[2017] UKFTT 586 (TC)

TC06029

Appeal number: TC/2016/03349

VALUE ADDED TAX – (1) input tax – fuel costs reimbursed by employer – whether sufficient evidence to justify credit – yes. (2) Penalties for 3 inaccuracies in 3 periods – Schedule 24 FA 2007 – whether valid assessment of penalties - whether inaccuracies – whether potential lost revenue correctly calculated – whether disclosure unprompted – whether behaviour deliberate or careless – appeals allowed – whether to award costs to appellant on account of HMRC's unreasonable conduct - yes.

FIRST-TIER TRIBUNAL
TAX CHAMBER

GEKKO & COMPANY LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD THOMAS
MOHAMMED FAROOQ

Sitting in public at Magistrates Court, Peterborough on 20 July 2017

Mr Justin Rushworth (former director) for the Appellant

Miss Esther Hickey, Presenting Officer, for the Respondents

DECISION

1. This was the hearing of four appeals by Gekko & Company Ltd ("the appellant") against an assessment to value added tax ("VAT") of £69 (sixty-nine pounds) and against three assessments of a penalty under paragraph 1 Schedule 24 Finance Act ("FA") 2007 of £780, £8.85 (eight pounds eight-five pence) and £10.35 (ten pounds thirty five pence) respectively.

2. We have put the amounts in words in the last paragraph to make it clear that there is no typographical error in setting out the amounts in dispute. This decision is a great deal longer than we would ordinarily write in a case involving such small amounts: this is because there are a number of disturbing features about the way the case has been conducted by the respondents ("HMRC"). We except Miss Hickey, the presenting officer, from any strictures on this score.

Background facts

3. These are taken from the bundle of documents with which we were supplied and which were not in dispute. We also has a certain amount of oral evidence from Mr Rushworth and he had also sent to HMRC and brought to the Tribunal a bundle of papers which we did not in the end need to consider.

4. The appellant was registered for VAT with effect from 12 May 1997. Its business was property investment and it exercised an option to tax.

5. In the remainder of this section we set out the facts we find taken from the documents and evidence. Passages italicised and in square brackets [ ] are comments by the Tribunal and are not part of the facts we find. Passages between quotation marks are taken verbatim from the papers.

The compliance check and aftermath

6. On 15 January 2015 HMRC wrote to the appellant informing it that a check of its records would be made covering the four years ended with the most recent VAT return. The letter gave no explanation of the reason for making the compliance check although a copy of Factsheet CC/FS1A was enclosed which stressed that penalties might be payable and that the European Convention on Human Rights and the Human Rights Act 1998 might be relevant..

7. A visit by Miss Rachael Pearce, an officer of the Commissioners for Her Majesty's Revenue and Customs ("HMRC") with the rank of Higher Officer, took place on 11 February 2015 at the offices of the appellant's accountant in Boston, Lincs.

8. In a letter of 23 February 2015 Ms Pearce referred to the sale of land at Ferry Lane, Bath which had been sold in June 2011 but not included in the VAT return for the prescribed accounting period of the 3 months ending with June 2011 ("06/11"). She said that the omission of this sale had been identified in 2013 but not corrected until a declaration of the sale in the return for the 06/14 period. She asked for the reason for the three year delay in reporting the transaction to HMRC.

9. In the same letter she sought information about an input tax claim for fuel on the 06/14 return, including details of the vehicles the claim related to, their owner and the use in the business.

10. In an email of 17 March 2015 "Gemma[1]" Rushworth told Miss Pearce that the fuel was used by Mr and Mrs Rushworth and Mrs Rushworth's stepfather in their own cars. Gemma Rushworth was and is a director of the appellant at all relevant times: Justin Rushworth was a director until 9 August 2013.

The letter of 18 May 2015 and its attachments

11. On 18 May 2015 Miss Pearce wrote to the appellant setting out the conclusions of her compliance check. There were three issues, the input tax on the motoring expenses and the declaration of the output tax as already mentioned and a query about input tax on purchases in relation to a property at Fellands Gate, Old Leake, nr Boston, Lincs..

12. As to motoring expenses Miss Pearce referred the appellant to Public Notice 700/64 which she said details various methods available to enable input tax to be claimed for fuel costs. She said that when mileage records have not been kept the options are not to claim input tax or to apply a fuel scale charge to account for private use, and that she intended to disallow the input tax of £88 for the period 06/14 [*thereby apparently pre-empting the choice of the appellant*].

