TC04468

Appeal number: TC/2014/04169

VAT – penalties – input tax – "flat rate scheme" – meaning of "carelessness"– failure to apply "appropriate percentage" to VAT-inclusive "relevant turnover" – HMRC officer mistakenly confirms method applied correct – whether appellant careless– no – appellant claiming input tax credit for services received – whether appellant careless – yes – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

SIMON THOMAS T/A THE STABLEYARD **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at The Royal Courts of Justice on 10 April 2015 and subsequently considering written submissions sent on 23 April 2015 and 14 May 2015.

The Appellant in person

Rita Pavely, Officer of HM Revenue & Customs, for the Respondents

DECISION

1. At all material times, the appellant carried on a business known as "The Stableyard" and had opted to calculate his VAT liabilities associated with that business under the "flat-rate scheme" (the "Scheme") established under s26B of the Value Added Tax Act 1994 ("VATA 1994") and Part VIIA of the Value Added Tax Regulations 1995 (the "Regulations").

2. The appellant appeals against penalties charged under Schedule 24, Finance Act 2007 ("Schedule 24") for inaccuracies in the appellant's VAT returns from, and including, the period 02/10 to, and including, the period 11/13.

Background and matters not in dispute

3. At all times material to this appeal, the appellant was a "flat-rate trader" for the purposes of the Scheme. There was no dispute that the "appropriate percentage" applicable to the appellant's business at the relevant times was 10.5%.

4. In all of his VAT returns relating to the period 02/10 to, and including, the period 11/13, the appellant calculated his "relevant turnover" for the purposes of the Scheme by aggregating the (VAT-exclusive) value of the supplies that he made. He then applied the appropriate percentage to the amount so calculated in order to calculate the amount of VAT due to HMRC. Therefore, if the appellant made standard rated supplies of £1,000 in a VAT period, his approach would have resulted in the "appropriate percentage" of 10.5% being applied to £1,000 to produce a VAT liability of £105. The appellant is not a tax specialist and prepared those VAT returns himself without engaging the services of a professional tax adviser.

5. It is common ground that the appellant has calculated "relevant turnover" incorrectly. Under s26B(2) of VATA 1994, "relevant turnover" should be calculated by reference to the VAT-inclusive value of taxable supplies. Therefore, using the figures set out at [4] above, the appellant should have applied the "appropriate percentage" of 10.5% to VAT-inclusive turnover of £1,200 to produce a VAT liability of £126.

6. In November 2008, Mr Steve Rickwood, an officer of HMRC visited the appellant's business premises for a routine compliance check. Officer Rickwood made a note of that visit that included the following section:

> "Checked for application of correct FRS percentage and found satisfactory. Correct tax base applied to calculations. "

7. In his VAT return for the period 11/13, the appellant claimed credit for input tax of £7,177.23 and £4,404.88 charged on two invoices (the "Invoices"). The Invoices were in respect of the professional services of a firm of solicitors and a firm of surveyors that the appellant had received in connection with the sale of land used in his business. HMRC consider that the Scheme prevents the appellant from obtaining credit for input tax shown on the Invoices.

8. HMRC discovered the nature of the appellant's claim for input tax credit relating to the Invoices and that he was calculating "relevant turnover" wrongly during a visit arranged by HMRC in January 2014. While the appellant has at all times been entirely co-operative and transparent in his dealings with HMRC, it was HMRC themselves who identified these issues rather than the appellant who brought them to HMRC's attention.

9. HMRC issued assessments to counteract the effect of what they regarded as the errors described at [5] and [7] above. The appellant has not sought to appeal against those assessments.

10. On 14 May 2014, HMRC informed the appellant that they were seeking penalties of 15% of the "potential lost revenue" on the basis that the appellant had been "careless", but had made a "prompted" disclosure of the inaccuracies in question. HMRC considered that there were no "special circumstances" to justify a further mitigation of the penalties. They also concluded that, since the appellant, had, on 20 February 2014, applied to cancel his VAT registration, the conditions set out in paragraph 14(3) of Schedule 24 were not satisfied and HMRC had no power to suspend the penalties.

Matters in dispute and evidence

11. The appellant disputes that any penalties are due and argues as follows:

(1) He denies that he made any mistake in connection with the Invoices.

