[2017] UKFTT 522 (TC)

TC05971

Appeal number: TC/2012/00192

VAT – Fleming claim – whether all supplies exempt or non-business, No. Repayment of input tax attributable to taxable supplies made from 1974 to 1997 – whether quantifiable with sufficient precision – No. – FA 2008, Section 121 – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

NHS LOTHIAN HEALTH BOARD **Appellant**

- and -

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

TRIBUNAL: MEMBER: PETER R SHEPPARD, FCIS, FCIB, CTA

Sitting in public at George House, 126 George Street, Edinburgh on 11 and 13 May, 16 and 17 June, 10-13 November 2015, and 21, 22 and 23 June 2016

David Southern, QC, instructed by Liaison Financial Services Limited, for the Appellant

Sean Smith, QC, instructed by Douglas Pate, Solicitor, Office of the Advocate General for Scotland, for the Respondents

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DECISION

Introduction

1. The hearing of this appeal took place before Judge Kenneth Mure QC and Mr. Peter Sheppard FCIS FCIB CTA. Judge Mure died suddenly and unexpectedly before a decision could be released. This decision has been prepared by Mr. Sheppard, with the agreement of the parties and by authority of the president of the Tax Chamber."

2. This is a claim for repayment of input tax relating to taxable services supplied by the appellant's laboratories during the period 1974 to 1997. These were rendered to private (non-NHS) customers such as local authorities, other public bodies, and foods and drugs manufacturers.

The Law

3. In addition to the relevant statutory provisions, particularly FA 2008 Section 121, the Tribunal was referred extensively to many authorities, documents and publications. Those which the Tribunal considered relevant are set out in a list which is appended hereto as Appendix A. Section 121(1) provides:-

> "(1) the requirement in section 80(4) of VATA 1994 that a claim under that section be made within 3 years of the relevant date does not apply to a claim in respect of an amount brought into account, or paid, for a prescribed accounting period ending before 4 December 1996 if the claim is made before 1 April 2009."

Evidence

4. In addition to settling an Agreed Statement of Facts both parties led extensive witness evidence. On the first two days of the hearing the Tribunal heard brief introductory evidence from the appellant's witnesses who could speak to the pattern of the laboratories' activities at the material time, sources of income, and various aspects of the accounting systems then in place. Each read out his or her Witness Statement, was then asked any supplementary questions and thereafter cross-examined.

5. Firstly **Linda Mulhern** gave evidence (vol 5, tab 7). She is the operational science manager in microbiology. She has responsibility for the microbiology laboratories of the appellant Health Board, attends at the new Royal Infirmary and St John's Hospital, and has responsibility for health and safety in the microbiology laboratories.

6. She started work with the appellant in 1988 as a trainee bio-medical scientist. She holds an honours degree in microbiology and a master's degree too. She became a senior bio-medical scientist in 1997.

7. Mrs Mulhern explained that the appellant carried out work for external agencies. Borders Council would send water samples for testing. Oysters, milk and cream were also tested. Eggs were checked for salmonella. The laboratories were in the hospital grounds. She remembered the food testing which was being carried out when she started in 1988. It continued until at least 1996.

8. Medical care for patients included checking samples of body fluids and swabs. The laboratories undertook general public health work too. The laboratories carried out National External Quality Assessment Scheme ("NEQAS") work. Also, the laboratories conducted drugs research work, often at weekends and in the evening. Mrs Mulhern considered that 70% of the laboratories' work was for the NHS and the balance for external, private work. Public health work, she said, reduced towards the end of the 1990s.

9. Mrs Mulhern was not cross-examined. She confirmed to the Tribunal that she was not registered as a medical practitioner.

10. Then **Miss Gillian Fewster** gave evidence (vol 5, tab 6). She is deputy health and safety officer for microbiology and bio-medical scientist team manager. She is involved also with diagnostic microbiology. She started working for the NHS in 1973 at the Western General Hospital. She became an advanced bio-medical scientist in 1993.

11. At the Western General Miss Fewster was involved in processing and reporting on *private* samples, including work for public health departments of various local authorities, examining water, milk, creams, swimming baths' water, shell fish, certain food samples and sewer swabs.

12. Miss Fewster had undertaken research and development work for a period, for which she was paid additionally. Also she had tested cattle and poultry samples for bacteria harmful to humans, including milk-testing. Her public health work ceased in about 1993, then re-started for a period with another manager, until this work was transferred to the City Analysis Laboratory in 2000.

13. Miss Fewster indicated that she was registered with the Health Care Professional Council.

14. Next **Miss Jane McIvor** gave evidence (vol 5, tab 9). She is a bio-medical scientist with the appellant, having started as a trainee in 1980. She explained that she had been involved receiving, processing, and reporting on samples sent for testing, for third parties for public health purposes. The tests were not medical but for environmental purposes. Scottish Water now competes for this work. Miss McIvor had also been involved in testing cream and dairy products for environmental health purposes.

15. Miss McIvor explained that her "non-NHS work" took up about 1—1½ hours per day. She indicated that she held an HNC and was registered with the Health Care Professional Council.

16. The final witness on the first day of the hearing was **Andy Mitchell** (vol 5, tab 8)**.** He is a "grade 7" bio-medical scientist. He started working for the appellant in 1973 and gained his first senior post in 1992. He was involved with public and environmental health work from 1974 to 1997. Milk and water samples were tested regularly. Of a laboratory staff of 25-30, four would have been involved for three days per week on this work, although he agreed in cross-examination that the volume of private work was variable. It was a relatively small proportion of the laboratories' work. Food testing took place too, including in the summer ice-cream testing. Water was tested for bacterial contamination from animal matter and water in public swimming pools was checked too. Water-testing was done since the start of his employment in 1973 to at least 1990. This work tailed off in the 1990s but in about 2006 efforts were made to recover it from other competitors.

17. Mr Mitchell agreed that he had no financial experience nor was he medically qualified.

18. On the second day of the hearing the Tribunal heard evidence from **Dave Wright** and **Doreen Anne Howard**, both accountants, who spoke to aspects of the appellant's financial management.

19. Mr Wright (vol 5, tab 5), who is CIMA qualified, worked for the appellant from 1981 to 2014, with an interval between 1988 and 1992, after which his involvement in its finances began. He had responsibility for laboratory services from the late 1990s. He had discussions with Ross Muir of Liaison in May 2008 about the management of laboratory services and VAT implications. There were negotiations with HMRC about VAT recovery. The appellant's laboratories generated income from non-NHS bodies, both public and private sector during the "Fleming" period 1974-1997. Invoices would have been raised for commercial organisations for commercial research. Mr Wright and certain colleagues were involved in the Scotmeg Group which concentrated on improving income-generation activities, charging on a commercial basis. It sought to ensure that VAT was correctly accounted for. Many of these arrangements were not the subject of formal contracts, and much paperwork will now have been destroyed.

20. Mr Wright's evidence was elaborated on by further questioning by Mr Southern. He confirmed that "outside" work by the laboratories was charged for, rates were fixed locally, and that it was intended to be profitable. In the prime accounts those receipts would be recorded distinctly, although in the annual accounts they would not be separately identifiable. Mr Wright explained further that while there were detailed records for expenditure, there were none for income.

21. Mr Wright was referred to the accounts for the Year to March 1977. He noted laboratory expenditure there in excess of £3M. By the 1979 accounts laboratory expenditure had increased to £4⅓M and had since then further increased. In the 1980 accounts laboratory expenditure had almost reached £5M and in the 1981 accounts it had increased to just over £6M. Mr Wright was asked about "re-charges". He was not certain what these were, but they matched expenditure.

22. In cross-examination Mr Wright explained that the role of the Finance Department was to account for expenditure across all functions. The sales ledger would record invoices raised. The management accounting side was involved reporting income and expenditure. An invoice would be raised by the invoicing section. Mr Wright was in charge of the team which issued invoices. Charging was done on a local basis except where the service was charged on a standard basis. Laboratory charges were now standardised, but had varied before. The sales ledger department determined VAT matters arising: Mr Wright had no responsibility for that.

23. Mr Wright was then referred to the accounts to March 1992. He explained that this was not an income and expenditure account. It was prepared on a cash basis. Specifically it did not show income arising from the laboratories: that was aggregated with other sources. Mr Wright tried to explain various headings and abbreviations in the accounts. Some explanations were not clear-cut. Perhaps curiously receipts for "silver" related to the sale of old x-rays. "Pigswill" related to wasted food sold. In respect of catering "re-charges" to other hospitals, these were not strictly income but re-charges. "Trading accounts" focus on areas where services were rendered to external parties. If a "Lothian-wide" service was not provided, there would be no need for a trading account. Mr Wright confirmed that any income received from the laboratories would be included as miscellaneous income, even if not specified. He was asked to comment on the sum of £2,852,760 which appears twice. Mr Wright said they have to relate to the same income. Mr Wright was uncertain whether it related to laboratory income. It could relate to NHS funding but not income from external bodies. The laboratories conducted different types of work including haematology, microbiology, clinical chemistry, pathology and genetics, each of which disciplines could generate income.

24. In re-examination Mr Wright explained that before 1990 Health Boards used "cash flow" accounting, which did not require the same detail. Later the Health Board trusts adopted "resource" accounting. Wages and salaries represented between 70% and 93% of laboratory costs.

25. **Miss Howard** (vol 5, tab 4) a certified accountant, is head of financial control with the appellant currently, having started working with it in 2000 as a management accountant. As head of financial services she was responsible in 2006 for completion of the appellant's VAT returns. She explained that when she was involved in tidying up physically the appellant's financial records, she realised that a lot of documentation had been confidentially destroyed without reference to her. A folder containing one VAT return (01/95) had been given to Mr Muir of Liaison.

26. She recollected attending a VAT seminar, hosted by Liaison for the various Health Boards. There, one senior financial officer recollected that Lothian had never recovered VAT on indirect business activities during the *Fleming* period. VAT had been recovered only for COS services. Miss Howard acknowledged that she in her managerial capacity had attended in June 2007 an extended meeting with HMRC. Business activities were reviewed, annual adjustments were approved, and payments reviewed.

27. In cross-examination Miss Howard indicated that she discovered the VAT file referred to in November 2009.

28. The next two days of the hearing were devoted to taking the evidence of **Martin Campbell Kaney** (vol 5, tab 2), a VAT author and specialist practitioner. His witness statement had been circulated before he gave evidence and this gave the respondents and, indeed, the Tribunal an opportunity to consider its terms in advance. On the morning of the resumed hearing when Mr Kaney was due to give his evidence, Mr Smith raised objection as to its admissibility. His objections were fourfold. Substantially, Mr Smith submitted, its contents were irrelevant and did not assist the determination of the matters at issue. Further, the factual basis supporting his assertions were undisclosed. This precluded satisfactory cross-examination, Mr Smith suggested. Thirdly, Mr Kaney's evidence might prejudice the interests of third parties, and breach duties of confidentiality. Finally, at various stages in his witness statement Mr Kaney had ventured legal opinions, which, of course, were for the Tribunal to form.

29. The Tribunal did not consider that Mr Kaney's evidence in terms of his witness statement should be excluded or excised. We decided that his evidence should be led albeit under reservation as to questions of relevance and competence. The witness statement had formed part of the Tribunal's pre-reading and while certain elements might not be strictly relevant, substantial excisions were in the Tribunal's view inappropriate.

30. As a professional Tribunal, the Tribunal felt that it should be able to form its independent conclusions in law without being unduly influenced by Mr Kaney – or by any other witness – who might offer an opinion. The Tribunal agreed with Mr Southern's view in his responses to Mr Smith that Mr Kaney's professional experience substantially formed the factual base for his assertions. Otherwise, the factual basis could be explored and probed in cross-examination. The aspect which did concern the Tribunal was the possible prejudice and breaches of confidentiality owed to third parties. In the event the third parties seemed to be the other Scottish Health Boards and related trusts. This appeal is one of a large number at the instance of the various Scottish Health Boards. It is the second "Lothian" appeal. There is a community of interests shared by the Health Boards about the progress of these appeals. The Tribunal did not consider that any obvious prejudice or breach of confidence need arise.

31. Accordingly the Tribunal proceeded to hear Mr Kaney's evidence. He did make limited excisions from his witness statement. (In particular the reference to "procedural impropriety" in para 7 was removed and also the opinion voiced in para 23.) In the event hearing his evidence in full did not give rise to any embarrassment or difficulty.

32. Mr Kaney explained that he held degrees in Arts and Law and is a professional expert witness. He has extensive experience of Value Added Tax derived from service in HM Customs & Excise and as an independent tax consultant. Between 1984 and 1992 he was an officer of C&E involved in civil and criminal investigations.

He presently is a director of X-VAT, an on-line consultancy. Previously he worked for RSM Tenon and Deloitte. Earlier he was Head of Tax Services for Liaison in Scotland and has been retained by it in respect of the present series of Health Board "Fleming" claims. As Mr Kaney's evidence emerged, the narrative became complex and the Tribunal considered it useful to have notes of his evidence extended. These are now produced (vol 8, tabs 3 and 4).