13. On Fellands Gate she referred to the fact that the farm building there was transferred to the (joint) ownership of Mrs Rushworth and the appellant "in partnership". That meant that input tax such as electricity or maintenance costs "cannot be recovered via this VAT registration". She intended to disallow input tax of £59 for the period 06/13.

14. On the land at Ferry Lane, Bath she said that she would "move the sale to the correct VAT period".

15. In relation to all the matters she said, under the heading "Penalties for Inaccuracies" that she had reviewed the information the appellant had provided and she attached "sheets" which provided full details of the penalties she considered appropriate.

16. She added that she intended to issue a Notice of Assessment and Penalty Notice based on the information in the letter on or shortly after 15 June 2015 and she sought any additional information the appellant wished her to consider "prior to" this date.

17. The "sheets" attached consisted of a "Penalty Explanation" letter. It referred in particular to suspension conditions shown in the schedules which she asked the appellant to confirm acceptance of by 15 June otherwise the penalties could not be suspended.

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[1] At the hearing Mr Rushworth told us (and Miss Hickey) that it was mostly him actually composing the emails.

18. For the Ferry Lane sale the Penalty Explanation Schedule contains the following:

(1) "Description of the inaccuracy: output tax in relation to sale … in June 2011 declared on VAT return [06/14]"

(2) Potential Lost Revenue £5,200 [*this is 20% of the sale price of £26,000 although the Schedule does not explain this*]

(3) The behaviour was "deliberate". This was because the error was identified in 2012[2] during preparation of the company's annual return but was not included in the return made for the period of discovery but for the 06/14 period. Details about a court case which the appellant said had contributed to the omission did not rate to the appellant.

(4) The disclosure was "unprompted" because the appellant had told HMRC about it before the appellant had reason to believe HMRC had discovered it or were about to.

(5) The reduction for the quality of disclosure was 100%, giving a penalty percentage of 20%, thus 20% of £5,200 which is £1,040.

(6) The amount to be suspended as shown at the end of the schedule was £0.

19. For the input tax on Fellands Gate the Penalty Explanation Schedule contains the following:

(1) "Description of the inaccuracy: input tax – not relevant to this legal entity".

(2) Potential Lost Revenue £59.

(3) The behaviour was "careless".

(4) The disclosure was "prompted" because the appellant had not told HMRC about the inaccuracy before the appellant had reason to believe HMRC had discovered it or were about to.

(5) The reduction for the quality of disclosure was 100%, giving a penalty percentage of 15%, thus 15% of £59 which is £8.85 [not rounded down to £8].

(6) The amount to be suspended as shown at the end of the schedule was £8.85.

(7) The proposed suspension conditions were the appellant must meet all its notification and filing obligations and must check input tax is relevant to the business prior to inclusion "of" [*sic*] its VAT return. The suspension period proposed was 6 months.

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[2] In her letter of 23 February 2015 Miss Pearce had said that the error was identified in 2013 by Mr Apthorpe, the appellant's accountant when preparing the accounts. The accounts that contained June 2011 were those to 31 March 2012, which Companies House shows as being filed on 31 December 2012. They must then have been prepared in 2012. The exact year has no bearing on the outcome of the appeals.

20. For the input tax on fuel the Penalty Explanation Schedule contains the following:

(1) Description of the inaccuracy: input tax – not relevant to this legal entity and insufficient supporting evidence.

(2) Potential Lost Revenue £88.

(3) The behaviour was "careless". This was because there was insufficient evidence that business and private use of vehicles had been considered.

[*There was also strangely a reference to the Fellands Gate claim, it seems in error (too much carelessly copying and pasting) which explains the double description of the inaccuracy*]

(4) The disclosure was "prompted" because the appellant had not told HMRC about the inaccuracy before the appellant had reason to believe HMRC had discovered it or were about to.

(5) The reduction for the quality of disclosure was 100%, giving a penalty percentage of 15%, thus 15% of £88 which is £13.20 [*not rounded down to £13*].

(6) The amount to be suspended as shown at the end of the schedule was £13.20.

(7) The proposed suspension conditions were the appellant must meet all its notification and filing obligations and must check input tax is relevant to the business prior to inclusion "of" [*sic*] its VAT return and maintain a record of such checks. The suspension period proposed was 6 months.

