[2016] UKUT 0266 (TCC)

Appeal number: UT/2014/0055
UT/2014/0056

COSTS – whether First-tier Tribunal had power to make an order in respect of costs under Rule 10(1)(c) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (Complex category) - application by appellants for recategorisation to Complex on first day of hearing, including intention not to opt-out – whether subsequent request to opt out under Rule 10(1)(c)(ii) effective – jurisdiction of Upper Tribunal to re-make costs order of the FTT – exercise of discretion – costs order in the Upper Tribunal proceedings

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

(1) DARREN HILLS
(2) LYNNE HILLS **Appellants**

- and -

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

TRIBUNAL: JUDGE ROGER BERNER

Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 1 June 2016

Rebecca Murray, instructed by The VAT Consultancy, for the Appellants

Hui Ling McCarthy, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. By its decision released on 25 April 2016, this Tribunal (Judges Sinfield and Brannan) dismissed the appeal of the Appellants, Mr and Mrs Hills, against the decision of the First-tier Tribunal ("the FTT") (Judge Cornwell-Kelly and Mr Coles) released on 2 July 2014 to the effect that an option to tax was valid in respect of a certain property and that the sale of that property to Mr and Mrs Hills was chargeable to VAT at the standard rate.

2. Issues in relation to costs fall to be determined both in this Tribunal and in the FTT. In this Tribunal there is a straightforward application for costs by HMRC as the successful party. That application is not opposed in principle, but the parties are far apart on quantum. The amount claimed by HMRC is £25,070. As I indicated to the parties, in view of the amount and the dispute between the parties, which gives rise to questions of reasonableness and proportionality, I did not consider it appropriate for me to make a summary assessment. The order will therefore be for detailed assessment, unless the parties agree.

3. This decision therefore focuses on the issues in relation to the question of costs in the FTT, which raises some important questions of jurisdiction and practice.

Background

4. In the FTT, the appeal was initially categorised as a Standard case. That meant, so far as is material to the issues in this case, first that the appeal would be incapable of transfer to the Upper Tribunal under Rule 28 of the Tribunal (Procedure) (Tax Chamber) Rules 2009 ("the FTT Rules"), and secondly that the FTT would have no general costs-shifting power; instead, under Rule 10, the FTT's powers to award costs would be restricted to wasted costs (which is not relevant here) and the power to order costs where a party or their representative had acted unreasonably in bringing, defending or conducting the proceedings.

5. That position remained up to the start of the substantive hearing before the FTT on 19 May 2014. At that time the FTT re-categorised the appeal as Complex. It explained its reasons for doing so at [21] of its decision:

> "… in regard to the reallocation of the case to the complex track, although we are aware that such a course is very unusual as late as the commencement of the hearing, and is inevitably then too late to benefit from much of the procedural advantage associated with it, it was nevertheless clear to us that this was a case in which, had the application been made earlier, it would have been granted. The complexity of the legal issues and the likelihood that the questions of law inherent in this case will lead to it proceeding beyond the first instance – including now the possibility of there being parallel proceedings in the High Court – justify that conclusion under Rule 23(4)(b). Ms McCarthy indicated that she did not resist the application strongly, and Ms Murray indicated that the appellants did not intend to

> opt out of liability for costs under Rule 10(1)(c). We therefore decided on balance to accede to the appellants' application."

6. As I understand the position, the question of re-categorisation arose, at least partly, out of concern that the substantive hearing could fall to be adjourned. That possibility had arisen as a result of what was at the time referred to as a purported exercise of discretion by HMRC to dispense with the need (should there have been a need) for prior permission to have been obtained for the election to waive exemption (or option to tax). An application for adjournment had been made by Mr and Mrs Hills, in part because of a possible application by them for judicial review of that exercise of HMRC's discretion.

7. That raised the possibility of a transfer of the appeal proceedings to the Upper Tribunal under Rule 28. One of the conditions for such a transfer is that the case has been allocated as a Complex case. But another condition is that both parties must consent; HMRC indicated that they would not consent, and so the question of re-categorisation with transfer of the case in mind fell away.

8. The FTT nonetheless dealt with the application of Mr and Mrs Hills for re-categorisation, and acceded to it for the reasons it gave at [21]. The effect was that, under Rule 10(1)(c) of the FTT Rules, and subject to any written request of the taxpayers (in this case Mr and Mrs Hills), or either one of them, to the FTT, within 28 days of receipt of notice that the case had been allocated as a Complex case, that the proceedings be excluded from potential liability for costs under that Rule, the FTT would have a general costs-shifting power.

9. The hearing before the FTT ran its course and concluded on 20 May 2014. The FTT released its written decision on 2 July 2014. It dismissed the appeal. It held, in relation to what was described as the Grantor issue, that the sale of the property was not, as argued for Mr and Mrs Hills, by a Mrs Patel rather than the trustee of a self-invested personal pension plan (SIPP), of which Mrs Patel was a beneficiary. In relation to what was described as the Prior Permission issue, the FTT held that in the circumstances prior permission for the exercise by the trustee of the option to tax had not been required and that the option was accordingly valid. The FTT refused Mr and Mrs Hills permission to raise a new argument to the effect that the trustee had not exercised the option to tax at all, and it also refused to permit HMRC to amend their statement of case to include the dispensing of the need for prior permission (the Dispensation issue).

