[2016] UKFTT 041 (TC)

TC04840

Appeal number: TC/2011/05943
TC/2012/06796

VAT – whether supplies for a consideration below "open market value" – whether "standard method override" set out in Regulations 107A to F of the Value Added Tax Regulations 1995 should be applied – whether assessments "global assessments" and whether made in time – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

TEMPLE FINANCE LIMITED **Appellants**
TEMPLE RETAIL LIMITED

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at The Royal Courts of Justice, Strand, London on 16 to 20 November 2015

Nicola Shaw QC and Michael Firth, instructed by Grant Thornton UK LLP, for the Appellant

Sarabjit Singh, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. These are the joined appeals of Temple Finance Limited ("TFL") and Temple Retail Limited ("TRL") against the following decisions of HMRC:

(1) a direction made on 31 May 2012 under Schedule 6 of the Value Added Tax Act 1994 ("VATA 1994") to the effect that the value of certain supplies made by TRL to TFL and relating to showrooms owned by TRL ("Store Services"), and to advertising and marketing services ("Advertising Services"), should be taken to be their open market value ("OMV");

(2) assessments to output tax made on TRL on 4 June 2013 (for £1,354,748) and 1 May 2014 (for £2,906,416) made because HMRC did not consider that TRL had complied with the direction made under Schedule 6 of VATA 1994;

(3) assessments made on TFL on 5 July 2011 (for £159,043) and 11 July 2012 (for £433,311) adjusting TFL's recovery of input tax by applying the "standard method override" ("SMO") set out in Regulations 107A to F of the Value Added Tax Regulations 1995 (the "VAT Regulations").

2. As well as asserting that HMRC's decisions are wrong, the appellants are arguing that the assessments made on 4 June 2013 and 5 July 2011 were made out of time. One aspect of that argument relates to the question of whether those assessments were single "global assessments" or multiple assessments in relation to different VAT periods. I set out my conclusion on this issue in Part III of this decision and, accordingly, references that I make elsewhere in this decision to assessments (in the plural), or assessment (in the singular) should not be taken as themselves expressing any view on this point.

3. The assessments that are in issue are summarised in Appendix I of this decision. A glossary of terms used is attached at the end of the decision.

Evidence

4. On behalf of TFL and TRL, I had evidence from Mr Alaric Smith, the Finance Director of the PerfectHome group, and from Mr Mark Barry, the Group Tax Manager of the PerfectHome group, both of whom prepared witness statements and were cross-examined. I considered both to be reliable and honest witnesses. At [88] below, I set out my conclusion on a specific point that was made as to the reliability of a particular aspect of Mr Barry's evidence.

5. On behalf of HMRC, I had evidence from Officer Joseph Bird and Officer Shelagh Ford, both of whom prepared witness statements and were cross-examined. Mr Firth made specific challenges to the reliability of both officers' evidence. I will deal with those in detail later in the decision but for the time being record my view that I regarded both officers as reliable and honest witnesses.

6. Officer David Powell of HMRC prepared a witness statement but did not attend the hearing to give evidence. Neither party sought to rely on any aspect of Officer Powell's witness statement. I have, therefore, not taken Officer Powell's evidence into account in this decision.

7. I was not able to have any evidence from John Murphy, an independent consultant, who prepared a report dealing with matters of cost allocation as he has sadly passed away.

8. I also had various volumes of documentary evidence in the form of a helpful hearing bundle that the appellants prepared.

General overview of the PerfectHome business

9. TFL and TRL are both companies incorporated in the United Kingdom. Both TFL and TRL are wholly owned subsidiaries of PerfectHome Holdings Ltd, the ultimate holding company of the group. There was no dispute that TFL and TRL were "connected" for the purposes of Schedule 6 of VATA 1994. It was not disputed that TFL is "partially exempt" for VAT purposes and not able to recover all of the input tax that it incurs.

10. TFL and TRL both carry on the activities of the "PerfectHome" business. The precise nature of TFL's and TRL's respective activities was disputed, and I will make detailed findings of fact on that issue later in the decision. In this introductory section will set out an overview of the activities of the PerfectHome business as a whole without distinguishing between the activities of TFL and TRL.

11. The PerfectHome business is operated from 67 showrooms located in various parts of the UK. The business involves the sale of household goods (such as washing machines and refrigerators), furniture and electronic goods (such as TVs and gaming consoles) to consumers. The business is aimed at credit-constrained customers whose credit scores are too low to enable them to acquire goods using loans or credit cards, but who nonetheless want good quality products. Although some 2% of sales that PerfectHome makes are paid for in cash, the remaining 98% of sales involve the customer acquiring goods on hire-purchase ("HP") terms that require the customer to make weekly payments.

12. The HP agreements that PerfectHome uses typically have a three-year term. Those agreements provide that the customer only becomes the legal owner of the goods in question when the final weekly payment due has been made. Therefore, in a commercial sense, if not necessarily in a legal sense, the goods represent security for PerfectHome's loan to its customer as, if the customer does not pay the weekly payments due, PerfectHome can repossess the goods and sell them second-hand. PerfectHome, therefore, has an ongoing interest in the maintenance and condition of the goods after the customer has taken possession of them. Accordingly, before making a sale to a customer, PerfectHome seeks to ensure that the customer has adequate insurance cover against the risks of theft or accidental damage to the goods. If a customer does not have such cover of their own, they can purchase an insurance

policy ("TAD") from PerfectHome covering the risk. Approximately 88% of PerfectHome's customers purchase TAD from PerfectHome.

13. PerfectHome also sell a warranty product known as "Coverplus" which covers the goods for actual or apparent mechanical breakdown. The Coverplus warranty runs for the life of an HP agreement and requires the payment of a single lump sum premium on purchase. PerfectHome tells customers buying on HP that, if they purchase the Coverplus warranty, PerfectHome will allow them to terminate the HP agreement, and return the goods, at any time with the result that customers are not locked into that agreement[1]. Approximately 90% of PerfectHome's customers purchase the Coverplus warranty. Most of these customers are not in a position to pay the lump sum premium in cash and so take out a fixed sum loan agreement ("FSLA") alongside their HP agreement and make weekly payments under the FSLA at the same time as they make their weekly payments under the HP agreement.

14. PerfectHome has an ongoing role in relation to the 98% of goods that are sold on HP terms that continues after the customer has taken the product home. For example:

(1) If a product breaks down or delivers a fault, PerfectHome will need to deal with claims under the Coverplus warranty or other complaints.

(2) PerfectHome needs to ensure that weekly payments under the HP agreement (or FSLA) are made when due. Historically, a number of customers visited the showrooms to make weekly payments in cash, but increasingly they make payments by telephone using a debit card which involves PerfectHome staff, generally at the till area, taking payment details over the telephone.

(3) Some customers miss their weekly payments. In that case, a PerfectHome customer relationship manager will contact the customer in question by telephone and seek to agree terms under which any arrears are paid off. For data protection reasons, these discussions do not take place in the public area of the showrooms, but in the "secure area" of those showrooms to which the public do not have access.

(4) PerfectHome does, occasionally, take legal action against defaulting customers. However, it is more usual to focus on recovery of the goods in question in cases of default. Goods recovered from defaulting customers are then sold as "quality refurbished" ("QR") goods as described below.

15. Approximately 40% to 50% of PerfectHome's customers terminate their HP agreements early. Customers can do this in accordance with the terms of the HP agreement if they have purchased Coverplus. They are also entitled by consumer credit law to terminate their agreements early when they have made over half of the total payments due. As noted above, termination can also take place outside the terms of an HP agreement when a customer goes into arrears.

[1] In practice PerfectHome may sometimes take a commercial decision to permit a customer to terminate an agreement early even if they have not purchased Coverplus.

16. In the situations described at [15] above, PerfectHome will tend to recover used goods. After checking those goods for safety, repairing them and effecting any necessary repairs, they are restocked in PerfectHome's showrooms and resold as "quality refurbished" ("QR") goods. The sales process for QR goods is virtually identical to that for new goods and both Coverplus and TAD cover are sold together with QR goods in just the same way as they are sold together with new goods. QR sales represent approximately 30% of all sales that PerfectHome makes.

Transactions between, or involving, TFL and TRL

17. The PerfectHome business is not carried on by a single company but rather is carried on by TFL and TRL together. That means that there are a number of transactions entered into between TRL and TFL that are governed by the terms of an Intra-Group Services Agreement ("IGSA"). The IGSA was entered into orally on 1 April 2008, was reduced to writing on 26 February 2009 and has been amended on occasions subsequently. As noted, the precise scope of TRL's and TFL's respective activities is disputed, but the facts set out at [18] to [24] below were not in dispute.

18. TRL is the tenant under leases of the 67 showrooms used by the PerfectHome business.

19. TRL enters into contracts with third party suppliers of advertising services to advertise the PerfectHome business generally. Those advertising services include the preparation of leaflets and "flyers" advertising new store openings and advertising the range of products available at a particular store as well as available HP terms.

20. TRL enters into contracts for the purchase of goods to be sold in the PerfectHome business and arranges for those goods to be distributed to showrooms. In the 2% of cases in which goods are sold to customers for cash, no HP agreement is entered into and TRL completes this sale itself without any involvement from TFL.

21. In the 98% of cases in which goods are sold under HP agreements, the following transactions take place:

> (1) Pursuant to the IGSA, TRL sells the goods to TFL for a price equal to 97% of the advertised price of the goods. That is a standard rated supply for VAT purposes.
>
> (2) TFL enters into the HP agreement with the customer and sells the goods for 100% of the advertised price. The HP agreement involves TFL making both a standard rated supply of the goods (which is treated as made when the HP agreement is signed) and an exempt supply of finance (being the credit provided under the HP agreement).
>
> (3) TFL enters into a contract with the customer to provide any TAD that the customer had purchased. That is an exempt supply of insurance for VAT purposes.

(4) TFL enters into a contract with the customer to provide any Coverplus cover the customer purchases. That is a standard rated supply for VAT purposes.

(5) TFL has contractual responsibility to customers for delivery of bulky items. Pursuant to the IGSA TFL pays TRL 5% of the purchase price of the goods to deliver goods on its behalf and this is a standard rated supply of services from TRL to TFL.

22. TFL has both contractual and statutory responsibility for the condition of goods sold to customers under HP agreements. TFL also has contractual responsibility to customers for the servicing and repair of goods under both the TAD and Coverplus contracts. Pursuant to the IGSA TFL subcontracts responsibility for repairs to TRL and this represents a standard rated supply from TRL to TFL.

23. Since 1 April 2011 TRL and TFL have jointly employed staff of the PerfectHome business. Prior to that date, TFL was the sole employer and staff costs were shared under the terms of the IGSA.

24. TRL and TFL have not made any election to be considered as part of a group for the purposes of s43 of VATA 1994. Therefore, supplies made pursuant to the IGSA are not disregarded for VAT purposes.

Overview of the dispute and the decisions under appeal

Matters relevant to TRL

25. TRL makes only taxable supplies for VAT purposes and, therefore, is entitled to recover 100% of the input tax that it incurs in the course of its business. By contrast, TFL is partially exempt for VAT purposes and, accordingly, its entitlement to input tax recovery is limited in accordance with the rules applicable to partially exempt businesses. HMRC were evidently concerned that TRL and TFL could have an opportunity to bolster their aggregate input tax recovery by charging fees ("Store Fees" and "Advertising Fees" respectively) for Store Services and Advertising Services at a price below OMV. Accordingly, on 31 May 2012, Officer Mintoft of HMRC issued a Notice of Direction to TRL in the following terms:

> In pursuance of paragraph 1 of Schedule 6 of the Value Added Tax Act 1994 the Commissioners of HM Revenue and Customs hereby DIRECT that the value of the supply of services to Temple Finance Ltd relating to:
>
> - shop advertising and launch costs in respect of PerfectHome stores and
> - relating to the occupation and use of the PerfectHome shops
>
> made by you between 1 June 2009 and the date of this Notice and which was made:
>
> a) for a consideration in money less than its open market value, and

b) to a person with whom at the time of such supply you were connected within the meaning of paragraph 1(4) of Schedule 6 to the Value Added Tax Act 1994, and who is not entitled under sections 24 to 26 of the said Act to credit for all the tax on the supply

shall be taken to be its open market value.

26. HMRC considered that TRL had not complied with the direction under Schedule 6 of VATA 1994 and that the Store Fees and Advertising Fees that it received from TFL were below the OMV of the relevant supplies. Therefore, HMRC made their own determinations of the OMV of these supplies and, on 4 June 2013 and 1 May 2014 issued TRL with assessments, summarised in Appendix I, for under-declared output tax.

27. The essence of HMRC's approach in making these assessments was as follows:

(1) The OMV of Store Services should be determined by allocating costs associated with the retail stores between TRL and TFL in the ratio 25:75 by following the methodology (with some adjustments) that John Murphy, an external consultant engaged by PerfectHome, had used in a report he prepared between November 2008 and January 2009 (the "Murphy Report") dealing with the allocation of staff costs. The OMV of Store Services would be TFL's share of those costs marked up by a factor of 10%.

(2) Only 2% of sales that PerfectHome made to customers were paid for in cash (and so made directly by TRL as described at [20]). The remaining 98% were made by TFL who sold both the goods, and provided finance, warranties and insurance, to the customers. Therefore, 98% of the group's advertising and launch costs benefited TFL. Accordingly, the OMV of Advertising Services was 107.8% of the cost that TRL incurred (i.e. TFL's 98% share of those costs, marked up at 10%).

Matters relating to TFL

28. TFL is partially exempt for VAT purposes and is therefore entitled to recover only a proportion of the input VAT that it incurs on its overheads. The dispute centres on the determination of this proportion. TFL argues that it should be calculated on the basis of the "standard method". However, HMRC considers that the SMO should apply so as to result in TFL recovering a lower proportion of its input tax.

The burden of proof and matters to be decided

29. Mr Singh submitted that, in relation to Schedule 6 of VATA 1994, the matters to be decided (and burden of proof) can be summarised as follows:

(1) As regards the appeal against the Schedule 6 direction, the burden is on TRL to show that HMRC were wrong to conclude that the supplies in question were charged for at less than OMV. If the Tribunal finds that the

supplies were charged for at less than OMV, to any extent, the appeal against the Schedule 6 direction fails.

(2) If the Tribunal allows the appeal against the Schedule 6 direction, then the appeal against the assessments against TRL should be allowed (since those assessments have been made on the footing that the OMV of the supplies that TRL has made is higher than the consideration charged).

(3) If the Tribunal upholds the Schedule 6 direction and finds that the extent of the undervalue was as HMRC claim, the Tribunal should issue a decision in principle to this effect rather than a final decision upholding the assessments (since the parties would seek to agree minor adjustments to the assessments in that case).

(4) The Tribunal may decide that the consideration for the supplies was below OMV but not to the extent that HMRC claim. In that case, the assessments should not be quashed as it was not suggested that they were raised to the best judgement of the officers concerned, but they should be reduced. The Tribunal has full appellate jurisdiction in this case to determine the amount of the assessments.

30. I agree with Mr Singh's summary of these matters. Ms Shaw appeared to be content with this summary as well, but suggested that the appellant is entitled to succeed on the Schedule 6 issue if she can establish that HMRC's determination of OMV is based on a "false premise". I do not agree with that submission. Even if HMRC's calculations were based on a "false premise", they might still produce a correct determination of OMV (if only by accident). The burden is on the appellant to establish that its calculation of VAT due is correct and, accordingly, merely identifying a false premise in HMRC's approach will not do that.

31. I did not hear any specific submissions on the burden of proof in relation to the partial exemption dispute. However, I have concluded that it is similar to that outlined at [30] above. In particular, the burden of proof is on the appellant not merely to show that the reasons underpinning HMRC's calculation of the SMO are flawed, but also to show that its own determination of input tax recovery is correct.

PART I - THE SCHEDULE 6 DISPUTE

The Schedule 6 dispute – applicable statutory provisions

32. The amount of "output" VAT that is chargeable on a supply and the amount of "input" VAT for which a taxable person receiving a supply is entitled to credit is calculated by reference to the value of that supply. Section 19 of VATA 1994 sets out rules that apply to determine the value of any supply. However, s19 of VATA 1994 is expressed to be subject to Schedule 6 of VATA 1994. Therefore, Schedule 6 sets out an exception to general rules that govern the determination of the value of a supply.

33. Schedule 6 of VATA 1994 provides, so far as relevant, as follows:

SCHEDULE 6

VALUATION: SPECIAL CASES

1(1) Where –

a) the value of a supply made by a taxable person for a consideration in money is (apart from this paragraph) less than its open market value, and

b) the person making the supply and the person to whom it is made are connected, and

c) if the supply is a taxable supply, the person to whom the supply is made is not entitled under sections 25 and 26 to credit for all the VAT on the supply,

the Commissioners may direct that the value of the supply shall be taken to be its open market value.

(2) A direction under this paragraph shall be given by notice in writing to the person making the supply, but no direction may be given more than 3 years after the time of the supply.

(3) A direction given to a person under this paragraph in respect of a supply made by him may include a direction that the value of any supply-

a) which is made by him after the giving of the notice, or after such later date as may be specified in the notice, and

b) as to which the conditions in paragraphs (a) to (c) of sub-paragraph (1) above are satisfied

shall be taken to be its open market value.

34. "Open market value" is defined in s19(5) of VATA 1994 in the following terms:

(5) For the purposes of this Act the open market value of a supply of goods or services shall be taken to be the amount that would fall to be taken as its value under subsection (2) above if the supply were for such consideration in money as would be payable by a person standing in no such relationship with any person as would affect that consideration.

35. The above statutory provisions have their root in Council Directive 2006/112/EC (the "Principal VAT Directive"). Article 80 of the Principal VAT Directive provides, so far as relevant, as follows:

Article 80

1 In order to prevent tax evasion or avoidance, Member States may in any of the following cases take measures to ensure that, in respect of the supply of goods or services involving family or other close personal ties, management, ownership, membership, financial or legal ties as defined by the Member State, the taxable amount is to be the open market value:

a) where the consideration is lower than the open market value and the recipient of the supply does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177

36. Article 72 of the Principal VAT Directive defines "open market value" as follows:

> For the purposes of this Directive, 'open market value' shall mean the full amount that, in order to obtain the goods or services in question at that time, a customer at the same marketing stage at which the supply of goods or services takes place, would have to pay, under conditions of fair competition, to a supplier at arm's length within the territory of the Member State in which the supply is subject to tax.
>
> Where no comparable supply of goods or services can be ascertained, 'open market value' shall mean the following:
>
> 1) in respect of goods, an amount not less than the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price determined at the time of supply;
>
> 2) in respect of services, an amount that is not less than the full cost to the taxable person of providing the service

37. The definition in the Principal VAT Directive is different (in small respects) from that set out in s19(5) of VATA 1994. Since the Principal VAT Directive takes direct effect in the UK, I will apply the definition set out in Article 72 for the purposes of this decision.

The Schedule 6 dispute – preliminary procedural and evidential matters

38. Before dealing with the substantive dispute in relation to Schedule 6 of VATA 1994, there are some matters of procedure and evidence to be addressed.

Ms Shaw's objection to certain aspects of Mr Singh's skeleton argument

39. Both Ms Shaw and Mr Singh prepared skeleton arguments on behalf of the appellants and respondents respectively. HMRC applied to the Tribunal for an extension of time in which to serve their skeleton argument which the Tribunal refused. Nevertheless, Mr Singh's argument was served some four days later than the time limit prescribed in the applicable directions.

40. Mr Singh's skeleton argument contained passages dealing with what was submitted to be the "artificiality" of the structure of the appellants' arrangements particularly in relation to the fact that the PerfectHome business is not carried on by a single company. In addition, Mr Singh's skeleton argument contained passages criticising the appellants' reliance on Grant Thornton's transfer pricing reports. Mr Singh argued that Grant Thornton's reports dealt with the OECD Transfer Pricing Guidelines (rather than the question of OMV with which Schedule 6 of VATA 1994 is concerned) and therefore were not relevant to the matters at issue in this appeal. He also made a number of specific criticisms of the methodology that Grant Thornton employed in the "benchmarking" exercise they performed.

41. Ms Shaw objected to the passages referred to above for the following broad reasons:

> (1) The "artificiality" argument was being introduced at a late stage in a skeleton argument that had itself been filed late. She submitted that it was

a serious allegation, similar to an allegation of fraud and should have been pleaded specifically in HMRC's Statement of Case. The late introduction of this point amounted to prejudice to the appellants who were not able to address the argument in detail in their evidence.

(2) The question of "artificiality" was, in any event, irrelevant given that HMRC were not asserting that the principle set out in *Halifax plc v Customs and Excise Commissioners* (Case C-255/02) applied. Therefore, HMRC were simply seeking to make points that were prejudicial to the appellant in raising arguments based on "artificiality" and "contrivance".