(2) He denies that he was careless.

(3) He argues that HMRC should have mitigated the penalties altogether.

(4) He argues that, even if the penalties were correctly determined, HMRC should have suspended them.

12. The appellant gave oral evidence and provided written submissions after the hearing. I found him to be a straightforward and honest witness.

13. HMRC produced no witness evidence. I heard submissions from Ms Pavely who appeared for HMRC. She also provided written submissions following the hearing.

Overview of the Scheme

14. As a general matter, a taxable person is obliged, in each VAT period, to determine the amount of "output tax" on supplies that it makes and the deductible "input tax" it has suffered on supplies that it has received. The amount due to HMRC in relation to that VAT period is essentially the output tax less input tax.

15. The Scheme seeks to reduce the VAT compliance burden for small businesses by taking some of the work out of recording VAT on sales and purchases. Instead of following the normal approach set out above (which necessitates calculating both

output tax and input tax), a taxpayer operating the Scheme is allowed to calculate the amount of VAT due to HMRC for a particular VAT period by simply applying a flat-rate "appropriate percentage" to (VAT-inclusive) "relevant turnover" for that period. Different "appropriate percentages" apply to different categories of business.

16. A taxpayer operating the Scheme is generally prevented, by s26B(5) VATA 1994, from claiming credit for input tax on supplies received. This is because an estimate of input tax recovery is built into the "appropriate percentage" applicable to the type of business conducted. However, paragraph 55E of the Regulations permits input tax recovery in certain limited cases.

Was the appellant entitled to claim input tax in relation to the disputed invoices?

17. The appellant is maintaining that he made no mistake in claiming credit for input tax shown on the Invoices. Ms Pavely did not suggest that, given he is not appealing against the assessments themselves, he should be prevented from making such an argument in this appeal. It may be that such an argument would have been open to Ms Pavely. However, since the appellant's assertion can be disposed of quickly, I will do so.

18. Paragraph 55E of the Regulations permits a flat-rate trader to claim credit for input tax on a supply that he receives only if it is not a "relevant purchase", or it is a "relevant purchase" of "capital expenditure goods".

19. By virtue of paragraph 55C(1) of the Regulations, subject only to exceptions set out in paragraphs 55C(3), (5) and (6) of the Regulations, any supply of services to a flat-rate trader is a "relevant purchase". None of those exceptions is relevant and it follows that the supplies in question were "relevant purchases".

20. Therefore, the appellant is not entitled to input tax recovery unless the supplies constituted relevant purchases of "capital expenditure goods" as defined in paragraph 55(1) of the Regulations. That definition relates only to goods and cannot include any services. Therefore, since the input tax in question related to supplies of services, it could not have been input tax incurred on supplies of "capital expenditure goods" as defined. Accordingly, the input tax shown on the Invoices was not creditable.

The law

21. Paragraph 1 of Schedule 24 provides as follows:

> (1) a penalty is payable by a person (P) where –
>
> (a) P gives HMRC a document of a kind listed in the Table below, and
>
> (b) Conditions 1 and 2 are satisfied.
>
> (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to –
>
> (a) an understatement of a liability to tax,

…

(c) a false or inflated claim to repayment of tax

(3) Condition 2 is that the inaccuracy was careless within the meaning of paragraph 3.

22. The relevant Table includes a VAT return as a specified category of document. The appellant accepts that the relevant VAT return contains an "inaccuracy" that resulted from his calculation of "relevant turnover" and I have concluded at [20] that his return for 11/13 contained an "inaccuracy" consisting of a claim for input tax credit relating to the Invoices. Those inaccuracies led to the results specified in paragraph 1(2) of Schedule 24. Therefore, the sole question arising from paragraph 1 of Schedule 24 is whether the inaccuracies in question were "careless".

23. By virtue of paragraph 3 of Schedule 24, an inaccuracy in a document is "careless" if the inaccuracy is "due to failure by P to take reasonable care".

24. Paragraph 4 of Schedule 24 provides that, for a domestic matter such as that in issue in this appeal that involves "careless" action, the standard percentage penalty is 30% of the "potential lost revenue".