10. Importantly, at [75] of its decision, the FTT made a costs order against Mr and Mrs Hills. It dismissed the appeal with costs on the standard basis, to be assessed in accordance with further order of the FTT if not agreed within a certain period.

11. The FTT panel, when making that order, was unaware that on 16 June 2014, after the end of the hearing but before the release of the FTT's decision, the representatives for Mr and Mrs Hills, The VAT Consultancy, had sent an email to the tribunal stating: "Please be advised that the Appellant in this case wishes to opt out of the costs regime with regard to this action." The panel was not notified of that email prior to making and releasing its decision, and no copy of it was sent to HMRC until

26 June 2014. Furthermore, when it made its order, the FTT had not given Mr and Mrs Hills any opportunity to make representations.

12. No appeal from the FTT was made in respect of the Grantor issue. Mr and Mrs Hills appealed to the Upper Tribunal on the Prior Permission issue, and HMRC cross-appealed the FTT's refusal to allow an amendment in respect of the Dispensation issue. The Upper Tribunal dismissed Mr and Mrs Hills' appeal, and also decided the Dispensation issue against them.

13. Mr and Mrs Hills' grounds of appeal concerned the substantive issues. They did not include any ground of appeal in relation to the FTT's order for costs. That issue was not therefore before the Upper Tribunal when it determined the substantive appeals.

14. What the representatives of Mr and Mrs Hills had done was to refer HMRC, by email dated 10 July 2014, to the request with respect to costs sent by Mr and Mrs Hills to the FTT on 16 June 2014. That email asserted that in consequence of the request the FTT had no jurisdiction to award costs. That was followed, on 29 July 2014, by a protective application by HMRC to the FTT for costs which submitted, first, that the FTT had jurisdiction to make such an order, and secondly that in any event, for a number of reasons, the FTT had power to award costs by reason of the unreasonable conduct of Mr and Mrs Hills.

15. On 1 September 2014 Mr and Mrs Hills filed with the FTT a response to that costs application.

The issue in relation to the FTT's costs order

16. The question to be determined in relation to the FTT's costs order is whether the FTT had the power to make it. Mr and Mrs Hills submit that, in making the costs order that it did, the FTT was doing so on the basis that it had a full costs-shifting jurisdiction by virtue of the categorisation of the case as Complex. There is, they say, no suggestion in the FTT's decision that it was making its order on the basis of unreasonable conduct.

17. On that footing, Ms Murray argued that the FTT had no power to make such a costs order. First, the FTT had failed to take account of the opt-out request made by Mr and Mrs Hills within the 28-day time limit under Rule 10(1)(c)(ii); the effect of that opt-out is that the power that the FTT would otherwise have to make a costs order in a Complex case is not available to it. Secondly, and in any event, the FTT made its order without having given Mr and Mrs Hills an opportunity to make representations, in breach of Rule 10(5); that failure means that the order made could not validly have been made.

18. For HMRC, Ms McCarthy submitted that, in applying for a direction that the case be re-categorised as Complex, Mr and Mrs Hills made a representation that they would not opt out of the costs-shifting regime that would result, and – as shown by the reference to it by the FTT at [21] – the FTT had relied upon that representation in

re-categorising the case. To purport to opt out subsequently would, argued Ms McCarthy, be a clear abuse of process. The purported notification on 16 June 2014 should not therefore be capable of being a valid written request under Rule 10(1)(c)(ii).

19. In the alternative, Ms McCarthy submitted that, even if the opt-out should be considered valid, the making of it by Mr and Mrs Hills in the circumstances in which the FTT had re-categorised the case had been unreasonable, such that the FTT had jurisdiction to make a costs order under Rule 10(1)(b). Had Mr and Mrs Hills not acted unreasonably in opting out, HMRC would have been entitled to their costs of the appeal; accordingly, that is the award that the tribunal should make.

20. Further, Ms McCarthy pointed to other aspects of the appeal where she submitted Mr and Mrs Hills had acted unreasonably, and which she argued brought Rule 10(1)(b) into play.

Jurisdiction

21. I am here concerned with a costs order made by the FTT. It arises in these proceedings in the Upper Tribunal because the case has proceeded to this Tribunal on appeal. The first question is whether the Upper Tribunal has jurisdiction to consider the question at all.

22. For HMRC, Ms McCarthy submits that the Upper Tribunal has no such jurisdiction. The matter, she says, should be dealt with by the FTT, treating Mr and Mrs Hills' application as a (late) application to set aside the FTT's costs order for procedural irregularity under Rule 38 of the FTT Rules. Such an application could be granted only if the FTT were to consider it in the interests of justice to do so.