(3) The nature of the dispute between the appellants and HMRC (at least in relation to Schedule 6 of VATA 1994) was primarily whether TRL was the company undertaking the effort and expense of getting customers to the point where they wished to purchase goods. The dispute, she submitted, was one of principle, not valuation and the parties had agreed between themselves that expert evidence was not needed. Therefore, HMRC should be prohibited from criticising Grant Thornton's methodology and calculations or, alternatively, that there be an adjournment to allow Grant Thornton to serve an expert witness report with closing arguments on the Schedule 6 issue taking place after Grant Thornton's evidence had been heard.

42. I did not accept Ms Shaw's submissions in this regard for the following reasons:

(1) I considered that HMRC's Statement of Case made it clear that HMRC were disputing whether TRL was receiving consideration of at least the OMV of Store Services and Advertising Services. I did not consider that the Statement of Case suggested that it was limited to questions of "principle". It was not suggested that the parties had reached an explicit agreement to the effect that the only matters at issue were questions of principle.

(2) Mr Singh's arguments as to "artificiality" and "contrivance" were relevant. He was arguing, in essence, that the appellants had put in place an "artificial" and "contrived" structure in order to allow them to improve their aggregate input tax recovery by charging Store Fees and Advertising Fees at less than OMV and that, moreover, the appellants' structure only made commercial sense if those fees were at less than OMV. Of course, he would need to make those submissions good by reference to evidence before the Tribunal but, in principle, those arguments were relevant to the question of OMV since, if the appellants intended their business structure to allow them to manipulate the price charged for services, that would be highly relevant to the question of whether they charged OMV for those services.

(3) I was not satisfied that an argument that a business structure is "artificial" or "contrived" is tantamount to an allegation of fraud. I therefore did not consider that such an allegation had to be specifically pleaded. HMRC had unambiguously pleaded a case based on the OMV of

supplies that TRL made and were, therefore, entitled to raise the "artificiality" argument, which was relevant to that case.

Mr Singh's application to introduce new evidence in the form of a report by the All Party Parliamentary Group

43. In February 2015, the All Party Parliamentary Group on Debt and Personal Finance ("APPG") released a report (the "APPG Report"). Mr Singh requested permission to introduce the APPG Report, and submissions that the PerfectHome group made to the APPG, as evidence and, in cross-examination, to put questions to one of the appellants' witnesses, Mr Alaric Smith, based on that report. The grounds for that request were that the APPG Report contains some information on the nature of the PerfectHome business, who it competes with, and who its customers are which was relevant to the questions at issue in this appeal. He also submitted that the appellants would not be prejudiced by the late introduction of this evidence as the APPG Report was well known to them and they were themselves the authors of the submissions made to the APPG.

44. Ms Shaw objected to Mr Singh's application. She questioned the relevance of the APPG Report and submitted that it added nothing to the appellants' own evidence as to the nature of the PerfectHome business, its competitors and other issues. She also submitted that, since the APPG made some comments that were critical of the "rent to own" business sector that Mr Singh was seeking to introduce the APPG Report as evidence primarily to paint a prejudicial picture of the appellants' business.

45. I decided to admit the APPG Report as evidence. In principle, the subject matter of the report appeared capable of being relevant. If it turned out not to be relevant or, as Ms Shaw submitted, merely prejudicial I would disregard it. If it was relevant then I would consider the weight of the APPG Report in just the same way as I would consider the weight of other pieces of evidence. In fact, I found this material to be of little assistance.

The weight that should be attached to the Grant Thornton transfer pricing reports

46. Grant Thornton have not prepared any expert reports for the Tribunal in this appeal as the parties were agreed between themselves that no expert evidence was needed. Nor did anyone from Grant Thornton prepare a witness statement or attend the hearing to give oral evidence or to be cross-examined. Therefore, I am not treating the various transfer pricing reports that Grant Thornton prepared for TRL and TFL as expert reports that have been prepared for the benefit of the Tribunal in order to assist in the determination of this appeal. Since the Grant Thornton reports consist largely of statements of opinion made by persons who are not giving witness evidence, it is necessary to consider firstly whether Grant Thornton's reports should be admitted as evidence at all and, if so, what weight should be given to those reports.

47. Unlike the courts, the Tribunal has few specific rules on the admissibility of opinion or hearsay evidence. Instead, Rules 5(1) and 5(2) of the Tribunal Rules,

together with Rule 15, confer a wide discretion on the Tribunal as to how it deals with matters of evidence.

48. Mr Singh did not object to the admission of Grant Thornton's reports on the basis that they were inadmissible hearsay or opinion evidence. I am, therefore, happy to treat them as evidence but, since they are not formal expert reports, I have to make up my own mind on the expressions of opinion that they contain. However, as well as making specific criticisms of the contents of the Grant Thornton reports which I will deal with later on in this decision, Mr Singh submitted that irrespective of their contents and Grant Thornton's obvious expertise in transfer pricing matters, there were two reasons why I should give the reports relatively little weight:

> (1) The reports deal with transfer pricing matters that involve an application of the OECD Transfer Pricing Guidelines. While these guidelines are relevant to an allocation of profit for corporation tax purposes, Mr Singh submitted that they have no bearing on the question of OMV of particular supplies for the purposes of Article 72 or Schedule 6 since they involve a determination of overall profit rather than an examination of the OMV of particular supplies.
>
> (2) Grant Thornton are the appellants' advisers in this appeal (as well as being their auditors). In those circumstances, the opinions they express are not independent.

I will deal with those points in turn.

(a) The challenge as to relevance

49. An introductory section to Grant Thornton's first report states that:

> The related party transactions covered under this report have been analysed with a view to assist [sic] the companies in implementing transfer pricing policies that comply with the arm's length principle as described in the [OECD's] Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

50. Section 5 of that report is headed "Economic Analysis" and considers different types of intra-group transaction separately from each other with a view to establishing the "arm's length" nature of the pricing of that transaction. There are separate sections dealing with, for example, the sale of goods from TRL to TFL, the provision of staff by TFL to TRL, the "store concessions" provided by TRL to TFL and repair services provided by TRL to TFL. In each of these sections, I consider that Grant Thornton seek to identify "arm's length" pricing for the particular transaction under consideration. I do not consider that this report, or any of the subsequent reports, is concerned with identifying overall profitability of a business as a whole: the focus is very much on the pricing of individual transactions.

51. As a matter of ordinary usage, a party will be transacting at "arm's length" with a counterparty if it is seeking to obtain the best deal for itself and without any intention to confer a gratuitous benefit on the counterparty. Where services or goods are

supplied on "arm's length" terms, it would be normal for them to be charged for at OMV since, if less than OMV were charged, the counterparty would be receiving a gratuitous benefit. There may be exceptions to this rule. For example, a person urgently in need of money may decide, in an arm's length transaction, to sell property for less than OMV if he or she is more interested in getting money quickly than in getting the highest possible price for the property. However, I consider that such a situation is exceptional and that, in most cases, if goods or services are supplied on "arm's length" terms, they will be charged for at OMV.

52. I can see no reason why, in the circumstances of this appeal, the "arm's length" price for goods and services that TRL supplies TFL would be anything other than the OMV of those supplies. I have said at [50] that I consider that the various Grant Thornton reports do seek to identify an arm's length price for particular transactions rather than an overall assessment of profitability. It follows that I do not accept Mr Singh's submissions as to the relevance of the Grant Thornton reports as I consider that they are relevant to the question of whether particular supplies are made for consideration equal to OMV.

(b) The challenge as to "independence"

53. Grant Thorton's first transfer pricing report was prepared in February 2009, before HMRC made any direction under Schedule 6 of VATA 1994. The first paragraph of that report makes it clear that it was prepared to assist TRL and TFL "in implementing pricing policies that comply with the principle of arm's length pricing". Therefore, when preparing this report, Grant Thornton owed duties only to TRL and TFL, there was no question of any duties being owed to the Tribunal (as would be the case if the Tribunal had directed that Grant Thornton prepare an expert report in compliance with Part 35 of the Civil Procedure Rules ("CPR")).

54. Ms Shaw submitted that Grant Thornton's situation was no different from that where accountants employed by HMRC give expert evidence in the course of a tax appeal. I do not agree. If HMRC accountants provide expert reports that comply with Part 35 of CPR, it will be clear that their primary duty is owed to the Tribunal, rather than to HMRC. By contrast, when Grant Thornton were preparing their first transfer pricing report, they owed no duty to anyone other than PerfectHome Holdings Ltd, the company that was instructing them.

55. However, Grant Thornton are one of the largest accounting firms in the world and as such I am satisfied that they are both reputable and competent. Therefore, while I will give less weight to Grant Thornton's first transfer pricing report than I would to an independent expert opinion, I still regard it as appropriate to give that report weight as I consider that a firm of Grant Thornton's size and reputation can usually be relied upon to give dispassionate and objective advice to their clients.

56. I believe that a similar conclusion applies to Grant Thornton's second transfer pricing report. That was prepared after HMRC made their direction under Schedule 6 of VATA 1994 but only by a matter of a few days and I therefore consider that it would similarly be dispassionate and objective.

57. Grant Thornton's third transfer pricing report was prepared for the purposes of an attempt by PerfectHome and HMRC to settle their dispute by way of ADR. Paragraph 1.7 of that report states as follows:

> This report is neither intended to be transfer pricing documentation nor a technical VAT analysis. This report has been prepared to assist the Parties [defined as including the PerfectHome group and HMRC] in their ADR discussions.

From that I have inferred that the third transfer pricing report was to be shared with HMRC and used as a reference point in discussions aimed at settling the dispute. In those circumstances, I consider it less likely that the third transfer pricing report was dispassionate and objective. Rather, I consider that its purpose was more likely to be to put forward PerfectHome's arguments, almost like a piece of written advocacy, in ADR discussions. I make no criticism of Grant Thornton in making this observation: it is quite proper that professional advisers should act in the interests of their clients. However, I do consider that this aspect means that I can attach relatively little weight to the statements of opinion in Grant Thornton's third report. However, I attach weight to the arithmetic calculations that they perform in it.

Findings of primary fact relating to the PerfectHome business that are relevant to the Schedule 6 issue

58. I have made the findings of primary fact set out at [59] to [141] below in relation to the Schedule 6 issue. In the section headed "Schedule 6 dispute - Discussion", I will apply those primary facts to make inferences of fact as to the factual issue in dispute that revolves around the determination of the OMV of particular supplies. In most cases, the facts set out below were in dispute and, to explain the nature of that dispute, and the reasons for reaching my conclusion, in many cases I refer to the parties' submissions. In the interests of brevity, I have not set out all of the parties' submissions on the particular issues but have simply sought to summarise them in sufficient detail to explain the nature of the dispute and the reasons for reaching my conclusion.

The nature of the supplies in question

59. HMRC's direction under Schedule 6 of VATA 1994 was expressed to apply to:

> [the] supply of services to Temple Finance Ltd relating to:
>
> - shop advertising and launch costs in respect of PerfectHome stores and
> - relating to the occupation and use of the PerfectHome shops

It is, therefore, necessary to understand exactly what these services are before it is possible to determine the OMV of them.

60. Pursuant to the IGSA, TRL grants TFL a licence to occupy TRL's showrooms in return for an annual fee of £20,000 plus 5% of "Relevant Income". In addition TRL agrees to provide TFL with "marketing/advertising/launch support" as agreed from

time to time for a consideration equal to the "share of the costs as agreed by the Parties from time to time". Therefore, the IGSA does not explain in any great detail what precise services TRL is providing to TFL.

61. The "licence to occupy" the stores that TRL granted under the IGSA was, I consider, the relevant service relating to the "occupation" of the stores embraced by the Schedule 6 direction. That leaves open the question of what services are embraced by the "use" of PerfectHome shops referred to in that direction. I consider that question can be answered by reference to evidence that Mr Smith gave, which was not challenged in cross-examination, as to both the sales process, and the after sales process in PerfectHome stores.

62. As regards the sales process, Mr Smith said (in summary):

> (1) When a customer enters a showroom he or she is first approached by a member of staff, acting on behalf of TRL, to discuss the product the customer is interested in.
>
> (2) If the customer does wish to buy a particular product, he or she is asked if the purchase is to be on HP terms.
>
> (3) If the customer wishes to acquire a product on HP terms, a member of staff, acting on behalf of TFL, gathers information using a laptop while sitting at the tables and chairs that are on display in the showroom.
>
> (4) This conversation often results in the customer agreeing to purchase TAD and/or Coverplus from TFL.
>
> (5) Having finalised in principle the products, including TAD and Coverplus, that the customer is going to buy, the customer is referred to a manager or assistant manager to double check that the customer has been through all relevant points and the relevant agreement is then concluded at the till area of the shop.
>
> (6) From 1 April 2011 QR goods are displayed in TRL's stores and sold on TFL's behalf in the same way as other goods.

63. In relation to the after-sales process, Mr Smith said, in unchallenged evidence that:

> (1) Some customers visit stores to make weekly HP payments in cash to staff operating the till.
>
> (2) Increasingly, more customers prefer to make HP and FSLA payments to TFL by debit card over the phone, in which case staff at the store will process that payment.
>
> (3) Late payments due to TFL are chased and arrangements with customers in arrears are entered into by customer relationship managers who work in secure and private office space at the rear of the store. A typical store will involve two full-time members of staff undertaking this activity.

64. I consider that, in permitting, or enabling the stores to be used for the purposes set out at [62] and [63], TRL is providing a service "relating to the use" of its stores to TFL which are within the scope of the direction under Schedule 6. In addition, I consider that TRL provides a service "relating to the use" of its stores consisting of organising those stores in a manner that is conducive to TFL being able to enter into HP agreements with customers. For example, if TRL did not carry on a retail business at those stores, focused its retail business on customers who did not need HP, or failed to display goods at the stores in a manner that emphasised the particular kind of HP arrangement involving weekly payments, the value of TFL's access to TRL's stores would be diminished. Therefore, I consider that the Store Services that are within the scope of Schedule 6 are all of these services, combined with the grant of the formal licence to occupy set out in the IGSA.

65. The nature of Advertising Services that are within the scope of the Schedule 6 direction is more straightforward. TRL commissions advertising and marketing materials from third party suppliers. The nature of the service that it provides to TFL consists of procuring that these materials adequately promote TFL's business as well as that of TRL.

Economic aspects of the PerfectHome business

66. The price that TRL pays wholesalers to acquire goods is around 60% of the price that customers of TFL or TRL (in the 2% of cases where customers pay cash and so transact with TRL rather than TFL) pay for those goods. PerfectHome therefore makes a 40% margin on sales of goods to customers. Since TRL sells goods to TFL for 97% of their advertised price, it makes a 37% margin when it sells goods to TFL.

67. The vast majority of the PerfectHome group's profit comes from its business of making taxable supplies (essentially the business of selling goods and Coverplus) as compared with its business of making exempt supplies (the "finance element" of HP agreements and the sale of TAD). For reasons of commercial confidentiality, I will not give precise figures but between 2010 and 2014, over 75% of the group's commercial profit came from its business of making taxable supplies, although the proportion was lower, but still over 70%, in 2015. I did not have evidence going back to 2009 (in which the first VAT period at issue in this accounting period fell), but I find that the situation in this year would be similar.

68. Mr Smith said in his evidence that he regarded retail groups such as DFS, Currys and Littlewoods as being "competitors" of PerfectHome. Mr Singh challenged that in cross-examination, putting to Mr Smith that his own evidence, together with the APPG Report, made it clear that PerfectHome's business targeted credit-constrained customers specifically and as therefore offering a product focusing on the ability to acquire goods on HP terms by making weekly cash payments. Mr Singh also produced evidence that he submitted demonstrated that the cash price of PerfectHome's products tended to be higher than that of other high street stores. That caused Ms Shaw to produce evidence of products whose price she submitted compared favourably with the price of similar products on sale in high street stores.

69. I have concluded that PerfectHome is a specialist business, that focuses on a particular sector of the market. Mr Smith himself said in his witness statement:

> PerfectHome was commenced because we believed that there was sufficient market capacity for us to compete with Brighthouse. The target market of both companies is the sector of credit constrained people who are unable to acquire goods using loans or credit cards because they have insufficiently high credit scores.

70. Mr Smith accepted in cross-examination that the cash prices of products in PerfectHome stores were "generally" higher than those in high street stores such as Currys. I therefore agree with Mr Singh that PerfectHome is not to any significant extent in competition with high street shops such as Currys, DFS or Littlewoods but rather that its competitors are other businesses that are similarly focused on credit-constrained customers such as Brighthouse.

The nature of TRL's and TFL's respective businesses. Whether they amount to separate businesses or one single business.

71. Mr Singh submitted that TRL and TFL carried on a single business. In support of this submission, Mr Singh noted that both companies operated under "PerfectHome" branding and that the name "PerfectHome" appears on shops, advertisement and the business's website. He also referred to the fact that the boards of directors of TFL and TRL are the same and that Mr Smith accepted in cross-examination that those directors would make all their decisions in the interests of the PerfectHome business as a whole.

72. I have concluded that TRL and TFL carried on separate businesses although, as Mr Smith noted in cross-examination, those businesses were commercially intertwined and operated in tandem. I have reached this conclusion firstly because TRL and TFL are separate companies. There was no evidence before me that, for example, they were conducting the PerfectHome business in partnership. I did not consider that there was any agreement for TRL and TFL to share their respective profits with each other, although the effect of the IGSA was that they did provide some services to each other and did share costs between themselves. Secondly, it is not at all uncommon for separate companies within a group to carry on different businesses, but use the same branding for all of those separate businesses. Nor did I consider that Mr Smith's admission that directors of TFL and TRL made decisions in the interests of the PerfectHome business as a whole affected the issue. He was clear in his evidence that the respective companies' directors were aware of their fiduciary duties to each company of which they were a director. Provided that they comply with the fiduciary duties that they owe to each company separately (and Mr Singh did not suggest they did not) there is nothing wrong in taking decisions in the interests of the group's business as a whole. Finally, Mr Smith was repeatedly pressed on the assertion that there was a single business in cross-examination and was absolutely firm in his conclusion that there were two businesses. Mr Smith is finance director of the PerfectHome group and can be expected to know the group's affairs in detail. His evidence on this point, therefore, carries significant weight.

73. I considered that the activities of TRL can be described as follows:

(1) acting as tenant under leases of the showrooms granted by third party landlords;

(2) administering the showrooms by determining, for example, their layout lighting and design;

(3) determining the type and range of stock and organising the sourcing of that stock from wholesalers, determining the price at which goods are to be advertised for sale to the public;

(4) organising the distribution of stock to showrooms, delivering goods sold to PerfectHome's customers and collecting goods from customers for servicing or on termination of an HP agreement;

(5) (prior to April 2011) selling QR goods having first purchased from TFL goods that TFL had repossessed from customers;

(6) (after April 2011) refurbishing goods that TFL had repossessed from customers to enable TFL to sell those goods itself as QR goods;

(7) dealing with the servicing and repair of goods;

(8) initiating and managing advertising of new store openings and of the goods that PerfectHome has available for sale and the HP terms available;

(9) selling goods direct to PerfectHome customers in the 2% of situations when those customers purchase for cash;

(10) Selling goods to TFL (at a price equal to 97% of the advertised retail price) in the 98% of situations where PerfectHome's customer purchases those goods under HP terms.

(11) Following April 2011, acting as joint employer of PerfectHome staff with TFL.

74. I considered that TFL's activities can be described as follows:

(1) purchasing, from TRL, for 97% of the advertised price, goods that TFL sells to customers on HP terms;

(2) selling goods to customers of the PerfectHome business on HP terms and entering into ancillary agreements such as the sale of TAD, Coverplus and FSLAs. (TFL does not, however, offer finance that a customer could use to purchase goods from anyone other than TFL so a customer could not, for example, take out finance from TFL and use that finance to purchase goods from Currys);

(3) securing, processing and enforcing payment under HP agreements both as regards the "capital" element (being the purchase price payable for the goods sold) and the "interest" element (being the finance charge payable);

(4) recovering goods from customers where there has been a default under an HP agreement;

(5) (prior to April 2011) selling goods that TFL recovered from customers to TRL for TRL to sell as QR stock;

(6) (with effect from April 2011) selling QR stock itself;

(7) dealing with complaints in relation to goods sold and meeting claims under TAD and Coverplus warranties;

(8) until April 2011, acting as employer of PerfectHome staff (and charging TRL a share of staff costs);

(9) from April 2011, acting as joint employer of PerfectHome staff with TRL.

75. Mr Smith said in his evidence that some 40% to 50% of customers who purchase goods from TFL under an HP agreement terminate that agreement before its scheduled maturity. Some of these early terminations arise because the customer defaults, others because the customer, having purchased Coverplus or having paid more than 50% of the amounts due under the agreement, exercises a statutory or contractual right to terminate early. Mr Singh therefore submitted that TFL's business should be characterised, as involving not the "sale" of goods on HP terms, but rather the "provision of goods". I do not think it matters precisely how TFL's supply of the goods is characterised since it was common ground between the parties that, for VAT purposes, TFL was making a taxable supply of the goods that took place immediately on signature of the HP agreement (even though the purchase price due would be payable in instalments over a period). It was also common ground that a PerfectHome customer would only become the legal owner of the goods once the final instalment due under the HP agreement had been paid. However, for completeness, I record my conclusion that TFL does indeed "sell" goods on HP terms; it does not merely rent them.