25. Paragraph 10 of Schedule 24 requires HMRC to reduce penalties that would otherwise be due by reference to the standard and quality of disclosure. However, where, the standard percentage is 30% and the taxpayer has made a "prompted", rather than an "unprompted" disclosure, paragraph 10 does not permit HMRC to reduce the penalty to below 15% of the "potential lost revenue".

26. Paragraph 11 of Schedule 24 permits HMRC to reduce a penalty due under paragraph 1, including to an amount below the minimum stipulated in paragraph 10, if there are "special circumstances".

27. Under Paragraph 14 of Schedule 24, HMRC may suspend a penalty for a careless inaccuracy due under paragraph 1 of Schedule 24. However, paragraph 14(3) of Schedule 24 provides as follows:

"(3) HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy"

28. Paragraph 15 of Schedule 24 confers rights of appeal. A taxpayer has the right to appeal against, inter alia, a decision of HMRC that a penalty is chargeable, a decision as to the amount of the penalty and a decision not to suspend a penalty.

29. Paragraph 17 sets out the Tribunal's powers on an appeal which includes a power to substitute for HMRC's decision another decision that HMRC had power to make. However, this power is qualified in some respects:

(1) If the Tribunal substitutes its decision for that of HMRC, it may rely upon paragraph 11 of Schedule 24 (relating to "special circumstances") to a different

extent from HMRC only if the Tribunal thinks that HMRC's decision on the application of paragraph 11 was flawed.

(2) If the Tribunal is considering an appeal that a penalty should be suspended, it may order HMRC to suspend the penalty only if it thinks that HMRC's decision not to suspend was flawed.

30. Paragraph 17(6) provides that a decision is "flawed" if it is flawed when considered in the light of principles applicable in proceedings for judicial review.

Findings of fact

Notice 733

31. I found that the appellant was aware of HMRC's Notice 733 entitled "Flat Rate Scheme For Small Businesses" ("Notice 733"), although he had not read all sections of it.

32. I found that paragraphs 6.2, 7.3 and 7.4 of Notice 733 would make it clear to a person without tax expertise who consulted them for the purposes of complying with the provisions of the Scheme that "relevant turnover" is to be calculated by reference to a VAT-inclusive figure and not a VAT-exclusive figure. It may well be that, as the appellant suggested, a worked example of the calculation of "relevant turnover" would have made these sections of Notice 733 even clearer. However, I did not accept the appellant's submissions that Notice 733 was unclear.

33. I found that a person without tax expertise but reading paragraphs 2.4 and 15 of Notice 733 for the purposes of complying with the provisions of the Scheme would have realised that no credit could be claimed for the VAT shown on the Invoices since the Invoices did not relate to a purchase of "high value capital goods".

34. I did not accept the appellant's submission that HMRC's standard form VAT returns were unclear or contradictory because they failed to include a specific warning that flat-rate traders needed to apply different rules for calculating tax due and claiming input tax credits. Rather I have concluded that Notice 733, of which the appellant was aware, made it abundantly clear that the Scheme would produce very different outcomes for flat-rate traders from the application of general VAT principles.

35. I concluded that the appellant did not read relevant extracts of Notice 733 carefully and that he relied more upon intuition than on careful study of Notice 733 when completing his VAT returns. I have reached this conclusion because:

(1) The appellant admitted that he had not read Notice 733 "from cover to cover" as "there was lots of it".

(2) I considered the appellant to be an intelligent man not least since he handled the conduct of his appeal ably and without professional support. Since the relevant parts of Notice 733 are clear, the appellant would not have made the errors he did make if he had read those sections clearly.

(3) The appellant noted that, if a trader outside the Scheme made a supply to the value of £100, the amount of VAT due would be determined by applying the 20% VAT rate to the VAT-exclusive consideration of £100. He stated that he had therefore assumed that the same methodology would apply in the case of a flat-rate trader and that he should therefore apply the "appropriate percentage" to the value of his VAT-exclusive supplies.

(4) The appellant said that he had assumed that he could claim input tax credits for the VAT shown on the invoices because he considered thathe would be entitled either to an income tax deduction or to increased "base cost" for capital gains tax purposes for the amount of the expense. He said that, since his conclusion seemed obvious, he did not see any need to verify it.

