TC04207

Appeal number: TC/2010/09356

VAT – costs application – Rule 10 - whether HMRC behaviour unreasonable

FIRST-TIER TRIBUNAL
TAX CHAMBER

MARSHALL & CO **Appellant**

- and -

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

TRIBUNAL: JUDGE PETER KEMPSTER

Sitting in public at Priory Courts, Birmingham on 11 November 2014

Mr Patrick Cannon of counsel (instructed directly) for the Appellant

Mr William Brooke (HMRC Appeals Unit) for the Respondents

DECISION

1. The Appellant ("Marshall & Co") is a VAT-registered chartered accountancy practice whose proprietor is Mrs Marshall. Following a control visit in December 2008 the Respondents ("HMRC") queried certain items, in particular the purchase of a motorhome ("the Motorhome") where £11,617.02 input tax had been claimed. Following correspondence HMRC issued an assessment under s 73 VATA 1984 in March 2009 in the amount of the disputed VAT. In October 2009 HMRC notified Marshall & Co that they were commencing an investigation on suspicion of dishonest conduct. In December 2009 HMRC issued a penalty of £5,374 under sch 24 FA 2007, alleging deliberate behaviour. In November 2010 HMRC issued a penalty of £7,676 under s 60 VATA 1984 alleging dishonest evasion. Appeals were lodged with the Tribunal against all three decisions: on 10 December 2010 against the VAT assessment; on 5 April 2011 against the s 60 penalty; and on 13 January 2013 against the sch 24 penalty.

2. On 31 January 2014 Marshall & Co made an application for costs under Tribunal Procedure Rule 10 ("the Application"). The schedule of costs has undergone some revision since then and currently stands at around £97,000. That Application now comes before me.

3. Before the appeals came to trial a settlement was negotiated between the parties. The outcome was (i) Marshall & Co accepted the VAT assessment – albeit that the disputed VAT was to be recovered by a separately registered partnership between Mrs Marshall and her husband; and (ii) HMRC withdrew both penalties. I issued a consent order in those agreed terms on 25 July 2014.

Rule 10

4. Tribunal Procedure Rule 10 provides, so far as relevant:

> "**10. Orders for costs**
>
> (1) The Tribunal may only make an order in respect of costs (or, in Scotland, expenses)—
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> (a) under section 29(4) of the 2007 Act (wasted costs) and costs incurred in applying for such costs; [or]
>
> (b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings;
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> …
>
> (2) The Tribunal may make an order under paragraph (1) on an application or of its own initiative.
>
> (3) A person making an application for an order under paragraph (1) must—
>
> (a) send or deliver a written application to the Tribunal and to the person against whom it is proposed that the order be made; and

(b) send or deliver with the application a schedule of the costs or expenses claimed in sufficient detail to allow the Tribunal to undertake a summary assessment of such costs or expenses if it decides to do so.

(4) An application for an order under paragraph (1) may be made at any time during the proceedings but may not be made later than 28 days after the date on which the Tribunal sends—

(a) a decision notice recording the decision which finally disposes of all issues in the proceedings; or

(b) notice under rule 17(2) of its receipt of a withdrawal which ends the proceedings.

(5) The Tribunal may not make an order under paragraph (1) against a person (the "paying person") without first—

(a) giving that person an opportunity to make representations;

…

(6) The amount of costs (or, in Scotland, expenses) to be paid under an order under paragraph (1) may be ascertained by—

(a) summary assessment by the Tribunal;

(b) agreement of a specified sum by the paying person and the person entitled to receive the costs or expenses (the "receiving person"); or

(c) assessment of the whole or a specified part of the costs or expenses, including the costs or expenses of the assessment, incurred by the receiving person, if not agreed.

(7) Following an order for assessment under paragraph (6)(c) the paying person or the receiving person may apply—

(a) in England and Wales, to a county court, the High Court or the Costs Office of the Supreme Court (as specified in the order) for a detailed assessment of the costs on the standard basis or, if specified in the order, on the indemnity basis; and the Civil Procedure Rules 1998 shall apply, with necessary modifications, to that application and assessment as if the proceedings in the tribunal had been proceedings in a court to which the Civil Procedure Rules 1998 apply;

…

(7A) Upon making an order for the assessment of costs, the Tribunal may order an amount to be paid on account before the costs or expenses are assessed.