33. Mr Kaney explained that since 1999 he had acted for over 100 NHS organisations throughout the UK submitting VAT Returns and claims for business activities. Invariably where an NHS organisation had acute services and laboratories, it made taxable supplies varying depending on its particular circumstances. He and **Miss Langley** (HMRC's witness in this appeal – see para 109 *et seq*) had settled a methodology for resolving these.

34. In 2009 Mr Kaney had submitted 83 "Fleming" claims for 20 NHS organisations in England, Scotland and Wales. He had used an HMRC approved formula for these. His researches of Customs & Excise records showed that there were no approved business activities claims before the mid-1990s ie after the Health Board Trusts were created. Earlier approved claims related to contracted-out services.

35. After he joined Liaison in 1990, Mr Kaney explained, he became aware that certain business activities claims for the mid-1990s had not been submitted. Two of these (for Greater Glasgow Primary Care and the Scottish Ambulance Service) had been rejected as out-of-time and were not re-visited after the FA 2008. This tended to confirm that no indirect input tax was previously claimed. Before the Health Board Trusts were established in the early 1990s, NHS (Scotland) submitted one consolidated VAT Return.

36. In the late 1990s several NHS bodies had made retrospective claims for indirect input tax back to 1973. These had been "capped". This confirmed that no indirect input tax had been recovered, and these claims were not re-visited after FA 2008.

37. In 2010 Mr Kaney had attended a meeting with HMRC to discuss aspects of "Fleming" type VAT repayment claims. There HMRC indicated that they regarded the earliest available data as the best and that the standard of proof should be an objective standard of certainty, rather than the balance of probabilities. The year 2006/07 was the first year after the abolition of Health Board Trusts in Scotland for which consolidated accounts for NHS Lothian were prepared. It was also the first year for which it was possible to "sectorise" the business activities claim in relation to taxable supplies from the laboratories. This followed previously agreed principles and was accepted by Miss Langley. The taxable percentage in relation to the laboratories was 14.70%, which is typical of the level of taxable activities in NHS laboratories. Mr Kaney considered that this was the most satisfactory base-line for *Fleming* calculations in the present appeal.

38. Mr Kaney complained that HMRC have challenged every calculation and revision. He considered that he had taken account of all reasonable criticisms. 14.70% had been used as a starting figure and adjusted. Certain of HMRC's

challenges were ill-founded, such as a failure to apply direct attribution. However, in a "sectorised" claim direct attribution had already been taken account of. Another criticism, the absence of a partial exemption calculation, was unjustified. That was relevant to apportionment between taxable and exempt supplies. Here, the apportionment is between business and non-business supplies. Further, COS refunds were not subject to Section 121 FA 2008. Hence a retrospective COS adjustment was inappropriate.

39. Next, Mr Kaney commented on Miss Langley's proposed treatment of services rendered pre-May 2007 by persons on the professional register as exempt (para 12 of her additional witness statement). This, he claimed, was inconsistent with her approach in other instances and with HMRC's policy pre-May 2007. However, the Tribunal would observe that ultimately exempt status for medical services and its scope are topics for legal submission, not evidence. Essentially, the status of medical laboratory technicians and inclusion in their professional register and their re-classification as "bio-medical scientists" falls to be reviewed in determining the scope of the exemption.

40. The exemption from VAT was applicable to medical services. There was no exemption for medical research as such, Mr Kaney considered. There was an education exemption (FA 1972, Schedule 5, Group 6) applying to research by a school or university. Those bodies eligible included NHS and other not-for-profit organisations but not businesses or commercial organisations.

41. Mr Kaney confirmed that the appellant and the other Scottish NHS Boards had not made any previous recoveries of indirectly attributable input tax. Indeed there was no mechanism to facilitate this.

42. Mr Kaney then explained that he and Miss Langley had agreed a methodology in respect of VAT on business activities claims in about 2001 and 2002. It was still in use in 2006/07 although Mr Kaney was not then involved personally. The methodology was an inputs method and cost-based, rather than based on outputs or income. It arose from the business/non-business apportionment calculation rather than a partial exemption calculation. HMRC had to determine whether the result was fair and reasonable. All Liaison clients adopted this method, Mr Kaney continued. Up to 80% of NHS bodies in Scotland adopted it. It was used widely and accepted by HMRC. The core methodology used in the VAT repayment claim in respect of business activities for 2006 and 2007 was the same as that agreed in 2001 and 2002. While the Health Boards varied in scale they were consistent in terms of their activities. The Trusts, however, varied.

43. The negotiation and agreement as to methodology was documented in correspondence. The business/non-business apportionment was submitted and a settled form was finally resolved after a period of between one and two years. Mr Kaney explained that the relevant correspondence could not be traced. That agreement related to a claim based on a certain methodology rather than the methodology as such. HMRC distinguished the process of business/non-business

apportionment and the process of partial exemption. Mr Kaney agreed that these were completely distinct.

44. Mr Kaney then explained the "base line" figure in his calculations. He explained that HMRC would not negotiate or engage with representatives in advance of repayment claims being submitted. Thus the taxpayer and its advisers had to determine a reasonable methodology to calculate a *Fleming* claim. His method corresponded with that of other advisers, choosing a representative period of not more than 2 years to provide a base-line percentage for repayment purposes. That would be extrapolated historically to other years. There were three distinct stages. Firstly, a representative period had to be selected. Next the relevant percentage of taxable activities was calculated, ie taxable business where there would be an entitlement to a repayment of input tax. And thirdly that percentage would be extrapolated to earlier years, back to 1973, introducing such variations and adjustments as were necessary for particular years. In the present case the base-line percentage was 14.70%, being the percentage for business use for the laboratories for 2006 and 2007. In making this calculation any VAT incurred on non-business activities would be considered irrecoverable input tax. Recoverable input tax was VAT incurred in relation to taxable business activities. The partial exemption calculation represented an apportionment between taxable and exempt supplies. Mr Kaney stressed that his methodology would eliminate from any repayment claim input VAT on any exempt supplies.

45. In an attempt at recapitulation Mr Kaney stressed that the first stage in the process of identifying recoverable VAT was directly attributing input VAT to supplies, so far as possible. Identifying VAT attributable to COS complicated the process. He noted four points. Firstly, there was no practical difference between input VAT on non-business and exempt supplies: none was recoverable. Secondly, recovery of VAT on COS had, however, been allowed by HM Treasury. Thirdly, a COS adjustment was wrongly categorised, and so wrongly re-claimed. Fourthly, partial exemption is inapplicable where input VAT has been directly allocated to particular supplies.

46. The apportionment of VAT between business and non-business activities did not require HMRC's approval, Mr Kaney explained, in that they approved a *claim* not the methodology involved. Here the repayment claim was in respect of input tax on taxable business supplies, and it was misleading to call it a "partial exemption claim". This particular claim had been prepared by **Mr Lee** (see para 67 *et seq*) and **Mr Muir** (see para 88 *et* seq) although Mr Kaney acknowledged that he had reviewed the calculations and discussed at length their final form with Mr Muir.

47. In the conclusion to his examination-in-chief Mr Kaney confirmed that he was speaking essentially to four stages. The first was settling a methodology for VAT treatment of business activities which was done for 2001/2002. Then that method was applied to 2006/2007. The third stage was calculating a business recovery percentage of VAT for 2006/2007. Finally, the 2006/2007 claim was used as a base-line for the repayment claim for 1973 to 1997.

48. Further, Mr Kaney explained that a "sectorised" claim related to a specific part of a business which had to be looked at individually because of its having a different combination of taxable activities including non-business and exempt. Examples of sectorised activities would be catering and pharmacy. Sectorisation was described also as "tunnelling, digging out the VAT". Thus a complex business would be viewed as several distinct businesses for VAT purposes. So, the scientific laboratories of the Lothian Health Board would be a typical sector. Mr Kaney explained that the process of sectorisation was subsequent to making (firstly) direct attribution of input VAT to outputs in the main claim. Sectorisation was indirect attribution occurring after the main claim, and it was made in respect of each unit of a business. Finally, a residual claim would be made for general costs and overheads which could not be attributed. Mr Kaney stressed that at the intermediate sectorisation stage, direct attribution was inappropriate since that should have been completed already at the initial stage.

49. Mr Kaney had concluded (para 8 of his witness statement) that the level of taxable activities in NHS Laboratories was 14.70%. At this point Mr Smith objected to the exploration of the basis for this. However, it was then explained that this income was derived from NEQAS, clinical trials, and public health testing. Reliance had been placed on HMRC's public notices to determine the correct VAT treatment.

50. In relation to the VAT classification of health-care Mr Kaney indicated that he regarded work for the NHS to be non-business. If work were done for BUPA, then as private health care it was exempt. Similarly patient-related services, provided by a health professional outwith a hospital environment, would be non-business if carried out for the NHS, but exempt if for a private body, such as BUPA. On the other hand non-medical services provided for payment, would be standard-rated.

51. Mr Kaney was then cross-examined by Mr Smith. He was asked firstly about the capacity in which he gave evidence. He acknowledged that while he was a member of the Institute of Expert Witnesses, he had been retained by Liaison not as an independent expert but as a specialist adviser in relation to the claim in this appeal. Next, he agreed that in respect of this appellant, Lothian, the first claim in respect of laboratory income was in respect of 2006/07, and made in late 2007. By that stage Mr Kaney had left Liaison's employment, and he had not been involved in the original preparation of this claim. In clarification Mr Kaney explained that he had been employed by Liaison from 1999 to October 2006 and thereafter had "wound down" his work with it.

52. Mr Kaney was then cross-examined on the nature and extent of the agreement between him and Miss Langley. While the methodology of claims for residual input VAT had been agreed, he accepted that a "base-line" had not. That methodology was input-based. A "sectorised" percentage was appropriate where a particular area of activity could be separately identified, and would differ from general residual calculations.

53. Mr Kaney accepted that the input-based methodology agreed in 2002/03 in relation to residual VAT was not – at least directly – relevant to the adjustment for 2006/07. While the 2002/03 methodology had schedules for various sectors as agreed

with Miss Langley, it did not include a schedule in respect of laboratory costs. Catering costs and laboratory costs should be considered distinctly in this context.

54. Schedule ID (vol 2, tab 17, p110) follows an income-based methodology, and produces a percentage of taxable income of 14.70. The percentage for internal recharges, correspondingly, is 85.3. While Mr Kaney had not examined the relevant source material, he believed from discussions with Mr Lee and Mr Muir that these were income reports. The 2006/07 calculation related to the Year from April 2006 to March 2007 and parts would not have been the subject of a *Fleming* appeal.

55. Mr Kaney explained that in 2009 he prepared and submitted 83 (or possibly a few more) *Fleming* claims for various NHS bodies throughout the UK. Only one was for a Scottish NHS body, a special Health Board. While these claims covered different supplies in different circumstances, only the catering claims were in fact paid. The baseline for these claims was a business activities calculation for 2007/08 approved by HMRC. Mr Kaney regarded 2007/08 as providing the best baseline as data was current and the most comprehensive.

56. Mr Kaney explained that the English Trusts would have responsibility typically for one or two district hospitals, serving similar populations, and not varying greatly in activity. While records could go back for six years, where these were in paper form, they could not be analysed as readily as electronic records. Mr Kaney agreed that this could complicate claims. While past VAT Returns might be retained, ledgers, reports and management accounts might not.

57. In his witness statement Mr Kaney had referred to "handwritten records of approved claims" and noted that there had been no such claims pre the mid-1990s, when HMRC's "admin" team had been set up. He explained that while he had not joined Liaison until 1999, his responsibility would go back some three to four years because of the operation of the "CAP" affecting the qualifying period for retrospective claims. Therefore, joining Liaison in 1999 meant that his responsibilities went back to about 1996.

58. Mr Kaney was then asked about the confidentiality of other taxpayers' claims (see para 5 of his witness statement). He accepted that disclosure of information relating to one client would require its permission. He considered that he had the necessary authority of Liaison on their behalf. These clients had remained with Liaison. Mr Muir had confirmed that these clients had authorised any disclosures made in relation to their VAT affairs. In para 6 of the witness statement Mr Kaney had noted that other NHS authorities had made retrospective claims for unclaimed VAT. He became aware of this around 2002, at about the time of the *Marks & Spencer* claims. Some of these had been lodged by advisers other than Liaison.

59. In para 7 of his witness statement Mr Kaney had referred to a meeting with the Public Bodies Group of HMRC in 2010. At that time he was working with RSM Tenon. He agreed to remove the imputation of a procedural impropriety by HMRC. This had been made in the context of complaints which had not been resolved. Further, it was suggested by Mr Smith that the meeting was called to resolve why

claims of about £15½M had been made without the taxpayers' authority. Mr Kaney rejected this. He explained that certain authorised claims had been made by another agent, not Liaison. But also a secondary "back-up" claim had been made on behalf of Strategic Health Authorities without their consent. These, Mr Kaney stressed, had been made to protect these taxpayers' interests. As a "back-up" he did not view these as claims: they could not take effect unless the original claims failed. He agreed that following that meeting the claims were withdrawn.

