather than the limited periods now applicable. Such claims are possible because of section 121 of the Finance Act 2008 and the very fact that there had to be a specific provision for them shows that they fall outside the norm for VAT input tax claims.

18. Section 121 refers to the claims as ones "for which the applicant held the required evidence". It is significant that the past tense is used. There are requirements for record keeping in the VAT legislation and normally the Commissioners seek to interpret that legislation very strictly and often in litigation in the Tribunal they attempt to seek proof by way of documentary evidence to an absurd degree of detail. As Mr Southern pointed out, given that Parliament specifically legislated for claims going back well before the time for which traders are required to keep records and given the reference to records "held" in the past; it must have been Parliament's intention that the usually strict requirements are not applicable. That inevitably leads to a conclusion that something of a broad brush approach is possible and we agree with Mr Southern that that is the case. Indeed the respondents' published guidance shows that they accept that is the case. We would perhaps use an expression such as a reasonable degree of proof given the circumstances rather than broad brush but nothing turns on that.

19. We will therefore describe and comment on the method actually adopted.

20. In order to make a valid claim it seems clear that three steps are needed. The first is to identify what input tax could have been claimed. The second is to identify how much, if any, was claimed in the past. The third is then to compare the two and

the claim should then be the difference if it has been demonstrated that the amount claimed was less than it could have been.

21. The method adopted so far as identifying the amount that could have been claimed was as follows. We set it out step by step:

- (Step One) For the years 2005/6, 2006/7 and 2007/8 only, the Trust has records of what the proportion of drugs supplied to private out patients was compared to the total drugs expenditure of the Hospital. It was .63%, .88% and 1.39% which averages .97%.

- (Step two) For each year of the claim the private patient income was identified as a proportion of the estimated total income of the Hospital.

- (Step three) For each year of the claim the total drugs expenditure of the Hospital was identified or estimated and the total private patient drugs income was then expressed as the same proportion of the total drugs expenditure as private patient income was as a proportion of the overall income (as calculated at step two).

- (Step four) For each year of the claim the actual amount of the private out patients' drugs income was calculated by dividing the figure derived from the .97% at step one by the total private patients drug figure derived at step three with the consequence that the .97% was reduced to .87% of the overall drugs expenditure.

- (Step five) The VAT on the figure calculated at step four was calculated and claimed.

22. A number of issues arise in connection with those steps.

23. As far as step one is concerned we hold that it would be better to take a weighted average of the three years rather than just a mathematical average of the percentages.

24. For step two the total income of the hospital was not known for all the years covered by the claim. Mr Harwood said that in order to calculate what it had been in all the years, he had taken 1993/4 as the base year and he found that between then and 2007/8 the average increase in income had been 8% a year. For years before 1993/4 he worked the figures back deducting 8% each year. HMRC questioned this and proposed that a figure for increases in expenditure for the NHS as a whole would have given a more accurate figure although, as they had not in fact attempted to make that calculation themselves, we have no way of knowing whether that calculation would have proved more or less advantageous to the appellants than the one taken by Mr Harwood.

25. HMRC argued that the earliest known year i.e. 1993/4 should be taken as the basis of these calculations because it is their practice that the earliest year should always be the basis because it is the nearest to the Fleming claim as they put it.

26. Mr Harwood gave evidence that he had worked forward from 1993/4 applying the RPI index increases for each year and had found that that arrived at a less accurate figure for 2007/8 than applying the 8% forwards as well as backwards from 1993/4 would have done. He felt therefore that the 8% figure was corroborated by that exercise and we agree that it should be used as the basis for the calculation of the total income for the years before 1993/4.

27. We find that that is a more satisfactory basis for a method to be used by the appellant than taking the earliest year without more would have been and we therefore reject HMRC's contention about that particular aspect of the calculations.

28. Step two also makes the assumption that private patient income as a proportion of the whole income had been consistent over the years. Proof of that was largely based on anecdotal evidence gleaned by Mr Harwood in conversation with staff of the Hospital none of whom had actually worked there throughout the period. In the absence of any other evidence and given that estimates are necessarily being used we hold that that is a reasonable assumption to apply.

29. Step three involves taking the known or estimated private patient income and expressing it as a proportion of the total income. The ratio between the two is assumed to have been constant before 1993/4 and so the 8% annual decrease is therefore applied to both figures.

30. At step four the figure for private outpatient drug use (.97%) was applied to the ratio of private outpatient drugs to total private patient drugs for the years for which those figures were available and that resulted in a calculation that private outpatient drugs were .87% of total drugs. As we have found that the .97% should be amended to .94% the final figure should be .84% of the total drugs figure.

31. Finally at step five the relevant VAT fraction was applied to find the actual input tax which could be claimed on private outpatient drugs.

32. We should add that at each stage where it was relevant the outpatient drugs figure was itself calculated after deducting purchases of blood products and the appellant claims also after any purchased within the intra health service market were deducted. It was left open at the hearing as to whether that last point was in fact correct, that is to say whether intra health service supplies have been excluded. That is a point the parties may wish to pursue further and we make no finding on it at this stage.

33. With the minor adjustments and qualifications mentioned above we endorse the method used by the appellant as being appropriate and as arriving at a justifiable figure for the claim.

34. We are satisfied from the evidence we heard that the appellant has not duplicated any claims for input tax previously claimed. The record keeping methods used in the NHS to record purchases and sales as net or gross as required precluded any such deduction at the time and so preclude any duplication. That is the case both for the appellant's normal VAT return and its COS scheme activities.

35. Mr Kennedy in his evidence and Mr Mansell in closing accepted most of what had been done in the calculations once they had been explained and tested in evidence.

36. They still contend for taking 1993/4 as the basis at step two but we have rejected that contention.

37. In addition to the claims for input tax not previously claimed on purchases of drugs which were supplied to private outpatients the appellant also makes a claim based on its contention that the amount of tax it could have claimed under a partial exemption calculation is now higher than the amount it had claimed because of the increased proportion of taxable supplies to which such input tax can be attributed.

38. HMRC accepted that claim in principle but subject to discussions between the parties by which it is hoped HMRC will be satisfied that certain items of expenditure that should be excluded from such a claim have been excluded. It was agreed that the tribunal need not make any decision on those issues, if any arise, at this stage.

39. The appellant has indicated that it will claim interest on such sums as are now payable to it but the amount cannot be worked out at this stage because the amounts repayable are as yet not finally known.

40. We therefore release this part decision and give the parties leave to seek a further hearing to resolve any issues that remain undecided and/or un-agreed following the release of this decision. We direct that either party is to have leave to notify the tribunal within six months of the release of this decision that it wishes to have a further hearing and that if no such notification is made within that time then both parties are to notify the tribunal immediately after the expiration of that six month period that no further hearing will be required.

41. 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.

RICHARD BARLOW
TRIBUNAL JUDGE

RELEASE DATE: 6 February 2014