The visit of Officer Rickwood

36. I find that, when he wrote "correct tax base applied to calculations" in his note of his visit, Officer Rickwood was confirming that he had concluded that the appellant was, correctly, applying the "appropriate percentage" to the VAT-inclusive consideration when calculating "relevant turnover". Since he wrote that in his note of the visit to the appellant, I have concluded that he also told the appellant during the visit that the appellant's approach to calculating "relevant turnover" was correct.

37. HMRC's position was that Officer Rickwood was right to give the confirmation he did since, at the time of his visit, the appellant was applying the correct method and only subsequently adopted an incorrect method. The appellant submitted that HMRC had not previously suggested that he had altered his method of calculating "relevant turnover". He wished to make the argument that, at the time of Officer Rickwood's visit, he was applying the same incorrect method as he applied in his returns from 02/10 to 11/13 and that Officer Rickwood had accordingly been mistaken to give the reassurance that he did. Ms Pavely confirmed on behalf of HMRC that, if the appellant made this argument, HMRC would not seek to make additional VAT assessments beyond those that had already been issued and we agreed to hear further written submissions on this issue.

38. In her submissions Ms Pavely reported Officer Rickwood as saying that:

> "He remembers issuing an assessment to one business that was incorrectly calculating the percentage for sales on the net income total instead of the total of all income. As such, he says that he is sure that if he had checked the sales figures and Mr Thomas had been incorrectly calculating the FRS percentage at that time, he would have assessed him also".

39. For his part, the appellant repeated his evidence that he had not changed his method at any time. He supplied a VAT return for the period 08/06, some example invoices and other information to support his position.

40. On balance, I have concluded that the appellant was adopting the wrong method at the time Officer Rickwood visited and that, accordingly, Officer Rickwood was mistaken when he confirmed to the appellant that he was calculating "relevant

turnover" correctly. I have reached that conclusion firstly because the appellant's position was supported by a manuscript calculation on a "Post-It" note which he asserts (and HMRC do not deny) was prepared at the time he submitted his VAT return for the period 08/06 which was well before Officer Rickwood's visit. That calculation appears to show an "appropriate percentage" being applied to VAT-exclusive turnover. The report of Officer Rickwood's view summarised at [38] is at best hearsay evidence but states only that "if he had checked the sales figures" he would have identified the error. That leaves open the possibility that Officer Rickwood gave his confirmation without reviewing the sales figures, or perhaps without considering them in sufficient detail. I have concluded that this is more likely than the appellant deciding to cease to adopt a method that he believed HMRC to endorse and to adopt, instead, a different method that resulted in a lower VAT liability.

Discussion

Was the appellant careless?

41. Ms Pavely referred us to the 19th century case of *Blyth v Birmingham Waterworks Co* (1856) 11 Exch 781. While that is a well-known decision on the meaning of "negligence" in tort law, Ms Pavely did not provide us with submissions as to why, in her view, this old authority sheds any light on the meaning of "carelessness" for the purposes of Schedule 24.

42. I have therefore performed my own review of the authorities on the meaning of "carelessness". I respectfully agree with Judge Cannan who, in *Hanson v Revenue & Customs Commissioners* [2012] UKFTT 314 (TC), concluded at [19] that the question of whether a particular inaccuracy is "careless" needs to be determined by considering what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done. While that is primarily an objective test, it does contain some elements of subjectivity as Judge Cannan noted when he said at [21]:

> "What is reasonable care in any particular case will depend on all the circumstances. In my view this will include the nature of the matters being dealt with in the return, the identity and experience of the agent, the experience of the taxpayer and the nature of the professional relationship between the taxpayer and the agent."

43. Further support for the proposition that certain, subjective, characteristics of the taxpayer himself must be taken into account in assessing whether behaviour is careless can be found in *Harding v HMRC* [2013] UKUT 575(TC). In that case, Judges Bishopp and Sadler said, at [35]:

> "I do not accept that the Appellant, who admits that he considered that the 'severance payment' was possibly liable to tax in October 2008, could, by August 2009, reasonably have reached the conclusion that it was definitely not liable to tax. The Appellant is an intelligent person, and held a senior position (such as made him eligible to participate in

> his employer's profit share and bonus plans reserved for directors) in a company which forms part of a leading accountancy practice."

