TC01498

Appeal number: TC/2010/05083

VAT – Appeals – Costs – whether Respondents had acted unreasonably in defending or conducting the proceedings – Rule 10(1)(b) – late withdrawal of decision to refuse VAT repayment – Respondents' approach to matters raised by appeal and conduct in relation to its preparation – absence of agreed basis for withdrawing appeal before hearing – taking into account Respondents' conduct overall, held they had acted unreasonably and that costs should be awarded against them.

FIRST-TIER TRIBUNAL

TAX

THOMAS HOLDINGS LIMITED **Appellant**

- and -

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

TRIBUNAL: JOHN CLARK (TRIBUNAL JUDGE)
HARVEY ADAMS FCA

Sitting in public at 45 Bedford Square, London WC1 on 5 September 2011

Sam Grodzinski QC, instructed by PricewaterhouseCoopers Legal LLP, for the Appellant

Chris McMeeken, HM Revenue and Customs Local Compliance Appeals and Reviews, for the Respondents

DECISION – REASONS FOR DIRECTIONS

1. Following the hearing on 5 September 2011, we made the following Directions:

   (1) The appeal is allowed by consent;

   (2) The Respondents shall pay the Appellant interest on the sums claimed in an amount to be agreed between the parties or, if the parties are unable to agreed, to be determined by the Tribunal on an application by either party;

   (3) Pursuant to rule 10(1)(b) of the Tribunal Rules, the Respondents shall pay the Appellant's costs in respect of the appeal on the standard basis in a sum to be agreed or, if the parties are unable to agree, to be determined by a Costs Judge.

2. The parties requested us to set out our reasons for the making of these Directions.

Nature of the substantive appeal

3. The appeal was against the refusal by the Respondents ("HMRC") to repay £495,396.00 of VAT, which HMRC accepted had been overpaid. The fact of the overpayment had become clear following the judgment of the ECJ on 17 February 2005 in the joined cases of *Linneweber* ((C-453/02) and *Savvas Akridites* (C-462/02), which addressed the VAT exemption for betting and gaming activities, applying the principle of fiscal neutrality.

4. HMRC accepted that the VAT had been overpaid. However, their basis for refusing the repayment was their contention that the claim had been made by the wrong company, because the VAT in question had not been overpaid by the Appellant ("THL") itself, but by associated companies.

5. THL's case was that at the time when it had submitted the repayment claim in December 2008:

   (1) the right to reclaim the various sums of overpaid VAT belonged to THL's wholly owned subsidiary, Thomas Estates Ltd ("TEL"). TEL had acquired that right from Beacon Entertainments Holdings Ltd ("BEHL"), another THL subsidiary, when BEHL's business had been transferred to TEL in 2000;

   (2) TEL and BEHL were both members of a VAT group of which THL was the representative member.

As the substantive hearing of THL's case did not proceed and the argument at the hearing was confined to the issue of costs, we do not address in any detail the legal arguments put by THL in support of its contentions relating to the original dispute.

Events leading up to the hearing

6. The appeal was listed to be heard on 27 May 2011 before the same Tribunal Judge, but the hearing was postponed. It was later relisted for 5 September 2011.

7. Joint Directions submitted by the parties on 13 June 2011 were approved (subject to minor amendments) by Tribunal Judge Berner on 20 June 2011. Various steps were taken to prepare for the relisted hearing.

8. On 19 August 2011 at 17.12, THL's solicitors ("PWC Legal") submitted to HMRC an offer by THL to settle the dispute, made without prejudice save as to costs. This offer was not seen by Mr McMeeken until 22 August, following which he referred it to various other individuals within HMRC for their views.

9. On 26 August 2011 Mr McMeeken applied to the Tribunal Office for a postponement of the hearing listed for 5 September 2011. The reason given for the application was the submission by THLs' solicitors of a without prejudice proposal to settle the appeal. As the proposal would require consideration by HMRC for final acceptance, there was insufficient time before the hearing date for a decision to be formally made, as many of the necessary personnel were unavailable due to leave. He stated that he had sent a copy of his letter to the PWC Legal, "who are aware of this application".