…"

Appellant's case

5. Mr Cannon for Marshall & Co submitted as follows.

6. The schedule of costs had been amended to include only those incurred since commencement of proceedings before the Tribunal; that was in accordance with the decision of the Upper Tribunal in *Catanã v HMRC* [2012] STC 2138 - per Judge Bishopp at [10]. Those costs had been incurred necessarily by Mrs Marshall; as a

chartered accountant she was in a position to conduct the appeals against the VAT assessment and the sch 24 penalty herself; however, the s 60 penalty alleged dishonest evasion and it was reasonable of her to have sought independent representation to appeal against that penalty; the allegation of dishonesty was so serious, especially given her professional status, that the penalty had to be attacked thoroughly regardless of its amount.

7. The test under Rule 10(1)(b) had been explained in *Catanã* as follows:

> "[14] Mr Catanã has made a number of points about the phrase 'bringing, defending or conducting the proceedings'. It is, quite plainly, an inclusive phrase designed to capture cases in which an appellant has unreasonably brought an appeal which he should know could not succeed, a respondent has unreasonably resisted an obviously meritorious appeal, or either party has acted unreasonably in the course of the proceedings, for example by persistently failing to comply with the rules or directions to the prejudice of the other side.
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> [15] I cannot see that there is any possible criticism to be made of Judge Kempster's interpretation or application of the phrase. He quite clearly asked himself whether there was anything in HMRC's conduct, in resisting the appeal or in dealing with the matter before the tribunal, which merited the making of a costs direction against them, and decided that there was not. Thus he asked himself the right question, and answered it.
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> …
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> [17] For the reasons I have already given, Judge Kempster could make a costs direction in Mr Catanã's favour only if he was satisfied that HMRC had unreasonably resisted the appeal before the First-tier Tribunal, or conducted themselves during the course of those proceedings in an unreasonable manner. Mr Catanã has made a great many detailed complaints, in his skeleton argument and elsewhere, about HMRC's conduct, both in the course of the inquiry which led to the amendment to his return, and in the course of the tribunal proceedings, but even if I assumed in his favour that his complaints are all justified, they do not seem to me to help him, as they are based on a misunderstanding and in consequence are misplaced."

8. In *Catanã* the Upper Tribunal approved (at [9]) the following passage from *Bulkliner Intermodal Limited v HMRC* [2010] UKFTT 395 (TC):

> "[11] … one thing that has not changed is that the Tribunal's jurisdiction continues to be limited to considering actions of a party in the course of "the proceedings", that is to say proceedings before the Tribunal whilst it has jurisdiction over the appeal. It is not possible under the 2009 Rules [Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, SI 2009/273], any more than in was under the Special Commissioners' Regulations [Special Commissioners (Jurisdiction and Procedure) Regulations 1994, SI 1994/1811], for a party to rely upon the unreasonable behaviour of the other party prior to the commencement of the appeal, at some earlier stage in the history

> of the tax affairs of the taxpayer, nor, even if unreasonable behaviour were established for a period over which the Tribunal does have jurisdiction, can costs incurred before that period be ordered. In these respects the principles in *Gamble v Rowe* … remain good law. That is not to say that behaviour of a party prior to the commencement of proceedings can be entirely disregarded. Such behaviour, or actions, might well inform actions taken during proceedings, as it did in *Scott and anor (trading as Farthings Steak House) v McDonald (Inspector of Taxes)* [1996] STC (SCD) 381, where bad faith in the making of an assessment was relevant to consideration of behaviour in the continued defence of an appeal."

9. Thus, although the Tribunal is primarily concerned with the behaviour of HMRC after proceedings commenced, their prior behaviour should not be disregarded.

10. Marshall & Co contended that their case had remarkable similarities to *Carvill v Frost* [2005] STC (SCD) 208 where the Special Commissioners had awarded costs resulting from the wholly unreasonable behaviour of the then Inland Revenue:

> "62. We were shown the Revenue document IH 2508. This, which was produced by the Revenue as an exhibit to Mr Middleton's evidence, gives instructions to investigators as to how they should raise discovery assessments. The investigating officer is told to write to the taxpayer and the agent warning in advance of assessments and giving them the reason for the action. It goes on to say—'You must not raise such assessments without showing on the file why you consider there to be un-assessed liabilities and your basis for making the relevant discovery assessment.' It goes on to say:
>
> > 'It is a matter for your judgment to decide if and when it is appropriate to raise assessments for all the earlier years and you should, at the point the assessments are made, be able to demonstrate that you have sufficient grounds for making a discovery …'
>
> Particularly relevant to the present situation is the following passage:
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> > 'When a case has to come before Commissioners for a contentious hearing you should conduct a review at an early stage to ensure that all assessments have been properly raised for all years, including any necessary alternatives.'
>
> It seems to us from an examination of the papers put in evidence, being the material that Mr Bowes had in his possession, that he did not carry out the recommended procedures, at least as far as the Early Year Assessments were concerned. …
>
> 63. All those features further undermine the Revenue's claim that the Early Year Assessments had been based on discoveries and had been properly made. Again a proper review at the outset of the litigation proceedings would have revealed these shortcomings and the consequent weakness of the Revenue's position in relation to the validity of the Early Year Assessments.

