[2016] UKUT 0116 (TCC)

Appeal number: UT/2015/0043

Costs – settlement of case before First-tier Tribunal – whether HMRC acted unreasonably in defending or conducting the proceedings – Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, rule 10(1)(b) – whether FTT erred in law in refusing appellant's application for costs.

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

MARSHALL & CO **Appellant**

- and -

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

TRIBUNAL: JUDGE ROGER BERNER
JUDGE THOMAS SCOTT

Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 19 January 2016

Patrick Cannon of Counsel for the Appellant

Aparna Nathan of Counsel, instructed by the Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal against a decision of the First-tier Tribunal ("**FTT**") (Judge Peter Kempster) released on 30 December 2014 by which the FTT refused an application by the appellant, Marshall & Co, for an order for costs against HMRC.

2. Marshall & Co is a VAT-registered chartered accountancy practice whose proprietor is Mrs Marshall. In 2008 HMRC raised certain VAT queries, in particular relating to input tax which had been claimed on the purchase of a motorhome ("**the Motorhome**"). In March 2009 HMRC issued an assessment under section 73 of the Value Added Tax Act 1984 ("**VATA**") in the amount of the disputed VAT. In October 2009 HMRC informed Marshall & Co that they were commencing an investigation into suspected dishonest conduct. In December 2009 HMRC issued a penalty of £5,374 under Schedule 24 to the Finance Act 2007, alleging deliberate behaviour (the "**Schedule 24 penalty**") and in November 2010 issued a penalty of £7,676 under section 60 VATA alleging dishonest evasion (the "**Section 60 penalty**").

3. Marshall & Co lodged appeals with the FTT against the VAT assessment on 10 December 2010, against the section 60 penalty on 5 April 2011, and against the Schedule 24 penalty on 13 January 2013. Before the appeals came to a substantive hearing a settlement was negotiated between the parties. Under that settlement, Marshall & Co accepted the VAT assessment, the relevant input tax being recovered by a separately registered partnership between Mrs Marshall and her husband, and HMRC withdrew both the section 60 penalty and the Schedule 24 penalty.

4. On 31 January 2014, Marshall & Co made an application to the FTT for costs under Tribunal Procedure Rule 10. The FTT refused that application.

Grounds of Appeal

5. By an application dated 29 January 2015 (the "**Application**") Marshall & Co applied for permission to appeal against the decision of the FTT issued on 30 December 2014 to refuse the costs application. On 10 February 2015 Judge Kempster granted permission to appeal, on the following grounds as set out in the Application:

    (a) The FTT erred in law in failing to review in depth the background to the proceedings.

    (b) The FTT was mistaken in finding that HMRC did not act unreasonably after the appeal proceedings began.

    (c) The FTT was mistaken in holding that section 83G VATA applied to preclude the bringing of an appeal against the Schedule 24 penalty until the "review" was concluded so that there were no "proceedings" in relation to that penalty.

The Law

6. Section 29 of the Tribunals, Courts and Enforcement Act 2007 provides that all costs of and incidental to proceedings in the FTT shall be in the tribunal's discretion, subject to Tribunal Procedure Rules. So far as relevant, Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273) provides as follows:

> **"10. Orders for costs**
>
> (1) The Tribunal may only make an order in respect of costs ….
>
> (a) under section 29(4) of the 2007 Act (wasted costs) and costs incurred in applying for such costs;
>
> (b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings; [or]
>
> (c) if [the proceedings have been allocated as a Complex case].
>
> (2) The Tribunal may make an order under paragraph (1) on an application or of its own initiative."

7. It was common ground before the FTT and in this appeal that since the appeal was not categorised as Complex, and there had been no application for "wasted costs" as defined in the 2007 Act, the only basis on which an application for costs could be made in this case was under the "unreasonable conduct" head in Rule 10(1)(b).

8. By virtue of section 83(1)(q) VATA, an appeal to the FTT lies in respect of a VAT penalty. Under section 83A VATA, HMRC must offer the taxpayer a review of a decision to impose a penalty where such an appeal lies. A review offer accepted by the taxpayer in the normal time allowed takes place under section 83C. A review out of time takes place under section 83E.

9. So far as relevant, section 83G VATA provides as follows:

> **"83G Bringing of appeals**
>
> (1) An appeal under section 83 is to be made to the tribunal before –
>
> (a) the end of the period of 30 days beginning with -
>
> (i) in a case where P is the appellant, the date of the document notifying the decision to which the appeal relates ….
>
> (2) But that is subject to subsections (3) to (5).
>
> (3) In a case where HMRC are required to undertake a review under section 83C –
>
> (a) an appeal may not be made until the conclusion date, and

(b) any appeal is to be made within the period of 30 days beginning with the conclusion date.

