

Tribunal rules floor space partial exemption method acceptable[DCM \(Optical Holdings\) Ltd v HMRC \[2010 UKFTT 393 \(TC\)\]](#)

The First Tier Tribunal has decided that a retail optician business can use a partial exemption method based on the use of the floor area of its retail outlets but the method must not include 'zoning', i.e. the weighting applied to different areas of the retail premises for the purposes of calculating the value of rents payable.

Background

This case which concerns the Appellant's proposal for a reg 102 VAT Regulations 1995 partial exemption special method (PESM) based in part of the weighting applied to rental of its retail premises by landlords, the system referred to as 'zoning' whereby, for example, the rental per square metre is higher for the area adjacent to the window (where, in the Appellant's view, the activity carried on is predominantly the taxable supply of spectacles) than for areas at the rear of the premises (where exempt activities such as eye testing would be carried on).

Following an appeal on jurisdiction, the case was remitted to and heard by the First Tier Tribunal, which noted that the Appellant had made significant amendments to the proposal considered at the first hearing, which reduced the 'taxable' areas at the front of the shop, treated dispensing desks as 'exempt' rather than 'taxable' areas and introducing 'mixed' and 'void' areas. These amendments had the effect of reducing the proposed recovery rate to c. 50%, although the VAT & Duties Tribunal had noted that a reg 101 method would have yielded recovery of c. 25%.

Held

The First Tier Tribunal heard evidence from two expert witnesses, on the basis of which it decided that 'dispensing' of spectacles did not include the selection of the frames, rather it was confined to the dispensing desks and only exceptionally extended to the "taxable" area adjacent to the display stands. The essence of exempt 'dispensing', it decided, was a medical procedure, not concerned with fashion and aesthetic considerations, and it took place only at the dispensing tables.

The First Tier Tribunal also heard evidence that, in order to cover rising costs of employing opticians and professional staff, the exempt element of the charges to customers had been increased so that recovery of residual VAT would now, on the basis of the 'standard method', be c. 8%, and decided that this would not adequately reflect the use of the costs incurred in making

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taxable and exempt supplies, as there was no direct link between the salary costs incurred, the Appellant's levels of taxable and exempt income, and the use to which VAT-bearing items of expenditure were put.

The First Tier Tribunal noted that HMRC had negotiated methods based on use of floor area with other similar businesses, but that 'zoning' had been disapproved of in other VAT cases, e.g. the High Court's judgment in Vision Express (UK) Ltd [2009] EWHC 3245 (Ch). It held that the PESM proposed by the Appellant would, absent the 'zoning' factor, produce a 'fair and reasonable' result as regards the input VAT incurred on the Appellant's retail premises. It also approved the inputs-based calculation proposed for the Appellant's head office costs and, pending further representations from the parties, decided that such a method would, in principle, be acceptable.

The Appellant subsequently submitted that the proposed PESM should include 'zoning' in respect of the VAT incurred on rental of the retail premises, but the First Tier Tribunal again rejected that proposal.

Comment

Many businesses which have a mixture of taxable, exempt and non-business activities face real difficulty in reaching agreement with HMRC on input VAT recovery and specialist advice is recommended.

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