TC04256

Appeal number: TC/2014/03136

VAT – Flat Rate Scheme – Whether mechanical engineering relating to subsea equipment should be categorised as "architect, civil and structural engineer or surveyor" - no - whether HMRC decision was reasonable – no - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

SLL SUBSEA ENGINEERING LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE SCOTT, LLB, NP
MR PETER R SHEPPARD, FCIS, FCIB, CTA

Sitting in public at Atholl House, 84-86 Guild Street, Aberdeen on Monday 19 January 2015

Mr Stuart Kane for the Appellant

Mrs E McIntyre, Officer of HMRC, for the Respondents

DECISION

Introduction

1. Mr Ferrington of Abbey Tax Protection had represented the appellant in this appeal and he had lodged with the Tribunal a Skeleton Argument and relevant documentation including a copy of *Idess Ltd v HMRC*[1] *("Idess").* On the morning of this hearing he contacted the Tribunal to intimate that, unfortunately, his flight had been cancelled, that Mr Kane who is the sole director of the appellant would be attending and that the hearing should proceed in his absence.

2. At the outset of the hearing we asked Mr Kane if he wished an adjournment or whether he would be prepared to proceed in the absence of his representative. His very clear view was that he wished to proceed since all relevant information and arguments was already in the hands of the Tribunal and the parties. We decided that it was appropriate to proceed, as requested.

3. This appeal related to the assessment issued by HMRC on 18 March 2014 in the sum of £4,272 for under declared value added tax (VAT) for the periods 10/11 to 04/13 inclusive. The assessment also included associated default interest.

4. The basis for the alleged under declaration was that HMRC had decided that the appellant had used the wrong Flat Rate Scheme percentage. The appellant had chosen the business category "Any other activity not listed elsewhere" whereas HMRC took the view that the correct category was "Architect, civil and structural engineer or surveyor".

5. There was no dispute about the quantum, albeit certain elements thereof were less than clear, and the only issue for the Tribunal was in regard to categorisation.

6. We heard oral evidence from Mr Kane who was a clear and wholly credible witness.

The factual background to this appeal

7. The appellant registered for VAT with effect from 6 June 2011. The description of the business in the application for registration is "Design Engineering Services". It is concise, as it should be, but the services provided are rather more complicated.

8. Mr Kane is and always has been the sole employee. He has an HND in mechanical engineering and an HND in electrical engineering. He is currently studying for a B.Eng degree and that would entitle him to join the Institute of Mechanical Engineers. The appellant only has insurance in place to cover work in the field of mechanical engineering.

9. Mr Kane's specialism is oil and gas and in particular pressure containing components such as valves and pipe structures. He designs and supports the assembly and manufacture of pressure containing subsea equipment.

10. There has been no change in the activity of the business.

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[1] [2014] UKFTT 511 (TC)

11. The appellant, and/or Mr Kane, is registered with various agencies and the work is sourced through them. That work is all mechanical engineering in the subsea environment.

12. Almost all of the work undertaken relates to Christmas trees. A Christmas tree is an assembly of valves (spools, and fittings such as pressure gauges and chokes) and is used to control production in the oilfield (the downstream flow of hydrocarbons). Although Christmas trees are used in the oilfield, the appellant deals only with those which are utilised on the sea bed.

13. Typically, once a contract has been sourced, Mr Kane visits the client to talk to the Project Manager about the specification for the Christmas tree. Christmas trees come in a wide range of sizes and configurations, such as low or high-pressure capacity and single or multiple completion capacity. Mr Kane then does the necessary calculation analysis to support the designs. This involves the pressure analysis of component bores and mechanical functioning of hydraulically controlled valves.

14. Someone else would prepare the drawings. Once the calculations and drawings are complete Mr Kane then creates the instructions, which can amount to a manual, to enable the Christmas tree to be assembled and manufactured. That assembly would be completed in the client's workshop using the client's facilities but Mr Kane supports the assembly, machining and build.

15. When Mr Kane incorporated the appellant he sought professional assistance from Four M Accountants ("the accountants"). They had not encountered the Flat Rate Scheme (FRS) previously.