76. While I have concluded that they are separate, TFL's and TRL's businesses are highly symbiotic. In 98% of cases, a PerfectHome customer visiting a PerfectHome store will purchase goods on HP. Therefore, apart from in 2% of situations (when TRL will sell an item for cash to a customer and make a 40% margin), either both TFL and TRL will make a sale, or neither of them will. If both of them make a sale, TRL will make a 37% margin on sale of the goods to TFL. TFL will make most, if not all, of its profit from the finance element of the HP sale. It may also make a 3% margin on sale of the goods to the customer but this margin is completely eroded where the goods need to be delivered to the customer since TFL has to pay 5% of the sale price of the goods to TRL as a delivery charge.

Usage of the stores

77. I was shown a floor plan of what the parties were agreed was a "typical" PerfectHome store. From that, together with Mr Smith's evidence, I concluded that the overwhelming amount of the floor space in any store would be occupied by the display of goods for sale. I also concluded that there was no particular area of any particular store that would be reserved exclusively for TFL's use. TFL can use any part of any store for its business. In practice TFL tends to use different parts of a store

for different purposes as noted at [62] and [63] above. I also accepted Mr Smith's evidence that in some respects, TFL's use of the showrooms was a matter of convenience only, rather than something that was critical to TFL's business. For example, conceptually there is no reason why TFL could not manage customer payments from a separate central location rather than from individual stores and indeed TFL does this in relation to goods that are sold over the internet.

78. In cross-examination, Mr Singh pressed Mr Smith with the proposition that TFL was the primary or main user of the stores since 98% of customers would need HP in order to make a purchase which would result in those customers both buying the goods, and obtaining the HP, from TFL. He also suggested to Mr Smith that the "primary offering" that the PerfectHome business made to its customers was the credit offering with its focus on low weekly payments.

79. Mr Smith rejected these assertions. His evidence was that the ultimate aim of customers visiting a PerfectHome store was to buy a household item. If the goods that PerfectHome stocked were not attractive to customers, they would not make any purchases, no matter how attractive the finance package being offered. Put another way, he said that customers do not visit PerfectHome stores and ask what finance package they can obtain and then decide what items to buy with that finance package. On the contrary, their focus is on the goods and the finance package is the method by which they pay for the goods.

80. I accepted Mr Smith's evidence as I considered that, as finance director of the group, he was in a good position to speak of his customers' motivations and of the use made of the stores. His evidence was also consistent with common sense and was also consistent with the fact that TFL offers finance only for the purpose of acquiring PerfectHome products as noted at [74(2)] above. Moreover, in the 98% of cases in which a PerfectHome customer buys goods on HP, both TFL and TRL make a sale of goods displayed at the stores (with TRL selling to TFL and TFL selling to the customer). Accordingly, I have concluded that TFL was not the "primary" user of the stores.

The reasons for the "two company structure"

81. Mr Smith in his evidence said that the "two company structure" was adopted in order to maximise the opportunities for an eventual sale of the business as his experience was that, by having two recognisable entities, one of which was a retailer and one a finance company, the business as a whole was easier for prospective purchasers to understand and to value. He also said that, on any sale of the business, it could be marketed as either one or two separate businesses which increased flexibility. He explained his understanding that DFS and Brighthouse, who he regarded as competitors of PerfectHome also operated a "two company" structure.

82. Mr Singh challenged this evidence. He put it to Mr Smith that the current owners of the PerfectHome group, Cabot Square Capital Partners ("Cabot"), had purchased the group when it operated a "single company" structure and that, if Cabot could understand that structure and value it, there was no reason to suppose that other

potential purchasers could not. He invited Mr Smith to accept that the two companies were so commercially intertwined as to make it impossible for one to be sold without the other.

83. In the course of his submissions on "artificiality" and "contrivance", Mr Singh suggested that the reason for the "two company" structure was to reduce the amount of irrecoverable VAT by securing that supplies between TRL and TFL were at less than OMV. He pointed out that the structure adopted results in staff at showrooms switching roles multiple times during a single transaction, performing a "TRL function" when describing a product, but switching to a "TFL function" as soon as they discuss affordability or HP. He noted that the structure adopted requires TRL and TFL having to file two VAT returns and two sets of audited accounts and to put in place a system in which costs and expenses are recharged.

84. Mr Singh made the specific submission that, by having a "two company" structure, PerfectHome introduced a significant irrecoverable VAT cost associated with premises insurance and business rates. If a single company incurred these costs, it would not incur any VAT cost since supplies of insurance are exempt for VAT purposes and business rates are outside the scope of VAT. However, the "two company" structure necessitated these costs being recharged to TFL in the form of a taxable supply of intra-group services. That meant that TFL incurred input VAT, not all of which was recoverable, which Mr Singh submitted resulted in an additional cost to the group amounting to several hundred thousand pounds a year. He submitted that the group would only have tolerated this inefficiency if the "two company structure" was designed to ensure that greater VAT savings were made by ensuring that TRL undercharged TFL for Store Services and Advertising Services.

85. Finally, Mr Singh submitted that the fact that Mr Barry's involvement in advising on the structure was significant as, if no VAT advantage was sought, there would be no need for the Group Tax Manager to advise on it.

86. Having considered all the evidence, I was satisfied that the "two company" structure had not been set up with a view to securing VAT advantages whether by ensuring that supplies were made at an undervalue or otherwise. I accepted Mr Smith's evidence as to the commercial benefits of the "two company" structure. Even if Cabot had been able to appreciate the full potential of the business when it was operated by a single company, I did not consider that it followed that every potential purchaser or investor would be able to do so. Mr Smith is the finance director of PerfectHome and clearly has significant experience of the "rent to own" sector as a whole and I considered his clear evidence, from which he did not depart in cross-examination, as to how purchasers and investors might evaluate companies in the sector carried particular weight. Having reached that conclusion, I considered that most of the submissions that Mr Singh made about the complexity and cost of the "two company" structure fell away. At most those submissions demonstrated that the commercial decision to structure the PerfectHome group in two companies came at a cost both in terms of additional irrecoverable input tax, increased compliance costs and more complexity. However, that does not of itself make the decision uncommercial; on the contrary, I was satisfied from Mr Smith's evidence that the

respective companies considered the additional costs worth paying given the commercial benefits of the "two company structure". The presence of additional cost did not satisfy me that the "two company structure" had been designed to reduce irrecoverable VAT.

87. Nor was I satisfied that the irrecoverable VAT cost associated with the recharge of insurance and business rates was of the order of magnitude that Mr Singh suggested in his submissions since his calculation failed to take into account the fact that TFL would be entitled to some input tax recovery on those costs. The amount of input tax on overheads that TFL is entitled to recover is the subject of the dispute dealt with in Part II of this decision. However, at the time it set up the "two company" structure, the "standard method" could realistically be expected to result in TFL recovering in excess of 60% of its input VAT on overheads. Therefore, I considered that any additional irrecoverable input VAT that arose as a consequence of insurance and business rates being "recharged" by means of a taxable supply was considerably lower than the amount that Mr Singh put forward.

88. There is one final point I should make in relation to the evidence on this issue. When cross-examining Mr Barry, Mr Singh asked whether Mr Barry had ever disclosed a VAT avoidance scheme to HMRC to which Mr Barry replied "I don't believe I have". The day after Mr Barry finished giving his evidence, Mr Singh told the Tribunal (while Mr Barry was not in the room) that HMRC had evidence that suggested that Mr Barry had disclosed such a scheme but that HMRC's duties of taxpayer confidentiality prevented them for making that evidence available to the Tribunal. He asked that Mr Barry be recalled so that the question could be put to him again. I refused to recall Mr Barry since firstly I did not see how the question of whether he had disclosed a VAT avoidance scheme in the past had any direct bearing on whether the consideration that TRL receives for particular supplies is less than the OMV of those supplies or not. In any event, given that HMRC were not proposing to share the evidence that they said they had, I did not consider that anything would be achieved by recalling Mr Barry particularly if he simply repeated the evidence he had given the day before. At no point have I seen any evidence that suggests that Mr Barry gave an incorrect or untruthful answer to Mr Singh's question in cross-examination. It follows that I have accepted Mr Barry's evidence that he has not previously disclosed a VAT avoidance scheme.

Whether TRL charges TFL more than OMV for any goods or services

89. Schedule 6 of VATA 1994 applies only in relation to goods or services provided for a consideration that is <u>less</u> than their OMV. However, Mr Singh suggested that TRL charges more than OMV for certain goods or services and that this, in turn, suggests that TRL "compensates" for this element of overcharging by undercharging for Advertising Services and Store Services.

90. Mr Singh suggested that the first relevant "overcharge" was the price that TRL receives for goods that it sells, equal to 97% of the advertised retail price. He said that this was an overcharge since TRL should be compared to an independent wholesaler selling goods in bulk to TFL. It was not disputed that a wholesaler would charge

much less than 97% of the retail price for goods that it sold, but there was little evidence before us as to precisely what prices wholesalers of goods would charge, although I have inferred that it would be around 60% of the retail price given the findings at [66].

91. If TRL could be characterised as a "wholesaler", that would be relevant to the OMV of the goods that it provides given that the provisions of Article 72 of the Principal VAT Directive referred to at [36] above require an examination of the "marketing stage" of TRL and TFL . However, I was not satisfied that TRL is a wholesaler. That is because, from the description of TRL's business at [73], I concluded that TRL incurs the expense of maintaining a large number of retail showrooms whose purpose is to display the goods to the general public. A wholesaler, by contrast, would store stock in much larger warehouse facilities and would locate those warehouses in areas where rents are lower than those payable for high street locations. TRL also does not sell large quantities of goods in a single transaction. While it does sell large quantities of goods to TFL in aggregate, it only sells a particular item to TFL if TFL is about to sell that item to an individual customer. That is not a wholesale business since the essence of a wholesale business is that it involves the sale of large quantities of stock in single transactions with the result that the wholesaler is not exposed to the risk of carrying large quantities of unsold stock. TRL, by contrast, does have that risk since if individual visitors to PerfectHome's showrooms decide not to buy goods, TRL's sales will be reduced and it will have unsold stock on its hands. I was not, therefore, satisfied that TRL should be characterised as a wholesaler.

92. In addition, the decision of the Court of Appeal in *Volkswagen Financial Services Ltd v HMRC* [2015] EWCA Civ 832, referred to below in the context of TFL's appeal on the partial exemption issue, demonstrates that, in that appeal at least, the company providing the HP bought the goods in question from the car retailer for a price equal to 100% of the retail price. There was no evidence before me that suggested that it is normal for a finance provider, transacting on arm's length terms, to purchase goods at a significant discount to the retail price.

93. For reasons set out at [90] to [92], I concluded that TRL was not overcharging for goods that it sells to TFL.

94. Mr Singh also made a specific point about repair costs. As noted at [22], TRL charges TFL for repair services that it provides. Mr Singh submitted that a comparison of the input VAT that TRL incurred in connection with those repair services (for example on the purchase of parts needed to effect the repairs) with the output tax attributable to its supply of repair services to TFL demonstrated that TRL makes a 1075% mark-up on its repair services. He submitted that this was a clear indication that TRL overcharged for repair services.

95. Both Mr Barry and Mr Smith gave evidence that Mr Singh's comparison was a false one as it ignored the most significant cost associated with TRL's provision of repair services, namely the labour of PerfectHome staff who undertake the repairs. That labour will not result in TRL incurring input VAT and was therefore excluded

from Mr Singh's calculation. Taking into account the cost of providing that labour, both Mr Barry and Mr Smith said that TRL's mark-up on repairs would be much lower than 1075%. I have accepted that evidence and am, accordingly, in the absence of any more specific challenge to the price that TRL charges for repair services, I am not satisfied that it charges more than OMV for these services.

96. Finally, Mr Singh pointed to the undisputed fact that TRL charges TFL 5% of the sale price of a particular item to deliver it to the customer but that that TFL does not itself charge customers for delivery. He pointed out that the 5% delivery charge that TFL has to pay TRL is greater than the 3% margin that TFL makes on the goods as a consequence of buying them from TRL for only 97% of their retail price. Mr Singh suggested that this arrangement was uneconomic and indicated that TRL was overcharging for delivery services.

97. I do not accept Mr Singh's submissions in relation to the delivery charge. The mere fact that TFL chooses not to charge its customers a separate delivery fee does not itself demonstrate that TRL is charging it too much for deliveries. Nor does it follow that, because the delivery charge is higher than TFL's margin on its goods, TFL is overpaying for delivery services. TFL makes its commercial profit from its activities as a whole. The fact that one aspect of its activities does not, viewed in isolation, produce a profit does not mean that TFL is party to an uncommercial arrangement.

98. For all of the reasons set out at [90] to [97] above, I did not consider that TRL was overcharging for any goods or services so as to result in an inference that the Store Fees or Advertising Fees were set at below OMV to compensate.

PerfectHome's advertising material

99. I was shown examples of PerfectHome's advertising material in the form of flyers used to advertise a new store opening and showing goods for sale at a particular store. I was also shown a print out of pages from PerfectHome's website.

100. The flyers that I saw were largely taken up with pictures of the goods that were for sale. The flyers contained frequent and prominent references to "No Credit Checks, No Deposit, Weekly Cash Payments, Direct Debit Option, FREE Delivery, Never Beaten on Price". In addition, prominently displayed on a number of pages of the flyers was the phrase "BUY NOW – PAY WEEKLY . With the lowest weekly payments GUARANTEED, why shop anywhere else!"

101. Beside each item for sale a "cash price" would be shown. There would typically then be a box, in a smaller type, towards the bottom of each page that set out for each item shown on the page the cash price and the weekly amount that would be payable under an HP agreement depending on whether the item was purchased with, or without, Coverplus.

102. The print out from the website followed a broadly similar format. The phrases set out at [100] were used and pictures of goods were shown. The price shown next to the

picture of a particular item was a weekly price in the form "from only £3.99 per week". Unlike the printed adverts, a reader did not need to read a separate table to understand how a cash price would be translated into weekly payments.

103. The last page of one of the paper advertising flyers referred (in very small print) specifically to "Temple Finance Limited trading as PerfectHome" and gave an address together with TFL's company number. There was no similar reference to TRL. I could not see any similar reference on the print-outs of the website that I was shown although of course it is perfectly possible that a similar reference would have been found if the reader clicked on a particular link on that website. Ms Shaw submitted that the specific reference to TFL was necessary to comply with the Consumer Credit (Advertisements) Regulations which require any person causing a "credit advertisement" to be published to specify the name of the "advertiser". Mr Singh submitted that the reference to only TFL in the advertising material was nevertheless revealing as it suggested that TFL was the "advertiser" and that, accordingly, the advertisements were issued for its benefit.

104.I accepted Ms Shaw's submission. The very small print in which TFL's details appeared suggested that the details were included for compliance purposes. I did not consider that the inclusion of only TFL's details itself demonstrated that the advertisements were issued only for TFL's benefit. On the contrary, since the advertisements referred both to the goods and the availability of HP, I concluded that they were designed to induce customers to visit PerfectHome stores, or its website, and purchase goods financed, if the customer wished, by an HP agreement from TFL. I did not consider that, viewed objectively, the advertisements promoted only TFL's business since, even though in the 98% of cases in which a customer takes out an HP agreement, that customer would purchase goods from TFL, TRL would also benefit from such a sale since it would sell the goods in question to TFL at a 37% margin.

105.I therefore concluded that the PerfectHome advertising material that I was shown was designed to benefit, and did benefit, both TRL's business and TFL's business.

The Schedule 6 dispute - Grant Thornton's first transfer pricing report

106. In order to "benchmark" the price that should be charged for intra-group services made under the IGSA, a number of items of professional advice were commissioned. In February 2009, Grant Thornton UK LLP ("Grant Thornton") prepared a transfer pricing report (the "First Grant Thornton Report") that considered the transfer pricing analysis of what the report described as "store concessions" provided by TRL to TFL and of "sharing costs of marketing/advertising".

107.In that report, Grant Thornton performed a "functional analysis" of the PerfectHome business (which summarised the structure, and function, of various parts of the business and the employees available to it and also considered the risks to which that business was subject and how those risks were divided between TRL and TFL).

108.Having performed that "functional analysis", Grant Thornton summarised five transfer pricing methodologies that could be applied to identify the arm's length nature of transactions. The following three methodologies that Grant Thornton identified are relevant to this appeal:

(1) The "Comparable Uncontrolled Price" method which Grant Thornton stated:

> "compares the price charged for property transferred in a controlled transaction[2] with the price charged for property transferred in an uncontrolled transaction[3] under comparable circumstances."

(2) The "Cost Plus Method" which Grant Thornton noted is

> "most useful when semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy-and-supply arrangements or where the controlled transaction is provision of services"

(3) The "Transactional Net Margin Method" which Grant Thornton noted:

> "compares the net margins of the tested party and potentially comparable companies. The TNMM, as a profit based method, does not focus on the transaction but rather considers the net margins earned by the company to identify whether they fall within the arm's length range of operating margins earned by comparable companies."

109.Grant Thornton considered that "traditional transaction methods" (being methods which compare the prices charged in controlled transactions to those charged between independent entities "are the most direct way to establish whether the conditions made or imposed between parties are at arm's length". They set out their view that the "cost plus method" and the "comparable uncontrolled price" method were both examples of such traditional transaction methods.

110.Grant Thornton's report then went on to consider the economic analysis of the particular transactions they were asked to consider.

The analysis of Store Fees in the First Grant Thornton Report

111.Grant Thornton stated that their intention was to apply the "comparable uncontrolled price" method in order to identify third-party comparable transactions for what they described as the "concession charge proposed to be paid by Finance to Retail". They were not recommending an approach based on sharing the <u>costs</u> of the stores (for example rent payable to external landlords and general maintenance costs). However, they noted that there were no standard benchmarks for store concession fees in the retail industry since they vary depending on the strength of the store brand, the strength of the concession brand, the period of the concession and a number of other factors. They also set out their view that:

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[2] A term used in OECD transfer pricing guidelines which refers to a transaction between associated enterprises

[3] i.e. transactions made otherwise than between associated enterprises

> The arrangement between [TRL] and [TFL] is unique and is relatively difficult to benchmark, especially as there can be so much subjectivity in such arrangements. Further, it is very difficult to find details about the concession agreements between third parties due the confidential nature of these arrangements.

112. Despite these difficulties, Grant Thornton stated that, in their experience, the range of concession charges for normal concessions is approximately 10% to 25% of the concession's turnover and listed factors that would point to a fee at the higher end, and lower end, of the range respectively.

113. They then noted that:

> One of the most unique features of the concession arrangement under examination is that Finance sources all of its goods from Retail. Finance purchases these goods at 97% of the final selling price; the 3% being a typical volume discount. Retail benefits from the store concession in an additional unusual way in that, whenever Finance makes a sale, Retail also does in turn, to Finance. This extra benefit of having Finance as a store concession must therefore be taken into account when looking at the proportion of Finance's turnover that Retail receives as a concession charge.

114. The essence of their conclusion on the arm's length price for the Store Services can be described was as follows:

> Based on our experience, we would expect a store to receive approximately 10% to 25% of the concession's total turnover. Therefore, if the combination of Retail being remunerated £20,000 per shop plus 5% of Finance's non product sales revenue, together with the extra income it generates as a result of making sales to Finance, results in Retail receiving approximately 10% to 25% of Finance's total revenue, then the charge made should then be deemed to be consistent with the principles of arm's length pricing.

115. Grant Thornton produced the following table that calculated TRL's concession income as a percentage of TFL's turnover:

	Year end 31/3/09 £000	Year end 31/3/10 £000	Year end 31/3/11 £000	Year end 31/3/12 £000	Year end 31/3/13 £000
TFL's total revenue	27,235	32,197	39,465	49,859	60,123
Arm's length charge (based on 10% to 25% of TFL's total revenue)	2,724 to 6,809	3,220 to 8,049	3,947 to 9,866	4,986 to 12,465	6,012 to 15,031
Effective income received by TRL in relation to the concession charge	7,315	6,969	8,134	10,540	12,451

Effective concession income as a percentage of TFL's total revenue	26.86%	21.64%	20.61%	21.14%	20.71%

116. Grant Thornton calculated the income figures in row 3 of the above table by adding the (i) the actual fee that TFL paid TRL under the Intra Group Services Agreement (£20,000 per store plus 5% of non-product sales revenue) and (ii) the profit that TRL was assumed to make from sales to TFL on the basis that it bought goods from wholesalers at 60% of the final selling price and sold to TFL for 97% of that final selling price. Grant Thornton have, therefore, included the income that TRL realise from sales to TFL in the figure calculated in row 3 of the table. If that income were not included, the figures calculated in row 3 would be significantly reduced. It should be noted that the figures set out in this table must have been based on projections as to TFL's future revenue (rather than figures as to actual revenue) since the calculations relate to periods falling after the date of the report.

