TC01978

Appeal number: TC/2011/09927

VALUE ADDED TAX – Penalties – Schedule 24 FA2007 – inaccuracies in appellant's partial exemption calculations - whether inaccuracies as a result of careless actions – held yes – whether special reduction appropriate – held no – whether decision not to suspend the penalties was flawed – held yes – HMRC ordered pursuant to paragraph 17(4)(a), Sch. 24, FA 2007 to suspend the penalties – appeal allowed to that extent

FIRST-TIER TRIBUNAL
TAX CHAMBER

SHELFSIDE (HOLDINGS) LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN WALTERS QC
IAN B ABRAMS

Sitting in public at Bedford Square, London on 26 March 2012

Mr M George, financial controller, for the Appellant

Ms E Carroll, for the Respondents

DECISION

1. Shelfside (Holdings) Limited ("Shelfside") appeals against penalty assessments for the VAT periods 08/10 and 11/10 in the amounts of £3,615 and £4,358 respectively. These penalties were imposed by the Commissioners ("HMRC") following the finding of inaccuracies in the VAT returns which Shelfside rendered for these periods. The inaccuracies were discovered at (or soon after) an assurance visit to Shelfside by Officer John Goodwin on 27 January 2011. Shelfside's business includes running residential caravan parks and the ownership of various commercial and residential properties.

2. In relation to period 08/10, the penalty is £3,615.30, being 15% of the 'potential lost revenue' of £24,102. The penalty was imposed because in Officer Goodwin's opinion Shelfside had failed to take reasonable care in relation to the VAT returns and the 'potential lost revenue' had been discovered from information given to HMRC 'with prompting'. HMRC stated that the penalty percentage range in these circumstances is 15% minimum to 30% maximum and that the quality of disclosure determines the rate applicable within this range. In the circumstances of this case Officer Goodwin allowed a disclosure reduction of 30% 'for telling HMRC about it', a disclosure reduction of 40% 'for helping HMRC understand it' and a disclosure reduction of 30% 'for giving HMRC access to records'. These reductions total 100%, which is applied to the difference between the maximum and minimum penalty rates (i.e. 100% of 15%), leading to a reduction from the maximum percentage penalty of 30% of 15% to reach a net percentage of 15%, which is the percentage which was applied.

3. In relation to the period 11/10, the penalty is £4,358.70, which is arrived at in a similar way, being 15% of the 'potential lost revenue' of £29,058.60.

4. Shelfside submitted in its Notice of Appeal that the errors in question were not careless, on the basis that the VAT on expenditure now disallowed as input tax had been claimed in the past in returns which had been verified by HMRC. Shelfside submitted in its Notice of Appeal: 'We feel we have followed the process that has been verified and feel that we have taken the care that is necessary on what is a subjective decision process with regards to direct attribution in partial exemption'.

5. Shelfside submits alternatively that if the Tribunal finds that it had failed to take reasonable care then either the penalty ought to be mitigated to nil pursuant to paragraph 11, Schedule 24, Finance Act 2007 ("FA 2007") – reduction in special circumstances – 'due to the facts stated above regarding the complexities and subjectivity of partial exemption', or the penalty ought to be suspended (under paragraph 14, Schedule 24, FA 2007).

6. The inaccuracies identified by Officer Goodwin in Shelfside's VAT returns for the 08/10 and 11/10 periods were incorrect postings of sales to zero-rated outputs rather than exempt outputs, and incorrect postings of purchases to taxable outputs rather than exempt or residual input tax. As Shelfside is a partially exempt trader, this

impacts on the calculation of recoverable input tax, and the assessments made for the periods 08/10 and 11/10 address this matter.

7. This appeal is not against the VAT assessments raised by Officer Goodwin, but only against the penalties charged.

8. There is relevant background, in that before Officer Goodwin's visit on 27 January 2011, Officer Jenny Nash visited Shelfside on 26 October 2009. Her visit report states that she 'ran through T codes [the various posting codes relevant to Shelfside's partial exemption calculation] to establish the build-up of the [partial exemption] calculation. Mr Shipley, Mr Hanif and Mr Best [Shelfside personnel] had clear understanding of how the business was operating, the way they viewed input tax liabilities on the VAT return, however I identified items I considered to be incorrect'.

9. The items queried concerned the attribution of VAT on purchases, but they were relatively small in amount. There was a subsequent visit by Officer Nash and her colleague Mrs Vogues on 27 January 2010. Penalties were imposed for the VAT periods 08/09 and 11/09 of £266 and £424 respectively (on the same basis as the penalties in issue in the appeal and allowing a 15% discount for the quality of the disclosure), but HMRC agreed to suspend the penalties subject to the condition that the T codes were to be operated in accordance with the 'agreed listing' in order to allocate the liabilities correctly for the application of the partial exemption calculation. This condition was accepted by Shelfside in a document received by HMRC on 27 May 2010.

