

Mayflower Theatre Trust Ltd v Revenue & Customs Commissioners – Guidance for taxpayers

HM Revenue & Customs (HMRC) have issued revised guidance for theatres following the Court of Appeal decision in Mayflower Theatre Trust, which was reported in KPMG's Weekly Tax Briefing for the week ended 16 March 2007.

The Court of Appeal followed the High Court in finding in favour of the taxpayer in Mayflower, stating that it should not be denied a deduction for input VAT suffered, as it did not relate solely to exempt activities. The new HMRC guidance, contained within HMRC Brief 45/07, replaces the guidance previously provided in Business Brief 12/06, and provides affected taxpayers with an indication of how HMRC views the consequences of the Mayflower findings.

Background

The taxpayer in Mayflower is a charity which runs a theatre. It raises funds to pay for its activities in various different ways: primarily through the sale of tickets to the public but also through sponsorship and sales of other items such as programmes.

For VAT purposes the supply of theatre tickets is an exempt supply, but the other supplies made by the taxpayer are taxable. The taxpayer claimed to recover input tax incurred on services supplied by production companies. This claim was turned down by HM Revenue & Customs (HMRC) on the basis that the services supplied related solely to the exempt activity of supplying tickets to the public. This analysis was upheld by the VAT and Duties Tribunal.

The case – High Court

The taxpayer appealed to the High Court, which found that the Tribunal had erred in its decision. A key factor was that the Tribunal had not considered whether the inputs in question had been used to make exclusively exempt supplies. Rather, it had determined that as the inputs had been used in making exempt supplies, then the corresponding input tax deduction should not be allowed, without consideration of whether the inputs had also been used in making taxable supplies. Where there was a part exempt and part taxable use, input tax relating to the taxable element should be recoverable.

The High Court found that there had been both taxable and exempt supplies of the right to see the productions, arising through sponsorship (taxable) and the direct sale of tickets to the public (exempt). The costs of the production company on which the disputed input tax was incurred therefore related to both taxable and exempt supplies. Consequently, the Tribunal's conclusion that all of the input tax related to exempt supplies and was irrecoverable was incorrect.

The case – Court of Appeal

HMRC appealed to the Court of Appeal, which again found in favour of the taxpayer. However, the Court of Appeal's reasoning did not follow that of the High Court, and looked at the connection between the production costs and the programme sales rather than the sponsorship income. The Court of Appeal agreed with HMRC's argument that the tickets provided as part of the sponsorship packages could not be separated from the overarching supply of advertising provided to the sponsors.

The Court found, though, that there was sufficient connection between the production costs and the taxable programme sales for some of the input tax incurred on the production costs to be recoverable. The productions formed the subject matter of the programmes so had to be seen as part of the preparation of the programmes. As this was the case, HMRC's argument that the production costs related solely to the exempt cost of ticket sales must fail.

Leave to appeal to the House of Lords was refused.

HMRC guidance

The guidance contained in HMRC Brief 45/07 confirms that it is now HMRC policy that a theatre can treat input tax as residual (that is, partially recoverable) where they receive supplies of production services from touring companies, and where those supplies include material essential for the printing of the programmes.

This treatment will apply even where the programme material is only a minor part of the contract between the theatre and the touring company.

Supplies of (for example) costumes and scenery where the theatre stages its own productions, though, are not, in HMRC's opinion, to be treated as residual, as, in the words of the Brief, they "have a direct and immediate link with admissions and not with the printing of programmes, even though costumes and scenery might be visible in subsequent photographs".

Further issues are identified where input tax is treated as residual. The Brief states that many theatres use the standard method partial exemption calculation. Following the decision in the Court of Appeal, application of this method may lead to too much input tax being recovered, which may trigger the 'Standard Method Override' (SMO).

Under the SMO the recoverable tax must be recalculated in line with actual use. The Brief gives an example of what might constitute an appropriate recalculation method, which takes the value of programme sales as a proportion of overall (programme plus box-office) sales in arriving at the recoverable amount. An alternative to avoid the possibility of the SMO applying would be for theatres to apply for a partial exemption special method.

Claims for prior years

The guidance recognises that the outcome of the Mayflower case may have an impact on other theatres with claims or potential claims for input tax recovery in earlier periods. For those who have not yet made claims for earlier periods, it provides the following guidance:

- Claims are subject to the usual three year time limits;
- In calculating the amount of any recoverable VAT, a theatre must use the partial exemption method it was applying for the period in question, rather than the method in place at present (if it has changed);
- Where the relevant calculation method is the standard method, the possibility of the SMO applying should be considered.

Where taxpayers have already made a claim for relief that, following the findings in the Court of Appeal, is excessive (because the production costs on which relief is claimed exclude essential programme costs), the overclaimed tax and interest will be due back to HMRC.

Why is this important?

This case is important because it considers the (widely applicable) principles of input tax attribution, with the Court of Appeal judgment correcting some mistakes made by the VAT Tribunal (which originally found for HMRC and dismissed the concept of any link to the programme sales or any other taxable supplies made by the theatre). The judgment contained in-depth analysis of the concept of a direct and immediate link between an item on which input tax is incurred and a supply and also of the circumstances in which an exempt transaction will break the chain of attribution and prevent recovery of tax. The Court of Appeal decision, though, does not provide for all the input tax to be recovered. The precise calculation which needs to be applied to arrive at the deductible figure remains an issue for those in the same position as Mayflower. This new HMRC guidance casts some light on how taxpayers should proceed and on how HMRC have interpreted the Mayflower findings.