16. The FRS is designed to relieve small traders from the burden of detailed accounting for VAT. In this instance, although the appellant commenced trading on 6 June 2011, the application to join the FRS was dated 7 February 2012 but only submitted on 2 March 2012.

17. The accountants had sent to Mr Kane HMRC's "FRS7300-Trade Sector: A to Z of flat rate percentages by sector" ("Trade sectors"). In the first instance, the only category that Mr Kane thought might apply was "Manufacturing fabricated metal products" because that included "general mechanical engineering". However, he does not manufacture anything. Following discussion with the accountants, and because it seemed clear that the very specialised work in which he was engaged did not fit any specific category, he selected the category of business descriptor "Any other activity not listed elsewhere". The application form requested that the FRS be backdated to 6 June 2011. The flat rate of VAT for that category is 12%.

18. For reasons that are not clear, that application was not only accepted by HMRC but also backdated to 6 September 2011. Mrs McIntyre very fairly indicated that that had probably been a typing error and it was intended to be 6 June 2011. Backdating is very unusual but it seems to have been granted in this instance. Certainly the assessment would seem to indicate that it is now accepted that the FRS applies to the appellant from the date of VAT registration.

19. The first VAT return submitted for the appellant covered the period 6 June 2011 to 31 October 2011 (both dates included). Although the appellant had not, at that stage, applied to join the FRS, the accountants who prepared and submitted the VAT

returns for that period and the following period (01/12) calculated the VAT at a flat rate of 14.50%. That is the applicable rate for the business category "Architect, civil and structural engineer or surveyor" and a few other categories.

20. In the first year a trader operates the FRS the applicable rate is in any event reduced by 1%.

The Legislation

21. Section 26B of the Value Added Tax Act 1994 ("VATA") provides:

"(1) The Commissioners (HMRC) may by regulations make provision under which, where a taxable person so elects, the amount of his liability to VAT in respect of his relevant supplies in any prescribed accounting period shall be the appropriate percentage of his relevant turnover for that period.

…

(6) The regulations may

(a) provide for the appropriate percentage to be determined by reference to the category of business that a person is expected, on reasonable grounds, to carry on in a particular period;"

22. Regulation 55H of the Value Added Tax Regulations 1995 ("1995 Regulations") provides:

"(1) The appropriate percentage to be applied by a flat rate trader for any prescribed accounting period, or part of the prescribed accounting period (as the case may be), shall be determined in accordance with this regulation and regulations 55JB and 55K

(2) For any prescribed accounting period-

(a) beginning with a relevant date, the appropriate percentage shall be that specified in the Table for the category of business that he is expected, at the relevant date, on reasonable grounds, to carry on in that period."

23. Section 55K of the 1995 Regulations sets out a Table with the Categories of business and the appropriate percentages. It is lengthy and is set out at Appendix 1.

24. Section 83 of VATA provides:

"(1) Subject to sections 83G and 84, an appeal shall lie to the tribunals with respect to any of the following matters

…

(fza) a decision of [HMRC]…

(ii) as to the appropriate percentage or percentages (within the meaning of that section) applicable in a persons case"

25. Section 84 of VATA provides:

"(4ZA) Where an appeal is brought

(a) against such a decision as is mentioned in [Section 83(1)(fza)], or

(b) to the extent that it is based on such a decision, against an assessment,

the tribunal shall not allow the appeal unless it considers that [HMRC] could not reasonably have been satisfied that there were grounds for the decision."

HMRC Guidance

26. The guidance in Notice 733 makes clear (at paragraphs 4.1 and 4.2):

"The flat rate you use depends on the business sector that you belong in. All the sectors can be found at the link in paragraph 4.3. The correct sector is the one that most closely describes what your business will be doing in the coming year. Sections FRS7200 and FRS7300 of the Flat Rate Scheme Guidance show you which businesses we think belong in each sector…

We will not normally check your choice of sector when we process your application. So if you have made a mistake you may pay too much tax or too little. Paying too little could mean that you are faced with an unexpected VAT bill at a later date. However, if we approve you to join the scheme we will not change your choice of sector retrospectively as long as your choice was reasonable…

Note: Some business activities can reasonably fit into more than one sector. So changing your sector does not automatically make your original choice unreasonable."