…

68. It seems to us that the conclusion ultimately reached by the Revenue, which must have been based on advice that their case was highly likely to fail, could and should have been reached many years before December 2003. The beginning of the year 2000 was the occasion of the publication of Dr Avery Jones' decision. That contained clear findings of fact. The Revenue may not have liked these but the standards of reasonable behaviour required them, in our view, to carry out a thorough and objective review of the merits of their case at that stage. …

70. It is significant that the Revenue has not sought to point to any new information disclosed by Mr Carvill which changed their view of the merits of the Revenue's case. As we have already observed, most if not all of the factual information relied upon by Mr Carvill had been disclosed long in advance of the initial directions given by the Tribunal. …

71. As we see it the only relevant new material that came to light while the appeals were before the Special Commissioners were the Revenue internal memoranda showing the basis on which the Sch E assessments had been raised and the information on which the decision to make such assessments had been based. All this information had been in the possession of the Revenue.

72. As we have already indicated the Sch E appeals were crying out for a thorough and objective review shortly after the release of Dr Avery Jones' Decision. Had such a review been carried out it would have revealed both the technical weaknesses in the Early Year Assessments and the strength of Mr Carvill's case as regards his emoluments from IH. Instead of particularizing their case and stating the grounds on which they denied the allegations, the Revenue put forward generalised allegations concerning the genuineness of the contractual arrangements which implied that such arrangements were shams—allegations which they were later unable to sustain. … It is significant that the Revenue only accepted the commerciality of the arrangements at the preliminary hearing before Mr Oliver in May 2003. They gave no explanation for this change of position and as to why they had felt justified in adhering to their earlier stance for so long.

73. … Mr Brennan [counsel for the Revenue] told us that it was no part of our role in a costs application to look into the internal workings of the Revenue and examine the nature and extent of an internal review; if the taxpayer has a claim for administrative or other failing then that must be pursued elsewhere. It seems to us, however, at least in the circumstances of this case, that where we are required to determine the reasonableness or otherwise of the Revenue's conduct in pursuing a case from which it eventually decided to withdraw, internal action, such as the adequacy or otherwise of a review of the issues on which the Revenue's case is founded and which is carried out whilst the appeal is within the jurisdiction of this Tribunal, is directly relevant to the findings we are required to make as to the Revenue's conduct.

> 74. Taking all those factors into account we think that the Revenue acted wholly unreasonably in relation to the hearing. The costs should cover all expenses incurred since March 2000. They should cover the costs of the present proceedings.
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> …
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> 76. Before leaving the matter, we feel that there are certain lessons that should be learnt as a result of these proceedings. We trust that they will be given careful consideration at the appropriate level within HM Revenue and Customs."

11. Mrs Marshall was strongly aggrieved that HMRC had accused her of dishonest evasion. That is a serious charge for any taxpayer but especially so for a practising chartered accountant. HMRC should make such an allegation only after careful consideration and investigation; as stated by Carnwath LJ in *Khan (t/a Greyhound Dry Cleaners) v HMRC* [2006] STC 1167 (at para 79): "It has long been accepted that, even where the civil standard of proof is applicable, special care is needed before finding someone guilty of fraud or dishonesty." HMRC had not exercised such special care.

12. Mrs Marshall had completed the VAT returns for her practice on a basis discussed in advance in telephone conversations with HMRC officers. On 9 December 2009 HMRC had been asked to provide records of all telephone calls with Marshall & Co since the control visit. On 21 December 2009 HMRC replied, "I have now checked our departmental records and there are no records of any telephone conversations between Mrs Marshall and this department since Miss Plant's visit of 3rd December 2008." On 8 January 2010 and 15 March 2010 information was provided to HMRC which should have enabled them to identify, after diligent enquiry, the records of the relevant telephone conversations. HMRC had been wilfully blind to this information, and on 22 November 2010 issued the s 60 dishonest evasion penalty. That penalty had been upheld by formal internal review on 10 March 2011. The penalty had been appealed to the Tribunal on 5 April 2011. An official complaint had been filed concerning HMRC's conduct of the investigation.

