



Neutral Citation: [2024] UKFTT 00928 (TC)

Case Number: TC09324

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

[By remote video hearing]

Appeal reference: TC/2023/09005

Output VAT – caravans and removable contents - new more accurate method of calculating output VAT – HMRC accept new method going forward – error correction notice for four years - HMRC claim no error so refuse claim – manual refers to substantially more accurate – amount claimed is almost 50% of reported output VAT – held this is substantial – not necessary to compare claim to total output tax – appeal allowed.

Heard on: 10 October 2024

Judgment date: 17 October 2024

Before

**TRIBUNAL JUDGE ALASTAIR J RANKIN MBE
MR DEREK ROBERTSON JP**

Between

ABBEYFORD CARAVAN COMPANY (SCOTLAND) LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY’S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Michael Firth KC instructed by Johnston Carmichael LLP

For the Respondents: Ms Sindy Asokam litigator of HM Revenue and Customs’ Solicitor’s Office

DECISION

INTRODUCTION

1. The form of the hearing, with the agreement of the parties was by video using Teams. The documents to which we were referred were an electronic Hearing Bundle containing 271 pages, an electronic Authorities Bundle containing 135 pages, the Appellant's electronic Supplementary Bundle containing 51 pages, the Appellant's electronic skeleton argument containing 16 pages, the Respondents' electronic skeleton argument containing nine pages and the Appellant's electronic Reply containing seven pages.

2. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

BACKGROUND

3. The Appellant sold and still sells caravans. When a customer purchases a caravan from the Appellant, that customer purchases both the caravan itself and the removable contents contained within the caravan. For VAT purposes, the supply of the caravan was either liable to the zero-rate or reduced rate of VAT. The removable contents, on the other were subject to the standard rate of VAT.

4. This raises the question of how the price paid by the customer should be apportioned between the supply of the caravan (zero-rate or reduced rate) and the supply of the removable contents (20% VAT). At the time of originally submitting its VAT returns, the Appellant calculated this apportionment based on the apportionment of the costs of the two different elements adopted by the manufacturer (which will be referred to as the 'cost ratio method' or "the old method").

5. By way of example if we assume that the Appellant bought a caravan for £10,000, of which the manufacturer says £2,000 is attributable to the value of the removable contents the proportion of the purchase price attributable to the contents would be 20% using the cost ratio method. If the Appellant then sold the caravan and removable contents for £20,000 the same proportion would be attributable to the removable contents giving rise to VAT at 20% of £4,000..

6. The Appellant realised that there were significant problems with this approach to apportionment. and carried out a detailed sampling and valuation exercise to establish what proportion of the sale price of its caravans actually related to the removable contents and discovered that it was actually in the range of 5% to 9% of value. This compared to the range of 16 to 27% that was implied by the cost ratio method set out above.

7. The reason for this large difference (between actual value and supposed value calculated under the cost ratio method) was because the cost ratio method wrongly assumes that the increase in value from purchase of a caravan by the Appellant to sale is equally attributable to the caravan and the removable contents. It also became apparent that the cost that the manufacturers were attributing to contents were not just those contents that would be considered removable within the meaning of the case law. This meant that the ratio derived from the manufacturers' apportionments was not actually an apportionment between the caravan and only the removable contents. It is only the removable contents that are liable to the standard rate.

8. As a result, the Appellants carried out a detailed sampling and valuation methodology as follows:

8.1 Sales and purchase information for units sold in the period was obtained.

8.2 The data was analysed to identify the most frequently sold makes and models of caravan, as well as typical selling prices.

8.3 Based on that analysis, the Appellant commissioned a valuation exercise on a sample that reflected the most frequently sold caravans and the full range of selling prices.

8.4 The valuation exercise was undertaken on 13 June 2022 by David Gale-Hasleham of Savills, who had over 40 years' experience in valuation matters pertaining to caravan parks.

8.5 The sample covered 62% of caravans sold in the period to which the claim relates by make and model as well as the range of selling prices.

8.6 The removable contents were valued based on gross current replacement cost (i.e. the cost of replacing with a new, substantially similar asset).