23. To avoid further delay in determining this question, which would be occasioned if the case were to be required to be dealt with by a separate FTT hearing, it had been envisaged at the time of listing of this hearing that the judge, being authorised to sit both in the Upper Tribunal and the FTT, would be able to wear whichever judicial hat was required in order to found the necessary jurisdiction. Having considered the matter, however, I have come to the conclusion that the question of the FTT's costs order can properly be brought within the jurisdiction of this Tribunal, and that it is more expedient for all questions to be determined by me sitting in one capacity.

24. Until all relevant matters have been determined in respect of it, including matters of costs, there remains an extant appeal in this Tribunal. That appeal did not include any ground which sought to challenge the FTT's order for costs. Nonetheless, it is evident that the order has given rise to a point of law, such that a right of appeal would, subject to the grant of permission, arise under s 11 of the Tribunals, Courts and Enforcement Act 2007 ("TCEA").

25. Were there to have been no extant appeal in the Upper Tribunal, for which permission had already been given, Rule 21(2) of the Tribunal Procedure (Upper Tribunal) Rules 2008 ("the UT Rules") would have precluded a grant by this Tribunal

of permission to appeal the FTT's costs order; an application for permission to appeal may be made to the Upper Tribunal only if an application has been made first to the FTT and been refused or granted on limited grounds. But where, as in this case, permission to appeal has been given (it was given by the Upper Tribunal), there is nothing to prevent the Upper Tribunal, if it thinks fit, giving permission to add new grounds of appeal in an appropriate case.

26. In reaching this conclusion I have had regard to the obiter comments of Lord Tyre in this Tribunal in *Revenue and Customs Commissioners v Earlsferry Thistle Golf Club* [2014] UKUT 0250 (TCC), where the learned judge took the view, having regard to Rule 21(2) of the UT Rules, that a particular contention could not be entertained by the tribunal because leave had not been sought from the First-tier Tribunal. That was a case where, in contrast to this case, permission to appeal had been granted by the First-tier Tribunal to HMRC, and it was the taxpayer respondent to the appeal that wished to challenge an element of the decision of the First-tier Tribunal. In the circumstances of that case, Lord Tyre decided that the respondent would have required permission to appeal and that since no application for permission had been made by the respondent to the First-tier Tribunal, no such application could be entertained by the Upper Tribunal.

27. *Earlsferry* thus differs from this case in that no application for permission to appeal had been made by the respondent in that case. In this case, by contrast, an application was made by Mr and Mrs Hills to the FTT, the FTT refused the application, and permission to appeal was given by this Tribunal. Where permission to appeal has been given, whether by the First-tier Tribunal or the Upper Tribunal, an application in this Tribunal for further grounds to be permitted to be advanced is not properly regarded as a fresh application for permission to appeal, and does not require to be made in the first instance to the First-tier Tribunal. Nothing in *Earlsferry* runs counter to that basic proposition. I would add too that a similar analysis would apply on an application for permission to appeal in this Tribunal; once such an application has properly been made (for example, where the First-tier Tribunal has refused permission) any new ground of appeal which the applicant wishes to raise may properly be considered by this Tribunal, without first having to have been subject to an adverse decision below.

28. I therefore give permission for the question of law as to the validity of the FTT costs order to be added as a ground in Mr and Mrs Hills' appeal to this Tribunal. The effect is that, under s 12 TCEA, if I find that the making of the costs order involved an error on a point of law, I may (but need not) set aside the decision of the FTT in that respect and then either remit the case to the FTT or re-make the decision.

29. I am satisfied that the FTT made an error of law in this case, for the simple reason that it did not give Mr and Mrs Hills an opportunity to make representations in that respect. The consequence of that failure, under Rule 10(5) of the FTT Rules, is that the FTT had no power to make the order that it did. In those circumstances, as it seems to me, there is no rationale alternative to setting aside the FTT's decision.

30. I am conscious that there is always a discretion whether or not to set aside a decision. That discretion applies equally to a set aside by the Upper Tribunal under s 12(2)(a) TCEA and a set aside by the FTT under Rule 38 of the FTT Rules. I do not, however, accept the submission of Ms McCarthy to the effect, that the requirement under Rule 38 that the FTT be satisfied not only that there is a procedural irregularity but also that the setting aside of the decision is in the interests of justice, presents an applicant with a more onerous hurdle in the FTT than would be the case in the Upper Tribunal. The interests of justice is not a consideration unique to the FTT; if it would not be in the interests of justice for the Upper Tribunal to set aside a decision under s 12 TCEA, it would of course not do so.

31. In this case I consider that the interests of justice are served by setting aside the FTT's costs order. Having done so, it would not in my judgment be expedient for the case to be remitted to the FTT (even notionally, with me sitting as an FTT judge). I will therefore, in this Tribunal, re-make the decision in that respect.

Costs Order in the FTT

32. In re-making the decision of the FTT under s 12(2)(b)(ii) TCEA, the jurisdiction of the Upper Tribunal is limited by the powers which the FTT itself would enjoy if it were re-making the decision (see s 12(4)(a) TCEA). That then leads to the principal question, namely whether, having regard to the request for an opt-out of the Complex case costs regime which was made by Mr and Mrs Hill on 16 June 2014, the FTT has power to make a costs order under Rule 10 (1)(c) of the FTT Rules.