The appellant's reaction

21. In an email of 8 June 2015 Gemma Rushworth responded on each matter.

22. On fuel the appellant said that mileage records had never been requested and could be provided. [*See §12*]

23. On Fellands Gate the appellant said there was no partnership, and that the terms of the property provide for the appellant to incur the expenses.

24. On Ferry Lane the appellant was indignant that its behaviour was branded deliberate and said that the HMRC letter was in error about the notification and the reason for the non-reporting and the delay.

25. She also queried the NPPS101 about suspension and asked what it was for.

Miss Pearce's follow up & the VAT assessment

26. On 17 June 2015 Miss Pearce replied, asking for more details about the fuel claim; explaining that HMRC treats joint ownership of land as if it were a partnership and therefore as a separate person not the appellant; and asked for further information about the reason for late disclosure.

27. In addition she issued an assessment to VAT for the period 06/11 in the sum of £5,200. [*We note that Miss Pearce sought an invoice from Stakers estate agents the VAT on which had been claimed as input tax in 06/14. The invoice was produced and shows that it relates to the Ferry Lane sale and was dated 19 April 2011 with VAT of £320. This was clearly not included in the assessment for 06/11*]

Further correspondence

28. On 22 July 2015 Gemma Rushworth emailed mileage records to Miss Pearce.

29. On 10 August 2015 Miss Pearce noted the receipt but asked for the other four lots of information she had previously requested and added a request for details of the cylinder capacity of the vehicles. She also said she could not identify payment of the "mileage allowance" in the bank statements nor any fuel in the accounts.

30. She gave a deadline of 28 August 2015 for the information as she would then be using assessments and penalties.

31. On 13 August 2015 Gemma Rushworth gave all the outstanding information about fuel that had been requested.

32. On 22 August 2015 Gemma Rushworth wrote with copies of the fuel receipts which she said were available on the day of visit.

33. On 18 September Miss Pearce asked for a list of journeys in 2014/15 with dates and the type of fuel used by each car.

34. On 6 October 2015 Miss Pearce said that in the absence of a response she would "make the adjustments" previously explained on 18 May 2015. She asked for agreement to the suspension conditions by 12 October 2015 [*six days*], failing which she would be unable to suspend them.

35. On 6 October Gemma Rushworth replied by email complaining of the gobbledegook about suspension, but agreeing to suspension and asking what the conditions were. She also replied about the questions on fuel.

36. On 9 October 2015 Miss Pearce referred Mrs Rushworth to page 3 of Schedules 2 and 3 [*of what she did not say*] for the suspension conditions. She said that during the suspension period "you must meet the conditions you have agreed to". She pointed out that a decision by HMRC that the appellant had not met the conditions would lead to the penalty being imposed and that there was no appeal against that decision. She asked for confirmation that the appellant had read the conditions and remained in agreement to suspension.

37. Four more detailed questions were asked about fuel. The deadline of 12 October [*now 3 days*] was maintained for a reply.

The 13 November letter and subsequent documents

38. On 13 November Miss Pearce write to the appellant summarising details of her "VAT Review" [*no longer a Compliance Check, it appears*]:

(1) On motoring expenses she felt that she had supporting evidence to verify 5 purchases of fuel allowing her to reduce the amount of the proposed input tax assessment from £88 to £69 [*though by our calculations this is an understatement of the correct amount of the assessment by 66 pence. Thus rounding down applies to assessments of VAT but not of penalties*]

(2) She proposed to issue an input tax assessment for Fellands Gate for £59.

(3) On Ferry Lane she maintained that the behaviour was deliberate.

39. On 11 December 2015 a notice of penalty assessment was issued. Its features included:

(1) "Tax period for which the penalties assessed: From 1 April 2011 to 30 June 2014.

(2) Total penalty charged £1,062.05 of which £22.08 were suspended.

40. The bundle also contains a document dated 6 January 2016 headed "Notice of penalty assessment". It has the same penalty assessment number as the notice of 13 December 2015 but with the addition of "/NPPS-404672".

41. This notice breaks down the penalties into the three amounts and shows the tax period for each as the actual prescribed period.

