TC02911

Appeal number: TC/2011/06689

COSTS – whether unreasonable behaviour by HMRC – no reasonable prospect of success and HMRC should have known this - application allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

NATHANIEL DAVID RODEN **Appellant**
AND
REBECCA CATHERINE RODEN

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE

At both parties' request this application was decided on the papers on the basis of their written submissions

Mr T Brown, Counsel, instructed by Francis Clark LLP, for the Appellant

Mrs R Paveley, officer of HMRC, for the Respondents

DECISION

1. On 13 September 2012 the Tribunal upheld the appellants' appeal against a review decision issued by HMRC refusing to repay £70,000 in input VAT. The appellants now apply for their costs under Rule 10(1)(b) of the Tribunal Procedure (First Tier Tribunal) (Tax Chamber) Rules 2009 on the grounds that they consider that HMRC acted unreasonable in defending their appeal.

2. In their substantive appeal, there was no dispute on the facts and the only issues the Tribunal had been called to decide were ones of law. The decision ([2012] UKFTT 586 (TC)) records this Tribunal's findings of the law and there has been no appeal against it.

The facts relevant to the costs application

3. HMRC's case at the substantive hearing was in essence that the supply of accommodation in an hotel made by the appellants was exempt because it was not within Item 1(d) of Group 1 of Schedule 9 to Value Added Tax Act 1994:

> "the provision in a hotel of sleeping accommodation"

because the appellant's supply of an hotel room was (deemed) not to be made to a person who would actually use the accommodation and sleep in the room, but to an intermediary for such a person.

4. The appellant challenged this view of the law on two grounds. The first was that the deemed supply to the undisclosed agent necessarily had to have the same VAT status as the deemed supply by the undisclosed agent to the appellants' customer (the hotel guest). The second ground was that in any event Item 1(d) was not limited to supplies made to the actual user of the hotel accommodation.

5. The appellant failed on ground one in that I found that the deemed supply principal to undisclosed agent did not necessarily have to have the same status as the deemed supply by undisclosed agent to the principal's customer: see §§21-41.

6. The appellant succeeded on ground two in that I found that Item 1(d) and in particular the provision of the Principal VAT Directive which it implemented applied to all supplies of sleeping accommodation in an hotel irrespective of the identity of the recipient of the supply and whether or not that recipient would actually occupy the room.

7. Nothing more needs to be said on Ground one (which the appellants lost on) because HMRC's case depended on the Tribunal agreeing with their view of Item 1(d). Whatever the outcome of the appellants' case on ground one, to succeed in defending the appeal HMRC had to win on ground two. The question therefore is whether HMRC's case on Item 1(d) had a reasonable prospect of success.

8. I dealt with ground two quite shortly in the main decision at §§42-47. I dismissed HMRC's case for three reasons which were that:

> (a) the distinction HMRC drew between supplies to persons who would physically use the room and others was illogical and unlikely to have been intended by Parliament when enacting the legislation (and I noted, while not strictly relevant to an interpretation of the law that it was inconsistent with the prevailing understanding not least of HMRC's that supplies of hotel accommodation to companies for the use of their employees was standard rated);
>
> (b) there was even less justification for reading the provision of the Principal VAT Directive which Item 1(d) enacted as intending such an illogical distinction between physical users of the room and others;
>
> (c) it was a well established rule of EU law that exclusions from exemptions (such as Item 1(d)) should not be interpreted strictly – so I should not read in a limitation to physical users unless compelled to do so.

9. HMRC's skeleton did not advance any reason for its view that Item 1(d) only applies to supplies to the physical user of the room other than relying on the wording of that Item and in particular the use of the words "the provision…of sleeping accommodation" Much the same was said at the hearing. No authority for their view was cited. So far as I am aware it was a novel point and had not been raised before.

10. In pursuing their point on Item 1(d) in Tribunal were HMRC acting unreasonably?

What is unreasonable behaviour in law?

11. As I understand the appellants' position on costs it is that HMRC should not have defended the appeal because the position HMRC adopted on the law was (in the appellants' view) unsustainable.

12. What amounts to unreasonable behaviour? Is it unreasonable behaviour in all cases to defend (or pursue) an appeal on the on the basis of a legal position which did not have a reasonable prospect of success? Or would it only be unreasonable behaviour if the losing party ought to have known that it had no reasonable prospect of success?

13. HMRC drew to the Tribunal's attention the decision at first instance in *Leslie Wallis* TC2499:

> "It seems to us that it cannot be that any wrong assertion by a party to an appeal is automatically unreasonable…The rules clearly do not intend that just because a party is wrong that that party should be ordered to pay the other's costs….In our judgment before making a wrong assertion constitutes unreasonable conduct in an appeal that party must generally persist in it in the face of unbeatable argument that he is wrong. Thus for example a party who persists in a legal argument which is precisely the same as one recently dismissed by the

> Supreme Court and which has been drawn to his attention…..could be acting unreasonably…."

14. In that decision, it appears that the Tribunal was of the opinion that the party would not be acting unreasonably when pursuing a case without merit unless he ought to have known his case was without merit.

15. I agree. The Tribunal should not be too quick to characterise pursuing what is found to be an unsuccessful case as unreasonable behaviour: the Tribunal rules provide for a no-costs regime in virtually all tax cases (and the exception for complex cases does not apply in this case). So if in this case HMRC's view had no reasonable prospect of success, HMRC would have been acting unreasonably if they ought to have known this but not otherwise. In considering whether HMRC ought to have known whether the case had a reasonable prospect of success, I consider that I should consider HMRC as a whole and not just the individual officer presenting the case.

Conclusion

16. Was HMRC's case without a reasonable prospect of success?

17. My conclusion is that, taking into account:

- No authority even by analogy was presented to me;
- Unless expressly stated in the legislation, the identity of the recipient of a supply is irrelevant to the status of the supply
- Exceptions to exemptions are not interpreted narrowly
- There was nothing in the wording of either the UK legislation or EU Directive which implied that the identity of the recipient was significant;

HMRC's case did not have a reasonable prospect of success.

18. Should HMRC have realised its case did not have a reasonable prospect of success?

19. Taking into account HMRC's resources, they ought to have been aware of the normal rules of interpretation of exceptions to exemptions. They should have been aware that, without some kind of authority by analogy to support their case, or at least some kind of argument founded in law, it was extremely unlikely a Tribunal would read into Item 1(d) a limitation that was not indicated on its face, was irrational, and (in view of its unfortunate consequences for taxpayers in the hotel business) was unlikely to have been intended by the EU Council.

20. In conclusion, while there is nothing wrong in principle with taking to tribunal novel points of law unsupported by authority, in this case I find that HMRC acted unreasonably in defending this case based on this single, novel point of law which they ought to have known had no reasonable prospect of success.

21. I order HMRC to pay the appellant's costs in this appeal to be assessed on the standard basis if not agreed.

22. 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 1 October 2013