33. On its face, the mere making of that request is sufficient to exclude the power of the FTT to make such a costs order. Although framed in terms of a request, there is no requirement for the FTT, or any other party, to accept the request, and it cannot be refused. It is simply an administrative act which ousts what would otherwise be a general costs-shifting power in the FTT.

34. On the other hand, in construing the FTT Rules, two principles have to be borne in mind. The first is that under Rule 2(3) of those Rules the tribunal must give effect to the overriding objective, that is to deal with cases fairly and justly, when interpreting any rule. The second is that the Rules should be construed having regard to their purpose.

35. The Complex case costs regime in the FTT was extensively explored by the then President of this Chamber, Warren J, in *Revenue and Customs Commissioners v Atlantic Electronics Limited* [2012] UKUT 45 (TCC). So far as material to this case, I can summarise the principles he identified in the following way:

(1) The right of the taxpayer to opt-out of the Complex case costs regime is a recognition of the fact that different taxpayers may have different approaches to risk in the context of access to justice (at [6]).

(2) The time limit for the exercise of the right to opt out is, first, to achieve certainty for both parties at an early stage in the proceedings, and secondly to prevent the taxpayer from waiting to see how his case progresses (at [7]).

(3) The choice of the taxpayer is to prevail (at [8]). But what is seen as fair and just is that the option of deciding whether a full or limited costs shifting regime applies is to be exercised at a very early stage (at [28]).

(4) It was not intended that the ability for the taxpayer (and not HMRC) to elect for a full or more limited costs shifting regime should give rise to a one-way costs shifting. That would effectively be the case if a taxpayer was able to exercise his right of election at a late stage, or even until the result of the appeal was known, and was able to elect for the regime that was more favourable to him (at [7], [37]).

36. It is important to recognise that, in making these observations (which were *obiter*, as the appeal before him concerned the application of the transitional procedural provisions of the TCEA, and not a Complex case as such), Warren J was proceeding on the assumption that the categorisation of the appeal as Complex would itself ordinarily be made at an early stage. That, of course, is the normal position: under Rule 23 of the FTT Rules the allocation of a case to one of the categories must take place on the receipt by the tribunal of the appeal. But Rule 23(3) also provides for re-categorisation, which is not limited in time. Different considerations may apply to such cases, depending on their circumstances.

37. In considering, in *Atlantic Electronics*, an application in a case straddling the changeover (on 1 April 2009) from the former VAT and Duties Tribunal to the FTT for the costs rules of the former tribunal to be applied, Warren J postulated the position where an application was made later than a reasonable time after 1 April 2009. In those circumstances he concluded that taxpayer choice would no longer be a policy imperative, but the guiding principle should be one of certainty for the parties. If that provides any analogy to the position in this case, in my view it is directed principally at the wisdom of the FTT making any direction to re-categorise an appeal to the Complex category at a late stage in the appeal. But it is nonetheless relevant in relegating the importance of the perceived policy of taxpayer choice where an application for re-categorisation is made at a late stage.

38. Ms McCarthy put her case squarely in the camp of abuse of process. She pointed to the application that the case be re-categorised as Complex as making clear that: "If this is done, Mr and Mrs Hills do not intend to opt out of the costs regime …" and the FTT's evident reliance on that statement of intention when making its direction (see [21] of the FTT's decision, quoted above).

39. In my judgment, this is principally a question of construction of Rule 10 of the FTT Rules. If that Rule permits a valid opt out request to be made in the circumstances of this case, then I agree with the submission of Ms Murray that the mere exercise of the opt-out right provided by Rule 10 cannot be an abuse of process. The question is whether, applying both a purposive construction and having regard to the overriding objective, Rule 10 does fall to be construed in that way.

40. I do not consider that Rule 10 can be construed in a way that would give rise to an injustice. Although in normal circumstances justice is served by the making of a timely opt-out request, as that reflects the purpose of providing the taxpayer with the

choice of costs regime in the FTT, that consideration may be overridden by the circumstances. The reference to a request in Rule 10(1)(c)(ii) must be construed so as to apply only to such requests that serve the interests of justice. In the ordinary case, as Warren J said in *Atlantic Electronics*, at [28], it is seen as fair and just that the taxpayer should have the option to decide at an early stage the costs regime that is to apply. A request will accordingly ordinarily be effective to displace the Complex costs regime, as it will serve the interests of fairness and justice inherent in Rule 10. But there are circumstances when the interests of justice will not be so served. In those circumstances, Rule 10(1)(c)(ii) cannot, in my judgment be construed so as to compel an unjust result.

41. In my view this case is an example of those circumstances. The application was made for re-categorisation was made by Mr and Mrs Hills. It was made at a very late stage in the proceedings, and at a time when immediate expense was to be incurred. It was accompanied by a statement of intent which was clearly, in my judgment, intended to support the case for re-categorisation. That statement of intent was relied upon by the FTT in making its direction. It cannot be within the purpose of Rule 10 to enable a request to be made that fundamentally undermines the basis on which the application is made and the re-categorisation is directed. Such a request is not within the meaning of Rule 10(1)(c)(ii), as it does not serve the interests of justice.