10. On 30 August (at 17.28) PWC Legal sent an email to Mr McMeeken stating that they had received that day a copy of his request to postpone the hearing. They indicated that they were going to lodge an objection to that request, as they considered that the hearing should go ahead as scheduled in the event that HMRC were not able to address beforehand the offer made by THL. They asked Mr McMeeken to note that no reference could or should be made to the Judge to their without prejudice correspondence. They could not, therefore, see any grounds on which a postponement should be granted.

11. On the same day (at 18.08) they submitted to the Tribunal Office a Notice of Objection to HMRC's postponement application. Their grounds were that HMRC had referred only to THL's without prejudice correspondence; accordingly, HMRC had no grounds for their application. They stated that THL had made the claim which was the subject of the appeal in 2008 and had subsequently complied with all requirements for disclosure and the issued Directions dated 20 June 2011. They stated that any further delay was unacceptable and unnecessary.

12. On 31 August 2011 (at 15.07) PWC Legal sent an email to Mr McMeeken referring to the requirement for HMRC to serve their skeleton argument by 29 August. PWC Legal referred to the request which they had made in the light of the bank holiday on Monday 29 August and the early service of THL's skeleton argument on 17 August that HMRC should serve their skeleton argument on 25 August. Notwithstanding that request, PWC Legal had at the very least expected service of HMRC's skeleton argument by close of business on 30 August; nothing had been received by the time of the email message. In addition the solicitors had tried several times to contact Mr McMeeken during 30 and 31 August but had been unable to reach him. They requested him to confirm by return when he would be serving his skeleton argument.

13. On 1 September the Tribunal notified the parties that the application to postpone the hearing had been declined on the basis of THL's objection to the Judge seeing the document setting out HMRC's application. The Judge indicated that it was inappropriate for HMRC to have delayed submitting their skeleton argument beyond the time limit agreed in the Directions, irrespective of any offer to settle the case. Therefore HMRC should submit their skeleton argument immediately, or at the very least by 4 pm on 1 September, the submission to be made by email. The Tribunal confirmed that the hearing was therefore staying in the list.

14. On the same day at 16.05 (with a copy subsequently being faxed to Mr McMeeken at 17.57) PWC Legal applied for a direction that pursuant to Rule 7(2) and Rule 8 of the Tribunal Rules, HMRC be restricted from any further participation in and be barred from taking any further part in the proceedings. The grounds for the application were that HMRC had, by failing to comply with the Directions by virtue of not serving their skeleton argument on THL, acted unreasonably in conducting the proceedings.

15. On 2 September 2011 Mr McMeeken sent an email to PWC Legal. He apologised for not coming back to them sooner, but had had to await decision from necessary parties within HMRC. He stated:

> "While HMRC are no longer able to agree to your without prejudice proposals they have decided to withdraw the refusal of your client's claims."

16. He attached a copy of his letter of the same date to the Tribunals Service. This stated:

> "With reference to the appeals in respect of the above appellant.
>
> I am writing to notify the Tribunal that HMRC have withdrawn from the appeals against the decisions to reject the appellant's claims for repayment. As there are no longer any appealable decisions the hearing scheduled for 5 September 2011 should be cancelled.
>
> The repayments will therefore be issued to the appellant in due course.
>
> A copy of this letter has today been sent to PricewaterhouseCoopers."

17. Also on 2 September at 14.13, PWC Legal sent Mr McMeeken an email attaching a letter and a draft Notice of Application by consent. They requested him to respond by email as soon as possible and in any event by 3 pm that day. A further copy of the message was sent at 14.16 by Mr Skerrett, the partner responsible for THL's case. At 14.35 an email was sent to the Tribunals Service explaining the position and attaching copies of the letter and the draft Notice of Application by consent. The solicitors requested that until agreement had been reached between the parties, the 5 September hearing should stay in the list as it might still be required.

18. At 16.01 on 2 September PWC Legal sent a further email to Mr McMeeken attaching a letter. They referred to their previous letter that day to him and noted that they had not received any response by the requested 3 pm deadline. They stated that in order to enable them to vacate the hearing and conclude the matter they required,

by 5 pm that afternoon at the latest, HMRC's consent to the proposed joint application to the Tribunal. If they did not hear from him by that time, they would be attending the hearing to make the application relating to costs; their attendance would involve further costs, which they would also seek to recover.