(4) In a case where HMRC are requested to undertake a review by virtue of section 83E -

(a) an appeal may not be made -

(i) unless HMRC have notified P … as to whether or not a review will be undertaken, and

(ii) if HMRC have notified P… that a review will be undertaken, until the conclusion date;

(b) any appeal where paragraph (a)(ii) applies is to be made within the period of 30 days beginning with the conclusion date …

(5) In this section "conclusion date" means the date of the document notifying the conclusions of the review.

Rule 10(1)(b)

10. The scope of Rule 10(1)(b) has been discussed in this Tribunal in *Catanã v Revenue and Customs Commissioners* [2012] UK 172 (TTC), where Judge Bishopp, at [14], stated:

> "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 proceedings, for example by persistently failing to comply with the rules and directions to the prejudice of the other side".

11. The reference to "the proceedings" in Rule 10(1)(b) is to proceedings before the Tribunal which has jurisdiction of the appeal, whilst it has such jurisdiction. In *Catanã* this Tribunal approved (at [9]) the following statements from *Bulkliner Intermodal Limited v HMRC* [2010] UK FTT 395 (TC):

> "….. It is not possible under the 2009 Rules … 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."

12. Where HMRC eventually withdraw from a case against a taxpayer, in relation to the pre-2009 costs regime the Special Commissioners held in *Carvill v Frost* [2005] STC (SCD) 2008 that failure by HMRC properly to have reviewed its

decision to pursue a claim would be relevant. The Commissioners stated (at [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."

13. Again in the context of the withdrawal by HMRC of a case before the FTT, the decision of this Tribunal in *Tarafdar (t/a Shah Indian Cuisine) v Revenue and Customs Comrs* [2014] UKUT 362 (TCC) is relevant. In *Market & Opinion Research International Ltd v Revenue & Customs Comrs* [2015] UKUT 12 (TCC), this Tribunal endorsed (at [18]) the test set out in *Tarafdar* at [34]:

> "In our view, a tribunal faced with an application for costs on the basis of unreasonable conduct where a party has withdrawn from the appeal should pose itself the following questions:
>
> (1) What was the reason for the withdrawal of that party from the appeal?
>
> (2) Having regard to that reason, could that party have withdrawn at an earlier stage in the proceedings?
>
> (3) Was it unreasonable for that party not to have withdrawn at an earlier stage?"

The FTT's Decision

14. Judge Kempster set out Marshall & Co's arguments at some length. Those arguments began by referring to the passages from *Catanã*, including the reference to *Bulkliner*, referred to at [10] and [11] above. He summarised the effect of those passages as follows (at [9]):

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

15. He then cited a lengthy passage from the decision of the Special Commissioners in *Carvill v Frost*, to which Marshall & Co had contended that their case had "remarkable similarities".

16. In relation to the discussion in *Carvill v Frost* of the importance of HMRC reviewing its own action, Judge Kempster described Marshall & Co's argument that this was especially significant where, as here, HMRC raised an accusation of dishonest evasion.

17. Judge Kempster then described one of the Appellant's central arguments, that certain crucial telephone records had not been adequately, or promptly, identified and investigated by HMRC (at [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 central 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 3 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 s60 dishonest evasion penalty …
>
> 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 responses. 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."

18. The FTT decision then sets out the submissions made by Mr Brooke for HMRC. The original control visit had revealed various VAT issues, of which Marshall & Co as chartered accountants should have been aware. The trigger for the HMRC actions was described at [19]:

> "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 tax return. That was the behaviour that the case officer and her superiors had considered to be culpable."

19. The decision describes HMRC's chronology of relevant events in relation to the disputed telephone records, concluding at [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."

20. Judge Kempster then reiterated the question before him, per *Catanã* at [17], as 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."

21. At [28], he began his summary of certain key factual points as follows:

> "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."

22. As regards the disputed telephone calls, Judge Kempster expressed his findings of fact as follows (at [28]):

> "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."

23. The FTT's decision is set out at [29] and [30]:

> "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 Brooks] 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."