42. Ms Murray submitted that, in making its direction, the FTT was precluded from having regard to the consequences of re-categorisation, and that accordingly, even if the FTT had had regard to the statement of intent, that had not been a valid consideration and should be disregarded in the context of the subsequent request. She referred me to the decision of the Upper Tribunal (Warren J and Sir Stephen Oliver) in *Capital Air Services Limited v Revenue and Customs Commissioners* [2010] UKUT 373 (TCC) where, at [20], the tribunal said that it would be wrong for the FTT to assess whether a case should be allocated as Complex by reference to a subjective view as to whether there should be a costs-shifting power, and at [30] that ordinarily, where there are no special factors, a case satisfying the relevant criteria set out in Rule 23(4) should be allocated as Complex.

43. I do not accept that Ms Murray's submissions have any application in this case. *Capital Air Services* is not authority for the proposition she puts forward. The FTT in this case did not adopt as its reference point the subjective question whether it considered the case as one in which costs-shifting was appropriate. It was first satisfied that the case fell within the relevant criteria. It then proceeded to exercise its discretion, for which it would have been required to have regard to the overriding objective of dealing with cases fairly and justly, having regard to all the circumstances. It cannot be said that the statement of intent put forward by Mr and Mrs Hills was irrelevant to that consideration. It clearly was relevant, and it is indeed difficult to envisage the FTT making the direction that it did if such a statement had not been made. To do so would have been to give rise to the very situation of one-way costs shifting that Warren J described in *Atlantic Electronics*, at [7], as outside the policy of the FTT Rules.

44. There is, furthermore, a question of reasonable expectation. In an ordinary case, on the making of a direction that a case be categorised as Complex, there can be no reasonable expectation on the part of HMRC (or any particular taxpayer where there is more than one party who is a taxpayer) that full costs-shifting will apply up to the time when the 28-day period for the making of a request under Rule 10(1)(c)(ii) has expired. The position is different, however, if a representation is made with respect to the making of such a request. As Warren J said in *Atlantic Electronics*, at [26] – [27]:

> "[26] … No doubt one party might, by their actions or inactions and by what they say or do not say, lead the other party to believe that the first party would seek to apply one set of rules rather than the other, giving rise to some sort of reasonable expectation on the part of the second party that he could rely on the first party's representation. Matters of that sort can certainly be taken into account by the tribunal when it comes to exercising its discretion in relation to costs.
>
> [27] But even absent any matters of that sort, the tribunal has a wide discretion which is to be exercised in order to ensure that the proceedings are dealt with fairly and justly. Thus, when considering whether or not to make a prospective direction during the course of an appeal, the judge needs to consider whether such a direction would better achieve the aim of ensuring that the proceedings are dealt with fairly and justly than leaving costs to be dealt with under the default regime."

45. It makes no difference, in my judgment, whether the way in which an application is put is expressed as an undertaking, representation or statement of intent. The subjective view of the applicant as to what was intended to be conveyed by the making of the relevant statement is not material. What is material is the effect, of the statement, both on the decision reached by the tribunal and on the reasonable expectation of the other party and whether, viewed objectively, that would render a subsequent request unfair and unjust and thus outside the meaning of Rule 10(1)(c)(ii).

46. I have concluded that the request to opt-out of the Complex costs regime in the circumstances of this case would give rise to an injustice, and that consequently it was not a request within Rule 10(1)(c)(ii) of the FTT Rules. In exercising the power of this Tribunal to re-make the costs decision of the FTT, therefore, I have the same full costs-shifting power as the FTT has in a Complex case where there has been no opt-out.

47. That is an exercise of discretion. The arguments before me proceeded on the basis that the only alternatives were those of costs of the entire proceedings (HMRC's case) or no costs (Mr and Mrs Hills' case). I take the view, however, that in the circumstances of a re-categorisation of a case to Complex at an advanced stage of the proceedings, consideration should be given to the making of a costs order that reflects the time spent by the parties in the expectation that the regime of a Standard case (limited costs shifting) would apply. That would in my view be a proper consideration whether costs were to be awarded in favour of the party making the application to re-categorise, or the other party.

48. Support for this approach may be derived from *Atlantic Electronics*, albeit that that case was addressing the transitional provisions. There, at [58]- [61], Warren J recognised that the circumstances and the conduct of the proceedings, including whether or not particular applications were made, would give rise to different, and justifiable, expectations on the part of the parties, subject to any indication to the contrary from one party to another. Those different expectations might be met by the application of the tribunal of different costs regimes for different periods.

49. In my judgment, those considerations are equally applicable to a case, such as this, where the appeal is re-categorised to Complex at a time when substantial work has been carried out and expense incurred while the case was allocated to the Standard category. Absent special factors pointing in another direction, I consider the proper course to be for costs to be awarded to the successful party in such a case from the time when the appeal was re-categorised, and for there to be no costs for the earlier period.