60. Mr Smith then referred to the availability of data. Mr Kaney confirmed that in 2009 the earliest data available would be for 2002/03. He agreed that at the meetings with the Public Service Group the National Fleming Guidance had been discussed, and that that acknowledged the balance of probabilities test. However, Mr Kaney's conclusion following on the meeting was that HMRC would not interpret that as a 51% standard.

61. In para 8 of his witness statement Mr Kaney had described the taxable percentage of 14.70 as being typical for NHS laboratories. He accepted that he had not provided a comparative basis for applying this percentage to Lothian's laboratories, but considered that percentage typical in his experience.

62. The first repayment claims for laboratories were for 2006/07 apart from one made for the Fife Health Board. Thus, Mr Kaney agreed, there were then no other sectorised laboratory claims. He did not, however, accept the suggestion that if 14.70% were accepted for one claim, that would be regarded as a benchmark. The Fife Health Board claim had been for over 30%. Each claim should be calculated on its own data and merits. Mr Kaney explained why he considered 2006/07 the best evidence rather than 2002/03. In his opinion (he had not been involved personally in formulating the claim) the first consolidated accounts for NHS Lothian were for that Year. Before the new Board was formed, there were not consolidated accounts. These probably were not sufficiently accurate. Accordingly Mr Kaney could not say how the previous adviser to the Appellant Board had approached the calculation of the claim.

63. Mr Kaney was then asked about Liaison's treating NEQAS income as taxable first in 2006/07. He was unaware of this. He thought that where NEQAS income had been wrongly accounted for, the claim had been adjusted.

64. In para 9 of his witness statement Mr Kaney acknowledged that the Appellant's Claim had been revised. In para 10 there is reference to "direct attribution". Mr Kaney confirmed that this process should be unnecessary in sectoral claims as it should have been done at an earlier stage.

65. Mr Smith then referred Mr Kaney to the annual adjustment for 2006/07 for non-business activities (Vol 2, p32, Appendix 9). However, Mr Kaney was unable to comment on that as his role was supervisory rather than examining source material. He confirmed that the standard rated activities carried out by the laboratories would have been clinical drug trials, environmental health testing, research for pharmaceutical companies, and NEQAS assurance work.

66. In a brief re-examination Mr Kaney was asked, firstly, about paper (not electronic) records of detailed codes for the six preceding years. The detailed codes referred to (the absence of which made analysis more difficult) were the Board's own accounting codes. Further, Mr Kaney confirmed that the purpose of the 2010 meeting was to protect the NHS authorities' interests, and that by way of "back-up" claims. At that stage entitlement (see para 74) loomed larger than the methodology of calculation of the claim.

67. Finally, the Tribunal sought to clarify the process of "direct attribution" and its impact on the calculation of the claim. Here the calculation was by reference to a bulk cost code, which produced a percentage of 14.70 of income as representing taxable activities. Mr Kaney seemed to concede that a more precise figure might have been achieved if more specific information had been available. The appellant's codes had been used, not invoices for instance, and the codes were less specific.

68. At the next adjourned hearing (11-13 May 2015) the Tribunal heard firstly evidence from **Kenneth White Lee**. This was under reservation as to matters of relevancy. Mr Lee had prepared two witness statements and provided a third at the hearing (vol 5, tab 3). He has worked for Liaison since 2001 and previously as an officer of HM Customs & Excise, experienced in VAT matters. He read his first witness statement from para 23, the earlier content being superseded by the Statement of Agreed Facts.

69. Mr Lee considered firstly whether VAT had been charged by suppliers to the Health Boards. There was an acknowledged difficulty in tracing documentary evidence. The Health Boards had moved offices; there had been a reorganisation; and old records had been destroyed. It had been confirmed that purchase invoices would not be available generally. However, the "Blue Books" would show consolidated costs of the NHS in Scotland. (The "Blue Books" have been noted in the earlier related appeals. They contain detailed information as to expenditure but do not satisfactorily record income.) These costs would reflect what expense had actually been incurred. If VAT had been recovered, the net cost would be recorded. If not, the recorded cost would be inclusive of VAT. The COS provision does not allow recovery of VAT on purchases of goods. The Scottish Health Boards generally had not recovered VAT on indirect or residual overheads. As Mr Lee understood, the "Blue Books" and annual accounts would be the most reliable sources of information.

70. Mr Lee then considered whether the Health Boards carried out taxable activities in the *Fleming* period. VAT had generally been accounted for on taxable income by the Health Boards. Catering income could be determined. So far as Lothian's laboratories were concerned, Mr Lee understood that taxable income would have been invoiced during the *Fleming* period.

71. Then, Mr Lee considered whether VAT had already been recovered in respect of business activities. The Health Boards' general practice was to account for standard rate tax on outputs, to recover VAT on COS, and for direct trading activity eg the purchase and resale of confectionary. However, partial exemption was not taken account of, and VAT on indirect residual business activities (catering,

laboratories, laundries etc) was not recovered. Obtaining satisfactory documentary evidence was problematical, however. Consideration was given to recovering VAT Returns, approvals by HMRC on individual Health Boards' VAT circumstances, Liaison's own archives, Library and National Records, and outstanding business activities claims, and scrutinising these. Such Returns as were recovered were taken account of by Liaison in computing claims. What has emerged, Mr Lee considered, was that VAT was recovered on COS only, or possibly minimum amounts on trading activities too. The investigation confirmed that VAT was not recovered on indirect trading or residual overheads eg catering, laboratories, or laundries, and there were no partial exemption adjustments. Liaison's researches and the evidence and understanding of those Health Board officials canvassed, confirmed that there had been no VAT recovery on indirect business activities. Liaison's own researches in its own records and the records of the Lothian and Greater Glasgow Health Boards (kept respectively in Edinburgh University and at the Mitchell Library, Glasgow), traced nothing to suggest that the VAT had been recovered in relation to indirect business activities.

72. Mr Lee explained that with the creation of the NHS Trusts in the early 1990s, a more general awareness of the ability to recover VAT grew. In 1997 there were three claims pending in respect of recovery of VAT on business activities, including catering, laboratories, and laundries. HMRC refused these as "capped" and "out of time". That, in Mr Lee's view, tended to confirm that VAT was not being recovered over the *Fleming* period in respect of indirect and residual business activities. The present practice of the Scottish NHS Board is to recover on a monthly basis VAT on indirect and direct business activities. Partial exemption is also accounted for monthly. That has been the practice since about 2004.

73. When Mr Lee started working for Liaison in 2001 there was a backlog of claims for business activities and partial exemption to 1999. Then Claims were made annually. Between 2001 and 2006 Mr Lee submitted over 100 such Claims, which were technically complex, involving a large volume of records, and time-consuming. Miss Langley was the officer of HMRC dealing with these. Mr Lee completed the 2002/04 business activities and partial exemption claim. This and subsequent years' claims to 2006/07 were approved by Miss Langley. In particular the percentage apportionment which was first approved for business activities was 14.70% for 2006/07 (vol 2, p5). This process tended to confirm that there was no recovery of VAT for indirect business activities.

74. Mr Lee then discussed his role with Liaison and his meetings with the Health Boards and HMRC between 2008 and 2011. Since 2006 he has been involved managing NHS accounts in Scotland. He has also had some involvement with NHS claims in England. His role has been to mediate between HMRC and the Health Boards, while the claims of the individual Health Boards were prepared by Liaison's managers, including Mr Ross Muir (who speaks to this particular claim, *infra*). Mr Lee has had meetings with Miss Langley at a strategic level, rather than dealing with individual claims. In August 2010 Miss Langley had suggested for computational purposes founding on actual figures every five years. For intermediate

years it was conceded by HMRC that the RPI should be used for computational purposes.

75. Mr Lee then addressed the history of the present claim. Entitlement had been conceded by letter dated 16 December 2010 (vol 1, p110). Following on the reorganisation of the Scottish Health Boards there had been a controversy as to which of the new bodies had right and title to any outstanding unrecovered VAT. However, shortly after, on 23 December 2010 Miss Langley had by letter refused the claim (p117). At that stage Mr Lee sought a meeting with Miss Langley. She insisted that it should be put "on hold" (p122 and 123). The meeting was to cover all Health Board claims. In January 2011 Mr Lee arranged a meeting with representatives of all the Health Boards and Liaison's managers to discuss Miss Langley's rejection of Lothian and other Health Boards' claims. HMRC refused again to meet with Lothian and the Health Boards. On 14 January 2011 Mr Lee sought additional time to respond to Miss Langley's refusal. She allowed a short extension (p127). Having submitted further information Mr Lee offered to meet Miss Langley for a detailed consideration of the claims. This was not accepted and the matter has thus come before this Tribunal.

76. In his concluding summary to his first witness statement Mr Lee confirmed that in his understanding during the *Fleming* period Lothian and the other Scottish Health Boards were entitled to recover VAT under *Fleming* principles; VAT had been charged by Lothian's suppliers; Lothian had made taxable activities throughout the *Fleming* period; and VAT had not previously been recovered by Lothian or other Health Boards in respect of business activities. Mr Lee confirmed that he had coordinated information between the Health Boards and HMRC and updated this, and had facilitated meetings with the Health Boards.

77. In clarification of Mr Lee's first witness statement Mr Southern raised two matters. He noted the reference in paras 38e, 44 and 47 to "partial exemption". That, Mr Lee explained, was a restriction on COS VAT recovery. Para 47(a) sets out an example. Mr Lee was then asked to confirm the terms of para 59. All the Scottish claims had been dismissed in total by HMRC at the meeting on 11 January 2011.

78. Mr Lee was then invited to read out his additional witness statement (vol 5, tab 3c) which was a response to Miss Langley's witness statement of 21 April 2015. It starts by noting Miss Langley's view that there is no evidence of taxable supplies or taxable income during the *Fleming* period. This had been discussed when the Statement of Agreed Facts was settled. Mr Lee spoke to his experience working within the NHS and his understanding of the range of work undertaken, in particular, Fife Acute Hospitals NHS Trust had been recovering 18.5% of laboratory expenditure as representing business activities. This had been recovered over an extended period. It had, however, become out-of-date and so Mr Lee, using the same formula, calculated a taxable business percentage for the Year to March 2001 of 35.92%. In February 2002 Mr Lee submitted a Claim for training input tax in respect of laboratory expenditure of £4,092.49 for the preceding three years back to April 1999, the maximum repayment period then allowed. The calculation was cross-checked by Mr Kaney. In his covering letter Mr Lee explained that there had been substantial

changes in the organisation of the laboratories, including a merger of Trusts in 1999. That claim had been approved in May 2012 by Miss Langley. She had not queried the claim or the VAT liability on the laboratory's income, nor the matter of an adjustment for partial-exemption. She had been satisfied with the information in the covering letter submitted with the Claim in February 2002.

79. In 2002 Mr Lee had responsibility for three other Acute NHS Trusts in Scotland. He checked their income and expenditure in relation to their laboratories. In two cases, Forth Valley and Lanarkshire, the laboratory income and expenditure on external work was insufficient to warrant a separate sector for input VAT recovery. In 2004 the Fife Acute Hospital Trusts had a full VAT inspection, conducted by a senior and very experienced officer. His report is in vol 2, tab 13, p84/85. He concluded that every effort had been made to ensure that the Board's VAT affairs were correct. He did not restrict or assess the VAT recovery in relation to laboratory expenditure. Also, in August 2002 the Grampian Hospitals NHS Trust was inspected by the same officer. He confirmed that income from external services, eg bacteriological and food-testing services, should be standard-rated. In April 2004 Miss Langley approved the business activities and partial exemption claim for 2002/03.

80. Mr Lee had queried with HMRC the extent of any relevant manual records in respect of NHS Claims. They indicated that they had no records but then Mr Lee referred them to their letter of 14 November 2011 to Miss Howard of the Appellant Board, which suggested that HMRC had records dating back to April 1994. HMRC advised that there were three claims, viz (i) for £2,043,319 for April 1983 to March 1994 for COS VAT recovery, approved in November 1996; and (ii) for £84,096 for 1996/97 relating to "COS – trading activities"; and (iii) for "£3,760.69 for "COS" for period 08/98. Mr Lee understood that HMRC's manual records refer to no other claims for business activities or under-claimed input tax for laboratory expenditure relating to the Appellant Board.