117. Grant Thornton's conclusion set out at [114] needs to be understood together with the table at [115]. Grant Thornton were not concluding that the actual fee payable pursuant to the IGSA (£20,000 plus 5% of non-product sales revenue) was calculated using an arm's length methodology. Rather, Grant Thornton's conclusion was that based on projections as to future revenue, the combination of the fee payable under the IGSA and TRL's 37% margin on goods that it sells to TFL, would lead to TRL receiving a percentage of TFL's total revenue that falls within the 10% to 25% range, and that overall, based on these projections, TRL would be receiving an arm's length return in relation to the stores.

The analysis of Advertising Fees in the First Grant Thornton Report

118. The First Grant Thornton Report contained a much less detailed analysis of Advertising Fees. Their conclusion was simply:

> Based on our experience, marketing and advertising costs should be based on an analysis of the cost/income drivers of the activities. To be compliant with the principles of arm's length pricing, an appropriate allocation key should be established that follows sound business principles.

119. Therefore, although Grant Thornton did not say so explicitly, I do not consider that they were recommending a "comparable uncontrolled price" methodology to determine the arm's length price for Advertising Fees. Rather, they were considering a "Cost Plus Method" of the kind summarised at [108].

120. In a table that set out their summary conclusions on the various costs they were considering, Grant Thornton concluded that splitting the total advertising cost incurred "based on usage/benefit derived is an appropriate policy".

The Schedule 6 dispute - Grant Thornton's second transfer pricing report

121. On 21 June 2012 Grant Thornton updated the analysis that they had performed in the First Grant Thornton Report on the "benchmarking" of Store Fees. This report (the

"Second Grant Thornton Report") did not address the benchmarking of Advertising Fees. The conclusions expressed in the Second Grant Thornton Report in relation to Store Fees were similar to those expressed in the First Grant Thornton report, except that Grant Thornton considered that the range of concession charges for retail concessions was in the range of 15% to 35% of the concession's turnover (a change from the 10% to 25% range that they referred to in their earlier report). In part that conclusion was based on what Grant Thornton described as "confidential fee information relating to high end concessions in department stores".

122. They also prepared a calculation that showed that the combination of TRL's profit on the sale of goods to TFL and the Store Fees that it received from TFL gave it an amount that fell within the range of 15% to 35% of TFL's total revenue. Therefore, as in the table set out at [115], Grant Thornton included revenue that TRL realised from sales to TFL in considering the proportion of TFL's total revenue that it obtained out of the arrangement. Grant Thornton considered that the return that TRL could expect to receive would be at the higher end of the 15% to 35% range if the store:

> …provides staff, manages the till and customer invoicing or if the store brand is very strong.

123. Grant Thornton prepared a calculation of TRL's "effective concession income as a % of [TFL's] total revenue" similar to those outlined in the table at [115] indicating a figure of 26.88% for the year ended 31 March 2011, 20.39% for the year ended 31 March 2012 and 20.33% for the year ended 31 March 2013[4]. Those calculations were expressed to be based on a budget with which Grant Thornton had been provided and, accordingly, were subject to change.

124. As noted above, the Second Grant Thornton Report was prepared on 21 June 2012 which was just a few days after HMRC had made their direction under Schedule 6 of VATA 1994 and before HMRC made the assessments on TRL that are the subject of this appeal.

The Schedule 6 dispute - Grant Thornton's third transfer pricing report

125. In 2013, TRL, TFL and HMRC pursued alternative dispute resolution ("ADR") in an attempt to resolve their dispute as to the treatment of Store Services and Advertising Services. In October 2013 (after the date on which HMRC made their assessment of 4 June 2013 on TRL), Grant Thornton prepared a further report (the "Third Grant Thornton Report"). That report stated that:

> The purpose of this report is to assess the reasonableness of the Group's assessment of the "open market value" of the inter-company transactions under review. This report also compares the Group's transaction values with those suggested by HMRC.

[4] I have not included figures for other years as they fall outside the periods at issue in this appeal.

Analysis of Advertising Fees

126. The previous Grant Thornton reports had not dealt with Advertising Fees in any detail. However, the Third Grant Thornton Report did. Grant Thornton concluded that, since the Advertising Fees were payment for the provision of a service, it was reasonable for the "cost plus" method to be applied and went on to consider "how independent parties may have shared the costs between them".

127. At paragraph 1.20 of their report, Grant Thornton noted that:

> At arm's length, there is rarely one "right answer" as to the price that independent parties would agree. … Notwithstanding, we consider that it is reasonable to assume that, at arm's length, TRL and TFL would share the costs between them based on the amount of the shop advertising and launch activities that they "consume".

128. They then reached their conclusions in the following paragraphs:

> 1.21 We reviewed a sample of the Group's advertising and launch material to assess the relative representation of TRL's activities (ie pictures and words about furniture) compared with TFL's activities (ie pictures and words about HP finance or insurance cover). Our analysis suggested that references to TRL's activities were broadly around 70% representing TRL's business and 30% representing TFL's business.
>
> 1.22 As a secondary approach to consider how the launch costs should be split across the two businesses, we considered the relative floor areas allocated to TRL and TFL in some example stores. We applied this approach to assess whether the "consumption" of launch costs and in-store advertising was consistent with the split of the on-line and paper marketing material. Our analysis suggested that the store layouts were broadly allocated to TRL and TFL in the ratio 90% to 10%.
>
> 1.23 Per HMRC's letter of 31 May 2012, we understand that HMRC's suggested split of the advertising costs is 98% to TFL (plus 10% which effectively apportions over 100% of the costs to TFL) and 2% to TRL (based on the relative split of HP customers to on-the-day cash customers). We have not applied this approach in our analysis as it concentrates on how customers choose to pay rather than how entities that commission the marketing activities "consume" the service they have jointly procured.

Analysis of Store Fees

129. Grant Thornton set out a similar analysis of Store Fees to that set out in their previous report, although they used slightly different terminology in referring to the fee that TRL charged TFL for the right to use TRL's retail premises as a "facility fee".

130. They repeated their point about the lack of reliable public data on concession fees and stated that:

> However, we sought anecdotal evidence on the levels of concession fees and sales commissions paid across a range of industries as a proxy with which to test the arm's length nature of the facility fee

131. The report set out Grant Thornton's views on "concession fees" that were typically payable as follows:

> 1.29 Based on Grant Thornton's wider experience of concession fees in high end department stores, we understand that a department store might expect to receive a concession fee of approximately 15% to 35% of a the concessionaire's total turnover.
>
> 1.30 Following an interview with [Grant Thornton's] retail specialist in May 2013, we understand that the range of concession fees outside high end department stores may be lower and that a retailer might expect to receive a concession fee of between 15% and 25% of the concessionaire's total turnover…

132. Paragraph 1.31 repeated the view that Grant Thornton had expressed in their previous reports regarding the need to take into account the profit that TRL makes when it sells goods to TFL. At paragraph 1.32 they set out a table performing the same calculation of "TRL's income as a % of TFL's total revenue" that they had performed in their previous transfer pricing reports. That table indicated that the relevant percentages were 28.2% for the year ended 31 March 2010, 26.9% for the year ended 31 March 2011 and 24.1% for the year ended 31 March 2012. Those figures were not stated to be estimates, or based on future projections as to revenue. Moreover, the Third Grant Thornton Report was prepared in 2013 so it can be assumed that actual figures as to TRL's and TFL's revenue were available. I have therefore concluded that Grant Thornton based their conclusion on actual figures, and not estimates.

133. Grant Thornton also performed an analysis, which they had not undertaken in any of their previous reports, of considering whether the facility fee was similar in nature and value to sales commission income earned by independent businesses in other industries.

134. In order to do this, they first prepared a table setting out possible benchmark sales commission rates that they prepared by considering:

> (1) Sales commission rates payable under 17 third party sales agent agreements that were deemed comparable to TFL's and TRL's arrangements
>
> (2) A 2003 "MANA Survey of Sales Commissions" using rates identified for products being sold as "electrical products – consumer"
>
> (3) Anecdotal evidence of commission payments in the automotive sector.

135. As to the question of the figure to which the percentage rate should be applied, Grant Thornton expressed the following view:

> In addition, as the commission payments would generally only be paid on the income generated by TFL as a result of the activities of TRL, it

> would appear appropriate that the percentages are only applied to the turnover from those finance related products or services as TRL will already have generated income from the sale of the actual products.

136. Grant Thornton then included a table that expressed the facility fee that TFL paid as a percentage of its revenue derived other than from the sale of goods and concluded that the facility fee that TFL paid was higher than the benchmarked range.

137. Grant Thornton concluded this section of their report by considering HMRC's suggestion that the facility fee should be calculated by TFL paying 75.76% of the total costs of operating the stores following their amendments to the methodology set out in the John Murphy Report. Grant Thornton stated:

> We have not applied this approach in our analysis because from our research we did not identify any third party arrangements where a concessionaire pays a concession fee to a host entity on the basis of how the concessionaire's staff spent their time (more typically such fees are levied on the basis of turnover generated from the space "consumed" by the concessionaire).

138. The overall conclusion of the Third Grant Thornton report was that, recognising that the "concept of 'open market value' is a subjective area [to which] there is often no one right answer":

> the pricing of PerfectHome's two key inter-company transactions fall within the range of open market values that we have identified.

The Schedule 6 dispute - John Murphy's Activity Based Costing Exercise

139. In January 2009, John Murphy, an independent consultant provided a report (the "Murphy Report") to the PerfectHome group. The introduction to that report contained the following section:

> **1 Objectives**
>
> The primary objective is to allocate costs fairly to Temple Retail…
>
> The objectives of the project are to:
>
> 1) determine the cost drivers relating to each product supply chain currently in place within the PerfectHome Group
>
> 2) build a methodology and model to analyse the personnel time across products where individual members of staff are contributing to more than one product supply chain

140. Attachment I to the Murphy Report was a "Summary shop activity grid" that took the form of a spreadsheet. In that spreadsheet, Mr Murphy set out a number of tasks that he had concluded were undertaken by staff in PerfectHome shops from interviews he performed with staff. He then split those tasks into a percentage allocable to TRL and a percentage allocable to TFL, broadly by considering the extent to which a task benefited TRL and the extent to which it benefited TFL.

141.Having performed that high level allocation, Mr Murphy then sought to establish the percentage of staff time, at various levels of seniority, that was occupied on each task (based on an observation of how business in the stores was actually carried on). These figures ultimately were used to calculate an apportionment of payroll costs as between TRL and TFL.

The Schedule 6 dispute – respective approaches of the parties

142.I will not set out all of the submissions of the parties but, in this section, will give a general overview of their respective positions on the Schedule 6 dispute.

The appellants' position

143.The appellants' position was that TRL was not charging Store Fees or Advertising Fees to TFL that were less than the OMV of the relevant supplies. In particular:

> (1) The approach to calculating Store Fees set out in the Intra-Group Services Agreement was correct as it resulted in TRL receiving income that was comparable to the income that a "host business" would receive if it granted a concession to another business to operate a "shop within a shop" from its premises. Ms Shaw accepted that TFL was not the paradigm example of a "shop within a shop". However, since TFL was operating its business from TRL's retail premises, she submitted that the analogy was an apt one.
>
> (2) Advertising costs should be split between TRL and TFL in the ratio 80:20 since that was consistent with the use that the companies respectively made of the advertising services in question. A 10% mark-up should be applied to TFL's share of the costs and, accordingly, the OMV of the Advertising Services was 22% of the total advertising costs that TRL incurred.

144.Ms Shaw submitted that the above approach had been validated in Grant Thornton's various transfer pricing reports. By contrast, she criticised HMRC's approach as not being based on cogent principles and being based simply on the opinions of particular HMRC officers. HMRC's approach, she submitted, led to the following absurd results.

> (1) TRL is a retailer that achieves a retail price whenever it sells goods either to TFL or individual customers yet, under HMRC's approach, TFL and not TRL would be allocated the vast majority of the costs of maintaining those retail stores. Therefore, she submitted that HMRC's approach led to TRL being ludicrously "over-profitable" and TFL being effectively insolvent.
>
> (2) HMRC's approach would result in TFL having to pay 107% of the advertising costs that the PerfectHome group incurred (i.e. more than the entire cost to the group of those advertising services).

145.Ms Shaw noted that HMRC's analysis proceeded from an assertion that advertisements benefited only TFL and its business and that 82.5% of the costs of owning and operating the retail stores benefited TFL, with only 17.5% benefiting TRL. She argued that this approach ignored the crucial role of TRL and the fact that, in all situations where the PerfectHome business makes a sale, TRL would make a sale and receive a retail price (and a 37% or 40% margin) for doing so.

146.Ms Shaw also invoked the principles of legal certainty and fiscal choice that form part of EU jurisprudence in the VAT arena. She submitted that, in seeking to apply Schedule 6 of VATA 1994 in this context, HMRC were seeking to recharacterise the arrangements that TRL and TFL had entered into and that this was an impermissible approach absent any challenge under the *Halifax* principle. She submitted that, following the approach set out by the Court of Justice of the European Union ("CJEU") in *JP Morgan Fleming Claverhouse* (Case C-363/05) and applying the principle of fiscal neutrality, unless TRL was not a retailer (for example because it was a wholesaler or commission agent), there was no justification in treating it differently from any other retailer for VAT purposes.

HMRC's position

147.Mr Singh submitted that the appellants' approach ignored the fact that TRL and TFL were not separate businesses of retailer and financer respectively. Rather, they carried on a single business (consisting of the provision of goods on weekly HP terms) that had been artificially separated in order to improve aggregate VAT recovery. He submitted that, without TFL, TRL would have no-one to whom it could sell its goods in 98% of cases. Therefore, Mr Singh also invoked the principle of fiscal neutrality and submitted that the PerfectHome group should not be left in a better net tax position that its competitors as a result of the particular structure that it had adopted.

148.He submitted that the PerfectHome group had adopted an "artificial" structure to enable it to undercharge for Store Fees and Advertising Fees. He submitted that there was evidence that TRL overcharged TFL for other supplies (for example supplies of goods, repairs and delivery) and was compensating for this by undercharging Store Fees and Advertising Fees.

149.Although Mr Singh stressed that HMRC's case does not depend on the attaching of labels he submitted that TRL should not be seen as a retailer. In 98% of cases, it sells goods to TFL and, unlike a conventional retailer, has no need to advertise its goods or display its goods for sale (since, in 98% of cases, those goods are purchased by an affiliated company). Therefore, it was not correct to determine the OMV of Advertising Services or Store Services on the footing that TRL is a retailer. Moreover, since TRL is not a retailer, it followed that TRL was over-charging TFL for goods that it supplied (and was correspondingly undercharging Advertising Fees and Store Fees).

150. As well as making those general observations, Mr Singh submitted that, when the actual Store Fees and Advertising Fees were considered, it was clear that they were below the OMV of the relevant supplies for the following reasons:

(1) The Grant Thornton reports on which the appellant relies are seriously flawed and do not appropriately justify or provide evidence that Store Fees and Advertising Fees were at OMV.

(2) The "shop within a shop" analogy on which TRL relies to justify its pricing is not valid as the arrangement between TFL and TRL has none of the hallmarks of a concession arrangement.

(3) TFL, and not TRL, is the principal user of the showrooms. Therefore, it is right that TFL should bear the lion's share of the costs relating to the stores. The time spent by employees on "TFL tasks" within shops as compared with the time spent on "TRL tasks" is a valid approach to determining the OMV of the Store Services. Therefore, HMRC's approach of basing their calculations on the Murphy Report (a report prepared by an independent consultant and untainted by any tax considerations) was to be preferred to the appellants' approach.

(4) The appellants' calculation of Advertising Fees was flawed as no explanation was given as to how the analysis of the space taken up in advertising leaflet with various types of pictures and words respectively translated into actual use of those advertising costs. Given that the main aim of the advertising was to induce a sale of goods on HP terms (which would take place in 98% of cases) and would result in TFL transacting with the customer, it was right to conclude that TFL used 98% of the PerfectHome group's advertising. There was nothing objectionable in applying a 10% mark up to this use in order to calculate the OMV of the service being provided, even though it would mean that TFL would have to pay more for advertising than the PerfectHome group in aggregate incurred as that simply reflected that the value of the advertising services to TFL was higher than their cost to the group.

Schedule 6 dispute – Discussion

The general approach to take and the relevance or otherwise of Halifax

151. In *Halifax plc v Customs and Excise Commissioners* (Case C-255/02) [2006] STC 919, the CJEU established the principle that:

> the application of Community legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law

152. Mr Singh did not argue that this principle applies. Since it was not argued, I will not make any determination as to whether the principle applies, but will note that there was before the Tribunal an abundance of evidence suggesting that transactions

entered into under the PerfectHome "two company" structure were carried out in the context of normal commercial operations.

153. Since the *Halifax* principle is not argued to apply, I do not consider that Schedule 6 (or Article 172) permits any supplies to be "recharacterised" when assessing their OMV. Both Schedule 6 and Article 172 invite an examination of the OMV of the actual supplies that parties have made, not of different supplies that they might arguably have made. I have, therefore, approached the Schedule 6 issue by first considering the nature of the supplies which have been made (as to which findings of fact are set out at [59] to [65] above). I have then considered what the OMV of those supplies is.

154. I have concluded that the Tribunal's role is to determine what the OMV of those supplies actually is and not whether the appellants' determination of OMV is more likely to be correct than that of HMRC. In performing that task, I have applied the following approach:

(1) I have considered whether there is evidence that suggests that TRL is likely to be charging less than OMV for Store Services and Advertising Services, independent of any consideration of the nature of those services. In this context, for example, I have considered Mr Singh's submissions that TRL is charging more than OMV for goods (and so compensating for that by charging less than OMV for Store Services and Advertising Services). I have also considered Mr Singh's arguments on "artificiality" and "contrivance" and his arguments that TRL is not, in fact, a "retailer".

(2) I have considered the methodologies that HMRC and the appellant propose since, if a particular methodology is flawed, it may not result in an accurate calculation of OMV. In this context, I have considered in particular, whether a particular methodology proceeds from a flawed assumption (given, for example, HMRC's argument that the "shop within a shop" analogy is not a suitable one).

(3) Having considered the competing methodologies, I have sought to identify the one that I consider most appropriate to apply to determine the correct OMV of the supplies in question.

(4) Where I adopt a methodology for which either party has contended, I have noted that a methodology can be correct in theory, but applied wrongly. Therefore, I have gone on to consider how that methodology should actually be applied in order to produce a determination of OMV.

"Artificiality" and whether TRL overcharges TFL for other supplies

155. I have made findings of fact on this issue at [81] to [98]. In the light of those findings of fact, I do not consider that the way that the PerfectHome business is structured compels the conclusion that TRL charges for Store Services or Advertising Services at less than OMV. Nor do I consider that TRL overcharges TFL for other supplies (for example supplies of goods, repair services or delivery charges) and

compensates for these overcharges by undercharging for Store Services and Advertising Services.

156.Ms Shaw referred me to calculations that Mr Barry prepared which he appended to a letter of 16 January 2014 to HMRC. Those calculations set out Mr Barry's view that, using figures for 2010, if the PerfectHome group charged Store Fees and Advertising Fees by applying HMRC's methodology (rather than its own), the effect would be to increase TRL's operating profit from some £1.8m to some £9.4m and to turn TFL's profit of £3.2m into a loss of some £4.4m. She submitted that the overall result of HMRC's approach was that TRL became absurdly profitable and TFL became effectively insolvent and that this demonstrated the flaw in HMRC's method.

157.The anomaly to which Ms Shaw refers presupposes that TRL and TFL are paying and receiving OMV consideration for other transactions between them. Given that I am satisfied that TRL is not overcharging for supplies of goods, repair services or delivery charges, I consider that there is force in the argument that since HMRC's approach produces an illogical outcome, it is not the correct approach particularly given that no challenge was made to the substance of Mr Barry's calculations. However, while this is an indication that HMRC's calculation of OMV of the relevant services is not correct, I do not consider that it demonstrates that the appellants' calculation is correct.

The principle of fiscal neutrality

158.Both Ms Shaw and Mr Singh invoked the principle of fiscal neutrality. For present purposes that principle is encapsulated in the following extract from paragraph [36] of the CJEU's decision in *Claverhouse:*

> The principle of fiscal neutrality precludes economic operators carrying on the same activities from being treated differently as far as the levying of VAT is concerned.

159.I do not, however, consider that this principle assists either party to this appeal, in relation to the Schedule 6 dispute.

160.Ms Shaw's argument was that the principle of fiscal neutrality required that TRL should be treated in the same way as another retailer and TFL should be treated in the same way as any other provider of HP finance. However, that formulation overlooks the effect of Article 80 of the Principal VAT Directive and Schedule 6 of VATA 1994. Those provisions enable HMRC to treat supplies as being made for OMV consideration if TRL is charging less than OMV consideration. If TRL is actually charging less than OMV for its supplies, the principle of fiscal neutrality cannot save TRL from the consequences of doing so (except insofar as preventing TRL from being treated differently from a comparable retailer also making supplies at less than OMV to an affiliated, partially exempt, company).