50. Among the special factors to be taken into account is the conduct of the parties in bringing, defending or conducting the proceedings. The Standard costs regime is a no costs regime unless the FTT considers such conduct to have been unreasonable. Accordingly, in a case where there has been re-categorisation of the case to Complex part way through the proceedings and as a result the tribunal considers that costs ought not to be awarded by reference to its general costs-shifting power in favour of the successful party for the whole period of the proceedings, questions of conduct will, where relevant, fall to be considered in the overall exercise by the tribunal of its power under Rule 10(1)(c) in relation to that part of the proceedings for which the tribunal would otherwise not order costs shifting.

Unreasonable conduct

51. There are, as I have described, two aspects to HMRC's claim for costs based on unreasonable conduct. Before turning to each of those, however, I should first address the submissions made as to what is meant by "unreasonable" in this context.

52. Ms Murray referred me to a decision of the First-tier Tribunal (Judge Short), *William Archer v Revenue and Customs Commissioners* [2016] UKFTT 141 (TC), in which, in the context of Rule 10(1)(b) of the FTT Rules, the judge had referred to arguments put for HMRC in that case based on the judgment of the Court of Appeal in *Ridehalgh v Horsefield* [1994] Ch 205 in construing unreasonable conduct as conduct which is "vexatious, designed to harass the other side rather than advance the resolution of the case" and that "The acid test is whether the conduct permits of a reasonable explanation." The judge adopted those tests in concluding, on the facts of the *Archer* case, HMRC's conduct was not unreasonable.

53. I was not taken to *Ridehalgh v Horsefield* itself, but it is important to understand the context in which the meaning of "unreasonable" was considered in that case. The claim there was for wasted costs, and the full expression falling to be construed was that in s 51(7) of the Supreme Court Act 1981, namely "costs incurred by a party - (a) as a result of any improper, unreasonable or negligent act or omission on the part of

any legal or other representative or any employee of such a representative". The relevant passage from the judgment of Lord Bingham M.R. is at p 232:

> "'Unreasonable' also means what it has been understood to mean in this context for at least half a century. The expression aptly describes conduct which is vexatious, designed to harass the other side rather than advance the resolution of the case, and it makes no difference that the conduct is the product of excessive zeal and not improper motive. But conduct cannot be described as unreasonable simply because it leads in the event to an unsuccessful result or because other more cautious legal representatives would have acted differently. The acid test is whether the conduct permits of a reasonable explanation. If so, the course adopted may be regarded as optimistic and as reflecting on a practitioner's judgment, but it is not unreasonable."

54. Not only must regard to be had to the particular context, which can be seen from Lord Bingham's judgment to have been important, but it is evident that the references to vexatious conduct or conduct involving harassment were merely examples of conduct which might aptly be described as unreasonable. That is emphasised by the more generally expressed acid test of no reasonable explanation. Unreasonableness was clearly not intended to be confined, even in the context of wasted costs, to vexatious or other conduct at the extreme end of the scale. I do not therefore agree that it is appropriate, in the context of Rule 10(1)(b), to examine a party's conduct from the perspective of vexatiousness or harassing behaviour.

55. The question of what is unreasonable for the purpose of Rule 10(1)(b) has been considered in any number of cases in the First-tier Tribunal. This Tribunal has itself quite recently considered that question in *Market & Opinion Research International Limited v Revenue and Customs Commissioners* [2015] UKUT 0012 (TCC) where the tribunal said, at [49]:

> "It would not, we think, be helpful for us to attempt to provide a compendious test of reasonableness for this purpose. The application of an objective test of that nature is familiar to tribunals, particularly in the Tax Chamber. It involves a value judgment which will depend upon the particular facts and circumstances of each case. It requires the tribunal to consider what a reasonable person in the position of the party concerned would reasonably have done, or not done. That is an imprecise standard, but it is the standard set by the statutory framework under which the tribunal operates. It would not be right for this Tribunal to seek to apply any more precise test or to attempt to provide a judicial gloss on the plain words of the FTT Rules."

Opt-out unreasonable

56. With those comments in mind, I turn to the first of HMRC's arguments of unreasonable conduct. HMRC argued, as an alternative to its abuse of process case with respect to the request for an opt-out, that Mr and Mrs Hills' conduct in applying at the stage they did for re-categorisation of the case to Complex, stating their intention not to opt-out and then making a request to opt-out on the last available date was unreasonable.

57. As I have found that the request that was made was not a request within the meaning of rule 10(1)(c)(ii), it is unnecessary for me to decide this issue. But I should say, in case this matter goes further, that if I had come to a different conclusion on the construction of Rule 10(1)(c)(ii), I would have found that combination of conduct unreasonable, with the consequence that I would have made the same award of costs as might be ordered if the request had not been made. That, therefore, would have resulted in the same outcome as I have decided should be the appropriate order in the Complex regime on the basis of my earlier findings.