10. The 'agreed listing' appears to be a list of T codes included in Officer Nash's letter to Shelfside dated 2 February 2010, as follows:

> 'T1 – this is for all items which are used to make both taxable (zero-rated or standard-rated) and exempt supplies. In the attached schedule [the schedule of adjustments made by Officer Nash], some of the purchases listed as assets have been included in this T code as they relate to supplies made by the company as a whole, such as telephones, and vehicles.
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> T2 – this is purely for purchases relating to taxable supplies.
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> T4 – this is for purchases relating to exempt supplies – anything to be VAT exempt when it is sold, and includes any expenses incurred on a property for which ownership has been taken in part exchange for the sale of a taxable item. This also includes any purchase expenses incurred in acquiring or selling land, unless it has an Option to Tax.
>
> T6 – materials for purchases related to taxable sales including all work done to the land which is directly related to the property to be located and sold as a taxable supply, such as commercial building(s), or new domestic dwelling(s).
>
> T11 – this is currently used for the purchase of assets, but as explained at the time of the visit, it does not make the appropriate division regarding the VAT liability. As understood from our discussions, the assets will now be split one of the three ways and two new T codes will be set up and advised to us in due course.'

11. Mr George gave evidence for Shelfside and Ms Carroll chose not to cross-examine him. The evidence given by Mr George was as follows.

12. He told us that the inaccuracies identified by Officer Goodwin in Shelfside's VAT returns for the 08/10 and 11/10 periods (the incorrect postings of sales to zero-rated outputs rather than exempt outputs, and incorrect postings of purchases to taxable outputs rather than exempt or residual input tax) were as follows:

VAT of £20,725 – relative to the purchase and installation of a sewage treatment plant for a caravan park. No extra charge is made to Shelfside's customers for the use of the sewage treatment plant, but a charge (attracting positive-rated VAT) is made for clearing out the plant. We understand that the charge made compensates Shelfside for the cost incurred (which also attracts positive-rated VAT) in having the plant cleared out. This VAT was allocated to T2 as a purchase relating to taxable supplies (the clearing out charge) but Shelfside accepts that this was incorrect and that it should have been allocated to T4 (exempt supplies).

VAT of £1,703 – relative to solicitors' fees concerning a dispute about drainage on a caravan park. This VAT was allocated to T2 as a purchase relating to taxable supplies (of caravans) but Shelfside accepts that this was incorrect and that it should have been allocated to T4 (exempt supplies) as attributable to the pitch on which the caravan in question stands.

The balance of VAT – of £30,732 – being VAT relative to the cost of connecting up gas and electricity to caravans. Mr George told us that Shelfside made a charge (attracting standard-rate VAT) to customers for the connection, which recouped the cost. In these circumstances, the Tribunal could not see that there had been an inaccuracy in respect of the treatment of the VAT as being attributable to a standard-rated output – i.e. allocation to T2. Ms Carroll stated that she could not agree that there had been no inaccuracy or potential lost revenue (within paragraph 5 of Schedule 24, FA 2007) but offered no further submission on the point.

13. Ms Carroll did refer us to Officer Goodwin's revised partial exemption calculations for the VAT periods 08/10 and 11/10 and to the assessment for the period 08/10 which he raised, and the adjustment of the amount of VAT repayable for the period 11/10 which he imposed. These reflect 'potential lost revenue' of £24,102.33 and £29,058.89 respectively.

14. Since the hearing the Tribunal has attempted to trace back from Officer Goodwin's calculations to the source documents (invoices rendered to Shelfside). Unfortunately this was only possible for the period 08/10. We were unable to find the relevant invoices for the period 11/10 with our papers.

15. However the invoices for the period 08/10 were not consistent with the information given by Mr George. An analysis of them showed that £18,461.75 VAT in that period related to the purchase and installation of the sewage treatment plant; £8.697 VAT in that period related to legal fees (including Counsel's fees and travelling expenses as well as solicitors' fees) in connection with the drainage dispute; only £138 VAT related to the connection of the LPG supply; and a further £700 VAT

related to planning advice in relation to an enforcement notice, which would seem to be properly allocable to exempt supplies. Further, Mr George did not produce any evidence which showed that the errors made in the returns for the periods 08/10 and 11/10 related to transactions of the same type where the same treatment had been claimed in the past in VAT returns which had been verified by HMRC.

16. In relation to the care exercised by Shelfside in making the VAT returns, Mr George told us that although Shelfside retained the services of a VAT consultant, no advice had been taken with regard to the allocation of the disputed items in the partial exemption calculations used by Shelfside in the preparation of their VAT returns.