8.7 It was found that removable contents represented between 5.2% and 8.51% of the sale price of the caravan.

8.8 Where a make and model of caravan was directly studied in the sample, the result of that valuation was directly applied to calculate the claim.

8.9 Where a make and model was not directly studied, an average was applied based on the value bracket into which the caravan fell.

9. There is no dispute that this methodology produced a fairer and 'more accurate' figure for output VAT on the supply of the removable contents. The effect of this valuation exercise was very substantial and on 30 June 2022, the Appellant submitted an Error Correction Notice (ECN) claiming for overpaid output VAT for the periods 06/18 to 03/22 of £150,458.45 under section 80 of the VAT Act 1994 which limits claims to four years.

10. At the same time, the Appellant requested the Respondents to confirm that they accepted that the new method could be used going forward. The Respondents accepted the new method by email dated 12 April 2023 but only with effect from 1 April 2022 and rejected the claim for past periods on the basis that there was no error:

"It is possible to apply one of several apportionment methods with each method likely to produce a different result but, just because both methods produce a different result does not invariably mean that method either is wrong or produces an unfair result."

11. The Appellant sought a review of the decision to refuse its claim on 11 May 2023. The Respondents notified the review conclusion on 19 June 2023:

"The fact that using a different method would result in less output tax due does not mean that the original calculations were wrong. It was open to Abbeyford to use any method it chose, provided it gave a fair and reasonable result."

12. The appeal was notified to this Tribunal on 18 July 2023. The Respondents' position remained that there had been no error in the original VAT returns:

"The Respondents, following other tribunal decisions have accepted the proposed calculations going forward (from the receipt of the ECN), but this has not changed the Respondents position on retrospective applications. In summary, the Appellant can not change methods retrospectively when there were no errors made or any change in guidance."

13. The parties exchanged further correspondence in July and August 2024, with the Appellant pointing to the Respondents' manuals which said that a new method could be used retrospectively if it achieved a more fair and accurate attribution of value.

14. The Respondents' VAT Valuation Manual reference VATVAL04300 – Apportionment of monetary consideration: retrospective apportionment begins:

“Whether a business can be permitted to apply an apportionment retrospectively depends very much on the circumstances of the individual case. The general rule is that any proposed apportionment has to be allowed retrospective effect when a business is able to demonstrate that it achieves a fair and accurate attribution of values.”

Concerning changes of method, it continues:

You should therefore examine any proposals to apply a different apportionment method retrospectively in this situation with great care. A business will have to demonstrate that the new method is more than simply advantageous before retrospection can be permitted here. In effect, it must provide convincing evidence that the previous method was unfair or, at the very least, that the end result achieved by the proposed new method produces a substantially more accurate attribution of values than the old method. Whatever the position, the proposed new method can of course be allowed from a current date.”

15. The Respondents wrote on 15 August 2024 stating that the original method (i.e. the cost ratio method described above) was a fair and reasonable method but acknowledged that their original contention around there having to be an error in any previous method used was not technically right, as the valuation guidance has highlighted. The difference between the old method and the new method “would not be seen as ‘substantial’ for this business” because the amount of output VAT claimed was 5.8% of total output tax.

16. The Respondents also confirmed that the Appellant had “clearly demonstrated that the new suggested method was fair and reasonable and gave a more accurate recovery”. Accordingly, the Respondents' current position was that in order for the claim to be valid (and thus for this appeal to succeed), the Appellant did not need to show an error in the old method. Instead, the Respondents accepted that this appeal would succeed if the new method produced a substantially more accurate attribution as compared to the old method. The Respondents' view was that the difference was not ‘substantial’.

ISSUES FOR THIS TRIBUNAL TO DETERMINE

17. There are two issues for this Tribunal to determine:

17.1 Whether the Appellant's new method was the correct method (in light of the agreed fact that it produces more accurate results) such that the results of the previous method were not the correct figures for VAT purposes?