81. In summary he explained that his objective in preparing this supplementary Witness Statement was to respond to Miss Langley's suggestion that there was no basis for the present claim as there is no evidence of taxable supplies having been made or of any taxable income having been received during the *Fleming* period. On the basis of the evidence traced and his experience, Mr Lee confirmed that he was satisfied that there was a basis for the claim that taxable supplies had been made by the laboratories during the *Fleming* period; that Miss Langley had approved such a claim for the Fife Acute Hospitals Trust for 1999/2001; that that Trust had had a taxable business percentage of 35% in respect of their laboratory's activities, approved by Miss Langley by letter dated 15 May 2002; that that Trust had treated laboratory income in respect of micro- biological food testing for the local authority as standard-rated, which again had been accepted by Miss Langley; and another experienced officer of the Respondents had inspected that Trust and had verified that the correct VAT liability had been declared as income and that proper efforts had been made to ensure that the Trust's VAT affairs were correct. Mr Lee concluded that while that evidence related to another Health Board, it demonstrated that

Miss Langley was aware of standard-rated laboratory income within the NHS in Scotland back to 1988.

82. In amplification of the second witness statement Mr Southern confirmed with Mr Lee that two senior HMRC officers, viz Miss Langley and Mr Graham, had accepted that two Health Boards had had taxable supplies. Further, he agreed that laboratory income from non-health care matters would have been standard rated eg food testing for a local authority. Mr Lee agreed with Mr Southern's interpretation of HMRC's letter to Miss Howard (as noted *supra*) viz that they had records relating to Lothian dating back to April 1994.

83. In cross-examination Mr Smith queried firstly the reason why the meeting with Miss Langley noted in para 58 of his original witness statement was "put on hold". The witness had suggested that this related to issues of entitlement affecting English Health Board claims. Mr Smith's counter-suggestion was that this was in the context of Liaison wishing more time to formulate its Claim. Mr Lee explained that he had been taken aback by the respondents having rejected the Claim in its entirety so soon after conceding the issue of entitlement. He had been concerned that the Claim and its calculation had been rejected so quickly and feared that it may not have been considered with sufficient care. Mr Lee added that in preparing the Claims he had focussed on *entitlement* primarily, viewing quantification as secondary.

84. Next, Mr Smith queried his knowledge of Health Board VAT affairs in the *Fleming* Years. Mr Lee accepted that he had joined Liaison only in 2001 and that he had no direct knowledge of Health Board VAT matters in these Years. He had undertaken an information gathering exercise to confirm the basis for the Claim. Mr Lee was asked about the availability of documentary records. These, he explained, in the cases of *Greater Glasgow* and *Lothian Health Boards* were archived at respectively the Mitchell Library in Glasgow and in Edinburgh University Library. Also there were the "Blue Books" which recorded costs including utility charges. When he joined Liaison in 2001 there was a backlog of claims which extended to the three years preceding, then being the applicable period.

85. Mr Smith then considered the taxable business percentage figure of 14.70. He queried the extent of any agreement with the respondents as to its application other than in the context of 2006/07. Mr Lee accepted this. It had been an element in a Claim approved in its entirety. Mr Lee had used it as a base-line for other Years. He would have expected the respondents to pursue this as an issue had it been controversial.

86. Mr Lee was then asked about his second witness statement and the methodology of his calculation in para 9. He explained that that information would have come from the relative ledgers and that the calculation was "inputs" based. He did not consider 25% to have been too large. He considered that about one-third of the laboratories' work to have been taxable business activities.

87. Mr Smith then turned to Mr Lee's second witness statement which, he explained, emerged from the negotiation of the Statement of Agreed Facts and

Miss Langley's supplementary witness statement. Mr Smith asked firstly about the available evidence of taxable business activities. Mr Lee explained that Miss Langley was involved investigating VAT liability on laboratory income of the Fife Health Board. He himself was involved with the Grampian Health Board early in his employment with Liaison. It had not been charging VAT on laboratory income and it had been instructed by HMRC to standard rate it where it was not for health-care. Mr Lee agreed with that approach. In relation to Lothian he considered that there had been an accounting for VAT on the basis of its records. There was no reason to think that Lothian had acted differently from other Health Boards.

88. In a brief re-examination Mr Southern confirmed with Mr Lee that until entitlement was established, Liaison would have been uncertain about what Years' records were required. Mr Lee confirmed that in December 2008 he was aware of the deadline for the Claim of 31 March 2009, and he appreciated that if a claim were presented timeously, it could be adjusted subsequently.

89. The final witness for the appellant was **Ross Muir**. He is a senior VAT manager with Liaison and was the person primarily responsible for the preparation of the *Fleming* Claim in this appeal. He read his witness statement and adopted its terms (vol 5, tab 1). He spoke to the review of business activities conducted when the *Fleming* claim was prepared. To elucidate this, he set out some background information to the 2006/07 Claim. He spoke to an *impasse* in January 2011: HMRC's officers were unable to attend a meeting, and would not view the archived evidence used. The respondents rejected the claim on 12 April 2011 on the basis that the appellant had failed to provide evidence confirming the amount of input tax incurred, that it related to taxable supplies, and that the sum claimed had not already been recovered. In relation to recovery Mr Muir noted a conflict in correspondence from the respondents and from the Scottish Government which, he argued, indicated that no recovery had been made.

90. Miss Langley had requested more supporting evidence. This concern, Mr Muir considered, could be met as there is archived evidence in Edinburgh University, produced in vols 3 and 4. In the original calculation (see vol 1, p136) wages and salaries were removed. Cost figures have now been revised and no apportionment of wages is now required. The laboratory accounts detail the types of cost used to prepare the Claim. The level of detail can identify types of expenditure and services eligible for COS recovery.

91. Mr Muir then considered the background to the 2006/07 Claim. His colleague, Mr Lee (previous witness), completed the first review of the laboratories' VAT circumstances in 2006/07. This was agreed with Miss Langley in February 2009, just before the *Fleming* claim was submitted on 30 March 2009. Annual adjustments were sent routinely to the respondents for approval and this was done for 2006 to 2009. The capital section of the 2006/07 review was agreed with another of the respondents' officers, Mr Hoad.

92. In preparing the *Fleming* claim these approvals were adopted as a starting point by Mr Muir. The taxable percentage applied to the laboratory costs was taken from

the earliest percentage agreed with Miss Langley. The spreadsheets from the annual adjustments were applied to the calculation of the *Fleming* Claim. The taxable percentage in 2006/07 of 14.70%, being the earliest available, was used in the *Fleming* Claims. In the 2006/07 calculation the goods and services bought in for the laboratories are shown, as is VAT recovered in respect of COS. The input tax attributable to non-business supplies is then calculated. The direct attribution of costs in 2006/07 between taxable and non-business income is thus completed. The wholly exempt costs are minimal.

93. Mr Muir added that different types of activity would be identified for the *Fleming* claim. Costs were not included where VAT could not be reclaimed. Non-business costs were treated similarly. Separate claims were not submitted for recoveries under Section 41, VATA, or for partial exemption. In instances a partial exemption payback was required.

94. Mr Muir then dealt with the method of calculation for 2006/07. Firstly, the expenditure inclusive of VAT is totalled. Then, applying a fraction representing the prevailing VAT rate over gross costs is applied to calculate the amount of VAT. Next, the taxable business percentage is calculated, ie business income divided by income from all sources including re-charges and business income. That fraction is then applied to the total of the VAT to calculate the relevant amount of input tax recoverable. Additionally, a separate calculation is made for COS VAT applying the VAT rate to the net cost of these services. That is then multiplied by the partial exemption percentage to calculate the VAT restriction.

95. The manner of the calculation is more particularised in the five schedules following on paras 17/18 of Mr Muir's witness statement, and to which the Tribunal referred. "Taxable income" (essentially income from external sources) includes receipts from clinical trials, NEQAS Work, and Public and Environmental Health Commissions. That is the numerator over a denominator of "total income", being internal recharges ie the total laboratory income both internal and external, exempt and non-business income not liable to VAT, and taxable income.

96. In clarification Mr Southern asked Mr Muir about his professional commitments in March 2009. It was an exceptionally busy period as he recollected. There was competition for client business. 31st March 2009 was also the deadline for *Fleming* claims. Next, Mr Muir acknowledged that his original claim giving rise to this appeal had been reduced significantly. Wages had been removed. Meetings with HMRC discussing the laboratories' activities and negotiating the Statement of Agreed Facts had prompted other reductions. The taxable percentage of 14.70 had been restricted to 11% for certain Years. That was then allocated between NEQAS work, clinical trials and environmental and public health work.

97. With some prompting from Mr Southern (and objection by Mr Smith) Mr Muir summarised his evidence as follows. His calculation started with the 2006/07 figures, which produced the baseline percentage of 14.70. The records used for his calculations were from Edinburgh University Library, which maintained the Health Board's archived material. The types of goods and services were differentiated in the

records. Thus liability to VAT on individual items could be calculated. This could be cross-checked against the pattern of current expenditure for consistency. There was then a process of extrapolation. Liaison's Head Office had devised four or five methods. In relation to recovery of VAT on COS ("contracted out services") a figure of £380,000 was agreed with HMRC at the negotiations in April 2015.

98. In this process a distinction was drawn between "non-business" and public work and taxable business to produce a taxable percentage. In relation to the taxable business the only pay-back is in respect of COS. Further, in para 17 of his witness statement Mr Muir explained that steps (5) and (6) ie the adjustment for VAT on COS were a distinct stage from that of calculation of the taxable percentage.

99. In cross-examination Mr Smith asked Mr Muir, firstly, why the Claim for repayment of input tax in 2006/07 was for £22,000, yet in the *Fleming* period the annual claim could be as much as £65,000. Mr Muir explained that costs in the *Fleming* period were higher. There were more laboratory sites then, which later had been centralised. Mr Mitchell had referred earlier to the centralisation process of the Health Board's laboratories. The process of centralisation, Mr Muir explained, had resulted in savings in heating, rates, furniture and fittings, telephones, photocopiers and in the maintenance of property and equipment.

100. Mr Smith then queried the nature of the evidence of taxable income during the *Fleming* period.

101. In answer to many questions from Mr Smith, Mr Muir confirmed that there was little detailed evidence of income throughout the *Fleming* period. The annual accounts for 1991/92 had been traced and whilst these showed total income, there was not sufficient detailed information that would assist in an accurate calculation of the taxable proportion of that income.

102. Mr Muir was aware that in 2007/08 his colleague Mr Lee had agreed with HMRC (Miss Langley) a taxable percentage of 14.70%. In the light of the foregoing he saw this as a way forward. He confirmed that his understanding was that the 14.70% was arrived at by making a calculation of taxable income divided by total income. He had more information for periods outwith the Fleming period and had done his own credibility checks on those later periods. The outcome was percentages ranging from 15% to 17.58%.

103. In considering the Health Board claims as a whole, Mr Muir stated that where there was VAT that was identified as being wholly for non-business activities it was not included in the claims. Where there was VAT that could be identified as wholly for taxable activities it was included in the claims and where there were sectors which had mixed income, it was included as a sectorised claim. The claim in respect of the laboratories was included as a sectorised claim. He said he had checked various cost centres to ensure there was taxable income, for example, he checked paediatrics (The Royal Hospital for Sick Children) and found that the laboratory there does clinical trials which give rise to taxable income. Mr Muir had not quantified this taxable income.

104. Mr Muir mentioned that it was evident to him that there were taxable supplies to drug companies but he confirmed that he had not been able to trace any copy tax invoices for the *Fleming* period, although these were available for more recent periods.

105. In a brief re-examination by Mr Southern, Mr Muir confirmed that a lot of the activities of the laboratories had been transferred to a PFI hospital being the New Royal Hospital in Little France, Edinburgh. The result being that some functions were now outsourced.

106. In the course of the cross-examination of Mr Muir in relation to his access to prime records, it became clear to the Tribunal that he had had to rely on information provided by Mr Lee. Accordingly, the Tribunal considered that Mr Lee should be recalled about the nature of the evidence supporting taxable supplies during the *Fleming* period. This, also, had been the subject of challenge by Miss Langley (of HMRC) in para 39 of her supplementary witness statement (col 15, tab 10, p73). Mr Lee produced helpfully an additional witness statement (vol 5, tab 3) dealing with this. It had been the subject of discussions between Parties' representatives at the meeting in April 2015 to adjust the Statement of Agreed Facts. Mr Lee recalled his experience in 2001 advising the Fife Acute Hospitals NHS Trust. That Trust had been carrying out food and water testing for the local authority, and had accounted for standard rate VAT on the income arising. This seemed to Mr Lee to be correct. However, Mr Lee had noted that the Trust had been treating 18.5% of laboratory expenditure as relating to business activities. This went back to 1997/98. As part of his compliance review in late 2001, Mr Lee checked the percentage used to recover VAT on the business activities conducted by the laboratories. Using the 1998 formula, Mr Lee calculated a revised business percentage for 2001/02 of 35.35, and, also, for 2000/01 of 35.92.