58. In this respect, I do not accept the argument that, assuming Mr and Mrs Hills had the right to make the request to opt-out in these circumstances, that it could not be unreasonable for them simply to exercise that right. It is clearly the case that a party may make use of tribunal procedures in a way which renders the conduct of the party unreasonable. An obvious example is the making of spurious applications; the mere fact that the FTT Rules provide a procedure for the making of such applications does not make the conduct of that party immune from being regarded as unreasonable.

59. In relation to that part of the order which reflects the period when the expectation of the parties was that the Standard category costs regime applied, HMRC's submissions regarding the conduct of Mr and Mrs Hills in the proceedings generally remain apt. Those submissions are themselves in two parts, the first relating to the merits of a part of Mr and Mrs Hills' case, and the second to alleged unreasonable conduct in the proceedings.

The merits of case on the "Grantor" issue

60. The Grantor issue, put briefly, concerned whether a Mrs Patel, as the sole beneficiary of a SIPP established by a trust deed dated 6 April 2006 ("the 2006 Deed"), was the grantor on the sale of the property, and as such the person who would have needed to exercise the option to tax if the sale of the property were to be chargeable to VAT. It had been accepted as an agreed fact that Mrs Patel was the only person entitled to benefit under the SIPP, and the arguments on this issue were accordingly legal arguments as to the proper construction of the relevant provisions of the Value Added Tax Act 1994 ("VATA"), and the nature of Mrs Patel's interest in the SIPP as a matter of law.

61. However, the FTT considered that, notwithstanding the agreed fact of Mrs Patel's position, there was a factual issue to resolve in this regard, namely whether there were in fact other beneficiaries within the terms of the 2006 Deed. The FTT held, at [64], that Mrs Patel did indeed have relatives or dependants (within the definition of the 2006 Deed), and that those persons, potentially at least, had a beneficial interest in the SIPP.

62. The FTT went on to say that, even if that were not the case, the 2006 Deed contained other provisions which had the result that Mrs Patel could not have become entitled to the sale monies of the property, including the discharge of the mortgage debt on the property. Having regard to the construction given by the FTT to the relevant provision in the VATA, the consideration could not have accrued to Mrs

Patel in the sense required, and so Mr and Mrs Hills' arguments on the Grantor issue failed.

63. The FTT's finding of fact in this respect was based on a letter from the trustees' solicitors in the sale of the property dated 7 November 2011, to which the FTT referred at [5]. That letter, which was written in the context of a perceived delay in the sale process, referred to a time limit under pensions legislation within which benefits could be distributed to Mr Patel's "widow and family". It was that which led the FTT to make the finding it did at [64].

64. The FTT appears to have been perplexed as to how it had come about that Mrs Patel's position as the sole beneficiary of the SIPP had been agreed as a fact. It raised the issue with the parties at the end of the hearing. That gave rise to some correspondence from the parties. The VAT Consultancy, for Mr and Mrs Hills, wrote to the FTT on 22 May 2014 referring to a letter dated 27 October 2011 (not referred to by the FTT in its decision) which had also referred to the time limits for withdrawal of pension benefits, but without referring to the late Mr Patel's "family", and stating that this letter had been handed to the tribunal and an HMRC officer at a case management hearing on 3 October 2012. HMRC's response, dated 23 May 2014, noted the reference to the October 2011 letter but made the point that this was not the disputed letter; that was the November 2011 letter, and that letter had not been disclosed at that hearing.

65. HMRC say that if they had known of the November 2011 letter they would not have agreed that Mrs Patel was the sole beneficiary of the SIPP. Mr and Mrs Hills say that they do not consider that letter to have been decisive, and they maintained their case accordingly.

66. The position of the November 2011 letter remains unclear. But I have decided that I do not need to resolve the factual issues which surround it. Even if it were the case that the November 2011 letter was not disclosed until the first day of the hearing, I have decided that the circumstances are not sufficient for me to find that Mr and Mrs Hills acted unreasonably in that respect.

67. Although it is generally the case that the mere rejection of an argument by a tribunal does not of itself mean that the party putting forward that argument has acted unreasonably, there are occasions when the maintenance of a particular case may be unreasonable. Although every case must be considered in its own context, I accept that one of those possible instances is where a party persists with a case in the face of an unbeatable argument that he is wrong. That was the view expressed by the First-tier Tribunal in *Leslie Wallis v Revenue and Customs Commissioners and another* [2013] UKFTT 081 (TC), at [27]; the tribunal there gave an example of persistence with a legal argument the same as one rejected by the Supreme Court, when that rejection has been brought to the party's attention. That was relied upon by the First-tier Tribunal in *Roden v Revenue and Customs Commissioners* [2013] UKFTT 523 (TCC) where the tribunal said, at [14], that a party would not be acting unreasonably when pursuing a case without merit unless he ought to have known that his case was without merit.

68. I agree with those broad propositions, and I agree too with the tribunal in *Roden* when at [15] it cautioned against a quick readiness to characterise the pursuit of what is found to be an unsuccessful case as unreasonable behaviour.