17.2 Whether the difference between the previous method and the new method was substantial?

SUBMISSIONS BY APPELLANT

18. It is a fundamental principle of the VAT system, that VAT applies to the consideration actually paid by the customer for the supply in question. According to the European Court of Justice decision in *Elida Gibbs Ltd c CCE* (C-317/94):

“The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be

collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him.”

19. Accordingly, where a customer pays a single price for more than one supply (with the supplies liable to different rates of VAT), it is necessary to work out how much of the single price is being paid for each element of the package of supplies.

20. Section 19(4) of the Value Added Tax Act 1994 (VATA 1994) stated:

“Where a supply of any goods or services is not the only matter to which a consideration in money relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.”

21. In the Appellant’s submission, if there are two proposed methods for identifying “such part of the consideration as is properly attributable” to a supply, and one is more accurate than the other, the figure produced by the more accurate method is the correct figure and the VAT system (and s.19(4)) requires that figure to be used in calculating the amount of output VAT due.

22. To the extent that the taxpayer declares VAT in accordance with the less accurate figure, the difference between that figure and the figure produced by the accurate method is an error. It is either an underpayment or an overpayment of VAT by the taxpayer.

23. By way of example, in the present case the valuation report shows that the caravan came with a dishwasher with a new replacement value of £250. As the figures for the Appellant’s claim show, the previous method typically valued removables at about three times their actual value. Under the old method, the customer was paying £750 for a dishwasher that was actually only worth £250 (and would only cost that much to purchase elsewhere). This does not identify the part of the consideration for the caravan “properly attributable” to the purchase of the dishwasher. Indeed, if the effect of the error was the other way around, such that a taxpayer had apportioned £250 of the consideration to a standard rated supply of goods that would actually cost £750, and thereby underpaid VAT by 66%, it would be obvious that the taxpayer has made an error and should have to pay the difference.

24. The basic point is that the ‘cost ratio’ apportionment method is inherently unsuitable for businesses such as the Appellant’s for the reason given above – it wrongly assumes that all elements of the Appellant’s input costs used to make a supply contribute (and contribute equally) to the increase in value by the time the Appellant comes to make its output. As a result of that wrong assumption, it produces results that are wrong.

25. The apportionment in the present case should be based on the market value of the outputs which is what the Appellant’s new method does but which the old method did not do. The new method is plainly the correct method. The Respondents accept that it is more accurate. The Appellants therefore consider the VAT paid using the old method was paid in error and can be reclaimed under section 80 VATA 1994.

26. Finally, the Appellants consider the difference between the VAT paid under the old method and the correct amount due under the new method is substantial. The total output VAT paid under the old method for the quarters 06/18 to 03/22 was £296,906.85 whereas the amount payable under the new, correct method is £150,458.45. The Respondents’ own manual referred to at paragraph 14 above states:

“In effect, it must provide convincing evidence that the previous method was unfair or, at the very least, that the end result achieved by the proposed new method produces a substantially more accurate attribution of values than the old method.”

27. The Appellant's view is that the new method which results in a 64% reduction in the value attributable to removable contents cannot be described as anything other than a "substantially more accurate attribution".

SUBMISSIONS BY RESPONDENTS

28. The Respondents only consider retrospective apportionment in exceptional circumstances, such as where an error has been made. There has been no suggestion that an error has been made by the Appellants. As such, the Respondents contend that the standard method, as outlined in 'VAT Public Notice 701/20', was operated correctly. As the standard method produced a fair and reasonable result, the Respondents contend the ECN was correctly rejected on a retrospective basis.

29. The Respondents also contend the published guidance was not, and has never been, mandatory. The Respondents contend alternative methods should have been submitted sooner, or even discussed with the Respondents, if the Appellant felt the standard method was not producing a fair and reasonable result. The Respondents contend it was therefore the Appellant's decision to use the standard method, which the Respondents maintain produces a fair and reasonable approach. Although it is accepted different methods can produce different results, this does not automatically mean one method is 'better' or produces more fair and reasonable outcomes. The Respondents, following other tribunal decisions have accepted the proposed calculations going forward (from the receipt of the ECN), but this has not changed the Respondents position on retrospective applications. In summary, the Appellant cannot change methods retrospectively when there were no errors made or any change in guidance.