161.Mr Singh's argument was that the principle of fiscal neutrality prevented TRL and TFL being left in a better net tax position than its competitors. However, while Mr Singh has established to my satisfaction that high street stores cannot be described as

TRL's, or TFL's, "competitors", he has not explained at all what the tax treatment of those "competitors" is, or how TRL's and TFL's tax position is different.

Grant Thornton's use of the "shop within a shop" analogy

162.Mr Singh submitted that the "shop within a shop" analogy was flawed and that, accordingly, both the appellants and Grant Thornton were following an incorrect approach in seeking to ascertain the OMV of supplies that TRL made to TFL in relation to PerfectHome showrooms. In particular, he submitted that:

> (1) The Store Fees that TFL paid were not even described as concession fees in the Intra Group Services Agreement, suggesting that the parties did not regard themselves as party to a concession arrangement.
>
> (2) A concession arrangement involves a concessionaire carrying on a business that is separate from the host's business on the host's premises. Here, there is a single business that is being carried on.
>
> (3) A concessionaire would not ordinarily offer the same products as the host business. By contrast, both TFL and TRL sell identical goods.
>
> (4) Hosts and concessionaires normally use different trading names and have different brands, but TFL and TRL both trade using the PerfectHome brand.
>
> (5) A customer will normally be aware that they are buying goods from a concessionaire rather than the host business. However, as far as a PerfectHome customer is aware, he or she is dealing only with "PerfectHome" and is not aware of the separate existence of TRL and TFL.
>
> (6) A host business would not normally depend on a concessionaire to provide credit.
>
> (7) Concessionaires occupy space as a matter of necessity. However, the appellant's own evidence was that TFL uses TRL stores as a matter of convenience.

163.Ms Shaw accepted that the paradigm example of a "shop within a shop" was probably a cosmetics counter in a large department store and acknowledged that there are a number of differences between PerfectHome's situation and that paradigm. However, she submitted that the analogy was nonetheless valid in any situation in which one business is operating in the premises of another even if that was not a paradigm situation.

164.I do not think that any great weight should be placed on the fact that the Intra-Group Services Agreement does not describe TFL as paying a "concession fee". The appellants are not arguing that any particular label should be attached to the fee that is being paid but rather that the OMV of the Store Services that TFL is receiving can be determined by comparing the Store Fees with concession fees.

165.I have concluded that Grant Thornton were right to consider that the "shop within a shop" analogy was an appropriate one to use when seeking to determine the "arm's length" price for the Store Services.

166.I have reached that conclusion because TFL actually conducts its business in TRL's stores and I do not consider that it is relevant that it could, perhaps, conducted its business in a different way. I therefore think that it is conceptually valid to conclude that the OMV of the Store Services can be determined by considering the fees that are paid in similar situations where one business operates in the premises of another and, accordingly, the "shop within a shop" analogy is appropriate.

167. I have also taken into account that Grant Thornton, as one of the largest accounting firms in the world, have extensive experience of determining the "arm's length price", for transfer pricing purposes, of a number of services in a number of industries. The "shop within a shop" approach has been a feature of Grant Thornton's approach right from the First Grant Thornton Report onwards. Given Grant Thornton's expertise on transfer pricing matters (which was not in dispute), I do not consider that they would have advanced that analogy unless they considered it appropriate. Moreover, the fact that Grant Thornton, with all their experience of transfer pricing matters, considered that applying the "shop within a shop" analogy was the most appropriate way of seeking to ascertain the OMV of the Store Services, is good evidence that it was, even taking into account the fact that I have not given the First Grant Thornton Report full weight in the absence of a witness statement from the author of the report. Therefore, although the First Grant Thornton Report is not an expert report and I must accordingly make up my own mind on the opinions that Grant Thornton express, Grant Thornton's conclusion supports my own conclusion in this regard.

Grant Thornton's approach to the determination of the OMV of Store Services

168.At [46] to [48], I set out my view as to the status of the various Grant Thornton reports as evidence and at [52] I set out my view that those reports are relevant to the determination of the OMV of the supplies in dispute. In this section, I will address the validity of the approach that Grant Thornton follow in their reports in the light of criticisms that Mr Singh made of those reports.

169.Mr Singh criticised the Grant Thornton reports for what he submitted was their failure to consider the OMV of the particular supplies in question. For example, he said that the "Transactional Net Margin Method" referred to at [108(3)], in its own terms, did not focus on particular transactions, but considered the net margins of the "tested party" as a whole. He noted that paragraph 1.28 and 1.30 of the Third Grant Thornton Report made it clear that the analysis in those reports was based on "anecdotal evidence…across a range of industries" and interviews with an unnamed "retail specialist". In short, he submitted that Grant Thornton's reports failed to engage with the central question of the OMV of the particular supplies in question.

170.I do not accept Mr Singh's submission. The Grant Thornton Reports do, in my view, seek to determine the "arm's length price" (and hence the OMV) of particular

supplies that are being made. Grant Thornton seek to achieve that by applying a systematic process which includes both drawing on their own experience and on such public information as they can find on comparable situations. I consider that this is an appropriate approach to follow. It is similar in principle to the process of seeking to ascertain the OMV of a particular house on a particular street by considering sale prices of other comparable houses in the same, or adjoining, streets. Even though Grant Thornton refer to data on other transactions and situations, the overall process they are following is to use that data to estimate the "arm's length price" of the particular supplies at issue. In particular, I do not accept Mr Singh's submission on the unreliability of the "Transactional Net Margin Method" since it is clear from the First Grant Thornton Report that Grant Thornton are not applying that approach to determine the "arm's length price" of any of the supplies that are at issue in this appeal. On the contrary, Grant Thornton use the "Comparable Uncontrolled Price" method when analysing Store Fees and the "Cost Plus" method for determining Advertising Fees.

171. That then gives rise to the question of what concession fees are payable between parties transacting at arm's length. Grant Thornton's answer to that question evolved somewhat. In the First Grant Thornton Report, the range was expressed to be 10% to 25% of the concessionaire's turnover. In the Second Grant Thornton Report, Grant Thornton considered it to be 15% to 35% of the concessionaire's turnover (although that conclusion was expressed to be derived from confidential information relating to "high end" stores). In the Third Grant Thornton Report, Grant Thornton considered that the range was 15% to 35% for "high end" stores, but 15% to 25% for stores other than "high end" stores. Mr Singh criticised these ranges as being insufficiently reasoned. However, both the 15% to 35% range and the 15% to 25% range appear in the First Grant Thornton Report and the Second Grant Thornton Report to which I have given most weight. I am satisfied that Grant Thornton, in their professional practice, have access to information on concession fees that unrelated parties pay to each other. I consider that they estimated the ranges set out above by reference to objective facts following the exercise of professional skill in the transfer pricing arena. I am also prepared to accept that the 15% to 35% range that Grant Thornton specify in their Second Grant Thornton Report applied to "high end" stores (since Grant Thornton based their conclusion on data they had collected that pertained to "high end" stores) and that the 15% to 25% range mentioned in the First Grant Thornton Report would be relevant to stores other than "high end" stores.

172. Mr Singh suggested that Grant Thornton failed to follow their own methodology when performing their analysis of Store Fees. He said that Grant Thornton's conclusion was that a concessionaire would pay a fee of between 15% and 35% of its total turnover (if located in a "high end store") but that the effect of Grant Thornton's calculations was that TFL was paying much less than this since Grant Thornton had included TRL's own profit from sales of goods within that calculation. I do not consider that this criticism is valid. At [113] above, I have quoted an extract from the First Grant Thornton Report that explains why, in Grant Thornton's view, TRL's margin on sales of goods should be taken into account. I do not, therefore, consider that Grant Thornton failed to follow their methodology. On the contrary, I find that they applied it and gave reasons for doing so.

173. That then gives rise to the question of whether Grant Thornton are correct in saying that the" arm's length price" should take into account the 37% margin that TRL makes when it sells goods to TFL. That conclusion is central to the Schedule 6 issue. If Grant Thornton were wrong on this point, Grant Thornton's calculations would suggest that TFL would have to pay £9.5m more for use of the stores in the year ended 31 March 2011 (based on figures in the First Grant Thornton Report which are admittedly based on estimates). I have concluded that Grant Thornton are correct on this issue. Firstly, Grant Thornton's conclusion accords with common sense. If it became clear to the owner of a cosmetics concession in Selfridges that every time a customer bought something from the concession, she would also buy a handbag from Selfridges' own display next to the concession, I would expect the concession owner to argue that the concession fee should be reduced to reflect the additional benefit that Selfridges obtain. More specifically, I consider that Grant Thornton's approach is appropriate to the symbiotic nature of TFL's and TRL's respective businesses. As I have outlined at [76], TFL's presence in the stores means that in 98% of situations, either TFL and TRL both make a sale or neither of them do. It is right, therefore, that the appropriate price for use of the stores should take into account both sales that TFL makes and sales that TRL makes. Grant Thornton's methodology does that. TRL's 37% margin is taken into account as reducing the amount that TFL would otherwise have to pay. However, since the calculation of the arm's length price is based on a percentage of TFL's non-product revenue, it follows that this revenue is also taken into account in increasing the arm's length price. I consider that to be appropriate given the nature of TRL's and TFL's respective businesses.

174. I do not agree with Mr Singh that Grant Thornton's approach is flawed because TRL has no need to display goods for sale to TFL and therefore should not be treated as having incurred costs associated with maintaining retail stores. I have set out at [91] my conclusion that TRL is properly characterised as a "retailer". In addition, I consider that Mr Singh's submission ignores the fact that both TRL and TFL depend on the stores in a highly symbiotic way since, in 98% of cases, a customer entering a PerfectHome store will generate income for both TRL and TFL or for neither of them. In those circumstances, I consider that the OMV of Store Fees should take into account that symbiotic relationship and the income that both TRL and TFL generate from customers visiting the stores. For reasons set out at [173], I consider Grant Thornton's approach does that.

175. I have also not accepted Mr Singh's criticisms of the approach followed in the Third Grant Thornton Report dealing with sales agent commissions. Mr Singh said that this passage was misconceived since there was no basis on which the PerfectHome arrangements could be compared with those of a sales agent. He also criticised Grant Thornton's approach of relying on "anecdotal evidence" for the purposes of considering arm's length rates of sales commission payable. I have concluded that, in this passage of their report, Grant Thornton were simply performing a "sanity check" of their conclusions as to the pricing of Store Fees (which proceeded on the basis of the "shop within a shop" analogy) by considering whether their conclusion would be radically affected if the arrangement were characterised in another way. I consider that it was right for Grant Thornton at least to

consider the results that would be achieved if the question of "arm's length" pricing were approached in a different way.

176.It follows from what I have said at [169] to [175] above that I consider that Grant Thornton have a adopted a valid approach in seeking to ascertain the OMV of the Store Services by applying an analogy with store concession charges. I am also satisfied that the relevant level of "arm's length" store concession charges are 15% to 35% in a "high end" store and 15% to 25% outside a "high end" store.

177.It therefore follows that I consider that Grant Thornton have applied a valid approach to the calculation of the OMV of Store Services.

HMRC's approach to the calculation of the OMV of Store Services

178.HMRC's approach is set out in Officer Ford's letter of 4 June 2013 to TRL and is based on an analysis of time that staff at PerfectHome stores spend on activities allocable to TRL and activities allocable to TFL respectively.

179.Officer Ford took as her starting point the breakdown of staff time that Mr Murphy had set out in the Murphy Report. However, she adjusted these to reflect what she considered to be errors in Mr Murphy's approach. For example, Mr Murphy had concluded that 95% of the activity of "property administration" was attributable to TRL. Officer Ford concluded that only 2% of that activity was attributable to TRL since

> While physically use of public areas of shop space is mainly to display goods owned by TRL, in both economic and physical terms, TFL makes considerable use of shop premises. In excess of 98% of all product sales are on credit. TFL's activities generate over 98% of group income.

She similarly gave reasons for a number of other departures from Mr Murphy's figures.

180.Having allocated tasks as between TFL and TRL, Officer Ford then took into account the number of staff of various categories performing these various tasks and used that to calculate an overall percentage of total staff time allocable to TRL activities and TFL activities respectively. After rounding, she concluded that 25% of staff time was allocable to TRL and 75% to TFL. She concluded that the total external costs that the group incurred should be divided between TRL and TFL in these ratios and that the OMV of the Store Services that TRL supplied to TFL was TFL's 75% of the group's external costs, marked up at 10%.

181. I am not satisfied that this is a valid approach to calculating the OMV of Store Services. HMRC have not sought to test whether that basis of valuation is actually used by other parties transacting at arm's length or to gather information on what basis of valuation parties transacting at arm's length do adopt. Grant Thornton, by contrast did this, when performing their own benchmarking exercise.

182.I also consider that there is a flaw in determining the OMV of Store Services by reference to staff time. The amount of time that staff spend on TRL's business and TFL's business respectively seems to me to be relevant to the basis on which TRL and TFL share staff costs. TRL and TFL have agreed a basis for sharing staff costs between them in the IGSA (up until April 2011 when TRL and TFL became joint employers of staff). Mr Singh did not criticise the basis on which staff costs were shared. Therefore, if TFL and TRL are sharing staff costs appropriately, it was not clear to me why staff time should also be used when determining the OMV of Store Services.

183.In addition, given the findings I have made at [64], I do not consider that the benefit that TFL obtains from the Store Services can be explained solely in terms of the activities of staff. The benefit that TFL derives from Store Services depends on TRL conducting a particular kind of business at those stores (namely one that is aimed at customers who will require HP finance on weekly terms) and displaying goods in a particular way that prominently mention the availability of that finance. That benefit cannot be measured solely in terms of an analysis of staff time.

184.Finally, HMRC have based their approach on an adjustment to the figures that Mr Murphy produced in his report. Although HMRC have given some explanation of why they made particular adjustments to Mr Murphy's figures, I was not satisfied that HMRC's figures were necessarily to be preferred to figures that Mr Murphy had calculated based on his own actual observations of the activities that staff undertook.

185.Ms Shaw made other criticisms of HMRC's approach. For example, she submitted that an approach that used staff time as a proxy for calculating the OMV of Store Services should take into account the fact that staff spent time on TFL tasks in "cheaper" areas of the stores[5]. I did not consider that I had sufficient evidence as to the basis on which TRL's landlords charge TRL rent to enable me to decide on the validity of that criticism. However, the reasons set out at [178] to [184] above are sufficient for me to conclude that HMRC's approach to the calculation of the OMV of Store Services is not correct.

Applying Grant Thorton's approach to the calculation of the OMV of Store Services

186.I therefore consider that the OMV of Store Services should be determined by following the approach that Grant Thornton set out in their transfer pricing reports and that the approach HMRC are suggesting should not be followed. That naturally gives rise to the question of whether that OMV is at the higher or lower ends of the ranges that Grant Thornton set out.

187.Grant Thornton provide little analysis on this issue beyond stating that this question depends on matters such as the strength of the store brand and whether the

[5] In more detail Ms Shaw's submission was that commercial rents for retail shops were determined by reference to "zones" with the zone of the shop nearest the window being the most expensive and back-office and storage space being the least expensive. She submitted that "TFL" activities such as chasing customers for payment took place in these cheaper areas.

store provides staff and manages the till and customer invoicing. Applying those factors viewed in isolation appear to suggest a fee at the lower end of the range as I did not consider that the PerfectHome brand is strong in comparison with that of large department stores such as Selfridges. In addition, TRL and TFL share staff costs so, TFL is not benefiting from a concession in which it obtains the services of staff without having to pay separately for them.

188. However I consider that there are factors that suggest a higher fee might be appropriate. 98% of customers who enter a PerfectHome store and decide to make a purchase will end up entering into an arrangement with TFL. By contrast, a cosmetics concession in Selfridges could not be sure that 98% of customers who come into the department store and decide to make a purchase will inevitably buy cosmetics from the concession. Of course the close synergies between TFL's business and that of TRL carries risks for TFL as well as benefits. If PerfectHome stores stocked poor quality, or overpriced, products fewer customers would make purchases and so fewer would enter into a contract with TFL. By contrast, the owner of a cosmetics concession in Selfridges could still expect to make some sales even if customers did not like the products for sale in Selfridges generally. However, the PerfectHome group does produce a healthy annual profit and so it can be assumed that the benefits to TFL of this aspect of its relationship with TRL outweigh the risks.

189. This aspect of TFL's and TRL's business which is addressed in detail in the Grant Thornton's reports suggests to me that the OMV of Store Services should be towards the higher end of the range that Grant Thornton specify. From the figures set out in the Third Grant Thornton Report, I have concluded that an application of Grant Thornton's methodology results in TFL paying Store Fees that are above the range that Grant Thornton identify in the years ended 31 March 2010 and 31 March 2011. For the year ended 31 March 2012, Grant Thornton calculated that TRL's income as a percentage of TFL's total revenue was 24.1% which is slightly less than the 25% figure at the top of the range they specify for stores other than "high end" stores. However, I do not consider that this demonstrates that, in the year ended 31 March 2012, TFL was paying Store Fees of less than OMV. There is a range of prices that can be paid for services and any figure within the appropriate range could be regarded as OMV. Therefore, the fact that TFL is not paying Store Fees that are right at the top of the range does not demonstrate that it is paying less than OMV and overall I am satisfied that TFL is not paying Store Fees that are less than the OMV of Store Services.

Grant Thornton's approach to the determination of the OMV of Advertising Services

190. Grant Thornton only set out a detailed approach to the calculation of the "arm's length" price for Advertising Services in the Third Grant Thornton Report. In the First Grant Thornton Report they simply outline their general view that OMV of Advertising Services should be determined by reference to a "cost plus" method and give a general indication of how that method should be applied.

191. In the First Grant Thornton Report, Grant Thornton advised that determining the arm's length price for the Advertising Services should be based on the "cost/income

drivers of the activities". Yet, in the Third Grant Thornton Report, as noted at [126] to [128], they approached the question by comparing the space taken up by "pictures and words about furniture" with the space taken up by "pictures and words about insurance cover and HP finance" and also by considering the relative floor areas allocated to TFL and TRL in a sample store.

192. I consider that there are a number of flaws in this approach:

(1) While the advertising leaflets contain "words about insurance", I do not see how they can contain "pictures…about insurance cover and HP finance". HP finance and insurance have to be explained largely, if not exclusively, by words. The words used in the advertising material are much smaller than the pictures. The comparison that is performed can only ever lead to one conclusion – namely that "pictures and words about furniture" will occupy a greater area than "pictures and words about HP finance or insurance".

(2) TFL sells both goods and HP finance. Yet Grant Thornton's methodology presupposes that any "pictures and words about furniture" relate to TRL, not TFL.

(3) I have concluded at [77] that TFL does not use any part of TRL's stores exclusively. It is not clear, therefore, how the measurement of "relative floor areas allocated to TFL or TRL" could be performed in a rigorous fashion.

(4) It was not clear to me how either looking at floor areas, or the composition of the advertisements in question amounted to a consideration of the "cost/income drivers of the activities" which Grant Thornton advocated in the First Grant Thornton Report. In fact, it was not clear to me whether Grant Thornton were referring to the advertising "activities" or the business activities of TFL and TRL.

193. Moreover, this analysis appears in the Third Grant Thornton Report which, for the reasons I set out at [57] is the report to which I have ascribed relatively little weight.

194. For all those reasons, I am not satisfied that Grant Thornton's approach to calculating the OMV of the Advertising Services is correct. Since I am not satisfied that approach it is correct, I am not satisfied their calculation of the OMV of Advertising Services is correct.

HMRC's approach to the calculation of the OMV of the Advertising Services

195. HMRC's approach to Advertising Services is summarised at [27(2)] above. Conceptually, that approach appears to follow Grant Thornton's recommendation of considering the "cost/income drivers of the activities". No doubt Grant Thornton would not agree with HMRC's central analysis that, because 98% of sales are made on HP terms, 98% of the Advertising Services benefit TFL. However, HMRC's approach does at least attempt to value these services by reference to concepts of cost and income by contrast with the approach that Grant Thornton follow in the Third

Grant Thornton Report (which look at floor space and the composition of the advertisements).

196. Therefore, I consider that conceptually HMRC's approach to Advertising Services is the better one. However, I do not consider that the way they have applied that approach produces an accurate calculation of the OMV of the Advertising Services. The fact that 98% of sales are made by TFL to customers purchasing on HP does not demonstrate that the OMV of the Advertising Services that TFL receives is 98% of the cost that TRL incurs (marked up at 10%). HMRC's approach completely ignores the fact that every time TFL sells goods on HP terms to a customer, TRL makes a sale of goods to TFL on which it makes a profit margin of 37%.