42. Also dated 6 January 2016 is a "Notice of penalty suspension" showing the suspension period from 6 January 2016 to 5 July 2016. It lists the penalty for Fellands Gate showing it to be £8.85 and that the total penalty suspended for this period as being £8.85 and the total suspended for all periods as £19.20, though it does not mention fuel costs. The balance [*probably meant to relate to fuel costs*] is £10.35 whereas the 11 December notice shows the total suspended penalties as £22.08.

The review request and the review

43. On 9 January 2016 Gemma Rushworth asked for a review and saying she wanted to go to ADR and was preparing to lodge an appeal. The subject matter was the inaccuracy penalties and the assessment on fuel costs [*which is not in the bundle, nor is the assessment in relation to Fellands Gate*].

44. On 13 January Miss Pearce confirmed receipt of the request and set out the HMRC view of the matter.

45. On 27 January 2016 Mr Peter Hartley of Dispute Resolution wrote to Mrs Rushworth asking for an extension of time for the review.

46. On 7 April 2016 Mr Pete Matthews wrote to the appellant with the conclusion of his review. The letter contained the following points.

47. On the fuel costs assessment Mr Matthews said he had referred to VIT55400 (part of HMRC's Guidance on fuel costs) and VAT Notice 700/64 paragraphs 8.4 and 8.9. He upheld the assessment.

48. On penalties he said that the appellant should have been notified of three separate penalties each with its own tax period, but was not. "This is incorrect and the Notice of Penalty will need to be cancelled and reissued correctly".

49. He added that Miss Pearce would be asked to reconsider the characterisation of the behaviour in relation to Ferry Lane as deliberate and to consider "whether any conditions can be identified that would enable the penalty to be suspended".

The post-review events

50. In a letter dated 21 April 2016 Miss Pearce wrote to the appellant, referring to the review conclusions.

51. She said she was enclosing with the letter "a revised penalty calculation summary" for each of the three penalties. She had considered the reviewing officer's remarks about the behaviour for the Ferry Lane omission and had regraded it to "careless". As a result she said that suspension could be considered for that penalty and that she was able to set appropriate conditions. She asked the appellant to return the form confirming agreement to the suspension conditions by 21 May 2016.

52. The bundle contains a number of documents which are of the type referred to in Miss Pearce's letter. [*They are dated 18 April 2016 so we assume they were prepared a few days before the letter attaching them was issued*].

53. The first of these documents is a penalty calculation summary. It contains the words in the second line "This is not a penalty assessment or notice to pay". It also refers to the fact that if the figures are agreed a notice of penalty assessment will be sent, and that the recipient should not pay any penalty until a notice of penalty assessment is sent. The penalty calculation summary ends with a statement of the total penalty as being £799.20, but all of it is subject to being suspended.

54. There is also a single schedule which covers all three penalties, though each is separately discussed. This Schedule contains none of the explanations that are present in the Schedules attached to the original pre-assessment letter and referred to in §§18 to 20.

55. For Ferry Lane the relevant details are:

(1) Tax period to which the proposed penalty applies is: 01 April 2011 to 30 June 2011[3].

(2) Description of the inaccuracy: output tax – sale of Ferry Lane

[3] Confusingly the tax period is shown *before* a bold heading "Inaccuracy under Schedule 24 Finance Act 2007". This has the effect that the tax period for the second penalty appears in the text relating to the first and before the heading for the second, and equally so with the second and third penalties.

(3) Potential Lost Revenue ("PLR") £5,200 [as before]

(4) The behaviour was "careless".

(5) The disclosure was "prompted"

(6) The reduction for the quality of disclosure was 100%, giving a penalty percentage of 15%, thus the penalty is 15% of £5,200 which is £780.

(7) The amount to be suspended as shown at the end of the schedule was £780.

(8) The proposed suspension conditions were that the appellant must:

(a) meet all its notification and filing obligations

(b) check input tax is relevant to the business prior to inclusion on its VAT return and maintain a record of such checks.

(c) set up a system to ensure all supplies by the company are recorded on the appropriate VAT return

(d) set up a system to ensure any errors identified in the company's VAT records is corrected on the next available VAT return.

(9) The suspension period proposed was "06" months.

56. For Fellands Gate the position was:

(1) Tax period to which the proposed penalty applies is: 01 April 2013 to 30 June 2013.