13. It was only when the appeal was being prepared for hearing that HMRC, in the form of Mr Brooke, had seen fit to investigate the matter of the telephone conversations; he had, after obtaining some further information, identified the relevant telephone records. That was something that should have been done far earlier; the records demonstrated that the HMRC officers involved were indeed those whose names had been provided back in January and March 2010. HMRC had not learned the lessons advocated by the Special Commissioners in *Carvill v Frost*; the litigation had been allowed to proceed by a process of bureaucratic drift with the result that Marshall & Co had incurred substantial fees preparing an appeal that should have been unnecessary had HMRC properly reviewed the case at an early opportunity.

14. HMRC had sought to question the validity of some of the appeals. The position was complicated because HMRC had appeared to confuse formal internal reviews (under ss 83A *et seq* VATA 1994) with internal reconsiderations of the file; also, the sch 24 penalty notice had not been received by Marshall & Co until December 2012.

Marshall & Co contended that valid appeals had been commenced before the Tribunal on all three issues. HMRC were attempting to hide behind their own mistake.

15. HMRC's conduct had been unreasonable, to put it mildly, and it was appropriate for the Tribunal to exercise its discretion to provide a remedy in costs under Rule 10. Costs as detailed in the schedule were requested on an indemnity basis, to be assessed summarily.

Respondents' case

16. Mr Brooke for HMRC submitted as follows.

17. HMRC accepted that Marshall & Co had not received the sch 24 penalty notice until a copy was provided in December 2012; HMRC then accepted a late request for a formal review under s 83E VATA 1994. Although a notice of appeal had been filed with the Tribunal in relation to the sch 24 penalty, those were not valid proceedings as s 83G VATA 1994 precluded the bringing of an appeal until the review was concluded. HMRC had understood that this point had been accepted in the terms of the stay application made jointly by the parties in February 2013.

18. On the VAT assessment and the s 90 penalty, Marshall & Co's previous advisers had caused some confusion by requesting reviews before any appealable decision had been issued; that had been interpreted as a request for an internal reconsideration of the conclusions of the case officer, which had been acted upon. However, HMRC accepted that there were valid appeals to the Tribunal on those two matters.

19. The original control visit had revealed matters, other than the purchase of the Motorhome, which had resulted in adjustments; for example, VAT on the purchase of a BMW car had been refused. Marshall & Co were chartered accountants and so should have been aware of the relevant rules. Marshall & Co had then been on annual VAT returns but later changed to quarterly returns. After being informed that HMRC did not accept that the VAT on the Motorhome was input tax, Marshall & Co made an identical claim on the next return. That was the behaviour that the case officer and her superiors had considered to be culpable.

20. HMRC now accepted that Marshall & Co had discussed matters with HMRC officers by telephone before filing the second return. Also, that Marshall & Co had stated that had been done; and that HMRC had stated they could not trace any relevant telephone calls. Because Marshall & Co is an accountancy firm, it had many telephone dealings with HMRC on client matters and the information provided by Marshall & Co had not been sufficiently detailed to identify any relevant call records.

21. When the appeals were notified to HMRC's Appeals Unit and Mr Brooke became involved, he considered that with certain additional information it might be possible to trace the call records, if they existed. He requested that information from Marshall & Co's advisers in March 2012 and it was provided in April 2012; in August 2012 he completed his researches and reported to Marshall & Co; there was further

communication with Marshall & Co and their advisers in August and September, and on 24 September 2012 Mr Brooke wrote to Marshall & Co stating that he had discussed matters with the officers who were the original decision-makers and he proposed a meeting with a view to resolving matters. The meeting took place at counsel's chambers on 27 November 2012, which was the first convenient date.

22. HMRC had complied with all directions of the Tribunal concerning production of their statement of case and documents lists. The appeals had been originally listed for hearing in January 2012 but that was postponed (without objection from HMRC) at the request of Marshall & Co. A relisted hearing for April 2012 had again been postponed at the request of Marshall & Co to enable counsel to familiarise himself with the case.

23. HMRC firmly refuted any suggestion that relevant information had been wilfully ignored. The case officer did not have the call records in her possession. Her decision had been upheld by her colleagues. Eventually unearthing the call records had been a significant exercise, and had required extra information from Marshall & Co which was provided in April 2012. Once those call records had been traced HMRC had acted speedily to reconsider their position. The only delay had been that Mr Brooke wished to address matters in a meeting rather than in correspondence, and there had been a short delay while a mutually convenient date was identified.

24. It was noted that the taxpayer was unhappy at the conduct of the investigation, and that a formal complaint had been lodged. Consideration of that complaint was on hold pending the outcome of the costs application.

25. HMRC had not acted unreasonably in the proceedings and the costs application should be refused.

Consideration and Conclusions

26. Both Mr Cannon and Mr Brooke made detailed and well-prepared presentations of their respective cases, which I have summarised above. I consider I am able to determine the Application with only a short explanation.