27. At paragraph 4.4 the guidance identifies " business activities that are the source of common enquiry" and identifies the business activity of "engineering consultants and designers" and indicates that the appropriate trade sector should be "Architects, civil and structural engineers".

The arguments

HMRC

28. Simply put, HMRC argue that paragraph 4.4 in Notice 733 makes it explicit that engineering consultants and designers fall within the trader sector for Architects, civil and structural engineers. In registering for VAT, the appellant had described the main business activity as Design engineering services and therefore it was wholly unreasonable for the appellant to select the category "any other activity not listed elsewhere".

29. HMRC referred to the cases of *Archibald & Co Ltd v HMRC*[2] *("Archibald"), Vintage Tea House Ltd v HMRC*[3] *("Vintage"), C & N Hollinrake Ltd*[4] ("*Hollinrake*") and *A K Bray for Gardens Ltd v HMRC*[5] *("Bray")* on the basis that they all provided guidance in regard to the FRS. *Idess* was distinguished on the basis that it turned on its own unique facts.

[2] [2010] UKFTT 21 (TC)

[3] [2014] UKFTT 019 (TC)

[4] [2014] UKFTT 203 (TC)

[5] [2014] UKFTT 234 (TC)

The appellant

30. It was argued for the appellant that the category must be determined by reference to the law not the guidance. Reliance was placed on the decision in *Idess* which it was argued was very similar, if not identical to the facts of this appeal since that appellant was also a mechanical engineer.

31. It was further submitted that the appellant does not fall specifically into any of the categories listed in regulation 55K and that therefore the correct category is either "business services that are not listed elsewhere" or "any other activity not listed elsewhere". Both carry the same FRS rate of 12%.

32. Even if HMRC are correct in stipulating that "Architect, civil and structural engineer or surveyor" is the correct category, nevertheless the appellant's decision was reasonable and HMRC should have applied their own practice and not changed the choice of sector.

33. Lastly, it was argued that the representative had dealt with several other similar cases and redacted evidence was furnished showing that HMRC had settled with at least one other taxpayer.

Reasons for Decision

34. Firstly, the Tribunal can only be concerned with the decision, and assessment, that is the subject matter of this appeal. HMRC's handling of the affairs of other taxpayers, whether or not they were clients of the appellant's representative, cannot be considered or taken into account. This is not the forum for such issues.

35. What is the issue for the Tribunal? We must decide whether or not HMRC's decision, which gave rise to the assessment, was reasonable. We can only do that once we understand the nature of the business undertaken by Mr Kane and therefore the appellant. We have no hesitation in finding that, as Mr Kane freely agreed, the appellant does provide design engineering services but it is in a very specific and very limited field and always subsea and oil and gas related. It is entirely within the field of mechanical engineering. Mr Kane does not himself manufacture anything; the role is to support the manufacture by others.

36. It was not in dispute that HMRC's Notice 733 and various guidance materials (and manuals) are simply their interpretation of the law. They do not have the force of law. Indeed it can be seen from Notice 733 that where the law is quoted then it is placed in a box with a heading stating "The following rule has the force of law". It is clear that paragraph 4.4 is not a statement of the law itself. It is simply HMRC's opinion.

37. Therefore both parties must look at the law in order to determine the business category. There is no specific business category in section 55K, which even remotely refers to oil and gas. The only reference in the Trade sectors (and of course that is not the law) is that HMRC opine that "extraction of petroleum and natural gas" should be categorised as "Manufacturing that is not listed elsewhere". The appellant is not engaged in the extraction of hydrocarbons.