107. In view of the Fife Acute Hospitals NHS Trust's omission to fully recover input VAT, Mr Lee prepared a claim to HMRC by way of voluntary disclosure. The VAT recovery was on the basis of the total expenditure for the laboratories where there was no scope for recovery under COS. The total taxable income from the laboratories was then compared to their overall total income, taking account of any VAT already reclaimed. Early in 2002 a claim was made for £4,092.49 for the three years back to April 1999 (the then maximum period). Mr Lee's covering letter to HMRC is produced (vol 2, tab 12, p77-79). It noted the substantial changes in the laboratories' organisation, in particular the merger of trusts in 1999. In May 2012 the claim was accepted by Miss Langley on behalf of HMRC (p83) and the VAT was recovered via the May 2002 Return. The amount of recoverable VAT was not contested, nor was the liability to VAT on the income declared from the laboratories. No adjustment for partial exemption was proposed by HMRC.

108. In 2002 Mr Lee was responsible for three other Acute NHS Trusts, including Forth Valley and Lanarkshire. He checked their laboratory income and expenditure. These two Trusts did not have public health income. As they did not have teaching hospitals, external laboratory income was insignificant. (The third Trust, Grampian, is considered *infra*.)

109. Mr Lee had accompanied a Mr Graham, a senior visiting VAT officer, on an inspection of the Fife Trust in March 2004. His report to the Trust, dated March 2004, is produced (vol 2, tab 13, p84/5) and referred to earlier at para 78. He had examined sales invoices. He recorded that he was satisfied that every effort had been made to ensure that the Trust's VAT affairs were in order. He did not say that VAT on external income had been treated incorrectly. He did not restrict or assess VAT recovery in respect of laboratory expenditure.

110. The third Acute NHS Trust for which Mr Lee was responsible, was Grampian University Hospital Trust, part of the Grampian Health Board. In August 2002 Mr Graham conducted a VAT inspection of it. That Trust conducted external services such as bacteriological and food testing. HMRC considered that this income should be standard rated. In April 2004 Miss Langley had approved the business activities and partial exemption claim of the Trust for 2002/03. This was approved also for VAT recovery after some clarification and an adjustment.

111. Mr Lee had learned that the respondents had retained manual records of NHS claims. On 7 April 2015 he wrote seeking details of approvals issued to the appellant and their statutory successors. HMRC indicated that there were no records. However, he referred them to their letter to Miss Howard of Lothian indicating that they had records dating back to April 1994 (correspondence produced at vol 2, tab 14, p86-95). Apparently there were three "Lothian" claims viz:

i. A VAT recovery for just over £2M for COS, approved in November 1996;

ii. A claim for "COS – trading activities" for £84,096; and

iii. A claim for "COS" for £3,760 approved in period 08/98. HMRC's records do not contain any claims for under-claimed input tax by the appellant for laboratory expenditure.

112. Mr Lee explained that his additional witness statemenmt was to deal with Miss Langley's contentions that there was no basis for the present claim as there is no evidence of taxable supplies or of taxable income during the *Fleming* period. On the basis of the evidence and his experience Mr Lee maintained that so far as Fife Acute Hospitals NHS Trust was concerned there was evidence of taxable supplies by its laboratories in the latter part of the *Fleming* period. Miss Langley had approved a claim for the period 1991/2001 for relative trading input tax. That Trust has a taxable business percentage of 35% in its laboratories, which was approved by Miss Langley by letter dated 15 May 2002. With Miss Langley's approval the Fife Trust had treated as standard rated laboratory income relating to food testing services rendered to Fife Council. Another senior VAT officer, inspecting in 2004, verified that the correct VAT liability had been declared on income. While this evidence related to another Health Board rather than the appellant, it confirmed that Miss Langley was aware of standard rated laboratory income within the NHS in Scotland and that recoveries of VAT had been made for apportioned business activities.

113. Mr Lee was then cross-examined briefly. He confirmed that he had worked for Liaison since 2001 and in that time had been involved in adjusting many claims. He agreed that a distinction had to be drawn between an agreement as to an adjusted figure and an agreement as to the manner of adjustment. Specifically it was suggested to Mr Lee that in the course of adjusting the 2006//07 Claim, any agreement as to the methodology there was not to be extended to other Years and a Fleming claim. He agreed but under reference to his remarks at the end of the first paragraph on page 3 of his witness statement to the effect that the Health Board had relied on it as HMRC had never disputed the adjustment thereafter. Mr Lee was then asked about what documents he had made available to establish the 14.70 percentage for 2006/07. It seems that only debtors' invoices and purchase invoices were made available.

114. Mr Southern had no questions in re-examination and concluded his Proof.

115. The respondents led only one witness, their investigating officer, **Miss Kathleen Langley**. She is a VAT specialist with the respondents and has experience of *Fleming* claims made by NHS bodies. She spoke to the terms of both her witness statements dated 4 February and 21 April 2015. She explained that her second witness statement had been prompted by further issues raised after she had had sight of the appellant's witnesses' statements. In certain respects, Miss Langley added, her second witness statement had to be amplified.

116. Miss Langley's witness statement (vol 5, tab 10) explains the background to her refusal of the present Claim by her decisions of 23 December 2010 and 12 April 2011. It was accepted that the appellant had established its entitlement in principle to reclaim tax paid by its statutory predecessors from 1 April 1974 to 1 May 1997 (see HMRC's letters of 7 and 16 December 2010 (vo1 p104-116). It had made a *Fleming* claim for just over £2.3M for input tax on laboratory costs partially incurred for business use. This was part of a total claim of over £7M covering ten areas of activity. HMRC's policy in relation to such composite claims was to deal with each subject individually. In respect of the present claim Miss Langley referred to a two page summary (KL002 a and b) together with 15 Schedules (KL003 a to o). The classification of the claim proceeds on an apportionment of taxable income at 14.7%. Non-business income represents the balance of 85.30%. The taxable income percentage of 14.70 remains constant for each year throughout the period of the claim. The VAT on laboratory expenditure is stated, and 14.70% of that is claimed.

117. Initially, Miss Langley, complained there was no supporting evidence clarifying the nature of the business activities, their status as taxable or exempt, the amount of any taxable income and laboratory costs and the lodging of the 14.70% recovery percentage. Miss Langley sought further information in repeated written requests. This was responded to eventually by Liaison's email of 4 March 2011 (KL008) with an amended claim of just over £2¼ M and some limited supporting information which Miss Langley considered insufficient. Specific information sought had not been provided by Liaison although some further information was made available. Accordingly the Claim could not be allowed.

118. The appellant sought a review of Miss Langley's refusal. Her decision was upheld. Her criticism was of the lack of primary supporting evidence. A repayment of VAT depended on evidence of attribution of VAT incurred on expenditure to taxable supplies. That evidence was not forthcoming.

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119. Miss Langley's second witness statement was prepared after her meeting with Liaison in April 2015. She complains that the original claim had been reduced by about £84K without explanation. Then, the revised claim, for about half the balance (*viz* £1,132,267) is made on the basis of detailed archive figures. Part of the explanation may have been the wrongful inclusion of wages in the original calculation.

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120. Mr Muir (of Liaison) had referred to archive records at Edinburgh University Library. His claim related to all 44 laboratories yet, Miss Langley considered, certain of these, given their nature, would be wholly *non-business.* These should have been excluded. Direct attribution *ie* identifying input tax relating to taxable supplies or services, had not been done, resulting in an over-stated claim. Miss Langley had concerns also about the reduction in input tax from £150K to £34,756 in 2008/09. Mr Muir had explained that laboratory services had been contracted-out then – which she had accepted – but these were not in fact contracted out until 2009. This substantial variation remained unexplained.

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121. Further Miss Langley considered that the impact of the introduction of VAT on contracted-out services had not been fully addressed, although account had been taken of Section 41 VATA, allowing VAT recovery on *non-business* activities after January 1985.

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122. Miss Langley considered too, that the exemption from VAT for medical care by certain qualified persons (Item 1, Group 7 of Schedule 9, VATA) had not been taken account of. Prior to May 2007 these were exempt. Then, they became taxable unless they consisted of medical care. The services provided by the appellant's bio-medical scientists, who gave evidence, were exempt during the *Fleming* period, Miss Langley suggested.

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123. Next, Miss Langley considered that the taxable percentage of 14.70% was too high. (It was reduced to 14.60% for 1991/92 without explanation.) It included Nequas income which, during the *Fleming* period, was exempt. It became standard-rated and was included (correctly) as such in 2006/07, by reference to which the 14.70% was calculated. (The Nequas Scheme is used for external testing of pathology lab results.) That percentage, Miss Langley argued, was further inflated as *exempt* income had not been included in the calculation, so reducing the correct denominator. The percentage remained uncorrected in the calculation of the Claim.

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124. While the appellant's witnesses' statements refer to a range of activities, their treatment for VAT purposes was unclear. HMRC accepts that income from zero-

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rated catering activities had been documented, but the laboratory income was not. Some proof of these activities was necessary. A process of extrapolation was not appropriate as the details of the activities were inadequate. The time period during which these were conducted and their volume was unclear. The level of taxable income was unproven. Miss Langley and her colleague had examined personally the Board's financial records in the Lothian Health Service archives. That had not revealed any record of significant supplies for example no sales ledgers or taxable sales invoices have been produced. The adjustment of COS VAT remained in dispute. While some more detailed information as to expenditure had been produced, there remained a failure to carry out direct attribution.

125. Further in all eight of the appellant's *Fleming* claims, there had not been a proper partial exemption calculation. Significant COS VAT claims had been made, some of which VAT was used for exempt activities. Over claimed exempt VAT fell to be repaid. Originally it was asserted that NHS authorities generally had not carried out a partial exemption calculation. Mr Muir now seemed to contradict this. Miss Langley accepted that a small adjustment had been made towards repaying exempt COS VAT. However, only a percentage relating to laboratories had been deducted: an adjustment to repay the exempt portion for all activities was required.

126. Miss Langley remained of the view that the Claim was over-stated. Fundamental difficulties remained. She considered there was no evidence of taxable supplies having been made or of taxable income being received during the *Fleming* period. The method of extrapolation was flawed, being based on a taxable percentage, not representative of the *Fleming* period. A proper partial exemption calculation had not been made and the process of direct attribution had not been done. Miss Langley concluded that the Claim should be rejected in its entirety.

127. In elaboration on her witness statements Miss Langley indicated that even at that stage of the hearing, having heard all the evidence led, she believed that these criticisms remained, notwithstanding the records produced. The 2006/07 adjustment had been made on the basis of information available for that Year. That did not displace the need for evidence as to activities in earlier Years. Her requests to address the question of direct attribution had been ignored, she claimed. The evidence of the activities of Fife HB was not relevant in her view. There remained the problem of the lack of evidence as to taxable supplies having been made and taxable income arising during the *Fleming* period. The level of VAT claimed varied substantially when compared with 2006/07. Centralisation of laboratory services and contracting these out, did not resolve this. Credibility checks could not be satisfied. Probably expenditure was over-stated. Direct attribution had not been done. This suggested that 14.70% was not the correct percentage. While a VAT 21 form had been produced for the Western General, this was not a VAT Return. It did not show output tax paid.

128. Finally, Miss Langley was asked about the original form of the claim. The amount was £2,377,666, as set out on a double sheet of paper. No information as to its calculation had been provided. No specific information had been provided in

relation to the laboratories. On 4 March 2011 Mr Muir had sent an email, headed "Input Tax Revised Claim - £2,293,563.86, representing a small reduction. There was no explanation there of its calculation but some additional information had been provided. In March 2011 the claim was reduced further and by Mr Muir's first witness statement in 2015 the claim had been reduced by £1,169,296, apparently after reference to the archive records. (It is now reduced to £929,874. Miss Langley explained that the first reduction of over £1M resulted from taking out the wages figure from expenditure. An adjustment for NEQAS activity and for COS VAT had also been made. Miss Langley considered that it was unclear whether there was any consistency in the methodology at the various stages of reduction of the Claim.

129. In response to the Tribunal Miss Langley indicated that in relation to partial exemption there has not been an approved method in place affecting activities of the NHS in Scotland.

130. In cross-examination Mr Southern challenged Miss Langley's interpretation of the tax treatment of various of the appellant's activities. She had viewed as VAT exempt services provided by persons on the professional register, covering the activities set out in the various health professionals' WSs. These persons are now regarded as bio-medical scientists and were earlier categorised as laboratory technicians. Further, Miss Langley had apparently viewed NEQUAS income as exempt during the *Fleming* period. The Tribunal considered that the correct interpretation was a matter of law, but Miss Langley seemed to accept that her original views in her witness statements had been superseded. She still maintained, however, that there was uncertainty as to what supply had been made by the appellant and what the resultant VAT treatment was. Miss Langley was reluctant, when asked, to consider the tax treatment of the business labs service of the Fife Acute Hospital Trust in 2001/02. She regarded this as confidential, as the concern of another taxpayer, and in any event it was irrelevant to the present Claim.