Calculating the OMV of Advertising Services

197. I do not, therefore, consider that the appellants' approach or HMRC's calculation is correct. I have concluded that the OMV of Advertising Services should be calculated by reference to an appropriate share of the cost of the advertising services that TRL receives from third party suppliers. That is essentially HMRC's approach (and the approach that Grant Thornton outlined in the First Grant Thornton Report but did not really reflect in the detailed calculations in the Third Grant Thornton Report). However, I consider that a different share should be used from that HMRC adopt. I also consider that a mark-up should be applied to those costs since parties transacting at arm's length would not expect to provide services at cost. TRL has used a 10% mark-up itself when applying its methodology and I therefore consider that a 10% mark-up is appropriate.

198. The First Grant Thornton Report suggests that the costs of advertising services should be shared by reference to the "cost/income drivers" of the activities. I consider that to be correct and that the respective operating profits of TRL and TFL (which, by definition take into account both "costs" and "income") are the right figures to take into account in this regard since the purpose of advertising must be to generate income and hence profit. I therefore conclude that the OMV of Advertising Services should in principle be calculated as follows:

(1) First the total cost to TRL of obtaining the relevant advertising services from third parties should be determined.

(2) Then TFL's operating profits should be expressed as a percentage of the combined operating profits of TFL and TRL.

(3) The OMV of the Advertising Services is the figure in [198(1)] multiplied by the percentage in [198(2)] and then further marked up at 10%.

PART II – THE PARTIAL EXEMPTION DISPUTE

Background to the dispute

199. The partial exemption dispute concerns TFL's tax position, and not that of TRL.

200. TFL is partially exempt for VAT purposes. That is because, when it enters into an HP agreement, TFL is treated as making two separate supplies:

> (1) a taxable supply of the product, by virtue of paragraph 1(2) of Schedule 4 of VATA 1994 (on which TFL is obliged to account for output tax on the full price of the product by reference to a "tax point" occurring on the date of the contract); and
>
> (2) an exempt supply of finance under item 3 of Group 5 of Schedule 9 of VATA 1994.

201. In addition, TFL makes other taxable supplies in the course of its business (including, for example, the sale of Coverplus) and makes other exempt supplies (including the sale of TAD).

202. In the course of its business, TFL incurs input tax on supplies that it receives. Certain items of input tax are directly attributable to specific supplies and, accordingly, that input tax is either recoverable (if it is directly attributable to a taxable supply) or is totally irrecoverable (if it is directly attributable to an exempt supply).

203. "Overheads" are those supplies that TFL receives that are not directly attributable to specific supplies but rather relate to TFL's business as a whole. The principal overheads that are relevant in the context of this appeal are premises costs, IT costs, telephone costs and staff costs (for example travel, subsistence and uniform[6]).

204. Such overheads are recovered, in the first instance, on the basis of the "standard method" turnover apportionment. That method involves the calculation of a fraction (being TFL's turnover that is attributable to taxable supplies divided by its total turnover). That fraction of the input VAT on overheads is recoverable in the first instance. Mr Barry provided, in his witness statement, examples of how the "standard method" would apply. Those calculations were not challenged and help to explain the difference between HMRC's approach and that of TFL. For example, in its period 03/11, TFL made taxable supplies of £7,518,400 and exempt supplies of £4,611,623. Its total income was thus £12,130,023 (the sum of these two figures) and taxable supplies represented 61.98% of total supplies. That meant that applying the standard method in that VAT period would result in 61.98% of input tax on overheads being recovered.

205. Under the SMO set out in regulations 107A to 107F of the Value Added Tax Regulations 1995 (the "VAT Regulations"), if there is a "substantial difference" between the recovery rate applying the standard method (based on turnover set out above) and the recovery rate that would apply if consideration were given to the extent to which the overheads in question are "used … in making taxable supplies", TFL would be obliged to account for the difference.

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[6] Salary costs are not relevant since staff salaries are not subject to VAT.

206. On 6 May 2011, Officer Bird of HMRC sent TFL a letter dealing, among other points, with the application of the SMO. Officer Bird's conclusion was that, in applying the SMO, input tax recovery should be calculated by reference to a fraction that excluded turnover generated by (taxable) supplies of goods from both the numerator and the denominator. Applying that approach to the 03/11 figures referred to at [204], TFL would still be making exempt supplies of £4,611,623[7]. However, its taxable supplies (excluding sales of goods) would be only £1,589,807 which essentially represents consideration for the sale of Coverplus and other taxable supplies not related to goods. Therefore, the denominator of HMRC's revised fraction would be £6,201,430 and the numerator would be £1,589,807. That would result in a recovery percentage of only 25.64% on those figures, much lower than the 61.98% figure that the standard method would produce.

Officer Bird's reasoning

207. In his letter of 6 May 2011, Officer Bird explained his view that:

> HMRC do not consider that the inclusion of the full value of the sale of HP goods by TFL, in a turnover apportionment, reflects the use of the costs.

208. He accepted that:

> TFL makes taxable supplies of goods and the consideration paid by the customer relates to both the goods and the credit, therefore a use based SMO adjustment must reflect the economic use of the goods

209. However, he said that:

> HMRC consider that the main effort, and therefore use of the non-attributable input tax incurred by TFL after acquiring the goods is to complete the HP, Coverplus and TAD formalities with the customer.
>
> In the case of TFL, HMRC are of the view that the overhead costs of the HP transaction are not built into the initial supply of the goods but are built into the supply of the credit since this is where the profit is derived. Economically, the overheads are used in the "continuing contact and management of the customer" to ensure the ongoing payment of the outstanding financial commitments under the HP agreement.

210. He considered whether costs incurred after the sale of the goods could be regarded as incurred in order to secure payment of the outstanding consideration due under the HP agreement for the goods but concluded:

> I consider that the costs incurred after the taxable sale ensure the continuation of the finance income and feel it is reasonable to assume

[7] Strictly, HMRC's SMO adjustment would apply only to the annual "longer period" adjustment and not to individual VAT quarters. However, this calculation remains useful since it illustrates the difference between HMRC's approach and that of the appellant

> that the forecasted amount of returns is built into the value of the supply of credit rather than the value of the supply of goods.

211.Officer Bird's ultimate conclusion was that there was "potentially a very small amount of non-attributable input tax incurred by TFL in relation to the supplies of goods on HP" which could be dealt with in a partial exemption special method. However, he said that SMO were not required to be calculated with the precision usually found within a partial exemption special method and that accordingly that HMRC were satisfied that the exclusion of, inter alia, the values of taxable supplies of goods sold under HP from the standard method turnover apportionment resulted in a fair and reasonable estimation of the use of TFL's non-attributable input tax for the tax years 2007/08 and 2008/09.

Statutory and EU provisions

212.The provisions dealing with input tax recovery in the case of a partially exempt business are lengthy and for that reason, I set out most of them in the Appendix rather than here.

Findings of fact relevant to the partial exemption issue

213.I have not made separate findings of fact in relation to the partial exemption issue since I consider that findings I have made elsewhere in this decision will suffice. I would, however, emphasise the following particular points:

(1) Since TFL does not provide finance that enables its customers to buy goods from other retailers, without a sale of goods by TFL, there would be no supply of finance.

(2) Once TFL has entered into an HP agreement it continues to incur expenses associated with the taxable supplies of goods that it has made under the HP agreement. In particular, it uses the stores (which result in it incurring Store Fees) to carry on its debt management activities as set out at [63] above. Those debt management activities are entered into with a view to recovering both outstanding amounts due that relate to the supply of finance and the "principal amount" of the finance provided (being the original sale price of the goods). In addition, as noted at [63], it uses the stores in order to process weekly payments that customers make by telephone and to receive weekly cash payments from customers visiting the store. Those cash payments in part represent the finance element of the credit that TFL provides and in part represent payment for the goods themselves.

The contentions of the parties on the partial exemption issue

TFL's contentions

214.Ms Shaw said that HMRC's approach resulted in a conclusion that TFL obtained no input tax recovery on overheads used in connection with its activities of providing

HP. She submitted that this amounted to HMRC denying their characterisation as overheads and that this was precluded by the decision of the Court of Appeal in *Volkswagen Financial Services Ltd v HMRC* [2015] EWCA Civ 832 ("*VWFS*").

215. Ms Shaw also submitted that the overheads that TFL incurs are attributable to its business as a whole and relate just as much to the supply of goods as to the supply of finance. Therefore, she submitted that no SMO adjustment was required since the attribution on the basis of "use" for which the SMO provides would not produce a different result from a "turnover" based method of attribution.

216. Ms Shaw also disputed a number of Mr Singh's submissions set out below, but I will deal with the points she made in this context in the "Discussion" section below.

HMRC's contentions

217. During the hearing, the main focus of Mr Singh's submissions was on what he considered to be the link between the partial exemption issue and the Schedule 6 issue. He repeated points that he made on the principle of "fiscal neutrality" and submitted that HMRC are seeking an outcome that ensures that the net tax burden on the PerfectHome corporate group is the same as it would have been without an "artificial structure that gave rise to undervalued supplies and overly benign partial exemption method" and that PerfectHome should not be left in a better net tax position than its competitors.

218. Mr Singh accepted that, if HMRC were successful on the Schedule 6 issue, the PerfectHome group may suffer a more severe restriction of input tax than is appropriate. He therefore suggested that the Tribunal should not make a decision on the partial exemption issue but should first invite the parties to reach agreement on it in the light of the outcome of the Schedule 6 issue.

219. However, despite making those points, Mr Singh defended the assessments that had been made stating that they had been made to the best judgement of HMRC and were necessary to respond to the "artificial" structure that had been adopted. In particular, Mr Singh submitted that the decision in VWFS was not determinative of the partial exemption issue since that decision related to a situation in which HMRC were proposing a method of apportionment that attributed the entirety of use of particular overheads to an exempt supply. By contrast, in this appeal, HMRC are acknowledging that some, albeit small, component of the appellant's overheads are used for the purposes of taxable supplies of goods.

Partial exemption issue – discussion

Whether to invite parties to reach agreement on the partial exemption issue in the light of the conclusion on the Schedule 6 issue.

220. I do not consider that there is a link between the partial exemption issue and the Schedule 6 issue for which Mr Singh argues. HMRC are not arguing that the *Halifax* doctrine applies to result in the appellant's VAT obligations being completely recast

whether by particular arrangements being disregarded or otherwise. Therefore, the Schedule 6 and partial assessment aspects of this appeal are separate: the Schedule 6 issue is concerned with the OMV of particular supplies that TRL makes to TFL; the partial exemption issue is concerned with the question of the extent to which TFL uses overheads in making taxable supplies.

221. Mr Singh invokes the doctrine of fiscal neutrality to argue that the PerfectHome group should not be in a different overall VAT position from its competitors. I have made findings, in general terms, as to who PerfectHome's "competitors" are. However, in the absence of a *Halifax* challenge, I do not consider that the doctrine of fiscal neutrality requires, or even permits, the VAT treatment of transactions that the PerfectHome group has entered into to be completely recast. Moreover, I have not seen any detailed evidence as to the VAT positions of PerfectHome's competitors. Therefore, I do not consider that the doctrine of fiscal neutrality compels the conclusion that the Schedule 6 and partial exemption issues are interlinked.

222. I have therefore decided that I will not adopt Mr Singh's suggestion of inviting the parties to reach agreement on the partial exemption issue. Instead, I will make my own determination on this point.

Whether the partial exemption issue is determined by VWFS

223. The point at issue in *VWFS* is summarised at [6] of the reported judgment in the following terms:

> The issue in this appeal is whether any of the residual input tax paid by VWFS in respect of the general overheads of the business is deductible against the output tax paid on the taxable supply of vehicles to customers. In short, HMRC contend that the correct tax treatment of the residual input tax overheads in this case is that the overheads are all attributable to the exempt supplies of finance and the input tax is therefore irrecoverable.

224. Therefore, HMRC's argument in *VWFS* was centred on Regulation 101(2)(c) of the VAT Regulations (and the origin of those Regulations in the Principal VAT Directive) and amounted to an assertion that the input tax in question was directly attributable to exempt supplies.

225. The Upper Tribunal had approached this question by considering the question of "economic use" and concluded that there was no "direct and immediate link" between the overheads and the taxable supply of vehicles. They reached that conclusion noting that VWFS made no profit on the sale of vehicles (since it bought and sold them at cost) and that, from VWFS's perspective, the provision of finance was the "main event" and "what VWFS is all about".

226. However, the Court of Appeal did not consider that the factors on which the Upper Tribunal relied justified treating the entirety of VWFS's residual input VAT as attributable to, or used for, the exempt supply of finance. At [61] of the judgment, Patten LJ stated:

> VWFS is not a bank. It operates to provide a service to customers of VW who wish to purchase vehicles on HP. To provide that service, it has to make supplies both of the vehicles and of the finance required for their purchase. Neither can exist as part of its business without the other. This is not a case like *London Clubs* or *Aspinall's* where the gaming business could have continued without the making of the catering supplies. On the facts found by the FtT it was therefore entitled in my view to conclude as it did that the general overheads were used in part for the making of taxable supplies of the vehicles.

He went on to say, at [62]:

> Once it is conceded that the taxable supply (in this case of the vehicles) was part of the economic activities of the taxable person then the use of the overheads to fund that business is, on *Midland Bank* principles, sufficient to establish the direct and immediate link which the jurisprudence of the ECJ requires.

227. Mr Singh submitted that *VWFS* is not determinative of the partial exemption issue. In his submission, *VWFS* was dealing with the question of whether input tax incurred was directly attributable (in its entirety) to exempt supplies, and therefore irrecoverable in its entirety. In this case HMRC are not seeking to argue that TFL's input tax on overheads is all directly attributable to exempt supplies (and so irrecoverable in its entirety) but rather that, by operation of the SMO, the proportion of the input tax that is recoverable is to be based on a much smaller fraction than the standard "turnover" based method would produce.

228. I agree with Mr Singh in this respect. It follows that I have not accepted Ms Shaw's argument that HMRC's approach involves a denial of the status of TFL's expenses as overheads. As I understand HMRC's argument, they are asserting that, while those expenses are overheads, the amount of input tax recoverable on them is to be determined by applying a SMO rather than a "turnover" based method. It follows that I do not accept that *VWFS* conclusively determines the partial exemption issue against HMRC.

229. However, *VWFS* is still highly relevant in this appeal since, in order for an SMO to apply in this case, the attribution based on "turnover" under the standard method has to differ substantially from an attribution which represents the extent to which "the goods or services are used by [TFL] in making taxable supplies". Therefore, the SMO deals with questions of "use" which are very similar to those addressed in VWFS. I therefore consider that *VWFS* is highly relevant to the analysis of how the question of "use" should be determined for the purposes of the SMO.

Whether HMRC's assessments of 5 July 2011 and 11 July 2012 are correct

230. Both of HMRC's assessments of 5 July 2011 and 11 July 2012 are based on similar principles which include the proposition that the SMO should be applied to determine TFL's input tax recovery since it represents the extent to which "the goods or services are used by [TFL] in making taxable supplies". The justification for

Officer Bird's conclusion that the SMO does represent "use" in this respect is to be found in his letter of 6 May 2011 referred to at [207] to [211].

231.I do not consider that Officer Bird's conclusions are correct for reasons set out below.

232.Firstly, I do not agree with the assertion, referred to at [209] that non-attributable input tax that TFL incurs after acquiring the goods is to deal with "Coverplus, HP and TAD formalities". I am satisfied that residual input tax is incurred for purposes relating to the supply of the goods. In particular, as noted at [213] above, TFL incurs residual input tax in order to collect weekly payments that relate, at least in part, to the sale price of those goods. I do not consider those facts support Officer Bird's conclusion, referred to at [210] that TFL is concerned primarily to recover payments of finance cost. TFL is seeking to recover the totality of sums due that relate both to finance costs and the outstanding sale price for the original sale of the goods.

233.I do not agree with the assertion, summarised at [209] that, since overhead costs are not priced into the sale price of the goods, they are not "used" for the purposes of the taxable supply of goods. TFL's business is very similar to that of VWFS and the statements of the Court of Appeal referred to at [226] could be applied to TFL's business just as much as to VWFS's business. In those circumstances, I cannot see any justification for a conclusion that overhead costs that TFL incurs are not incurred for the purposes of the taxable supply of goods. I also note that this aspect of Officer Bird's assertions does appear to amount to an assertion that overhead costs are directly attributable to exempt supplies, a conclusion which I consider is not sustainable in the light of the *VWFS* decision.

234.In his skeleton argument, Mr Singh sought to defend Officer Bird's arguing that it prevented TRL and TFL obtaining multiple credits for the same input tax. I do not accept that argument. When goods are sold on HP terms, there are two taxable supplies of goods: the first from TRL to TFL and the second from TFL to the PerfectHome customer. TRL is not partially exempt and is therefore able to recover all of its input VAT. TFL is partially exempt and can recover only a proportion of its input VAT on overheads. However TRL and TFL are not claiming multiple credits for the same input VAT. TRL claims input tax credit for expenditure that it incurs. It recharges a proportion of that cost by making a taxable supply to TFL with TFL claiming input tax credit for a proportion of costs that are so recharged. Both TFL and TRL, therefore, claim input tax credit associated with costs that each respectively incur.

235.Therefore, I do not consider that Officer Bird's reasoning is correct. That, however, does not dispose of the issue. As noted at [31], the burden of proof is on TFL to prove that its calculation of VAT is correct and not merely to show that HMRC's reasoning is flawed. I am satisfied that TFL's business involves the making of taxable supplies of goods. Moreover, it cannot make exempt supplies of finance without making those taxable supplies (since it does not provide finance otherwise than for the purpose of enabling a customer to purchase goods from TFL). Therefore, TFL's business involves the making of taxable supplies and exempt supplies which

are inextricably linked with each other. I am therefore satisfied that TFL uses its overheads in the course of its entire business in just the same way as the extracts from *VWFS* set out at [226] above demonstrate that VWFS used overheads for the purposes of its entire business. Therefore, an apportionment of residual input tax on the basis of "use" would not lead to a different result from the standard "turnover" based method.

236. Finally, Mr Barry's witness statement contained a detailed passage on QR goods. He gave the example of a sofa that TFL sells to a customer on HP terms for £100 (having purchased it from TRL immediately prior to that sale for £97 and paying TRL £5 to deliver it to the customer on TFL's behalf). If the customer defaults after a year leaving £66, plus interest outstanding under the HP agreement, TFL might repossess the sofa and sell it as a QR sofa for £68. Mr Barry set out his view as to how that transaction should be characterised for VAT purposes. Mr Singh criticised Mr Barry's witness statements for containing what he considered to be excessive statements of opinion and I think that criticism was fair as regards the passage I have referred to. However, despite the passage dealing specifically with QR goods in Mr Barry's witness statement, neither party made any detailed submissions as to whether any particular considerations applied to sales of QR goods, although at one point Mr Singh suggested that sales of QR goods were not relevant to the partial exemption dispute since it was only after April 2011 that TFL itself sold QR goods to customers in PerfectHome stores and prior to then TFL had sold QR goods back to TRL with TRL selling them on to PerfectHome customers.

237. For completeness, I consider that sales of QR goods do have a bearing on the partial exemption issue. Even though TFL did not sell QR goods to external customers of the PerfectHome business until 2011, it was still making taxable supplies of QR goods prior to then when it sold them to TRL following repossession and refurbishment. The question of whether those taxable supplies should feature in a turnover-based apportionment of input tax on overheads is just as relevant as whether taxable supplies of QR goods made to PerfectHome customers should feature in that calculation. However, I consider that the conclusions I have expressed at [235] above apply just as much in the context of taxable supplies of QR goods as they do in the context of brand new goods.

238. My overall conclusion is that TFL's approach to calculating the input tax that it is entitled to recover on overheads is correct and that HMRC's approach to this calculation is wrong.

PART III – THE TIME LIMIT DISPUTE

Overview of the dispute

239. This aspect of the dispute relates to assessments made on TFL on 5 July 2011 (the "TFL Assessment") and on TRL on 4 June 2013 (the "TRL Assessment"). Both of those assessments relate to VAT obligations over a number of VAT accounting periods:

(1) The TRL Assessment dealt with matters covering VAT periods 09/09 to 03/11 and dealt with Advertising Services and Store Services separately.

(2) The TFL Assessment dealt with matters covering VAT periods from 09/07 to 06/09.

240. TRL and TFL contend that both the TRL Assessment and the TFL Assessment are "global assessments" (covering multiple VAT periods) and not separate assessments for each relevant VAT period. They go on to argue, in reliance on the judgment of Woolf J (as he then was) in *International Language Centres Ltd v Customs and Excise Commissioners (No. 2)* [1983] STC 394 that since HMRC were out of time to assess at least part of the VAT covered by those assessments, the whole of those assessments were made out of time.

241. HMRC do not dispute TRL's and TFL's summary of the principle in *International Language Centres*. However, HMRC do not accept that the assessments are "global assessments", but contend that they are separate assessments for separate VAT periods.

242. HMRC accept that they were out of time to issue assessments for at least part of the VAT dealt with in both the TRL Assessment and the TFL Assessment:

(1) In relation to the TRL Assessment, they accept that they were out of time to assess TRL in relation to Advertising Services.