Discussion and Decision

24. Turning to this appeal, it is important to emphasise at the outset that the issue before Judge Kempster - was HMRC's conduct in the proceedings unreasonable – was effectively a value judgment. As explained by Judge Bishopp in *Catanã* (at [16]):

> "The principal difficulty facing Mr Catanã in this appeal is the fact that …. the making of a costs direction is a matter for judicial discretion. If I am to allow this appeal I have to be satisfied, not that I would, or even might, have made a different direction myself, but that Judge Kempster exercised his discretion in an unreasonable manner – that is, he failed to apply the correct law, took into account the irrelevant, ignored the relevant or reached a conclusion which no judge, properly exercising his discretion, could reasonably have reached. That is, plainly, a difficult task."

25. Mr Cannon for Marshall & Co argued that the FTT had erred in three respects in reaching their decision to refuse the costs application.

26. First, he argued that the FTT made an error of law in failing to review in depth the background to the proceedings. By "the background to the proceedings", Mr Cannon referred in particular to HMRC's decision to issue the section 60 penalty even though Mrs Marshall had by that stage proposed a course of action to HMRC and had been told by HMRC, wrongly, that records of the telephone calls on which she relied did not exist. Furthermore, he argued, given that such an allegation of dishonest evasion required very careful consideration by HMRC, HMRC's decision to proceed with the section 60 penalty until proceedings commenced was egregious and fell far short of the standard to be expected of it or required by law.

27. We do not accept that the FTT made any error of law in this respect. In our judgment, Judge Kempster correctly identified the relevance of HMRC conduct before the commencement of proceedings, by reference to the relevant passages from *Catanã* and *Bulkliner*. His summary of those passages, identifying the Tribunal's primary concern as HMRC behaviour after proceedings have begun, was correctly expressed as a matter of law. In stating (at [9]) that HMRC's behaviour prior to that time "should not be disregarded", he referenced the statement in *Bulkliner* that prior behaviour could not be "entirely disregarded". His statement (at [28]) that he did not "intend to review in depth the background to the proceedings" was made in the context of acknowledging the caveat in *Bulkliner*, and was not contrary to authority.

28. The correct approach in law to the relative importance of behaviour prior to proceedings is clearly set out in the FTT judgment. Judge Kempster adopts that approach by considering both parties' submissions in this area, and concluding on the facts (at [28]) that he rejects Mr Cannon's suggestion that HMRC were "wilfully blind" and that he prefers the explanation of Mr Brooke as regards the disputed telephone calls. Given that there was no evidence of bad faith in the making of the assessment or the raising of the penalties (by contrast with *Farthings Steak House* as referred to in *Bulkliner*), we find that Judge Kempster made no error of law in his evaluation of HMRC's behaviour prior to proceedings. He clearly found on the facts that such prior behaviour had not, in the terminology of *Bulkiner*, informed actions taken during the proceedings.

29. Mr Cannon argued that the second error in the FTT judgment was that the FTT was mistaken in finding that HMRC did not act unreasonably after the appeal proceedings began.

30. In considering this argument, the approach set out in *Catanã* at [24] above falls to be applied. The proper approach of this Tribunal in this context is described in *Market & Opinion Research International*, at [15] to [17]:

> "[15] The condition in r 10(1)(b) is a threshold condition. It is only if the tribunal considers that a party has acted unreasonably in the relevant respect that the question of the exercise of a discretion can arise.

> [16] A determination of the question whether a party has, or has not, acted unreasonably is, accordingly, not the exercise of a discretion, but a matter of value judgment. An appeal against such a judgment, on a question of law, needs to be approached with appropriate caution. As Jacob LJ observed in *Proctor & Gamble UK v Revenue and Customs Comrs* [2009] EWCA Civ 407, [2009] STC 1990 (at [7]) it is the FTT which is the primary maker of a value judgment based on primary facts. Unless the FTT has made a legal error (for example by reaching a perverse finding or failing to make a relevant finding or misconstruing the statutory test) it is not for the appeal court or tribunal to interfere. Furthermore, as Lord Hoffman said in *Biogen Inc v Medeva plc* (1996) 38 BMLR 149 at 166, [1993] RPC 1 at 45:
>
> > "Where the application of a legal standard such as negligence or obviousness involves no question of principle but is simply a matter of degree, an appellate court should be very cautious in differing from the judge's evaluations.""

31. It is clear from the FTT's decision that Judge Kempster made no error of law in forming his judgment as to the unreasonableness of HMRC's conduct after proceedings had begun. As regards the central issue of HMRC's delay in identifying and evaluating the disputed telephone calls, which delay clearly contributed to the delay in HMRC withdrawing their case, the passage quoted at [23] above shows that he preferred HMRC's explanation of events.