17. We do not accept Shelfside's submissions that the preparation of correct partial exemption calculations involves any element of 'subjectivity'. The calculations ought to be objectively correct as a matter of VAT law. We do understand (and accept) that Shelfside finds the preparation of partial exemption calculations a complex matter, but in such circumstances a reasonably careful trader would take VAT advice on their preparation.

18. It follows from the above that the Tribunal finds that Shelfside did not exercise reasonable care in the preparation of the partial exemption calculations for the VAT periods 08/10 and 11/10 and therefore the VAT returns for those periods.

19. Subject to any VAT attributable to the cost of connection of gas and electricity to caravans, which we consider to be attributable to fully taxable supplies on the basis that the cost is recharged *via* a taxable supply by Shelfside, we also confirm Officer Goodwin's calculations of 'potential lost revenue' for the purposes of paragraph 5, Schedule 24, FA 2007.

20. We also find that there are no special circumstances in this case which would justify any reduction of the penalty under paragraph 11 of Schedule 24, FA 2007. The obligation to make a partial exemption calculation is an ordinary obligation of a partially exempt trader. Although the calculation may be difficult to make and so the trader may require the advice of an expert, the circumstances of the calculation being required are entirely ordinary – there is nothing special about them.

21. We are more sympathetic to Shelfside's submission that the penalty ought to be suspended.

22. The power to suspend a penalty is granted to HMRC by paragraph 14, Schedule 24, FA 2007. By paragraph 14(3), HMRC 'may suspend all or part of a penalty only if compliance with a condition of suspension would help P [a person who has given HMRC a document containing a relevant inaccuracy] to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy'.

23. By paragraph 14(4), a 'condition of suspension may specify (a) action to be taken, and (b) a period within which it must be taken'. On the expiry of the period of suspension (which cannot exceed two years and which must be specified in a suspension notice), if P satisfies HMRC that the conditions of suspension have been complied with, then the suspended penalty is cancelled, otherwise it becomes payable.

24. By paragraph 15(3), a person may appeal against a decision of HMRC not to suspend a penalty payable by the person. On such an appeal the Tribunal may order HMRC to suspend the penalty, but only if it thinks that HMRC's decision not to suspend the penalty was flawed (when considered in the light of judicial review principles) (paragraph 17(4) and (6)). HMRC's power to suspend a penalty is subject to the possibility of an order by the Tribunal under paragraph 17 (paragraph 17(7)).

25. It is for the Tribunal therefore to consider whether in this case HMRC's decision not to suspend the penalties for the periods 08/10 and 11/10 was flawed in a judicial review sense, which we take to be so unreasonable that no reasonable body of Commissioners acting properly within their powers could have taken it.

26. As to that, the Tribunal notes that, in principle, HMRC have regarded careless inaccuracies in the matter of the making of partial exemption calculations to be suitable to be addressed by the penalty-suspension procedure. This is clear from the fact that HMRC offered (and Shelfside accepted) a suspension of the penalties charged for the VAT periods 08/09 and 11/09. As we have stated above, these penalties were suspended on condition that 'T codes are to be operated in accordance with agreed listing in order to allocate liabilities correctly for the application of the partial exemption calculation' and the 'agreed listing' was Officer Nash's listing set out at paragraph 10 above.

27. Ms Carroll submitted that HMRC had concluded that suspension was not applicable to the penalties charged for the VAT periods 08/10 and 11/10 because the inaccuracies were of the same sort as those which featured in the returns for the VAT periods 08/09 and 11/09. There was also a penalty imposed for the VAT period 05/10 of £7,461 for a reason not connected with the partial exemption calculation. This penalty was suspended for 6 months on the following conditions: (1) that systems should be put in place to ensure that tax point errors are not possible; (2) that Shelfside meets its payment, notification and filing obligations to HMRC; and (3) that at the end of the suspension period Shelfside should confirm in writing that the suspension conditions have been met and, if required, allow HMRC access to information to check this statement.

28. The Tribunal also notices that Mrs Sarah Bates, Higher Officer in HMRC's Appeals and Review Unit, in her review letter dated 2 November 2011, in respect of the penalties charged for the VAT periods 08/10 and 11/10, wrote, in relation to suspension:

> 'Mr Goodwin did not consider that suspension was appropriate as despite previous penalties being suspended further errors have been made.
>
> In particular a penalty for period 11/09 was suspended with the condition agreed to being that T codes were to be operated in accordance with the agreed listing in order to allocate the liabilities correctly for the application of the partial exemption calculation.
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> Penalties in periods 08/09 and 05/10 were also suspended albeit with different conditions.
>
> I agree with Mr Goodwin's decision to not suspend the penalties for periods 08/10 and 11/10. I have taken into account the issue of repeated behaviour when coming to this conclusion – you

have made errors in this area before and you did not contact HMRC for further advice regarding the transactions that have resulted in the underdeclaration and the subsequent penalties.'