131. Mr Southern then referred to the revision of the exemption schedule from May 2007 following on the decision in *Dr Peter D'Ambrumenil*. It restricted the exemption to medical care, the services protecting the health of an individual. Mr Southern suggested that this revisal in 2007 following the *D'Ambrumenil* appeal was irrelevant to the present case. He also referred Miss Langley to two VAT notices and the commentaries therein namely VAT Leaflet No. 701/31/84 Health dated 1 January 1984 and VAT Leaflet No. 701/31/92 Health dated 1 March 1992 (Vol 2 Tab 16, documents 102A and 102B). In particular Mr Southern wondered whether Miss Langley could reconcile her phrase "regardless of their nature" in para 12 of her second witness statement with the limitation to medical services set out in these two VAT notices. Mr Southern suggested that if Miss Langley was correct it was a complete answer to the claim in that all input tax would be exempt input tax and therefore the appellant could not recover a penny. While the Tribunal considered that this was ultimately a matter of law for it itself to determine, it did note that Miss Langley declined to withdraw paras 10 to 14 of her witness statement as that had been set out on the information then available to her. Also she did not consider that it would determine the outcome of the Claim.

132. Mr Southern next referred to a letter from the Scottish Government dated 30 December 2010 (vol 1, p243) in which it is stated that from April 1973 to

March 1994 the then Scottish Office/Scottish Executive did claim VAT on behalf of the NHS Boards, mainly under the VAT Return of the Scottish Office Home and Health Department. HMRC, it is indicated, viewed that as evidence that the Health Boards claims for under-claimed VAT were probably invalid. Miss Langley indicated that HMRC no longer adhered to that stance as soon as the Scottish Government had clarified the letter. She had not founded on the letter in her evidence or her witness statements. She explained that she had inserted these terms in the letter on the instructions of a senior colleague.

133. Then Mr Southern asked about the nature and extent of the agreement about the 2006/07 annual adjustment. While the resultant figure was agreed, he believed that Miss Langley's stance was that that agreement did not extend to the methodology. Miss Langley considered that the agreement was in respect of input tax payable and any partial exemption. It would not extend to the individual elements of a claim. It was an agreement as to final figures, not underlying methodology. Miss Langley explained further that each separate calculation would be agreed on its own particular merits. The result would have to be fair and reasonable. She stressed that she disagreed with any suggestion from Mr Kaney or Mr Lee that the methodology had been agreed. She observed that neither side could provide any written confirmation of detailed terms of any agreement.

134. Miss Langley was then asked by Mr Southern about the three day review conducted with her colleague Mr Hoad. It was difficult for her to say precisely which of them carried out which particular tasks: some things were done together and others separately.

135. Miss Langley was then asked to comment on a passage in Mr Lee's second additional witness statement, *viz* – "There was a firm agreement between myself and Miss K Langley from HMRC. The NHS Board have placed reliance on this agreement and no subsequent steps were taken by HMRC to call in question this adjustment." In response Miss Langley explained that there was a six year time limit which enabled earlier periods to be revisited. A Return could be looked at again.

136. In clarification the Tribunal asked whether the 14.70 percentage had been agreed in respect of any years other than 2006/07. Miss Langley indicated that it only applied for that year and that no undertaking or indication had been given by HMRC that it was acceptable for any other years. Specifically 14.70% had not been agreed in respect of the *Fleming* years. Miss Langley considered that this percentage lay at the heart of the claim, and in her opinion was incorrect. She observed that she still did not know the level of exempt and standard rated activities.

137. She considered that it cannot be assumed that the appellant carried out business activities throughout the period without some proof of this.

138. She observed that the Blue books gave no detail of income, and that no sales ledgers or taxable sales invoices have been produced.

139. Miss Langley said that with a colleague she had visited the Lothian Health Service Archives in Edinburgh University library in order to inspect the surviving records to determine whether or not income from laboratory services had been

received in the *Fleming* period. She said the inspection did not reveal any record of significant supplies being made in respect of laboratories.

140. In such circumstances she concluded that extrapolation as put forward by the appellant was not suitable. The precise details and volume of activities carried out were not established. Neither was the period over which each activity was carried out.

141. Miss Langley considered the calculation which shows an adjustment of the COS VAT to be wrong.

142. Miss Langley criticised the lack of evidence to support the claim. She said all that has been produced are witness statements and expenditure records from the annual accounts. She said the correct expenditure amounts for each year still remain unknown, there has been no direct attribution or the removal of zero-rated purchases.

143. She observed that no proper partial exemption calculation had been completed which she considered compromised the claim. Miss Langley accepted that some of the points she raised had been corrected by the appellant but some remain and she therefore considers the claim is over-stated.

144. In summary Miss Langley considered that the fundamental difficulties with the claim are

- There is no basis for the claim as there is no evidence that taxable supplies were made during the *Fleming* period.
- There is no evidence of any taxable income during the period.
- The extrapolation method is unsuitable and does not take the place of such evidence.
- The extrapolation method is fatally flawed, since it is entirely based on a taxable percentage which is not representative of the *Fleming* period.
- A proper partial exemption calculation has not been completed.
- Direct attribution has not been done.

145. In Answer to a question from the Tribunal, Miss Langley confirmed that until 1994/95 there were no partial exemption methods in place for any NHS bodies and since 1994/95 no method has been in place for the appellant. She accepted that there had been no input tax recovered in that period.

146. When the hearing resumed on 21 June 2016 Mr Southern completed his cross-examination. He noted that the decision to acknowledge entitlement was given in December 2010 and later that month the decision to reject the claim on the basis of quantification was issued. Miss Langley indicated that the proximity of these decisions was coincidental. She said the two decisions of entitlement and quantum of the claim had proceeded separately along their own different routes. Entitlement had not really been in issue, she explained. Of the shortcomings of the Claim which she had set out in para 8 of her first witness statement, two of these, she insisted,

remained unresolved viz (2) whether there had been *business* income in the Claim period; and (3) what was the VAT status of the income and how had it been treated.

147. In para 9 she observed that there might have been an unintentional double-recovery of VAT. In para 9 and 14 (and para 7 of witness statement 2) Miss Langley noted her surprise at the lower level of claim. Mr Southern suggested two explanations, *viz* the contracting out of laboratory work in 2006/07 and the new Royal Hospital replacing existing units in 2003/04. Miss Langley did not accept these as explanations. Contracting-out took place only in 2009. While the laboratories were consolidated, the level of activity was not reduced. While rent and rates expenditure fell, these were not liable to VAT, and care costs remained and were higher than in 2006/07.

148. Miss Langley maintained that direct attribution of costs had not been carried out. This was not an invoice-level exercise, she accepted. However she insisted that expenditure wholly attributable to non-business income had not been identified and removed from the calculations. In this Claim the *business* to *non-business* apportionment had followed the 14.70% split. Miss Langley explained that *non-business* input VAT had to be eliminated first, and only then was 14.70% of the residual expenditure taken.

149. In addition to witness evidence parties settled a Statement of Agreed Facts. (This is incorporated as Appendix B to the Decision.) So far as the individual witnesses are concerned we accepted their evidence as truthful and straightforward, as might reasonably be expected of senior officials of public authorities and professional advisers. The nub of contention is whether the calculations or extrapolations made by Liaison are reasonable and meet the requirements of Section 121 FA 2008. This was addressed in turn by counsel for the appellant and respondents. We summarise their arguments below and consider these in our Conclusion.

Submissions

— **Appellant**

150. The Tribunal was addressed in turn by Mr Southern and Mr Smith. Helpfully they both provided written submissions for the Tribunal's assistance.

151. Mr Southern explained that the present Claim was part of a composite repayment claim, which related to the laboratories run by the appellant. It was lodged on 30 March 2009. The bulk of the laboratories' activities was *non-business* NHS work, outside the VAT system. Only a limited proportion of their activities, attributable to *business* supplies, was relevant to the present Claim. The negotiation of this and other Health Board repayment claims had progressed through two phases. Initially *entitlement* had been in issue, given that there had been changes in Health Boards' structures, and the devolving of entitlement to claims had been uncertain. This has now been resolved. The other phase, *quantification*, fell to be considered in this present appeal (and has been addressed by the Tribunal in other Health Board appeals). This process becomes complicated when there is narrow or insufficient documentary evidence available to compute a reasonably precise sum due. In such

circumstances, Mr Southern suggested, alternative evidence and processes of extrapolation might be used. He acknowledged that the primary evidence available showed expenditure levels rather than income. The key element in the structure of this Claim was the "taxable business percentage" of 14.70%. Was it a reasonable proxy to the reality?

152. Mr Southern acknowledged that the burden of proof rested on the appellant. He argued that it was clear that the laboratories' work included both *business* and *non-business* activities. More controversial was quantifying the proportion of taxable business income in relation to overall income, and the VAT status of the elements of business income.

153. The base-line for the Claim was 2006/07, Mr Southern continued. Wages were excluded. Taxable business income represented 14.70% of all income. Hence, recoverable input tax was 14.70% of the total input VAT. Mr Southern submitted that a separate partial exemption calculation was unnecessary where in the *business/non-business* apportionment, any exempt income was included in the denominator. Also, in a sectorised claim direct attribution has been done before considering individual sectors so there was no scope for further direct attribution. He set out calculations in support of this, which, he insisted, were consistent with the legislation and also with HMRC's guidance in its "business/non/business" manual

154. Mr Southern then addressed us on the role of the Tribunal in relation to quantification of history claims. Only limited documentary evidence is likely to be available. Hence, it was appropriate to rely on "alternative evidence". He drew an analogy with the exercise of "best of judgment" in appeals relating to underpayment of VAT (see *Pegasus Birds*, para 38 per Lord Carnwath. He found also on the approach of the FTT in *General Motors*, where it formulated its own methodology. Mr Southern referred also to the decision of Lord Tyre (sitting in the Upper Tribunal) in the related appeal, *Lothian NHS Health Board*. The First-tier Tax Tribunal, Mr Southern suggested, should use its own expertise as a specialist tribunal in assessing the present Claim. Arguably, an approximate sum would suffice.

155. Next, Mr Southern considered the respondents' stress on the need for "direct attribution" in allocating inputs. This concept, he said, related to the partial exemption calculation used where a business has both taxable and exempt supplies. Rather, what should be emphasised was the need for a "direct and immediate link" with taxable supplies for input tax to be recoverable. That link could be with either particular supplies or more generally with business activities. Mr Southern referred us to the decisions in *BLP Group plc, Investrand BV*, and *VW Financial Services*. Where a business has both taxable and exempt supplies, Regulation 101 of the VAT General Regulations prescribes a formulae for the apportionment of residual input VAT. There, the process of "direct attribution" was the first stage, which related so far as possible particular inputs to particular outputs. Remaining or residual expenditure was then apportioned in terms of a prescribed formula.

156. Mr Southern then considered specialties of VAT in the public sector. VAT incurred in performing public functions is not input tax. However, VAT attributable

to *business* supplies is input tax. If it is for exempt supplies, it is exempt input tax and not recoverable. Methods of *business/non-business* attribution are not statutorily regulated: any reasonable method should suffice. However, partial exemption methods affecting the deduction of residual input tax are the subject of specific regulation. There are special rules affecting VAT on contracted-out services ("COS VAT"). It removes the tax advantage of a public authority performing services "in-house". It does not extend to goods. This "tax neutrality" enables a public authority to outsource support services without a VAT disadvantage. Where COS VAT has been recovered and the services have been used for exempt and/or non-business activities, then an adjustment has to be made. However, in a "sectorised" claim ie the separation of one particular activity, a COS VAT adjustment should be made only in respect of that particular sector.

157. Mr Southern emphasised as the fatal flaw in HMRC's argument the over-emphasis on direct attribution. Rather, the core principle to be followed was the need for a direct and immediate link. He expressed concern that immediately after HMRC via Miss Langley conceded *entitlement* the Claim was then rejected by reference to its quantification. HMRC had feared – wrongly – that there might have been an earlier recovery by the Scottish Government of the VAT now claimed. All this suggested to Mr Southern that the fate of the NHS claims had been predetermined.

158. Mr Southern welcomed the settlement of the Statement of Agreed Facts. It helps to focus the issues which the Tribunal had to determine. These, he suggested, included whether the Claim in its present form represented a *new* claim; what business activities of the laboratories were taxable; what costs had been incurred as evidenced by the Blue Books; and especially whether the 14.70% recovery rate accepted for 2006/07, was appropriate throughout the years in the Claim.

159. Mr Southern rejected the suggestion that at this stage there was a *new* Claim. He referred extensively to the relevant case-law. The subject-matter of this Claim had been the same throughout (cf *Reed Employment Limited*). Amendment did not create a *new* claim. Changes in the calculation and the amount of a claim were permissible if they arose from the same circumstances. Here the methodology and evidence supporting the laboratories' Claim remained unaltered. It had been refined to make the calculation more accurate.