32. Judge Kempster did not refer again to *Carvill v Frost* in that passage, but it is clear that he was satisfied on the facts that Mr Brooke's "detective work" in pursuing the additional information in relation to the disputed telephone calls helped to satisfy any obligation on HMRC to "review" its decision to continue with its case. In any event, as Ms Nathan pointed out for HMRC, *Carvill* was very different on its facts to this appeal (involving, for instance, a dispute lasting some twenty years). As the opening sentence of [23] states:

> "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."

33. The FTT's decision does not adopt the precise formulation suggested by the three questions set out in *Tarafdar* and quoted at [13] above. It is, however, clear from the decision that Judge Kempster effectively applied the same test in reaching his conclusion. It is evident from the decision that the judge accepted that it was not unreasonable for HMRC not to have withdrawn from the proceedings prior to the discovery by Mr Brooke of the disputed telephone calls, and that any subsequent delay was not unreasonable in the context of matters being addressed in a meeting rather than by way of correspondence: see in particular the factual position as submitted by HMRC, which Judge Kempster preferred (at [23]).

34. We therefore conclude that the value judgment made by Judge Kempster, based on his findings of primary fact, does not disclose any error of law. The judge properly construed and applied the relevant test and made all appropriate findings. Those findings cannot be described as perverse. It is clear, in our view, that the judge was entitled, on the evidence, to make the findings that he

did and to conclude from those findings that HMRC did not act unreasonably after the proceedings had begun. We find no error of law in that respect.

35. The third argument raised by Mr Cannon was that the FTT was mistaken in holding that section 83G VATA applied to preclude the bringing of an appeal against the Schedule 24 penalty until the HMRC "review" was concluded, so that there were no "proceedings" in relation to that penalty.

36. Given his conclusion that HMRC had not in any event acted unreasonably within Rule 10(1)(b), Judge Kempster did not need to deal with this argument. In the same way, as we have found that there was no error of law in the judge's decision in that respect, it is not necessary for us to decide that issue for the purposes of this appeal. However, as Judge Kempster set out his view, and we have come to the opposite conclusion, we ought to comment briefly on the point.

37. Costs may only be awarded under Rule 10(1)(b) where a party has acted unreasonably in bringing, defending or conducting "the proceedings". In this case, an appeal was filed on behalf of Marshall & Co in relation to the Schedule 24 penalty on 13 January 2013. In the normal course, that date would have been the date on which "the proceedings" commenced in relation to that penalty. In this case, however, the facts were more complicated. While HMRC served on Marshall & Co a calculation of the penalty in October 2009, the operative penalty assessment was not received by them, due to HMRC administrative error, until December 2012. In the period between October 2009 and December 2012 correspondence took place between Marshall & Co's representative and HMRC regarding "reviews" of the penalty assessment. Following the receipt by Marshall & Co of the penalty assessment on 14 December 2012, a notice of appeal was lodged on behalf of Marshall & Co dated 13 January 2013. On the same day, however, Marshall & Co's representative requested HMRC to carry out a statutory review of the Schedule 24 penalty. It appears that the appeal was submitted (by email) the day before the request for a statutory review.

38. As a matter of law, the discussions of "reviews" between October 2009 and December 2012 were simply that – discussions. There could have been no HMRC "review" in that period (later or otherwise) in the sense that the VAT legislation uses the term, because that means a review of a decision by HMRC (for instance, to issue a penalty) which has been notified to the taxpayer and in respect of which an appeal lies under section 83: section 83A(1). Since the penalty assessment was not validly served until 14 December 2012, there could have been no review process before that date.

39. While the appeal against the 14 December 2012 assessment and the request by the taxpayer for a review bore the same date, the notice of appeal was lodged first, sent by email a day before the review request. In those circumstances, the review request was invalid, since a late review cannot take place once an appeal has been made. Section 83E(3) states:

> "HMRC shall not review a decision if P … has appealed to the tribunal under section 83G in respect of the decision."

40. In our respectful view, therefore, Judge Kempster was incorrect when he stated (at [31]) :

> "In relation to the sch 24 penalty, I agree with HRMC's analysis that although a notice of appeal was filed with the Tribunal, HMRC had already agreed to accept a late request for formal review under section 83E VATA 1994, and thus s83G precluded the bringing of an appeal until the review was concluded. Accordingly, there were no "proceedings" in relation to the sch 24 penalty dispute."

41. While we consider that the judge erred in this respect, that error was not one that was material to the decision of the FTT, and is accordingly not one that affects the outcome of this appeal.

Decision

42. For the reasons we have given, we dismiss this appeal.

ROGER BERNER **THOMAS SCOTT**

UPPER TRIBUNAL JUDGES

RELEASE DATE: 7 MARCH 2016