19. No response was received from Mr McMeeken or his office that afternoon. On 5 September THL and its solicitors came to the Tribunal for the hearing. As no appearance had been made on behalf of HMRC by the time the hearing was almost due to begin, attempts were made to contact Mr McMeeken, who subsequently attended the hearing.

Arguments for THL

20. Mr Grodzinski explained the history of the appeal. HMRC were now prepared to agree the order set out in the draft Notice of Application by consent; the outstanding issue was that of costs. HMRC's position was that there was no authority to agree costs.

21. THL was therefore making an application for costs to be awarded pursuant to Rule 10(1)(b) of the Tribunal Rules:

> "10. (1) The Tribunal may only make an order in respect of costs . . .
>
> (a) . . .
>
> (b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings;"

Rule 10(1)(c) was not in point as, although THL had originally asked for the appeal to allocated as a Complex case, this request had not been granted.

22. HMRC did not oppose the draft direction relating to costs, but did not agree that it should apply.

23. Mr Grodzinski submitted that HMRC had acted unreasonably. He referred to the decision of Judge Berner in *Bulkliner Intermodal Ltd v Revenue and Customs Commissioners* [2010] UKFTT 395 (TC), [2010] SFTD 1198 at [8]-[11]. This made clear that the unreasonableness of a party's actions had to be in the context of the proceedings rather than any matters arising before the commencement of proceedings. It also contrasted the position under Rule 10(1)(b) with that previously applying to appeals before the Special Commissioners; there was now no requirement to show that a party's actions were "wholly" unreasonable.

24. The basis for HMRC's resistance to the appeal was unreasonable. He submitted that there had never been any proper basis; the reasons were set out in THL's skeleton argument. HMRC had been maintaining that a valid claim could not be made by the representative member of the group; instead they were saying that it should be made under a VAT number which had been effectively obsolete for 14 years.

25. The correct position should have been abundantly clear to HMRC from the outset. PWC Legal had expressly mentioned the case of *Thorn PLC v Customs and Excise Commissioners* (1997) VAT Decision 15283) in a letter to HMRC dated 10 February 2010 and had stated that HMRC was wrong in refusing the claim. This letter had been written before the appeal had been launched. HMRC had not engaged with the argument based on the *Thorn* case. Inferences could be drawn based on HMRC's belated withdrawal of objection to the claims. For all these reasons, the entire defence was unreasonable, and THL should be awarded costs.

26. The second issue was HMRC's wholesale failure to avoid the costs of the hearing. THL had made what Mr Grodzinski described as a sensible offer on 19 August. There had been no reaction, simply complete silence on HMRC's part. Until Friday 2 September there had been no form of response. He submitted that the failure even to engage with this was at least a matter to be taken into account.

27. The third issue was HMRC's conduct in relation to Directions. On 3 August 2010 Judge Berner had directed that within 60 days from 23 July 2010 HMRC should serve on THL and file with the Tribunal a consolidated statement of case (in relation to the consolidated appeals). According to that timetable, the statement of case should have been served by 3 September 2010. HMRC had not served it until 10 December 2010, two and a half months late. There had been no application for an extension of time, nor had HMRC given any apology for the lateness of service of the statement of case.

28. Direction 9 of the Joint Directions agreed as amended by Judge Berner on 20 June 2011 had required HMRC to serve their skeleton argument by 29 August 2011, seven days before the hearing. Mr Grodzinski referred to the question put to Mr McMeeken by PWC Legal on 31 August 2011 as to the timing of HMRC's submission of their skeleton argument. There had been no reply; instead, there had been a letter from Mr McMeeken asking for the hearing to be postponed, and this had been posted and not emailed. This letter had mentioned that an offer had been made. Mr Grodzinski emphasised that it was improper to refer to the without prejudice basis on which the offer had been made. For HMRC to have done so was a flagrant breach.