69. The question I have to ask is whether the November 2011 letter had the effect that this aspect of Mr and Mrs Hills' case was without merit, and that it was unreasonable for Mr and Mrs Hills not to have appreciated that and accordingly to have maintained their case. I am unable to be satisfied that that is the case. The FTT made its finding, at [64], based on the November 2011 letter, but even that finding was not unequivocal. It referred merely to the possibility of persons other than Mrs Patel who might have had a beneficial interest in the SIPP. Nor was that the decisive finding of the FTT in this respect; at [65] it set what it described as "speculation" aside, it found that Mrs Patel was not immediately entitled to receive the sale price, and it held that it had not "on the balance of probabilities been proved that the consideration on the grant accrued to [Mrs Patel]" within the meaning of the relevant provision of the VATA as construed by the FTT. I cannot therefore be satisfied that the November 2011 letter reduced Mr and Mrs Hills' case to one of no merit; nor that Mr and Mrs Hills acted unreasonably in not appreciating the significance that the FTT would place on that letter. They were, in my judgment, reasonably entitled to maintain their case with regard to the Grantor issue, notwithstanding the November 2011 letter.

Failure to engage with HMRC and changes to Mr and Mrs Hills' case

70. HMRC say that there was an unreasonable refusal on the part of Mr and Mrs Hills to clarify their case on the need to prior permission for the option to tax to operate. HMRC made a request for further and better particulars in January 2014, which was refused by Mr and Mrs Hills. Further correspondence ensued to the same effect, and HMRC reserved their position as to costs both in an email to The VAT Consultancy and to the FTT in February 2014.

71. HMRC say that as Mr and Mrs Hills failed in their appeal on all grounds, it was plain that an earlier exchange of information would have assisted the parties in resolving the appeal without the need for a full hearing, not least, it is said, because HMRC would have been able to explain in correspondence why Mr and Mrs Hills' argument on the Prior Permission issue was misconceived.

72. I do not accept that submission. Its starting point is that the argument on the Prior Permission issue was misconceived. I do not consider that the argument can be so described. It was not described as such by the FTT in rejecting it. Permission to appeal to this Tribunal was given in respect of that argument, and this tribunal, although describing the interpretation of the relevant provisions put forward for Mr and Mrs Hills as "strained", nonetheless did not go so far as to characterise the argument itself as misconceived. Although Mr and Mrs Hills lost the argument, it cannot be said that their case was without merit such that the argument could not reasonably have been maintained whatever further particulars had been given of it.

73. That is not to say that it can never be unreasonable for a party not to provide a proper explanation of its case to the other party and to the tribunal. On the contrary, a party's case must properly be put "cards face up on the table", and it is generally unreasonable for it not to do so. To the extent that such a failure can be shown to have resulted in unnecessary expense being incurred by the other party, for example in applying to the tribunal for a direction for further particulars, that may properly be the subject of an order for costs under Rule 10(1)(b) of the FTT Rules. But in this case the argument was that the case could have been resolved without a hearing, an argument that I do not accept. There was no submission that, on the assumption that a hearing would have been required, HMRC incurred expense that would not have been incurred but for the failure by Mr and Mrs Hills better to particularise their case, and no application was made to the FTT for a direction for further particulars.

74. HMRC's arguments on what they say was the constantly changing case of Mr and Mrs Hills and attempts to rely on new evidence and arguments all centre on the substantive hearing itself before the FTT. It is complained that Mr and Mrs Hills sought to obtain new evidence during HMRC's submissions in response, sought to introduce new legal arguments in their reply and applied late in the proceedings (14 May 2014, so very shortly before the hearing) to include a new ground of appeal; an application that was rejected by the FTT at the hearing but which became a submission during the hearing and was likewise rejected by the FTT.

75. I do not need to consider whether, or to what extent, this conduct was unreasonable. Because I have decided that the Complex costs regime applies to the proceedings before the FTT, and that I should exercise my discretion to award costs to HMRC from the commencement of the hearing on 19 May 2014, the whole of the costs of the hearing are covered by that order, irrespective of the nature of the conduct of Mr and Mrs Hills during and with reference to it.

Means of Mr and Mrs Hills

76. I should mention that there were no submissions before me as to the means of Mr and Mrs Hills. Accordingly, there was nothing in that respect for me to consider in re-making the costs order of the FTT.

Order

77. For the reasons I have given, I make the following orders in respect of costs:

(1) In the Upper Tribunal, I order that Mr and Mrs Hills pay HMRC's costs of and incidental to the proceedings in the Upper Tribunal on the standard basis, such costs to be subject to detailed assessment by the Senior Courts Costs Office, if not agreed.

(2) In the First-tier Tribunal, by way of the re-making of the FTT's decision in relation to costs, I order that Mr and Mrs Hills pay HMRC's costs of and incidental to the proceedings in the First-tier Tribunal, to the extent that such costs were incurred from and including 19 May 2014, on the standard basis,

such costs to be subject to detailed assessment by the Senior Courts Costs Office, if not agreed.

ROGER BERNER
UPPER TRIBUNAL JUDGE

RELEASE DATE: 17 June 2016