30. The Appellant, in the Notice of Appeal, quotes sections of *The Advocate General representing the Commissioners of HMRC v KE Entertainments Ltd (Scotland)* [2020] UKSC 28. This appeal related to a change in the Respondents guidance (Business Brief 07/07) from February 2007. In the current appeal, as noted above, the Appellant's ECN relate from VAT PD 06/18 onwards where the Appellant had voluntarily chosen to use the standard method without any intervention from the Respondents. The clear distinction here is that the Respondents' guidance explained the standard method but also advised that if this was not fair and reasonable, then the business can use any method they see fit so long as it is fair and reasonable (subject to conditions). The Respondents contend the Appellant chose to use the standard method, no error had occurred and, as such, retrospective has been refused.

DISCUSSION

31. Both parties referred to the unanimous Supreme Court decision in *The Advocate General v. K E Entertainments Ltd* which concerned the calculation of output VAT payable in relation to supplies of bingo. The single price paid by the customer had to be apportioned between the stake (each customer's contribution to the cash prizes) which was not liable to VAT and the participation fee (the consideration for the supply of the right to participate) which was liable to VAT. At first, this apportionment was carried out on a game-by-game basis. It was subsequently decided that it was more accurate to calculate this apportionment by looking at a whole session of bingo, rather than doing it game by game (which resulted in some prize money being required to be funded from participation fees for other games).

32. The taxpayer sought to reclaim VAT on the basis of the more accurate, session by session method. In order to try and side-step the four-year time limit for retrospective claims for repayment under section 80 VATA 1994 the taxpayer sought to argue that both the old method and the new method were correct methods for calculating output tax and that, instead, there was simply a decrease in consideration resulting from a change in method of apportionment. Lord Leggatt said:

“26. On the other hand, if the taxpayer accepts that, as stated in the business brief, VAT should properly be calculated on the session by session basis and not the game by game basis, then the taxpayer is in principle entitled to be repaid the amounts of output tax that were overdeclared in past years as a result of using the game by game method of calculation on the ground that such amounts were not due to HMRC. The taxpayer has indeed made a successful claim on this basis for the years 2005 to 2007. However, if this is the correct view, then the present claim relating to earlier years is time-barred.

27. The way in which the taxpayer seeks to escape this dilemma is by arguing that both methods of calculation are, in principle, correct and consistent with the applicable legislation. Accordingly, when the taxpayer was using the game by game method, it was paying output tax that was due; but it was also complying with the legislation and paying output tax that was due when it adopted the session by session method of calculation.

28. Sometimes, however, a single price is charged by a supplier which comprises a taxable element and a non-taxable element (or element subject to a different rate of tax). This might be, for example, because a single price covers the supply of a service which is subject to VAT and another service which is exempt. In such cases some method of apportionment is needed to determine what part of the price paid by the customer is attributable to each element. This is often not an exact process. There may be no single “right” method of apportionment but two or more methods each of which is reasonable and legitimate.”

33. According to the Appellants this is the same argument that the Respondents are making in this appeal as they are arguing that even though the new method of apportioning consideration between different elements is more accurate, both methods were reasonable and legitimate. The Supreme Court said that this argument was wrong. Lord Leggatt continued:

“31. Counsel for the taxpayer was concerned to emphasise that deciding how to apportion a unitary price charged by a supplier into two elements for the purpose of calculating VAT can involve an exercise of evaluative judgment, as to which differences of view can exist within a spectrum of what is reasonable. This is undoubtedly true. But it does not follow that there must be more than one method of apportionment which the supplier may lawfully use. Although that is a possible conclusion for a court or tribunal to reach, in most cases where such a question is raised the court or tribunal can be expected to exercise its own judgment as to which method should be used. There is good reason for this. In matters of taxation consistency of approach is of critical importance. If the same exercise of apportionment may lawfully be carried out in more than one way, the result is likely to be that different taxpayers whose situations are identical will lawfully pay different amounts of tax. That offends the principle of equal treatment. It is also capable of distorting competition between businesses.