160. Mr Southern then considered at length whether the laboratories' supplies were standard-rated. Miss Langley had challenged this in her evidence, suggesting apparently that the supplies were exempt. This, Mr Southern submitted, was a question of law for the Tribunal to decide. Until 2007 the provision of certain medical care was exempt. That care had to be of a therapeutic nature, involving diagnosing, treating or curing disease or health disorders. Further, the care had to be provided by a person with a medical or para-medical qualification. Mr Southern noted the decision in *D'Ambrumenil* which set out the extent of the exemption, and contrasted the decision in *DvW* in which biological tests by a medical expert fell outwith the exemption. In the present case the activities under consideration were the *Nequas* work, clinical trials and drug testing, and public and environmental health work. Crucially, Mr Southern continued, these did not relate to the provision of

medical care. Further and in any event, none of the HB's employees who carried out this work and gave evidence were on medical or para-medical registers. The work accordingly was taxable and not exempt. Mr Southern concluded. Certain correspondence had suggested that *Nequas* work should be treated as exempt, but notwithstanding it appears that the appellant had treated it as a taxable supply. That was, indeed, correct.

161. Mr Southern considered that there were three elements in the laboratories' Claim, viz VAT inclusive expenditure, the making of table business supplies, and the 14.70% VAT recovery rate adopted throughout the claim period. The evidence in support fell to be considered, together with the methodology, the baseline years selected, the recovery rate adopted and the VAT element in the expenditure. The documentary evidence relied on were Board Archive papers lodged at Edinburgh University Library, the Blue Books, Annual Accounts and Year Books, returns for other authorities, and Liaison internal documents. The Blue Books and Annual Accounts provided complete evidence of expenditure throughout the claim period. These showed expenditure inclusive of VAT where it has not been recovered. While the appellant does not have evidence of taxable income, it appears to be accepted that business supplies were made throughout the relevant period, and the appellant's employees confirmed this.

162. Crucial to the methodology are the baseline Year selected, 2006/07, and the taxable business percentage proposed of 14.70%. In 2006/07 the laboratories' claim could be sectorised. 14.70% had been agreed for 2006/07, and Mr Southern submitted that on the balance of probabilities it was an appropriate business percentage throughout the Claim period. He relied on especially the evidence of Mr Lee and Mr Kaney, both of whom were former senior officers of HMRC, and well versed in the VAT system, and also on Mr Muir, who had researched painstakingly the information available. He accepted that there was no evidence of the level of income generated, but the laboratory staff had spoken consistently to the nature of the work done.

163. Mr Southern then turned to analyse HMRC's current stance in refusing the Claim. The level of income and expenditure would have been likely to fluctuate during the relevant period. The baseline percentage was flawed. The evidence of the nature of the appellant's activities and their tax status was unsatisfactory. The importance to the methodology of direct attribution, business/non-business apportionment, a partial exemption calculation, and allowance for COS VAT were not appreciated. Also, the Claim had been substantially amended.

164. Mr Southern considered that HMRC's objections had been sufficiently addressed. Costs were evidenced (on a VAT-inclusive basis) by the Blue Books. The types of expenditure could be identified by codes used. Evidence of taxable business income had been led. More controversial, however, was the 14.70% VAT recovery rate. That, Mr Southern emphasised, was one aspect of a successful claim for 2006/07, approved by Miss Langley. It was an appropriate baseline. It had been approved objectively by HMRC: it was not an arbitrary figure. It was likely to be an under-estimate, so not prejudicing HMRC's interests. It was consistent with witness

evidence. There was no other figure considered or proposed, and on the balance of probabilities, Mr Southern submitted, it was sufficiently accurate for the purposes of the present Claim.

165. In the calculation of the Claim, Mr Southern continued, a business/non-business apportionment took account of exempt supplies. This represented direct attribution. The partial exemption calculation becomes redundant as exempt input tax is removed in the business/non-business allocation. The basis of the *Fleming* claim here is the same as used in the 2006/07 claim.

166. HMRC had queried why the average annual amount claimed during the *Fleming* period was £150,000, yet in 2008/09 it was only £34,756. Mr Southern explained that pe-1993 there had been a significant volume of public and environmental health work. Laboratory services were contracted out in 2006/07. Further, laboratory facilities had been centralised too.

167. HMRC had suggested also that the COS adjustment in respect of the whole Claim should be set against the Laboratories' Claim. Mr Southern responded that COS matters should be distinguished from a Section 121 claim. Historic claims for recovery of COS VAT were not competent. The adjustment suggested by the appellant in relation to the Laboratories' Claim was a concession made in favour of HMRC in the hope of reaching a negotiated settlement.

168. In conclusion Mr Southern submitted that there was evidence of *business* supplies having been made by the appellant's laboratories in addition to their NHS work. The nature of that work was standard rated and the operating costs and VAT element had been accurately computed by reference to the Blue Books. It was now accepted that input tax had not been claimed. The methodology and recovery rate used had been taken from the 2006/07 negotiated settlement. The methodology was simple and straightforward and the 14.70% recovery rate was a sufficiently accurate approximation. It represented a reasonable "starting point". Significant adjustments had been made to meet HMRC's objections. On the balance of probabilities the sum claimed represented the VAT repayment due to the appellant. The appeal should therefore be allowed.

— **Respondents**

169. Mr Smith in reply adopted the same manner of presentation as Mr Southern. He provided the Tribunal with a typed manuscript in some detail (and, with impressive energy, finalised overnight to respond to the appellant's arguments) and discussed this with the Tribunal. He mentioned firstly the possibility that this present claim represented an attempt at "double-recovery" of VAT on the basis that all the appellant's outlays had been funded by the Government. This point arose from the terms of certain correspondence, but, as we understand (para 6), the respondents do not now pursue this argument.

170. Mr Smith then addressed us on the role of the Tribunal, making reference to the guidance given by Lord Tyre in the Upper Tribunal in a related Health Board appeal. He emphasised that the *onus* of proof rested on the appellant to quantify the Claim.

The Tribunal does not have a duty to investigate and determine a figure, still less to make a "best judgement" assessment, he argued. Further, the Tribunal should seek evidence which is reliable, preferably contemporaneous, and consistent with any oral evidence, with a view to supporting a reasonably precise figure. Moreover, there is not a lower standard of proof in *Fleming* claims, he suggested.

171. Next, Mr Smith considered the present form of the appellant's Claim. In particular, he pondered, did it represent a *new* claim, and as such belated, which should not be entertained. He noted Regulation 37 of VAT Regulations 1995 S.I. 2518 of 1995. Initially only limited supporting documentation had been produced, he claimed. Other documentation was then available, it seemed, and, he argued, greater efforts should have been made to investigate this. In particular, Mr Smith suggested, a trial balance, debtors' report, and budget statement should have been sought for earlier Years as they were for 2006/07. The proximity of any index or base Year to the *Fleming* period was critical. Primary records were crucial.

172. Even if the original Claim were in competent form, it had since undergone such a transformation to make it a *new* claim, Mr Smith submitted. That involved new amounts and a different methodology. Section 121 FA 1988 had provided a generous time-limit: it should not be extended artificially by the making of a skeleton claim.

173. Next, Mr Smith submitted that there was no evidence of taxable income. Also, the baseline Year of 2006/07 was 10 years from the last/nearest Year of the *Fleming* period. There was no complete record of taxable income. A continuing pattern and level of income could not be assumed. The available documentation confirmed only costs. Further, while certain accounts had been produced, the manner of their compilation was uncertain. It was unclear whether primary records had been used. Satisfactory evidence of income from the laboratories was not available. The chargeable percentage of 14.70% could not be reconciled with such information of income as was available.

174. The evidence of the witnesses led did not assist, Mr Smith argued. They were laboratory technicians, not finance personnel. Their evidence as to the volume of *business* work was imprecise and impressionistic. Their evidence could not be related to documentation produced.

175. Mr Smith then addressed the matter of the taxable percentage and the figure of 14.70% proposed. He felt that this had not been adequately explained. The clinical percentage had remained at 11% throughout the relevant period, which seemed improbable. The method of extrapolation for an extended period was not satisfactory. Comparisons with other Health Boards were unhelpful: each should be looked at on its own merits. Whatever agreement was made about 14.70% being applicable for 2006/07, it did not extend to other Years, Mr Smith continued.

176. He then dealt with the need for *direct attribution* raised by Miss Langley. All expenditure on *non-business* activities has to be excluded. The burden of proof is on the appellant to exclude this. Mr Muir's evidence, Mr Smith submitted, did not deal

with this satisfactorily, when considering the expenditure incurred for the laboratories. The effect of failing to address direct attribution is to inflate the present Claim.

177. Exempt COS VAT arises albeit as a relatively minor issue, Mr Smith suggested. Only a minor adjustment specific to the laboratories has been made. However, he submitted, all exempt input tax over-claimed should be repaid.

178. Finally, Mr Smith suggested as a credibility check, that the effect of centralisation should be scrutinised. The major savings in overheads, *viz* rent and rates, do not bear VAT. The costs affected would be heat, power and light, which are fairly minor in relation to total costs, he suggested. He concluded that expenditure had been over-stated as direct attribution had not been carried out in the calculation.

179. In conclusion, Mr Smith argued, the *onus* of proof has not been discharged. He submitted that there was no satisfactory evidence of taxable supplies; no evidence of taxable income; no sound basis for the process of extrapolation; and the taxable percentage used was not representative. Accordingly, he concluded, the claim should be dismissed in its entirety.

180. Mr Southern made a brief reply. He emphasised that the 2006/07 laboratories' VAT recovery claim, which produced the rate of 14.70%, was crucial to his argument. It had been acted upon by HMRC for that Year. Accordingly the methodology which produced it was of wider significance. The witness evidence spoke to a consistency in the work carried out by the laboratories throughout the *Fleming* period.

181. HMRC's argument that the laboratories' supplies were exempt was ill-founded. The personnel carrying it out were not on any medical register. The supplies by the Board were taxable, being standard or zero-rated.

182. Mr Southern repudiated the suggestion that the Claim was "new". Its contours and methodology were unchanged. The adjustments made had been the result of negotiations between tax professionals.

183. If 14.70% could be used as a baseline, it does not matter that there is no evidence of the level of income, Mr Southern continued. There was evidence of the level of expenditure, which was used to produce the income.

184. The examples in para 3.6 *et seq* of the appellant's Closing Statement, Mr Southern argued, confirmed the strength of the methodology used. The *business/non-business* allocation had been followed. By contrast "direct attribution" was a concept taken from Regulation 101.

185. The appellant had responded to "scatter gun" criticisms by HMRC. While this was a difficult case, the balance of probabilities had been satisfied by the appellant, and the appeal should accordingly be allowed.

Conclusion

186. The Tribunal is grateful for Counsels' submissions. These identified several distinct issues, all crucial to the outcome of the appeal. The Tribunal proposes to deal with these in order.

5 187. A preliminary issue arises as to whether technically there is *no* claim or whether, as now formulated the Claim is *new* and, therefore time-barred. Mr Smith advanced this forcefully, but the Tribunal has little difficulty in rejecting it. The Claim as now formulated and earlier related to expenditure on supplies to the laboratories for its *business* activities. The Tribunal accepts that the calculations have 10 been revised in response to a course of negotiations between the parties. The Claim as originally stated in March 2009 was revised in March 2011 and twice in 2015, the last following on a meeting prompted by the Tribunal in April. On each occasion the amount sought was reduced.

188. The Tribunal was referred to the terms of Regulation 37 of the VAT 15 Regulations 1995. The Tribunal does not consider that this should be read in a peremptory way to exclude the refinement of a repayment claim and, particularly, it should not be construed so as to frustrate the possible benefit of a course of negotiation.

189. The Tribunal accepts the evidence of the officials from the various predecessor 20 Health Boards as to the nature of the business activities conducted. These were Nequas work, Food-testing, Water-testing, Non-Medical testing of samples, especially for public health, and research and development. In the context of this Claim the nature of the work done did not change and it is reasonable to infer that the nature of the inputs would not have changed markedly. The Tribunal finds that the Claim all 25 along has been for unrecovered input tax attributable to taxable *business* supplies made throughout the period 1974 to 1997, and while reduced in total, it is essentially the same.

190. Next, the Tribunal finds that the appellant Health Board made *taxable* supplies throughout the period of claim. While the bulk of the appellant's supplies were *non-* 30 *business*, hence outside VAT, it did conduct *business* activities falling within the VAT system. As we have confirmed, we accepted the witness evidence of the employees about the nature and general volume of this work (para 150 *supra*). It follows that the Tribunal does not accept Miss Langley's assertion that all the supplies were exempt. The decision in the D'Ambrumenil case comments on the extent of the exemption. In 35 the present case the activities under consideration were the Nequas work clinical trials and drug-testing, and public and environmental health work. These did not relate to the provision of medical care. None of the appellant's employees who carried out this work were on medical or para-medical registers. Accordingly the supplies were taxable and not exempt.

40 191. Miss Langley's assertion that the supplies were exempt does of course confirm that HMRC thought there were business supplies even if they wrongly considered them to be exempt.