29. In any event, the making of an offer could not be a basis for delaying the service of HMRC's skeleton argument. He described the reason given, the absence of people on leave, as "hopeless". He stressed that PWC Legal did not have advance notice of HMRC's application. He referred to PWC Legal's email indicating that they would be lodging a notice of objection, and to the notice itself. He also referred to the Direction given by the Judge on 1 September 2011 (paragraph 13 above). There had been no letter from HMRC responding to this. As far as THL and its advisers had been aware, preparation for the hearing was continuing.

30. PWC Legal had made the "debarring" application (paragraph 14 above). This included reference to seeking costs under Rule 10(1)(b). There had been no response that afternoon. The application had also been faxed to Mr McMeeken.

31. Finally on Friday 2 September Mr McMeeken had emailed the "withdrawal" notification (paragraphs 15 and 16 above). Matters had not stopped there; early that

afternoon PWC Legal had emailed Mr McMeeken seeking a consent order (paragraph 17 above). They had made further attempts to email and telephone him that afternoon, but with no response.

32. Mr Grodzinski submitted that there could not be a clearer case of unreasonableness; HMRC had ignored the attempts to avoid the need for the hearing and the contacts which PWC Legal had tried to make on THL's behalf. As a result, THL had incurred a great deal of expense. This was wholly unfair. He submitted that the appropriate order was for HMRC to pay THL's costs on an indemnity basis. HMRC had treated THL with disdain. An order for indemnity costs throughout or for a significant proportion of the costs incurred by THL would send a salutary signal to HMRC. Even if indemnity costs were not awarded, this was a classic case for costs to be awarded.

Arguments for HMRC

33. Mr McMeeken emphasised that he was unprepared for the hearing. He had not received any of the emails sent on Friday 2 September, as he had been on leave from 2 pm. He had written to the Tribunal indicating the withdrawal. He stressed that he was HMRC's advocate, not a decision maker. Most of the delays had arisen on the "without prejudice" letter. He had not received this until 22 August; he had been away at the end of the previous Friday. May of the individuals at HMRC who were responsible for taking decisions relating to the claims and the appeal had been away on leave. He pointed out that one message had been left on his phone.

34. In response to the Tribunal's question whether he was in a position to respond to the points made on THL's behalf, he indicated that he was not. It would require an adjournment of two weeks to seek the necessary information and views from the relevant HMRC colleagues.

Reply for THL

35. Mr Grodzinski submitted that the without prejudice offer could not be a reason not to prepare for the hearing. An adjournment would not assist and would prejudice THL. Looking at HMRC's earlier conduct, there had been no letter asking for more time for service of HMRC's statement of case. He commented that if taxpayers operated like this, they would receive "excoriating criticism" from HMRC. He questioned why it had been necessary for HMRC to wait until Friday, the last working day before the hearing, to abandon the appeal. The system should not operate for Mr McMeeken's convenience. THL opposed any further application to delay the resolution of the appeal.

Discussion and conclusions

36. Following the parties' arguments, we adjourned briefly to consider the position and concluded that it was not appropriate to adjourn the hearing any further; the decision should be given immediately. Having announced the decision, we indicated that if either or both parties wished, we would produce a decision setting out the

reasons for the making of the Directions set out above. This Decision is accordingly issued in accordance with the parties' wishes.

37. Our general conclusions as expressed to the parties at the hearing were as follows. We accepted that the defence and conduct of the proceedings by HMRC was, in all the circumstances, unreasonable. However, we did not consider that HMRC's conduct was wholly unreasonable. Accordingly, award of costs on an indemnity basis was not appropriate.

38. We set out in the following paragraphs our reasons for arriving at these conclusions.

39. As Mr Grodzinski indicated, the scope for awarding costs in a Standard case is limited. In the present context, the only basis is under Rule 10(1)(b). The relevant elements of the tests referred to in that sub-paragraph as applicable to HMRC are their actions (which, on our reading of Rule 10(1)(b), must also include omissions) in defending or conducting the proceedings. We agree that, following Judge Berner's decision in *Bulkliner Intermodal*, HMRC's conduct before the commencement of proceedings falls outside the scope of the sub-paragraph. However, we do accept Mr Grodzinski's point that engagement with a point raised by PWC Legal in their letter dated 10 February 2010 (that the position was governed by the decision of the Tribunal in *Thorn PLC*) neither occurred before the commencement of proceedings nor, more importantly for the present purposes, in the course of any of the documents or correspondence produced by HMRC for the purposes of the appeal. (Whether the issue would have been dealt with in HMRC's skeleton argument cannot be established, as in the events which occurred, it was never served.)