38. Mr Kane was very clear that he has never considered that the work that he does has even the remotest connection with anything to do with architects, or civil and

structural engineers let alone surveyors. It was his view that the Trade sectors, which he had carefully examined, meant that if one was an engineering consultant or designer in a land related matter then one would fall into the category chosen by HMRC but in his words, "…that is night and day to where we come from". His argument is further supported by the fact that we note that the other examples in that category in Trade sectors, which have not been mentioned, are quantity surveyors and town planners.

39. Although no such argument was advanced to us we considered some of the other types of engineers who operate in the North Sea and those include chemical and process engineers. It is well nigh impossible to imagine what synergy, if any, they would have with town planners and architects in terms of business activity.

40. As far as the case law to which we were referred is concerned these are all decisions of the First-tier Tribunal and those do not bind us. However, there is nothing in any of those cases to which we take exception. Indeed, we agree with the reasoning, but by no means all of it is relevant to this appeal. Specifically, we highlight the following reasoning which we endorse and adopt:

(a) In *Archibald,* the Tribunal is wholly correct in stating at paragraph 19 that "it is significant that neither the 1995 Regulations nor the VAT Notice 733 contains any detailed description of the various trades, and it is accordingly a matter of applying the ordinary meaning to each of the descriptions as they appear."

Later at paragraph 26, "Significantly, s 84 of VATA restricts the power of this Tribunal to considering the reasonableness of HMRC's decision…The question for the Tribunal is a narrow one, namely, were there reasonable grounds for the decision…It is therefore not necessary for the Tribunal to determine what was the 'correct' trade sector".

(b) In *Hollinrake* under the heading "Discussion and conclusion" at paragraph 1 "The role of the tribunal is limited to deciding whether the Commissioners exercise of their discretion was reasonable and if it was not reasonable then it may be set aside." and at paragraph 7 "In looking at the decision of HMRC the tribunal must look to see whether they took into account anything which they should not have done or failed to take into account anything which they should have done."

(c) In *Bray* at paragraph 23 "We found as a fact that responsibility lay with the Appellant, who had first-hand knowledge of its business, to decide which trade sector was most appropriate." and at paragraph 26 "There being no specific category for… we concluded that the correct sector was a matter for the Appellant to consider and choose which it believed was most accurate."

(d) Paragraphs 21 and 22 of *Idess* are particularly pertinent and read as follows:

> "We note the wording of regulation 55K(4). The category proposed by HMRC refers to *civil* and *structural engineers.* That term whether read alone or in context with 'architects' and 'surveyors' denotes in our view operations relating to land, buildings and other structures. We consider that *mechanical* engineering is a distinct field. The adjectives, civil and structural, were, we must assume, chosen consciously and deliberately by the draughtsman.

> It is, we think well within judicial knowledge that there is an obvious defining line between *mechanical* engineering and the other two categories of engineering activity mentioned."

41. It is clear that there is very little detail indeed in section 55K and therefore if Parliament had intended that all engineering fell into that category there would have been no reason whatsoever to introduce the words *civil* and *structural.*

42. We take the view that the appellant was diligent and reasonable in selecting the category that was chosen since the nature of the business activity was not listed elsewhere. It most certainly was not an unreasonable decision.

43. Was HMRC reasonable in finding that that decision was not correct? We think not for a number of reasons. Firstly, in our view HMRC erred in looking to their own guidance as being authoritative. They should have looked at the legislation and given it its ordinary meaning. It is not opaque. On the contrary it is admirably clear and HMRC's chosen category is one of the most detailed descriptors. The appellant's business is not that of an architect, civil or structural engineer or surveyor or indeed anything analogous thereto.

44. Although HMRC's review, dated 21 May 2014, had six numbered conclusions running to 16 short paragraphs, it turns on the assertion that the appellant's trading activities, when considered in the light of HMRC's own publications, simply had to fall into HMRC's chosen category. That proposition was stated to be the case irrespective of the noted fact that the appellant had no involvement in civil engineering or architecture.

45. Paragraph 4.4 cannot extend the meaning of the 1995 Regulations (see paragraph 36 above). The fact that HMRC think that any engineering design or consultancy work falls into their chosen category does not change the ambit of that category at all.