27. Both parties accept, and I agree, that the question for me is whether "HMRC had unreasonably resisted the appeal before the First-tier Tribunal, or conducted themselves during the course of those proceedings in an unreasonable manner" (per *Catanã* at [17]).

28. Because my consideration of HMRC's behaviour is (subject to the point made in *Bulkliner*) confined to their behaviour after commencement of proceedings before the Tribunal, I do not intend to review in depth the background to the proceedings. However, it is appropriate for me to summarise certain key points. Mrs Marshall explained to HMRC soon after the December 2008 control visit (I refer to letters she wrote to HMRC on 11 January 2009 and 28 February 2009) the position concerning the Motorhome (as well as other items queried as a result of the visit) and provided copies of relevant documentation. In particular, she explained why the Motorhome

had been purchased in the name of her husband (rather than Marshall & Co) and the intended use for the Motorhome. HMRC took the view that the VAT on the Motorhome was not input tax for Marshall & Co – they noted that the vehicle registration was not in the taxpayer's name; also that the vehicle insurance was in the name of Mrs Marshall's husband, was for social use only, and the only other named driver appeared to be unconnected with Marshall & Co. As matters have progressed, Mrs Marshall established a business partnership with her husband, registered the firm separately for VAT, and that firm has been refunded the VAT on the Motorhome. The possibility of a separate partnership was set out by Mrs Marshall in her letters to HMRC to which I have already referred. What appears to have particularly irked HMRC, and led them to issue the penalties, was that after they told Mrs Marshall that they considered the Motorhome VAT was not input tax of Marshall & Co, she then on the subsequent VAT return again claimed a deduction for that VAT (the business was filing annual returns at the relevant time). Mrs Marshall explains (and, I understand, HMRC now accept) that she did so only after discussing the matter over the telephone with at least two HMRC officers. She explained what she had done to HMRC before the penalties were issued; HMRC stated that, after checking their departmental records, there were no records of any telephone conversations between Mrs Marshall and HMRC since the control visit. I do not accept Mr Cannon's suggestion that HMRC were "wilfully blind" to the matter of the telephone calls; rather I accept Mr Brooke's explanation that, as Marshall & Co were in regular contact with HMRC on client matters, it had not initially proved possible to trace Mrs Marshall's calls relating to the practice's own tax affairs. The way in which that was communicated to Mrs Marshall was imperfect but I do not accept that HMRC had merely ignored the explanation put to them. In any event, those events all preceded the commencement of proceedings before this Tribunal.

29. What is clear to me after considering all the evidence before me, and why I can deal with the matter fairly briefly, is that after the appeal proceedings were commenced HMRC did not act unreasonably. On the contrary Mr Brooke took the initiative to conduct further research on unearthing the call records by requesting additional information that he (correctly) believed might enable him to succeed where his colleagues had previously drawn a blank. He contacted Marshall & Co and their advisers for details and acted when he received them. Without his detective work the appeals may have proceeded to trial with HMRC continuing to deny any record of Mrs Marshall's calls. I consider the matter is fairly summarised in the note of the meeting on 27 November 2012:

> "EM [Mrs Marshall] stated that the phone calls she had identified to WB [Mr Brooke] had ultimately shown that the dishonesty penalty had not been appropriate. EM stressed she had mentioned phone calls in the past and had been advised that no such record of calls was available.
>
> WB advised that it was only by EM identifying the numbers she had called, that allowed him to trace the records he did. Further it was not until EM identified the nature of the discussions with particular officers, that he was able to do extra work to identify how the discussions re changing Marshall & Co into a partnership had been

> recorded. He stressed that within the appeal process the only delay, once the content of certain relevant calls had been identified, was to allow WB to meet with the officers in question and then to find an acceptable time to hold this meeting."

30. As HMRC did not act unreasonably in defending or conducting the proceedings I shall refuse the Application.

31. I should deal with two points, mainly in case this matter proceeds further:

(1) In relation to the sch 24 penalty, I agree with HMRC's analysis that although a notice of appeal was filed with the Tribunal, HMRC had already agreed to accept a late request for a formal review under s 83E VATA 1994, and thus s 83G precluded the bringing of an appeal until the review was concluded. Accordingly, there were no "proceedings" in relation to the sch 24 penalty dispute.

(2) At the conclusion of the hearing I indicated to the parties that I was intending to issue a decision in principle, with any subsequent quantification of costs being the subject of separate directions. Given my decision to refuse the Application I need not address the schedule of costs and, in case this matter proceeds further, I record here that I have not considered the schedule.

Decision

32. The Application is REFUSED.

33. 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.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 30 December 2014