40. We regard this as a significant omission. The position relating to the respective group registrations needed to be carefully considered, to determine the extent to which the decision in *Thorn PLC* governed the position. We emphasise that we have not attempted to consider the merits of THL's substantive case, and that we would not have been in a position to make any findings unless the substantive appeal had gone ahead. Mr Grodzinski indicated his suspicion that the question might only have been considered by HMRC at the stage of deciding to withdraw the decision not to repay THL's overpayment of VAT. We do not consider that there is any evidence to indicate HMRC's reasons for deciding not to proceed with the appeal; these may well have been for practical and tactical reasons, with the position of other taxable persons in mind. However, we see the omission to engage with this issue as part of the overall picture of HMRC's approach to the appeal and its defence.

41. The second element referred to by Mr Grodzinski was the failures by HMRC to comply with the relevant Directions, as described above. We find that these amounted to serious deficiencies in HMRC's conduct of the proceedings.

42. The next element was the application made by HMRC on 26 August 2011 for postponement of the hearing (paragraph 9 above). We agree with Mr Grodzinski that it was completely inappropriate to refer to a without prejudice offer. The position is

set out in the White Book at paragraph 31.3.40; we do not need to restate the principles here.

43. The final element was the withdrawal, on the last working day before the hearing, of the decision not to repay THL's VAT overpayment (paragraph 16 above). The letter to the Tribunals Service, which had not previously been discussed with PWC Legal, sought on a unilateral basis to cancel the hearing. It is not clear to us why Mr McMeeken considered that in the light of the withdrawal but in the absence of agreement on THL's behalf, the hearing should not go ahead. If his letter was intended to imply that withdrawal of the original decision somehow had the effect of bringing the appeal proceedings to an end, this would have been a mistaken view; however, we had no indication from him whether this might have been the intention, and therefore we are not in a position to make any finding in this respect.

44. PWC Legal's attempts to resolve the position that afternoon were frustrated by Mr McMeeken's absence on leave. We find it surprising that he was to be on leave on the last working afternoon immediately preceding a listed hearing, particularly as he indicated to us that only one other colleague in his office would have been present because of limitations on staff numbers. Immediately in advance of a hearing there is a strong probability that the respective parties will need to be in contact, either to prepare for the hearing or to make a final attempt to seek a negotiated settlement. In our view, HMRC should ensure that appropriate individuals are available at that stage to ensure that contact can be made and, where appropriate, negotiations to settle appeals can be properly carried out so as to avoid unnecessary hearings.

45. Mr McMeeken's initial lack of knowledge on Monday 5 September that the hearing would be proceeding caused some further difficulty and delay. Further, his indication that an adjournment would be necessary for him to consult colleagues and prepare HMRC's response to the points put on THL's behalf showed that appropriate and timely attention had not been paid by HMRC to the need to dispose of the appeal in a proper manner. As a result, we did not consider that it was in the interests of justice for the hearing to be adjourned.

46. Our reasons for deciding to direct that HMRC should pay THL's costs in accordance with Rule 10(1)(b) are based on the combination of the above elements, in other words the overall picture painted from the accumulation of detail (as described by Mummery J in *Hall v Lorimer* [1992] STC 599 at 611). Taking all the elements together, we concluded that HMRC had acted unreasonably in defending and conducting the proceedings. However, we were not persuaded that HMRC's conduct had been such as to justify an order for indemnity costs; without setting out detailed comment on cases where such costs have been awarded, we consider that the test for such costs is stringent and requires elements of conduct which were not present in relation to THL's appeal.

Right to apply for permission to appeal

47. 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.

JOHN CLARK

TRIBUNAL JUDGE
RELEASE DATE: 10 October 2011