29. Neither Mrs Bates nor Officer Goodwin gave oral evidence at the hearing of the appeal and so it was not possible for the Tribunal to obtain any elaboration of the reasons for HMRC's refusal to suspend the penalties in issue.

30. From the information we have it appears that these reasons were:

That the inaccuracies in the returns for the VAT periods 08/10 and 11/10 were of the same sort as those which featured in the returns for the VAT periods 08/09 and 11/09;

That despite previous penalties being suspended further errors have been made; and

That Shelfside did not contact HMRC for further advice regarding the transactions that have resulted in the underdeclaration and the subsequent penalties.

31. We bear in mind that all the inaccuracies which have featured in this appeal have been for careless actions, as opposed to deliberate actions (whether concealed or not) for which the suspension arrangements are not available. HMRC have at no stage alleged dishonesty (as opposed to carelessness) on the part of Shelfside.

32. We further bear in mind that the evident purpose of the suspension arrangements is to educate a trader who has acted carelessly giving rise to inaccuracies in his/her/its VAT returns by giving help to such a trader to avoid him/her/it becoming liable to further penalties for careless inaccuracy (cf. paragraph 14(3), Schedule 24, FA 2007).

33. We also bear in mind that the suspension arrangements envisage conditions of suspension which will assist the trader in the education referred to.

34. Against these considerations the Tribunal considers that HMRC acted unreasonably in not suspending the penalties for the VAT periods 08/10 and 11/10 in reliance on the facts (1) that Shelfside made inaccuracies in the returns for those periods of the same sort (i.e. in the partial exemption calculation) as those which featured in the returns for the VAT periods 08/09 and 11/09; (2) that this was despite the penalties for the VAT periods 08/09 and 11/09 being suspended – i.e. despite the suspension of those penalties and the conditions of suspension; and (3) that Shelfside did not contact HMRC for further advice regarding the relevant transactions in the VAT periods 08/10 and 11/10.

35. Our reasons for this are, first, that the simple repetition of inaccuracies of the same sort should not of itself be a reason for refusing suspension if the inaccuracies are careless and not deliberate and they relate to an area which the trader *bona fide* finds confusing and difficult to deal with correctly. This seems to the Tribunal to

highlight the need for the education referred to in paragraph 32 above (rather than penalisation) and therefore to make suspension more, rather than less, appropriate.

36. Secondly, we consider that the fact that the penalties for the VAT periods 08/09 and 11/09 were suspended was itself not a relevant consideration in deciding whether to refuse suspension in relation to the VAT periods 08/10 and 11/10. We note that HMRC suspended a penalty for the VAT period 05/10 despite the previous suspensions. By this HMRC seem to us to have accepted implicitly that repeated careless inaccuracy is not a reason in itself for refusing a suspension on a later occasion.

37. Thirdly, we consider that the relevance of the fact that inaccuracies relating to the same area (partial exemption calculation) were repeated was the failure of Shelfside to operate T codes in accordance with the agreed listing in order to allocate the liabilities correctly for the application of the partial exemption calculation. If this had been a failure to undertake a specific action included as a condition of suspension we would have regarded it as a valid reason for refusing a subsequent suspension in relation to a careless inaccuracy of the same type.

38. But we criticise the opacity of the condition to operate T codes in accordance with the agreed listing in order to allocate the liabilities correctly for the application of the partial exemption calculation. The agreed listing (included in this Decision at paragraph 10 above) was not much more than a paraphrase of the legal rules relating to the partial exemption calculation. It seems to us that it did not and could not have offered any real help to Shelfside in determining how, in any particular instance, those rules should be complied with.

39. Finally, we regard the fact that Shelfside did not contact HMRC for further advice regarding the transactions that have resulted in the underdeclaration and the subsequent penalties as a relevant consideration in that this was an eminently sensible and appropriate course of action to provide the education referred to in paragraph 32 above and should, as it seems to us, have been a condition of suspension for the penalties imposed for the periods 08/09 and 11/09. It was not, however, and in our judgment it was unreasonable of HMRC to rely on failure to contact them in this way as a reason for refusing a suspension in relation to the periods 08/10 and 11/10 when this had not been imposed as a condition of suspension in relation to the periods 08/09 and 11/09.

40. For these reasons we have concluded that the decision not to suspend the penalties charged for the periods 08/10 and 11/10 was flawed when considered in the light of the principles applicable in proceedings for judicial review (paragraph 17(6), Schedule 24, FA 2007) and we order HMRC (in terms of paragraph 17(4), Schedule 24, FA 2007) to suspend the penalty. The appeal is allowed to that extent.

41. 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.

JOHN WALTERS QC

TRIBUNAL JUDGE

RELEASE DATE: 13 April 2012