(2) In relation to the TFL Assessments, they accept that they were out of time in relation to matters arising in the VAT periods 09/07 to 03/09 (but contend that they were in time in relation to the period 06/09).

243. Therefore, the parties were in general agreement as to the approach to be taken:

(1) If the TRL Assessment is a "global assessment", then it is out of time in its entirety. Similarly, if the TFL Assessment is a "global assessment" then it too is out of time in its entirety.

(2) If the TRL Assessment is not a "global assessment", the parties were agreed that it should be treated as a series of separate assessments relating to Store Services and a series of separate assessments relating to Advertising Services and that the assessments relating to Advertising Services were out of time. However, it may (subject to the discussion at [283]) still be necessary in this case to determine whether the assessments relating to Store Services were in time on general principles.

(3) If the TFL Assessment is not a "global assessment", then at most the separate assessment relating to the 06/09 period could be in time with that question being determined in accordance with ordinary statutory principles. In that case, there would also be a question as to precisely how much VAT had been assessed for 06/09.

Principles of law relevant to the time limit dispute

Statutory provisions setting out the time limits

244. Section 73(6) of VATA 1994 sets out the time limit relevant to the VAT assessments on both TRL and TFL. It provides as follows:

> (6) An assessment under subsection (1), (2) or (3) above of an amount of VAT due for any prescribed accounting period … shall not be made after the later of the following:
>
> a) 2 years after the end of the prescribed accounting period; or
>
> b) one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge

245. The parties' dispute centred entirely on the time limit set out in s73(6)(b) of VATA 1994. In *Pegasus Birds Ltd v Customs and Excise Commissioners* [1999] STC 95, Dyson J (as he then was) considered the application of s73(6)(b) of VATA 1994 and summarised the legal principles to be applied as follows:

> 1. The commissioners' opinion referred to in s73(6)(b) is an opinion as to whether they have evidence of facts sufficient to justify making the assessment. Evidence is the means by which the facts are proved.
>
> 2. The evidence in question must be sufficient to justify the making of the assessment in question (see *Customs and Excise Comrs v Post Office* [1995] STC 749 at 754 per Potts J).
>
> 3. The knowledge referred to in s73(6)(b) is actual, and not constructive knowledge (see *Customs and Excise Comrs v Post Office* [1995] STC 749 at 755). In this context, I understand constructive knowledge to mean knowledge of evidence which the commissioners do not in fact have, but which they could and would have if they had taken the necessary steps to acquire it.
>
> 4. The correct approach for a tribunal to adopt is (i) to decide what were the facts which, in the opinion of the officer making the assessment on behalf of the commissioners, justified the making of the assessment, and (ii) to determine when the last piece of evidence of these facts of sufficient weight to justify making the assessment was communicated to the commissioners. The period of one year runs from the date in (ii) (see *Heyfordian Travel Ltd v Customs and Excise Comrs* [1979] VATTR 139 at 151, and *Classicmoor Ltd v Customs and Excise Comrs* [1995] V&DR 1 at 10).
>
> 5. An officer's decision that the evidence of which he has knowledge is insufficient to justify making an assessment, and accordingly, his failure to make an earlier assessment, can only be challenged on *Wednesbury* principles, or principles analogous to *Wednesbury* (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223) (see *Classicmoor Ltd v Customs and Excise Comrs* [1995] V&DR 1 at 10–11, and more generally *John Dee Ltd v Customs and Excise Comrs* [1995] STC 941 at 952 per Neill LJ).

> 6. The burden is on the taxpayer to show that the assessment was made outside the time limit specified in s 73(6)(b) of the 1994 Act.

246.Point 4 of the legal principles which Dyson J set out makes it clear that the question of "knowledge" is to be determined by reference to the subjective knowledge of the officer making the assessment. He explicitly rejected the submission that s73(6)(b) of VATA 1994 was concerned only with an objective test in the following passage:

> Moreover, I do not accept that, if an objective approach is not adopted, the protection afforded by the subsection to the taxpayer is illusory. This raises the question of the circumstances in which it is possible to challenge the opinion of the commissioners. It is common ground that, in forming their opinion of what evidence of facts is sufficient to justify making the assessment, the commissioners must have regard to their obligations to act to the best of their judgment as explained in *Van Boeckel v Customs and Excise Comrs* [1981] STC 290. Thus, they must perform their function honestly and bona fide, and fairly consider all the material placed before them, and, on that material, come to a decision which is reasonable. In some cases, the taxpayer may complain that the commissioners have made an assessment on insufficient material. In other cases, the complaint of the taxpayer may be that, in the light of the evidence of which they were aware, it was wholly unreasonable for the commissioners to delay making the assessment. In both cases, an appeal will succeed if it is shown that the commissioners' approach was wholly unreasonable, and fails to pass a test akin to the *Wednesbury* test. I recognise that this is a high hurdle for the taxpayer to surmount, but Parliament has entrusted these matters to the judgment of the commissioners, and it is right that challenges to the exercise of judgment should only succeed when something has gone seriously wrong.

Authorities on the concept of a "global assessment"

247.Mr Singh submitted that the term "global assessment" has a specific technical meaning and was limited to the kind of assessment that is made where it is not possible for HMRC to allocate specific amounts assessed to particular VAT periods. That was indeed the approach that Woolf J (as he then was) set out in the *International Language Centres* case already referred to where he said, at [396]:

> It is apparent from the judgments of the Court of Appeal in the Grange case that the use of global assessments is to be confined to those cases where it is not possible to identify a specific period for which the tax claimed is due.

248.However, in *House (trading as P&J Autos) v Customs & Excise Commissioners* [1996] STC 154, the Court of Appeal disapproved Woolf J's statement and Balcombe LJ said, at 160d:

> It is, I hope, clear from what I have just said that, far from it being so apparent from the judgments of the Court of Appeal, on my understanding of those judgments, the opposite is the case.

249.These authorities do not answer the question of how to decide whether a particular assessment is, or is not, a global assessment. I was referred to a number of authorities on this question and have drawn the following conclusions from them:

> (1) The ultimate question depends on construction of the documents served on the taxpayer (*Don Pasquale (a firm) v Customs and Excise Commissioners* [1990] STC 556).
>
> (2) The conclusion of a court on the construction of particular words in a particular form of assessment is not a conclusion of law that is binding on a court that subsequently comes to consider the construction of the same or similar words in a different form of assessment, although such a decision may be persuasive (*Customs and Excise Commissioners v Le Rififi Ltd* [1993] STC 725).
>
> (3) In approaching the question of construction, it is permissible to consider the notice of assessment itself together with any schedules to it and any calculations that accompany it (*Customs and Excise Commissioners v Post Office* [1995] STC 749).

Findings of fact relevant to the time limit dispute – TRL Assessment

Form of the TRL Assessment

250.On 4 June 2013, Officer Ford sent TRL a letter that referred to the direction that HMRC had made under Schedule 6 of VATA 1994. It included the following paragraphs:

> You have not notified me of any underdeclared VAT in respect of the specified supplies for periods prior to the issue of the notice [i.e. the direction under Schedule 6] so I am now raising assessments in order to protect the tax before the expiry of the statutory time limits for making the assessments.
>
> I enclose a Notice of Assessment in respect of your VAT return periods ending [between September 2009 and March 2011] totalling £1,354,748. This assessment comprises £244,758 in respect of recharges of advertising and launch costs and £1,109,990 in respect of recharges of shop costs. A computer generated Notice of Assessment will also be issued in respect of these assessments and will be sent to you in due course under separate cover.
>
> Statutory interest will be due on these assessments…
>
> The assessments have been raised up to and including the period ending March 2011 as I do not have sufficient information at this time to calculate the amounts due for later periods…

251.Attached to that letter was a "Notice of Assessment" in the following form:

Period of Assessment			**Amount Assessed**	
Period	**From**	**To**	**Due to HMRC**	**Due from HMRC**

Sept 2009	01-07-2009	30-09-2009	£125,532	0
Sept 2009	01-07-2009	30-09-2009	£27,036	0
Dec 2009	01-10-2009	31-12-2009	£125,532	0
Dec 2009	01-10-2009	31-12-2009	£27,036	0
Mar 2010	01-01-2010	31-03-2010	£146,454	0
Mar 2010	01-01-2010	31-03-2010	£31,543	0
Jun 2010	01-04-2010	30-06-2010	£171,976	0
Jun 2010	01-04-2010	30-06-2010	£38,414	0
Sept 2010	01-07-2010	30-09-2010	£171,976	0
Sept 2010	01-07-2010	30-09-2010	£38,414	0
Dec 2010	01-10-2010	31-12-2010	£171,976	0
Dec 2010	01-10-2010	31-12-2010	£38,414	0
Mar 2011	01-01-2011	31-03-2011	£196,544	0
Mar 2011	01-01-2011	31-03-2011	£43,901	0
Total			**£1,354,748**	**0**

252.It will be seen from the above that each VAT period contained two separate entries. Officer Ford confirmed in her evidence, and it was not disputed, that one of these figures related to Store Services and one related to Advertising Services.

Background leading up to the making of the TRL Assessment

253.Officer Mintoft of HMRC made the original direction under Schedule 6 of VATA 1994. Since Officer Mintoft was due to retire, on 5 July 2012, Officer Ford replaced Officer Mintoft as allocated case officer.

254.On 25 July 2012, Officer Ford became aware that TRL had appealed to the Tribunal against the making of the Schedule 6 direction. From that she deduced that TRL did not accept that it was receiving consideration for the relevant supplies that was less than their OMV and that she would need to establish what, in HMRC's view, was the OMV of the supplies. She identified that key documents that would assist her with this task were the Murphy Report and a spreadsheet analysing cross charges between TRL and TFL that Mark Barry had prepared.

255.One aspect of that spreadsheet related to depreciation costs. However, the direction under Schedule 6 of VATA 1994 related only to specific supplies (namely Store Services and Advertising Services) that TRL supplied to TFL. Therefore, while Officer Ford considered that depreciation costs were in principle relevant to the question of how OMV should be determined under Schedule 6 of VATA 1994, she needed depreciation costs that "stripped out" costs relating to head office and other non-shop premises (since those matters were outside the scope of the Schedule 6

Direction). She received that information from Philip Davies, an employee of PerfectHome, on 7 August 2012.

256.Officer Ford stated in her witness statement that she used the information on depreciation contained in the spreadsheet of 7 August 2012 to make the TRL Assessment. She accepted in cross-examination that this information was relevant only to her determination of the OMV of Store Services and had no bearing on the OMV of Advertising Services. I have therefore concluded that (i) Officer Ford considered that she needed the information in Philip Davies's spreadsheet in order to perform the task of determining the OMV of supplies that TRL made to TFL, but that (ii) the information contained in that spreadsheet was relevant only to the calculation of the OMV of Store Services.

Whether Officer Ford intended the letter of 4 June 2013 to be a single assessment

257.I will make findings of fact on this issue given the challenges that Mr Firth made to Officer Ford's credibility in cross-examination. However, as noted at [249] the question of whether this was a single "global assessment" is one of construction, and is not determined by Officer Ford's subjective intentions.

258.In cross-examination, Mr Firth noted that, in places in her letter of 4 June 2013 as well as in her witness statement, Officer Ford referred to this document as "an assessment" (in the singular). He put it to her that she had therefore intended her letter to make a single assessment. Officer Ford denied this and stated that it is common for VAT officers to refer to a single document that embodies assessments for multiple periods as "an assessment". Officer Ford has over 25 years' experience as a VAT officer. I accepted her evidence that VAT officers might refer to "an assessment" without necessarily turning their mind to the question of whether the document embodied one, or multiple, assessments.

259.Mr Firth suggested to Officer Ford that her reference to "the assessment" in her witness statement was particularly revealing. He put it to her that this witness statement had been prepared in order to establish 7 August 2012 (when she received Philip Davies's spreadsheet) as the date on which she had received the last piece of information necessary to assess TRL for output tax arising in consequence of the making of the Schedule 6 direction. Given that Officer Ford had accepted that this spreadsheet had no bearing on the OMV of Advertising Services, he suggested to her that the spreadsheet of 7 August 2012 could only be relevant on the assumption that she intended the document of 4 June 2013 to be a single "global assessment". If she had truly intended that document to make multiple assessments for different VAT periods in respect of Store Services and Advertising Services she would not have been able to say that the information on the spreadsheet of 7 August 2012 was used in making the assessments in respect of Advertising Services and she would have had to admit that those assessments were out of time. He put directly to Officer Ford that she knew she had made a single assessment but, having now seen the appellant's skeleton argument and realised that assessment would be out of time applying the principle of *International Language Centres,* she was now changing her story. In his

closing arguments, Mr Firth submitted that a possible inference that could be drawn was that Officer Ford was seeking to mislead the Tribunal in her evidence.

260.Mr Firth, therefore, made a serious challenge to Officer Ford's credibility. That challenge was made explicitly in cross-examination and must be addressed. However, I have no doubt that the challenge was unfair and unwarranted and that Officer Ford was an honest witness. As I have found at [258], officers of HM Revenue & Customs use the expression "assessment" without considering whether the document being referred to is a single, or multiple assessments. When Officer Ford prepared her witness statement (on 19 November 2014), there had as yet been no suggestion that the assessment she made was a "global assessment". In those circumstances, Officer Ford's witness statement was short and gave evidence to the effect that she used information in the spreadsheet of 7 August 2012 when making "the assessment". Very properly that witness statement did not contain legal argument as to why it was considered that Officer Ford's evidence supported a conclusion that the assessment of 4 June 2013 was in time: it simply recorded Officer Ford's evidence that she had used the spreadsheet information when making that assessment.

261.I do not see how any of Officer Ford's evidence can be said to be misleading. It may be that she would not have referred to the document of 4 June 2013 as "the assessment" if she had realised that the appellant was arguing that this was a single "global assessment". But her evidence, that she used information in the spreadsheet of 7 August 2012 when making the calculations set out in that document, was not challenged. HMRC have, since the date of Officer Ford's witness statement, accepted that those parts of the 4 June 2013 document that related to Advertising Services are out of time (in part no doubt because the spreadsheet of 7 August 2012 was not relevant to the OMV of Advertising Services). However, that does not make Officer Ford's evidence in her witness statement misleading or inconsistent with her evidence at the hearing as whatever view is taken of the legal question as to whether the assessment was in time or not, the factual point, that Officer Ford used information from the 7 August 2012 spreadsheet for the purposes of the document of 4 June 2013 was not challenged.

Findings of fact relating to the time limit dispute – TFL

The respective roles of Officer Bird and Officer Anderson

262.Officer Bird provided a full witness statement detailing discussions relating to TFL's partial exemption calculations going back to 2008. Much of that evidence was unchallenged, but I will not recite it all here as the position can be understood by reference to a selection of items from that chronology.

263.There were two aspects of HMRC's investigations into TFL's partial exemption position that are relevant to the timing dispute:

(1) The SMO aspect (which I have already dealt with at length) related to the question of whether TFL had to make an SMO adjustment to its annual partial exemption calculations applying the standard method. If an SMO

adjustment was needed, it was common ground that any difference would need to be accounted for in TFL's 06/09 VAT period (being the first VAT period to end after the expiry of TFL's "longer period" for partial exemption purposes)[8].

(2) There was also a more general question of whether the standard method had been applied correctly, either in particular VAT periods, or in annual adjustments. So, for example, there were questions such as whether undelivered stock should be deducted when calculating taxable turnover under the "standard method" as well as more basic questions of whether calculations applying the standard method were correct.

264. Both of the aspects above related to the application of the "standard method" for partial exemption purposes, but they were separate aspects of it. Officer Bird gave evidence that one of his colleagues, Officer Carolynn Anderson was, in general terms, responsible for the aspect set out at [263(2)], whereas he was taking the lead on the SMO aspect set out at [263(1)]. Mr Firth pressed Officer Bird in cross-examination as to whether he had delegated responsibility relating to the entirety of HMRC's "standard method" calculations to Officer Anderson, but Officer Bird remained clear that he and Officer Anderson had separate responsibilities for the two different aspects of that calculation set out above. I also considered that evidence to be consistent with the chain of correspondence summarised below which shows Officer Bird dealing with SMO issues and Officer Anderson dealing with more general aspects of the partial exemption calculation. I have accepted Officer Bird's evidence on these issues.

265. Between January 2009 and April 2010, Officer Anderson obtained various items of information from TFL on its partial exemption calculations and had meetings with TFL at which further information was supplied. On 27 August 2010, Officer Anderson sent TFL her partial exemption calculations. Consistent with Officer Bird's evidence at [264], Officer Anderson did not make any calculations as to the amount of SMO adjustment that was needed.

266. There then followed a period when TFL and Officer Anderson discussed her draft calculations and, on 21 February 2011, Officer Anderson provided TFL with a further draft calculation under cover of a letter headed "Partial exemption; calculating the standard method (mechanics)". That letter concluded with a request that TFL let Officer Anderson know if there was anything that she had not taken into account. I was not shown any letter specifically agreeing those calculations. However, on 3 March 2011, Alaric Smith wrote a letter summarising what he said were areas in dispute between PerfectHome and HMRC which made no mention of points coming out of Officer Anderson's calculations. On 25 March 2011, Officer Bird responded to that letter and in his letter said that he assumed Officer Anderson's calculations were agreed. Since TFL is not taking any issue in this appeal with the detail of Officer Anderson's calculations, I consider that TFL agreed those calculations some time between 21 February 2011 and the end of March 2011.

[8] HMRC accept that they are out of time to make a SMO adjustment in the 06/08 VAT period, so the SMO adjustment for 06/09 is the only one relevant to the TFL time limit issue

The information that Officer Bird required in order to make the assessment

267. In his letter of 25 March 2011, Officer Bird reminded TFL that he was still not in a position to consider whether any SMO adjustments were required and he set about making calculations.

268. As noted above, any SMO adjustments would take effect in a VAT period ending on 30 June in any calendar year. Therefore, in order to work out how much to assess by applying the SMO, Officer Bird said that he needed to know how much, if any, SMO adjustment had made in VAT periods ending on 30 June. On 5 May 2011, Officer Bird called Philip Davies at PerfectHome to ask about SMO adjustments that PerfectHome had made. He made a note of that call, the accuracy of which was not in dispute, that Philip Davies confirmed "no PE Annual Adjustment made in VAT period 06/09 (or otherwise)".

269. Officer Bird gave oral evidence to the effect that he needed the information from his call with Philip Davies in order to be able to make the assessments he did. Mr Firth put it to Officer Bird in cross-examination that HMRC's case to date had been that the last piece of evidence sufficient to justify the making of the assessment on TFL came to HMRC's notice when TFL agreed Officer Anderson's partial exemption calculations in the early part of 2011. Indeed, paragraph 42 of Officer Bird's own witness statement contained the following section:

> It wasn't until January 2011 that Carolynn Anderson confirmed to me that she had reached agreement regarding the recalculation of the [standard method] calculations. Therefore, I was not in a position to issue the assessment I did until these recalculations were agreed.

Mr Firth put it to Officer Bird that he was now changing his story, having realised from the appellants' skeleton argument that reliance on TFL's agreement of figures that Officer Anderson prepared could not be enough to save his assessment from being out of time (in the light of the VAT Tribunal's decision in *Lazard Brothers & Co Ltd v Customs and Excise Commissioners* VAT Decision 13476 and other authorities). Officer Bird denied Mr Firth's allegation.

270. The question for the Tribunal is whether the oral evidence that Officer Bird gave the Tribunal (that, at the time he made his assessments, he had a genuine belief that he needed the information Philip Davies gave him on 5 May 2011) is true. There is no doubt that there was a clear difference in emphasis between the evidence that Officer Bird gave the Tribunal and the statements he made in his witness statement and that is clearly relevant to my assessment of the reliability of Officer Bird's evidence. I have, however, also taken into account the fact that Officer Bird referred to his conversation with Philip Davies in his witness statement (and attached his note of that conversation as an exhibit to it) which satisfies me both that the conversation took place and that, at the time he made his witness statement, Officer Bird attached significance to it. I have also taken account of the fact that it seems entirely logical that, an officer considering making an assessment based on application of the SMO would need to know how much of a SMO adjustment the taxpayer had itself made in its VAT returns. To state the obvious, if a taxpayer has already made a SMO adjustment exactly equal to an amount that an HMRC officer is considering, there is nothing additional for that

officer to assess. I consider that these factors outweigh the inconsistencies between Officer Bird's oral evidence and his witness statement and I accept that, at the time he made the TFL Assessment, Officer Bird genuinely believed that he needed the information he had gleaned from Philip Davies in order to do so.

271. In addition to challenging Officer Bird's evidence that he genuinely considered he needed this information, Mr Firth also pressed him on whether he actually did need it. He suggested that Officer Anderson discovered this information herself during the course of her own work. Quite understandably, Officer Bird was unable to say whether Officer Anderson had received this information and I had no witness evidence from Officer Anderson herself. Therefore, I am not satisfied that either Officer Bird or Officer Anderson knew that TFL had not made any SMO adjustment in its 06/09 VAT period prior to 5 May 2011.