192. A peripheral issue arose as to whether Nequas work was *exempt* for VAT purposes. It seems that it had been so treated for a while by the appellant. Apparently certain correspondence from HMRC had been misunderstood by the appellant, but it corrected that error. HMRC confirmed that this work was taxable, which indicates that it was aware of its being conducted. (Mr Smith objected to this element of the repayment sought, as, he claimed, output tax had not been accounted for.) We should confirm that in our view exempt status for medical services did not apply to the laboratories' *business* work. It was not medical care, nor was it provided by medical professionals. It follows that the Tribunal considers that the appellant does have a basis for a claim in that as the Tribunal has found that taxable supplies have been made then any input tax attributable to those taxable supplies was recoverable.

193. Thirdly, the Tribunal has to consider whether the *business* income of the laboratories can be calculated. Whilst the evidence of the officials from the various Health Boards was helpful in determining that taxable supplies were made, that evidence fell short of facilitating its quantification. While the business income is almost certainly significant, the Tribunal does not consider that it has been quantified satisfactorily for the whole period. The Blue Books do not record income except for that arising from catering. Such other accounting information as is available is insufficient to show each element of sectorised income of each Health Board. There was for a time one common VAT return which was submitted for all Health Boards, stating only aggregate figures. No sales ledgers or copy tax invoices were produced to support the quantification of taxable supplies. Consequently the amount of output tax paid to HMRC in respect of the *business* income received by the laboratories and included in those common VAT returns has not been established. In the absence of those figures it is difficult to confirm the reasonableness of any input tax claim relating to that income.

194. While the Tribunal accepts the officials' testimony about a general level of activity providing *business* supplies and their nature, it is not sufficiently precise to use as a basis for quantification of the Claim throughout the relevant period.

195. This shades into the final and major consideration in the appeal, which is the calculation of the taxable percentage. This, it is acknowledged by HMRC, was agreed at 14.70% for 2006/07. That, certainly, was the figure acted upon for that year. However, that agreement did not extend to other Years. The appellant's advisers, Liaison, adopted it as a starting-point, then "extrapolated" that back about ten years to the end of the relevant period, and then further back to its start.

196. The Tribunal does not consider such an approach reasonable or acceptable. While the witnesses confirmed that there had been no changes to the general pattern of activity, there had not been any reference to reliable primary data. The time-scale involved also undermines the likely accuracy of the process of extrapolation. There is an interval of ten years between the end of the relevant period and 2006/07, and that is preceded by a taxable period of about 25 years. The value of the claim (about £900,000 as now adjusted) is substantial. The ratio of each activity might vary over an extended period: so too might profit margins. The Tribunal finds that there is no written agreement concerning use of 14.70% for any period. It was used in

calculating an agreed amount recoverable in 2006/07. All this tends to undermine the validity of 14.70% as a *business/non-business* fraction used over an extended period. The Tribunal noted that another Health Board had used a fraction of 35%. No invoices or VAT Returns were available. (The Tribunal learned that Miss Howard had innocently had records destroyed except for one VAT Return, which she delivered to Mr Muir.)

197. The Tribunal would suggest that there is a need to have a verifiable percentage, calculated by reference to prime records at regular intervals. For example, it might well be acceptable in a 25 year period to have verifiable figures every five years, and if there is not significant variation, to use extrapolated figures for the intervening four Years. The Tribunal observes that in the actual calculation of the Claim (vol 2, p103-App I), 14.70% was not used throughout 11% was used, and also 12.15%.

198. An adjustment for exempt COS VAT has been made. In a "sectorised" claim only that relating to the laboratories need be taken into account in the Tribunal's view.

199. The Tribunal is conscious of the efforts made by the appellant's advisers in researching the Claim. The essential flaw, however, is in seeking to apply the taxable percentage of 14.70% throughout the relevant period. There is no basis in our view for invoking the percentage used for 2006/07 to other Years, especially given the interval of time involved. Levels of turnover, expenditure, and profit, all of which tend to affect the calculation of this Claim, are unlikely to remain constant. The Blue Books have value as prime records. But they show essentially the level of expenditure with a coded breakdown. The witness evidence, while we accept it, speaks only very generally to the types and level of *business* activity, but is not sufficiently precise or satisfactory as a basis for the claim.

200. In respect of partial exemption methods the Tribunal finds that no partial exemption method was agreed for any part of the period. In the early years it would have been possible for the appellant to use a standard partial exemption method without the agreement of HMRC. It was confirmed in evidence that NHS (Scotland) submitted one consolidated VAT return until the early 1990s. In her evidence Miss Langley said that no partial exemption method was used in those early years. The Health Boards only started to carry out partial exemption calculations in 1994/95.

201. The appellant points out that this claim is one sector of a number of claims by NHS bodies and that direct attribution was done before any of the sectorised claims was made. Therefore no further direct attribution is necessary. HMRC considers further direct attribution is necessary. The Tribunal considers that the dearth of information concerning income and the tax liability of it does put into question whether direct attribution has been done to an adequate extent. The claims proceeded on the basis of extrapolation of figures used in later years where a sectorised method was used. No attempt was made to show what recovery could have been made if a standard method had been used for the earlier years. The Tribunal presumes that such a calculation would have been very difficult for the appellant because of the lack of detailed information quantifying income during those years.

202. For all of these reasons the Tribunal rejects the Claim as now calculated as representing the amount of VAT recoverable on *business* activities during the *Fleming* period. The appeal accordingly is dismissed.

203. 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.

PETER R. SHEPPARD
TRIBUNAL MEMBER

RELEASE DATE: 26 JUNE 2017

APPENDIX A

JOINT LIST OF AUTHORITIES

Cases

1.	*Argyll v Argyll* 1963 SLT (N) 42
2.	*C J McD v HM Advocate* 2002 SCCR 896
3.	*Birmingham Hippodrome Theatre Trust Ltd v Revenue & Customs Comrs* [2014] EWCA Civ 684 STC 2222
4.	*Maxi Construction Management Ltd v Mortons Rolls Ltd* 2001 Court of Session CA 39/01
5.	*Bratt Auto Contracts Ltd v Revenue & Customs Comrs* 2014 TC/2010/04037 & TC/2010/04039 UKFTT 676 (TC)
6.	*Nathaniel & Co, Solicitors v Revenue & Customs Comrs* [2010] UKFTT 472 (TC)
7.	*D v W* (Case C-384/98) [2002] STC 1200
8.	*C & E Comrs v Pegasus Birds Ltd* [2004] [2015] EWCA Civ 1015 STC 1509
9.	*Investrand BV v Staatssecretaris van Financiën* (Case C-435/05) [2008] STC 518
10.	*Lothian NHS Health Board v R & C Comrs* [2015] UKUT 264 (TCC) STC 2221
11.	*Northern Lincolnshire & Goole Hospitals NHS Foundation Trust v R & C Comrs* [2015] UKFTT 0103 (TC)
12.	*Volkswagen Financial Services (UK) Ltd v R & C Comrs* [2016] STC 417
13.	*R & C Comrs v General Motors (UK) Ltd* [2016] STC 985
14.	*General Motors UK Ltd v R & C Comrs* [2013] UKFTT 443 (TC)
14.	*R & C Comrs v General Motors (UK) Ltd* [2015] UKUT 605
15.	*R & C Comrs v Vodafone Group Services Ltd* [2016] UKUT 89 (TCC) STC 1064
16.	*R & C Comrs v Associated Newspapers Ltd* [2016] UKUT 641 (TCC) STC 1143
17.	*BLP Group plc v Customs & Excise Commissioners* (Case C-4/94) STC 424
18.	*Reed Employment Ltd v Revenue & Customs Comrs* [2013] STC 1286 [2013] UKUT 0109 (TCC)
19.	*Fleming trading as Bodycraft v R & C Comrs; Conde Nast Publications Ltd v R & C Comrs* [2008] STC 324
20.	*Dr Peter d'Ambrumenil v Customs & Excise Comrs* (Case C-307/01) [2005] STC 650
21.	*Kretztechnik AG v Finanzamt Linz* Case C-465/03; [2005] STC 1118; [2005] 1 WLR 3755
22.	*Staatssekretaris van Financien v Vereniging Aardappelenbewaarplaats* [1981] ECR 445
23.	*Websons (8) Ltd v Revenue & Customs Comrs* [2013] UKFTT 229 (TC)
	Ambulanter Pflegedienst K□gler Gmbh v Finanzamt für Korperschaffen 1 in Berlin (Case C-141/00)
24.	*EC Commission v Italy* (Case C-45/95) [1997] STC 1062
25.	*NHS Greater Glasgow & Clyde* [2015] TC04324 UKFTT 119 (TC)

5

Legislation

1.	The Value Added Tax (General) Regulations 1972 (SI 1972/1147)
2.	The Value Added Tax (General) Regulations 1974 (SI 1974/1379)
3.	The Value Added Tax (General) Regulations 1975 (SI 1975/2204)
4.	The Value Added Tax (General) Regulations 1977 (SI 1977/1759)
5.	The Value Added Tax (General) Regulations 1980 (SI 1980/1536)
6.	The Value Added Tax (General) Regulations 1985 (SI 1985/886)
7.	The Value Added Tax (General) Regulations 1995 (SI 1995/2518)
8.	The Value Added Tax (General) Amendment Regulations 1984 (SI 1984/155)
9.	The Value Added Tax (General) (Amendment) (No. 2) Regulations 1987 (SI 1987/510)
10.	Commissioners for Revenue and Customs Act 2005, section 18
11.	VAT Act 1994
12.	Finance Act 1972
13.	Finance Act 1983
14.	Finance Act 1988
15.	Finance Act 1994
16.	Finance Act 2008
17.	Finance Act 2008, Section 121
18.	Health and Social Work Profession Order 2001

Other references

1.	Walker & Walker, *The Law of Evidence in Scotland,* 4th edition, paragraphs 1.7.8 and 16.3.8
2.	Davidson, Evidence, paragraphs 9.02-9.05
3.	McPhail, *Evidence*, paragraph 21.14
4.	Revenue & Customs Brief 06/07 VAT changes to the exemption for medical services, 1 May 2007
5.	Stair Memorial Encyclopaedia Vol 18 para 121
6.	VAT in the Public Sector and exemptions in the public interest Final Report for Tax UD 2009/FR/316 of 1 March 2011
7.	VAT Leaflet 701/31/84 Health [1 January 1984]
8.	VAT Leaflet 701/31/92 Health [1 March 1992]
9.	VAT Notice 706 Partial Exemption (April 1984)
10.	VAT Notice 706 Partial Exemption (April 1987)
11.	VAT Notice 706 Partial Exemption (April 1990)
12.	VAT Notice 706 Partial Exemption (April 1992)
13.	Extracts from HMRC Partial Exemption and Business/Non-business Manuals
14.	HMRC's Fleming Guidance on Section 121 of the Finance Act 2008 (17/9/10 version)
15.	Tolley's VAT and the Partial Exemption Rules 1987

APPENDIX B

IN THE FIRST-TIER TRIBUNAL

Tribunal Centre: Edinburgh
Reference no: TC/2012/00192

NHS LOTHIAN

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

STATEMENT OF AGREED FACTS

1) It has been accepted by the Respondents that NHS Lothian is entitled to make claims for the period 1 April 1974 to 30 April 1997.

2) NHS Lothian incurred costs on laboratory expenditure between 1974 and 1997 (Annual Accounts 1976/77 & 1978/79 to 1991/92 inclusive).

3) Wages and salaries do not incur VAT. Therefore they have been removed from the total expenditure. They are excluded from the input tax claim.

4) NHS Lothian incurred VAT in relation to certain or some of the costs on laboratory expenditure between 1974 and 1997.

5) The expenditure will be shown in the annual accounts as VAT inclusive where the NHS incurs the total cost and as VAT exclusive where the NHS has recovered the VAT and further may be zero rated or exempt or may not bear VAT.

6) The contracted out services VAT incurred in relation to laboratories expenditure has been identified and removed from the Fleming claims on the basis of the services provided. They were on the list of eligible services and it is assumed the contracted out services VAT was claimed at the appropriate time, form and manner (The London Gazette, 1984 -1993) The contracted-out VAT recovered from 1984/85 to 1991/92 is £381,445.03.

7) A partial exemption adjustment in respect of laboratory contracted out services VAT has been completed using the percentage used for the 2006/07 claim. 2006/07 was the first year where there was a recovery of input tax on laboratories.

8) NHS Lothian carried out the laboratory business activities within the period of 1974 to 1997.

9) The laboratory business activities include:

- Non Patient Tests
- NEQAS (National External Quality Assessment Service)
- Drug Trials
- Food and Water Testing

10) NHS Lothian did not claim input tax in respect of laboratory expenditure which may be attributable to business activities between 1974 and 1997.

11) Any input tax in respect of laboratory expenditure which may be attributable to the relevant business activities between 1974 and 1997 was not claimed on behalf of NHS Lothian by the Scottish Office or the Scottish Executive.