32. In the case of a pan-European system of taxation such as VAT, there is an additional consideration that recognising more than one method of apportionment as lawful could result in inequality in competition between businesses situated in different member states. This was a matter emphasised by the CJEU in *MyTravel plc v Customs and Excise Comrs* (Case C-291/03) [2005] STC 1617. That case concerned the apportionment for VAT purposes of a single price charged by a tour operator to customers for a package holiday which comprised services bought in from third parties (for example, hotel owners) and services provided by the tour operator itself (for example, where it used its own airline). In an earlier decision, *Customs and Excise*

Comrs v Madgett and Baldwin (trading as Howden Court Hotel) (Joined Cases C-308/96 and C-94/97) [1998] STC 1189, the CJEU had considered two possible methods of making such an apportionment. One method treated the consideration attributable to each component as proportional to what it cost the operator to supply the service. The other method was based on the market value of each component, if sold separately. Both methods involved assumptions which were to some extent arbitrary. The court had ruled (at para 46 of the judgment) that:

“a trader may not be required to calculate the part of the package corresponding to the in-house services by the actual cost method where it is possible to identify that part of the package on the basis of the market value of services similar to those which form part of the package.”

34. The European Court of Justice in *My Travel plc v Customs and Excise* (Case C-291/03) [2005] STC 1617 stated:

“34. As the Advocate General has stated in point 68 of his Opinion, the Commission of the European Communities is justified in its view that the apportionment of the package price between services bought in from third parties and in-house services should be made on the basis of the market value of the latter services where that value can be established. On the other hand, as the Advocate General has also observed in point 69 of his Opinion, it is difficult to rule out altogether the option of derogating from that principle. Accordingly, it is acceptable for a travel agent or tour operator who is able to prove that the actual cost method accurately reflects the actual structure of the package to apportion his package prices using that method rather than the market value method.

35. Thus, a travel agent or tour operator who, in return for a package price, supplies to a traveller services bought in from third parties and in-house services must, in principle, identify the part of the package corresponding to his in-house services on the basis of their market value where that value can be established, unless he can prove that, for the tax period under consideration, the method based on the criterion of actual costs accurately reflects the actual structure of the package.

36. In addition, it is for the national tax authorities and, where appropriate, the national court or tribunal, to assess whether it is possible to identify the part of the package corresponding to the in-house services on the basis of their market value, and in this context to determine the most appropriate market.”

35. Turning to the question whether the new method, when applied to the output tax for the 06/18 to 03/22 period results in a “substantially more accurate attribution of values” the Respondents have argued that the claimed rebate of £150,458.45 is not substantial when compared to the total VAT output for this period. It is about 5.8% of the total VAT output. The Respondents have referred to Statutory Instrument 1995/2518 (which relates to input tax). Regulation 107C where it is stated that a difference is substantial if it exceeds £50,000 or 50% of the amount of input tax falling to be apportioned under regulation 101(2)(d) within the prescribed accounting period referred to in regulation 107A(1), or longer period, as the case may be, but not less than £25,000.

36. The Appellant has produced a breakdown of the total claim which shows that in each of the four years covered by the ECN the rebate claimed exceeded £25,000.

DECISION

37. The Respondents have accepted that the new method adopted by the Appellant is the correct method going forward. In accordance with the Supreme Court’s decision in *K E Entertainments Ltd* there must be only one method of calculating the output tax in order to

achieve fairness and equality. The new method achieves “a fair and accurate attribution of values”.

38. The Respondents have not referred to any case law on the interpretation of “substantial”. Their own manual refers to a “substantially more accurate attribution of values”. The Tribunal considers the reduction in output Vat for the period 06/18 to 03/22 from £296,906.85 to £150,458.45 by using the new method is by any measure substantial. The Tribunal does not need to resort to the reference to the input VAT legislation to reach this decision but even if it did, the differences in each of the four years meet the requirements of that legislation.

39. Accordingly, the appeal is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

40. 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.

**ALASTAIR J RANKIN MBE
TRIBUNAL JUDGE**

Release date: 17th OCTOBER 2024