The making of the TFL Assessment

272. On 6 May 2011, Officer Bird sent the letter which I have already referred to at length (see [207] to [211]). That letter notified TFL, inter alia, that HMRC proposed to make assessments to give effect to the SMO. Appendix D to that letter was as follows:

> Appendix D
>
> Proposed Standard Method Override Assessments
>
> …

A	B	C	D
VAT Period	**Standard Method Recalculation (See Appendix B)**	**SMO Adjustment (within Annual Adjustment VAT period) (£)**	**Total (after rounding adjustments) (£)**
09/07	(7,408.82)	0	(7,409)
12/07	7,271.96	0	7,271
03/08	0.67	0	0
06/08	(13,085.25)	103,789.62	90,704
09/08	(8,808.70)	0	(8,809)
12/08	(19,347.08)	0	(19,847)
03/09	118.06	0	118
06/09	(5,102.21)	101,617.41	96,515
Total			159,043

273. Officer Bird's evidence, which was not challenged, and which I have accepted, was that the figures in Column B came from Officer Anderson's calculations.

274. On 5 July 2011, Officer Bird sent TFL a letter that included the following section:

> NOTIFICATION OF ASSESSMENT(S)
>
> The purpose of this letter is to notify you of an assessment(s) in relation to VAT periods 09/07 to 06/09 totalling £159,043.00 under the terms of the VAT Act 1994 Section 73 to 77 (and interest where appropriate). Please note that a computer printed notification of this assessment (V655) will be issued under separate cover by my colleague Carolynn Anderson.
>
> This assessment(s) relates to Partial Exemption calculation errors for tax years 2007/2008 & 2008/2009 as detailed within my letter dated 6 May 2011. A schedule of the assessment is included within Appendix D of the same letter.

275. A Form VAT655 was duly issued, although I could not determine the precise date it was issued. That form was described as a "Notice of Assessment(s) and/or Overdeclaration(s). On the front page of that form was a table headed "Summary" that showed the figure of £159,043 in a box headed "Net Amount Due to Customs and Excise". The box headed "Net Amount Due From Customs and Excise" in that box was empty. Over the page were separate entries relating to VAT periods from 09/07 to 06/09 each of which contained a "Due to HMRC" column and a "Due from HMRC" column. The figures from Appendix D of Officer Bird's letter of 6 May 2011 were transcribed into those tables with positive amounts from Column D of that appendix appearing in the "Due to HMRC" column, and negative amounts appearing in the "Due from HMRC" column.

Whether Officer Bird considered he was making a single global assessment

276. As I have noted, I do not consider that the question of whether an assessment is a "global assessment" or not can be determined solely by reference to the subjective intentions of the officer making that assessment. However, since Officer Bird gave evidence as to his beliefs, and was cross-examined on them, I will make some findings in this regard.

277. Officer Bird was clear in his evidence that he intended to make separate assessments for each relevant VAT period. I am satisfied that was his intention. Later in this decision, I will consider whether the relevant documents, properly construed, gave effect to that intention.

Time limit dispute applicable to TRL – Discussion

Whether the assessment of 4 June 2013 was a "global assessment"

278. In line with the approach summarised at [249] above, I have considered this issue by seeking to construe Officer Ford's letter of 4 June 2013 together with the "Notice of Assessment" attached to it.

279. Unsurprisingly, Mr Firth referred me to a number of instances in that communication in which the assessment was referred to in the singular and Mr Singh referred me to instances in which assessments were referred to in the plural. Given that I accepted Officer Ford's evidence to the effect that HMRC officers would not necessarily attach significance to the use of either the singular or the plural, and given that the ultimate question is one of construction, that is not determined conclusively by the subjective intentions of the officer making the assessment, I derived relatively limited assistance from this approach.

280. I found the submissions relating to the form of the Notice of Assessment to be more helpful. Mr Singh emphasised that the Notice of Assessment clearly sought to allocate particular figures to particular VAT periods and submitted that, for each VAT period mentioned, it should be regarded as making two assessments, one relating to Store Services and one relating to Advertising Services.

281. Mr Firth attached significance to the "Due From HMRC" column in the TRL Notice of Assessment. He acknowledged that, in each case, the amount shown in that column was nil. However, he submitted that the column remained important. Given that there was no column in which amounts "due from HMRC" could be netted against amounts "due to HMRC", he said that the Notice of Assessment could not take effect as separate assessments for each period since there was no column which, on the face of the Notice of Assessment, communicated an actual amount being assessed for each VAT period. In any event, he said that it was possible for the amount "due from HMRC" to be greater than the amount "due to HMRC". In that case, netting off the two amounts would produce a negative amount, yet there is no such thing as a "negative assessment" for VAT purposes. Accordingly, he submitted that the document should not be construed as producing a series of separate assessments (each of a net amount) since that construction would be unworkable if any net amount were negative. Finally, he submitted that it did not make sense for HMRC to make two assessments for each VAT period, one relating to Advertising Services and one relating to Store Services. The reality, he submitted, was that this emphasised that what HMRC intended was a single "global assessment" for £1,354,748 being the total sum set out in the notice of assessment.

282. I have concluded that Officer Ford made a series of separate assessments, not a single "global assessment". The Notice of Assessment contains separate figures for separate VAT periods and, while the total amount is shown, the clear inference is that, by doing so, Officer Ford was making separate assessments for different VAT periods. Mr Firth's submissions as to the significance of the "Due From HMRC" column founder on the obvious point that, in each case, the amount shown in that column is zero so that, even if Mr Firth is correct that it is not possible to make a "negative assessment", HMRC were not purporting to make a "negative assessment". In those circumstances, a reader of the Notice of Assessment could be in no doubt that separate amounts were being assessed for separate periods. Mr Firth's submissions that there were was no reason for Officer Ford to make separate assessments relating to Store Services and Advertising Services cannot alter this conclusion given that, in my judgment, Officer Ford did just that.

Whether any of the assessments made on TRL were out of time

283. It was not entirely clear to me whether TRL is arguing that any of the assessments made on 4 June 2013 were out of time, even if no "global assessment" was made. In his submissions on the time limit issue, Mr Firth said that, as regards TRL, the sole issue was whether a single or global assessment had been made. However, some of his questions to Officer Ford in cross-examination appeared designed to press the question of whether Officer Mintoft could have made these assessments before Officer Ford took over from him as TRL's case worker. In addition the appellants' skeleton argument contained submissions to the effect that it was unreasonable for Officer Ford to delay making the TRL Assessment until she had received depreciation figures from Philip Davies. I will, therefore, make a determination on this point.

284. As I have determined, TRL Assessment contained separate assessments relating to Advertising Services and Store Services respectively. HMRC concede that the assessments relating to Advertising Services were made out of time. However, Officer Ford's evidence that she relied on information contained in the 7 August 2012 spreadsheet when making her assessments, was not challenged. Therefore, HMRC did not receive the last piece of evidence which, in Officer Ford's opinion justified the making of the assessments relating to Store Services, until 7 August 2012 and those assessments were made less than 12 months later. The figures set out in the spreadsheet were plainly relevant to the elements of the TRL Assessment relating to Store Services and resulted in a material sum of money (£238,020) being excluded from the scope of those assessments. It was entirely reasonable for Officer Ford to want to take that information into account when making the TRL Assessment.

285. Accordingly, applying the approach set out in *Pegasus Birds*, I consider that the assessments relating to Store Services were made in time.

Time limit dispute applicable to TFL – discussion

Whether Officer Bird made a "global assessment"

286. As I have noted, this is a question of construction. I consider that, applying the reasoning set out in *Customs and Excise Commissioners v Post Office* [1995] STC 749, that question of construction should be determined in the light of Appendix D to Officer Bird's letter of 6 May 2011 and his letter of 5 July 2011 that notified TFL of the assessment. Although it is clear that the Form VAT 655 was issued after both of these documents, I consider that this Form is also relevant to the question of construction since it formed part of the same continuum of communication as Officer Bird's letters of 6 May 2011 and 5 July 2011.

287. As with Officer Ford's assessment, Mr Singh focused on references to "assessments" in those documents, while Mr Firth placed his emphasis on references to "assessment" in the singular. I do not think much can be determined from these references: at most they demonstrate that sometimes the singular was used and sometimes the plural suggesting that neither use conveyed any particular meaning.

288.It is clear that Officer Bird's letter of 6 May 2011 and the Form VAT 655 seek to allocate particular amounts to particular VAT periods. As I have said at [282] in connection with the TRL Assessment this clearly points towards a conclusion that multiple assessments were intended. However, unlike the TRL Assessment, some of the numbers allocated to certain VAT periods are negative. Mr Firth submitted that, since there is no such thing as a "negative assessment", neither document should be construed as making separate assessments for separate periods and rather should be construed as making a single assessment for the amount of £159,043. He amplified this point by submitting that, if the true intention of these documents had been to make a series of assessments, the total amount of these assessments could not be £159,043 (as was stated in all of the relevant documents) but rather would be £195,108 with credit of £36,065 (the sum of the negative amounts from Appendix D of the letter of 6 May 2011) being given to reduce the amount actually payable to £159,043.

289.I have not accepted Mr Firth's submissions in this regard. While the concept of a "negative assessment" may well not exist, a fair reading of Officer Bird's "Appendix D" makes it clear that, for those VAT periods where a negative amount was shown in Column D, Officer Bird was recording HMRC's acceptance that TFL had overpaid VAT to that extent. That impression is emphasised by the fact that, in the Form VAT 655, negative amounts shown in Officer Bird's table appeared in the "Due from HMRC" columns of the separate tables shown for each VAT period. Therefore, I am satisfied that for those periods in which a positive amount was shown in Column D, Officer Bird made a separate assessment for that amount that related to that period. Where a negative amount was shown, Officer Bird acknowledged that an overpayment had been made for that period.

290.Strictly, therefore, Officer Bird was not quite accurate when he said in his letter of 5 July 2011 that he had made "assessment(s) … totalling £159,043". He had actually made assessments totalling £195,108 and had reduced those by the total acknowledged overpayments of £36,065 so that only £159,043 was actually payable to HMRC. It is also true that Officer Bird did not spell out exactly what statutory or other power he was using when he applied TFL's overpayments of VAT to reduce the amount payable to HMRC in pursuance of the assessments. However, it was not suggested to me that no such power exists and, without having heard any argument on the point, I would have thought that even if there is no specific statutory power to do this, such a power must exist either at common law or pursuant to HMRC's general power of "care and management" over the tax system. This interpretation of Officer Bird's letter is also consistent with the wording used on the Form VAT 655 which refers to the "Net Amount Due to Customs and Excise" (rather than to the total amount of the assessments).

291.However, I do not consider that minor, and highly technical, defects in the terminology that Officer Bird used alter the clear impression from all of the documents I have considered that HMRC made a series of separate assessments on TFL. That was made abundantly clear from the fact that all documents allocate specific amounts to specific VAT periods.

292.Accordingly, I have concluded that Officer Bird did not make a "global assessment".

Whether assessments on TFL were made out of time

293.During the hearing, HMRC conceded that all of Officer Bird's assessments at issue, with the exception of that relating to 06/09 were out of time. Therefore, I need only consider whether the assessment for 06/09 was out of time.

294.In his closing arguments, Mr Firth submitted that TFL had been prejudiced by HMRC's late change of their precise case on the TFL assessments. HMRC's Statement of Case dated 24 January 2013 argued that the TFL assessments were in time because it was only in the early part of 2011 that TFL agreed Officer Anderson's standard method calculations and that the assessments on TFL were made less than 12 months after that agreement. HMRC's skeleton argument served just a few days before the hearing put HMRC's case on the same basis. However, following Officer Bird's evidence, HMRC's case changed significantly. In closing, Mr Singh relied upon Officer Bird's conversation with Mr Davies on 5 May 2011 as supplying the last piece of factual evidence that he needed to make the assessment and he accepted that TFL's agreement with calculations that HMRC had prepared could not amount to "evidence of fact" for the purposes of s73(6)(b) of VATA 1994.

295.I have accepted that Officer Bird genuinely held the opinion that the information he received from Mr Davies was necessary to enable him to make the assessment. However, I accept Mr Firth's submission that the fact that HMRC only raised the relevance of this opinion during the hearing itself has prejudiced TFL's ability to make this part of its case. Therefore, while I have made findings on the "global assessment" issue relevant to TFL and have made findings of fact in relation to Officer Bird's evidence, I will not make a final determination of the question of whether the assessment for 06/09 is in time or not. I am separately releasing directions to the parties for the disposal of this issue.

Conclusion

296.The parties were agreed that, where relevant, this decision should be a decision in principle as the parties hoped to agree between themselves certain matters relating to quantum. My conclusion on the key issues is as follows:

(1) TRL has charged Store Fees of an amount equal to the OMV of Store Services.

(2) The OMV of Advertising Fees should be determined as set out at [198] above.

(3) The proportion of TFL's recoverable input tax on overheads should be determined by applying the standard (turnover-based) method and no SMO is required.

(4) The TRL Assessment is not a global assessment: it is a series of separate assessments taking effect for the VAT periods set out therein. The

assessments relating to Advertising Services are out of time (as the parties agreed). The assessments relating to Store Services are in time.

(5) The TFL Assessment is not a global assessment: it is a series of separate assessments taking effect for the VAT periods set out therein.

(6) The question of whether the assessment for 06/09 contained within the TFL Assessment is in time remains to be determined and I have released directions to the parties to enable this to happen.

297. The directions which I am releasing at the same time as this decision deal with the procedure for making applications for costs and other procedural matters.

298. 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.

JONATHAN RICHARDS

TRIBUNAL JUDGE
RELEASE DATE: 25 JANUARY 2016

APPENDIX I – SUMMARY OF ASSESSMENTS IN ISSUE

Date of assessment	VAT periods covered	Relevant company	Whether argued to be out of time	Amount
5 July 2011	09/07 to 06/09	TFL	Yes	£159,043
11 July 2012	06/10 and 06/11	TFL	No	£433,311
4 June 2013	09/09 to 03/11	TRL	Yes	£1,354,748 (£244,758 in respect of Advertising Services and £1,109,990 in respect of Store Services)
1 May 2014	06/11 to 03/13	TRL	No	£2,906,416 (£710,640 relating to Advertising Services and £2,195,776 relating to Store Services)

APPENDIX II – LAW RELATING TO PARTIAL EXEMPTION

1. Articles 167 to 177 of the Principal VAT Directive provide for the deduction of input tax in so far as it is used in the making of taxable supplies. Article 173 provides as follows:

> In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.

2. Articles 173 to 175 set out the method by which the deductible proportion is to be established. The standard method (in Article 173(1) is that the deductible proportion is equal to the ratio of taxable turnover to total turnover. However, Member States are permitted to derogate from the standard method and can, inter alia, require the deductible proportion to be established on a "use made" basis (pursuant to Article 173(2)(c) of the Principal VAT Directive).

3. The right to deduct input tax is implemented in UK law by s26 of VATA 1994 which provides as follows:

> **26 Input tax allowable under section 25**
>
> (1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.
>
> (2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—
>
> (a) taxable supplies;
>
> (b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;
>
> (c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection.
>
> (3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above, and any such regulations may provide for—
>
> (a) determining a proportion by reference to which input tax for any prescribed accounting period is to be provisionally attributed to those supplies;
>
> (b) adjusting, in accordance with a proportion determined in like manner for any longer period comprising two or more prescribed

accounting periods or parts thereof, the provisional attribution for any of those periods;

(c) the making of payments in respect of input tax, by the Commissioners to a taxable person (or a person who has been a taxable person) or by a taxable person (or a person who has been a taxable person) to the Commissioners, in cases where events prove inaccurate an estimate on the basis of which an attribution was made; and

(d) preventing input tax on a supply which, under or by virtue of any provision of this Act, a person makes to himself from being allowable as attributable to that supply.

(4) Regulations under subsection (3) above may make different provision for different circumstances and, in particular (but without prejudice to the generality of that subsection) for different descriptions of goods or services; and may contain such incidental, supplementary, consequential and transitional provisions as appear to the Commissioners necessary or expedient.

4. The method of establishing the "fair and reasonable" proportion of input tax that is attributable to taxable supplies is set out in Regulations 101 and 102 of the VAT Regulations. Regulation 101, insofar as relevant, provides as follows:

101 Attribution of input tax to taxable supplies

(1) … the amount of input tax which a taxable person shall be entitled to deduct provisionally shall be that amount which is attributable to taxable supplies in accordance with this regulation.

(2) … in respect of each prescribed accounting period—

…

(b) there shall be attributed to taxable supplies the whole of the input tax on such of those goods or services as are used or to be used by him exclusively in making taxable supplies,

(c) no part of the input tax on such of those goods or services as are used or to be used by him exclusively in making exempt supplies, or in carrying on any activity other than the making of taxable supplies, shall be attributed to taxable supplies,

(d) where a taxable person does not have an immediately preceding longer period and subject to subparagraph (e) below, there shall be attributed to taxable supplies such proportion of the residual input tax as bears the same ratio to the total of such input tax as the value of taxable supplies made by him bears to the value of all supplies made by him in the period,

(e) the attribution required by subparagraph (d) above may be made on the basis of the extent to which the goods or services are used or to be used by him in making taxable supplies,

(f) where a taxable person has an immediately preceding longer period and subject to subparagraph (g) below, his residual input tax

> shall be attributed to taxable supplies by reference to the percentage recovery rate for that immediately preceding longer period, and
>
> (g) the attribution required by subparagraph (f) above may be made using the calculation specified in subparagraph (d) above provided that that calculation is used for all the prescribed accounting periods which fall within any longer period applicable to a taxable person.

5. Regulation 101 therefore sets out a provisional method of determining the amount of recoverable input tax in a taxpayer's "prescribed accounting periods" (which are typically periods of three months). That provisional method is then subject to an annual adjustment. Taxpayers who make exempt supplies have a "longer period" that broadly corresponds to their VAT tax year (by virtue of Regulation 99(4) of the VAT Regulations) and must make an adjustment at the end of each tax year based on the application of their standard method calculation to figures for the entire longer period.

6. After their first longer period, such taxpayers generally perform their standard method calculations in "prescribed accounting periods" using the recovery rate for the immediately preceding longer period (pursuant to Regulation 101(2)(f) of the VAT Regulations) and calculate their annual adjustment using the standard method turnover calculation in Regulation 101(2)(d) (see Regulation 107(1)(d)).

7. The "standard method override" that applies to these annual adjustments is contained in Regulations 107A to 107F of VATA 1994. Regulation 107B requires a comparison between the attribution made under the standard "turnover" based calculation set out in Regulation 101(2)(d) and an attribution based on the basis of "use" (rather than turnover). If the difference is "substantial", it must be accounted for (usually on the next VAT return). Regulation 107C provides that a difference is "substantial" if exceeds £50,000 or 50% of the input tax falling to be apportioned (but is not less than £25,000).

GLOSSARY OF DEFINED TERMS USED IN THIS DECISION

Term	Meaning
Advertising Fees	Fees that TFL pays TRL for Advertising Services
Advertising Services	The supply, by TRL to TFL, of shop advertising and launch services in respect of PerfectHome stores which are the subject of HMRC's direction under Schedule 6 of VATA 1994
APPG	The All Party Parliamentary Group on Debt and Personal Finance
APPG Report	The report that the APPG prepared in February 2015
Cabot	Cabot Square Capital Partners, owners of the shares in the ultimate holding company of the PerfectHome group
First Grant Thornton Report	Grant Thornton's first transfer pricing report, prepared in February 2009
FSLA	A "fixed sum loan agreement" that customers of PerfectHome take out in order to fund the lump sum premium payable for Coverplus protection
HP	Hire purchase
IGSA	The Intra-Group Services Agreement entered into between TRL and TFL setting out the terms on which various intra-group services would be supplied
Murphy Report	The report of the "activity based costing exercise" that John Murphy prepared between November 2008 and January 2009
OMV	Open market value
QR	"quality refurbished" goods which have been recovered from customers, and refurbished, following an early termination of an HP agreement
Second Grant Thornton Report	Grant Thornton's second transfer pricing report, prepared in June 2012
SMO	The "standard method override" contained in Regulations 107A to F of the VAT Regulations
Store Fees	Fees that TFL pays TRL for Store Services

Store Services	The supply, by TRL to TFL, of services relating to occupation and use of PerfectHome shops which are the subject of HMRC's direction under Schedule 6 of VATA 1994
TAD	Insurance that TFL sells to PerfectHome customers against the risk of theft of, or accidental damage to, products
TFL	Temple Finance Limited
TFL Assessment	The assessment on TFL dated 5 July 2011 which TFL argues was made out of time
Third Grant Thornton Report	Grant Thornton's third transfer pricing report, prepared in October 2013
TRL	Temple Retail Limited
TRL Assessment	The assessment on TFL dated 4 June 2013 which TRL argues was made out of time