44. Applying those tests, I am satisfied that the inaccuracy involving the incorrect claim for input tax credit resulted from carelessness. I consider that a reasonable person without specialist tax knowledge who was preparing VAT returns himself and exercising reasonable diligence in the preparation of those returns would have read relevant extracts from Notice 733 carefully. Having read those extracts, he would have formed the conclusion that no credit for input tax could be claimed on the Invoices. However, for reasons set out at [35], I have concluded that the appellant did not read Notice 733 sufficiently carefully and rather trusted too much to intuition when preparing his VAT return. It follows that the "inaccuracy" relating to the excessive claim for input tax was, as HMRC claim, due to the appellant's failure to take reasonable care.

45. I have, however, reached a different conclusion in relation to the inaccuracies in the calculation of "relevant turnover". I accept Ms Pavely's submissions that the appellant's diligence in reading Notice 733 left much to be desired. If Officer Rickwood had identified the appellant's error in 2008, the appellant would have had little cause for complaint if he had received a penalty for "careless" behaviour at that time. However, I have concluded that the fact that Officer Rickwood gave the appellant a reassurance that he was calculating "relevant turnover" correctly, even though he may not have reviewed the appellant's calculations in detail before giving that reassurance, changes matters considerably. That is because, given the discussion at [42], the taxpayer's behaviour needs to be assessed by reference to that of a hypothetical reasonable taxpayer who had received a confirmation from an HMRC officer that he was calculating "relevant turnover" correctly. I consider that it would be reasonable for such a taxpayer to conclude that, having received a "sign off" from HMRC it was no longer necessary to double-check the position by reading relevant extracts from Notice 733.

46. In reaching the conclusion at [45] I am not, of course, saying that a reasonable taxpayer would always accept every confirmation of an HMRC officer at face value, no matter how outlandish it appeared. However, Ms Pavely based her case on "carelessness" on the appellant's failure to digest Notice 733 properly. She did not submit that a reasonable taxpayer would have concluded that Officer Rickwood's confirmation was obviously questionable and that further researches were necessary to determine the true position. I have concluded that HMRC have not shown that the inaccuracies stemming from the incorrect calculation of "relevant turnover" are due to the appellant failing to take reasonable care.

Mitigation

47. Given the agreed facts at [10] above, the appellant's disclosure of his errors can only be regarded as "prompted". Therefore HMRC have, applied the greatest possible level of mitigation that is available without "special circumstances".

48. I was not satisfied that there were any "special circumstances" that related to the incorrect claiming of input tax credit in relation to the Invoices.

49. I have found that the inaccuracy relating to the calculation of "relevant turnover" was not careless. That means that it is not necessary to conclude on the question of "special circumstances" in relation to that aspect of the penalties. However, I have noted that, in assessing penalties, HMRC took no account of the fact that Officer Rickwood had confirmed to the appellant that he was calculating "relevant turnover" correctly. I would regard that as a highly relevant factor and, if it had been necessary to determine the point, I would have concluded that the failure to take this factor into account made HMRC's decision "flawed" in the sense set out in paragraph 17(6) of Schedule 24. Therefore, had I needed to decide on "special circumstances", I would have exercised my power under paragraph 17(5)(b) of Schedule 24 to conclude that the penalties, insofar as relating to the incorrect calculation of "relevant turnover", should be mitigated altogether.

Suspension

50. As noted at [27], HMRC have power to suspend penalties only if "compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy". Given that, by the time the penalties had been assessed, the appellant had applied to cancel VAT registration, I consider that it was entirely reasonable for HMRC to conclude that the appellant would, in the future, no longer be subject to the VAT penalty regime at all, with the result that suspension would not help him to avoid becoming liable for further penalties. I do not, therefore, consider that HMRC's decision in this regard was "flawed".

Conclusion

51. The taxpayer's appeal against the penalties relating to the claim for credit for input tax shown on the Invoices is dismissed.

52. The taxpayer's appeal against the penalties relating to errors in the calculation of "relevant turnover" is allowed.

53. 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.

JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 9 June 2015