46. Further, the review baldly states that the appellant's choice of category was not reasonable. No explanation is offered. Since HMRC's Skeleton Argument states that it was not a reasonable choice in light of "the information published by them", presumably the assertion that the choice was unreasonable was on the basis that engineering design is listed in the Trade sectors, so it could not be said that "Any other activity not listed elsewhere" applies. Patently that cannot be the case as the word "elsewhere" relates, and can only relate, to the rest of the categories in section 55K of the legislation.

47. Accordingly, for all of these reasons we find that the decision underpinning the assessment was unreasonable. HMRC should not, and could not, reasonably have been satisfied that there were grounds for the decision. Therefore the appeal succeeds, and the assessment and any penalty fall to be set aside.

48. 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.

ANNE SCOTT
TRIBUNAL JUDGE

RELEASE DATE: 28 January 2015

APPENDIX 1

Section 55K of the 1955 Regulations

[55K.—
(1) Where, at a relevant date, a flat-rate trader is expected, on reasonable grounds, to carry on business in more than one category in the period concerned, paragraph (3) below shall apply.

[...] [2]
(3) He shall be regarded as being expected, on reasonable grounds, to carry on that category of business which is expected, on reasonable grounds, to be his main business activity in that period.

(4) In paragraph (3) above, his main business activity in a period is to be determined by reference to the respective proportions of his relevant turnover expected, on reasonable grounds, to be generated by each business activity expected, on reasonable grounds, to be carried on in the period.

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Category of business	Appropriate percentage
Accountancy or book-keeping	14.5
Advertising	11
Agricultural services	11
Any other activity not listed elsewhere	12
Architect, civil and structural engineer or surveyor	14.5
Boarding or care of animals	12
Business services that are not listed elsewhere	12
Catering services including restaurants and takeaways	12.5
Computer and IT consultancy or data processing	14.5
Computer repair services	10.5
Dealing in waste or scrap	10.5
Entertainment or journalism	12.5
Estate agency or property management services	12
Farming or agriculture that is not listed elsewhere	6.5
Film, radio, television or video production	13

Financial services	13.5
Forestry or fishing	10.5
General building or construction services*	9.5
Hairdressing or other beauty treatment services	13
Hiring or renting goods	9.5
Hotel or accommodation	10.5
Investigation or security	12
Labour-only building or construction services*	14.5
Laundry or dry-cleaning services	12
Lawyer or legal services	14.5
Library, archive, museum or other cultural activity	9.5
Management consultancy	14
Manufacturing fabricated metal products	10.5
Manufacturing food	9
Manufacturing that is not listed elsewhere	9.5
Manufacturing yarn, textiles or clothing	9
Membership organisation	8
Mining or quarrying	10
Packaging	9
Photography	11
Post offices	5
Printing	8.5
Publishing	11
Pubs	6.5

Real estate activity not listed elsewhere	14
Repairing personal or household goods	10
Repairing vehicles	8.5
Retailing food, confectionary, tobacco, newspapers or children's clothing	4
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	8
Retailing that is not listed elsewhere	7.5
Retailing vehicles or fuel	6.5
Secretarial services	13
Social work	11
Sport or recreation	8.5
Transport or storage, including couriers, freight, removals and taxis	10
Travel agency	10.5
Veterinary medicine	11
Wholesaling agricultural products	8
Wholesaling food	7.5
Wholesaling that is not listed elsewhere	8.5

*"*Labour-only building or construction services"* means building or construction services where the value of materials supplied is less than 10 per cent of relevant turnover from such services; any other building or construction services are "general building or construction services.

] [3]

] [1]

Notes

1. Added by Value Added Tax (Amendment) (No. 2) Regulations 2002/1142 Pt II reg.7 (April 25, 2002)
2. Revoked by Value Added Tax (Amendment) (No. 6) Regulations 2003/3220 Pt 3 reg.18(3) (January 1, 2004)
3. Table substituted by Value Added Tax (Amendment) (No. 3) Regulations 2010/2940 reg.4(1) (January 4, 2011)