(2) Description of the inaccuracy: Input tax – Fellands gate

(3) Potential Lost Revenue ("PLR") £59 [as before]

(4) The behaviour was "careless" [as before]

(5) The disclosure was "prompted" [as before]

(6) The reduction for the quality of disclosure was 100%, giving a penalty percentage of 15%, thus the penalty is 15% of £59 which is £8.85 [as before].

(7) The amount to be suspended as shown at the end of the schedule was £8.85.

(8) The proposed suspension conditions were that the appellant must:

(a) meet all its notification and filing obligations

(b) check input tax is relevant to the business prior to inclusion on its VAT return and maintain a record of such checks.

(c) set up a system to ensure all supplies by the company are recorded on the appropriate VAT return

(d) set up a system to ensure any errors identified in the company's VAT records is corrected on the next available VAT return.

(9) The suspension period proposed was "06" months.

57. For fuel input tax the position was:

(1) Tax period to which the proposed penalty applies is: 01 April 2014 to 30 June 2014.

(2) Description of the inaccuracy: Input tax – motoring

(3) Potential Lost Revenue ("PLR") £69 [was £88 before]

(4) The behaviour was "careless" [as before]

(5) The disclosure was "prompted" [as before]

(6) The reduction for the quality of disclosure was 100%, giving a penalty percentage of 15%, thus the penalty is 15% of £69 which is £10.35 [not as before].

(7) The amount to be suspended as shown at the end of the schedule was £10.35.

(8) The proposed suspension conditions were that the appellant must:

(a) meet all its notification and filing obligations

(b) check input tax is relevant to the business prior to inclusion on its VAT return and maintain a record of such checks.

(c) set up a system to ensure all supplies by the company are recorded on the appropriate VAT return

(d) set up a system to ensure any errors identified in the company's VAT records is corrected on the next available VAT return.

(9) The suspension period proposed was "06" months.

58. There is a "NPPS1 – Agreement" form in blank on which the appellant is asked to choose between "I agree all the details shown in the Penalty calculation summary and, where applicable, the suspension conditions" or "I do not agree all the details in the Penalty calculation summary".

59. On 22 May 2016 Mrs Rushworth emailed Miss Pearce and Mr Matthews. Her main objection was now being told that the disclosure of the sale of Ferry Lane was "prompted". She also asked for clarification about suspension.

60. Miss Pearce replied on 27 May by email. She confirmed that the appellant's accountant told her about the circumstances regarding Ferry Lane at the start of their meeting. The decision to change the penalty to "prompted" was based on Public Notice 700/45. In particular it was based on paragraph 4.3 which says that correcting the error on a subsequent return is not a disclosure for the "new" [*sic*] penalty rules. Because separate notification was not received by HMRC, the disclosure in this case was viewed as prompted.

61. She also clarified that the initial characterisation of the appellant's behaviour in relation to this error as deliberate was because the error was not corrected as soon as it was identified. Thus the behaviour was "changed from careless to deliberate". She

adds that "I adjusted the behaviour so it is based on the behaviour at the time the 06/11 VAT Return was submitted."

62. She also refers to suspension, saying that for the errors other than Ferry Lane the conditions remain the same "as previously agreed".

63. On 22 May 2016 Mrs Rushworth also emailed Mr Matthews, the reviewing officer. She said she had realised that to appeal to the Tribunal she had 30 days from the date of his conclusion letter, but as that letter was 43 days late she assumed he would not oppose a late appeal.

64. On 12 June 2016 the appellant appealed to the Tribunal against the penalties. The date of the decision is shown as 21 April 2016. HMRC do not oppose a late appeal.

65. On 15 July 2016 HMRC Solicitor's Office (Miss Hickey) pointed out to the Tribunal that they were uncertain quite what had been appealed, as Part 3 of the Notice of Appeal seemed only to apply to the penalties, but Parts 6 and 7 suggested it is the underlying tax matter which was being appealed.

66. She went on to say that given that it may be the underlying tax that is under appeal, then the hardship provisions would apply, something about which Miss Hickey said she would write to the appellant. She did so in a letter to the appellant on 15 July 2016.

67. It seems that on 7 December 2016 the appellant emailed Miss Hickey concerning hardship. On 4 January 2017 an anonymous "Hardship Officer" wrote to the appellant with a determination of the application for hardship.

68. It says that having considered the circumstances on this occasion the Commissioners were satisfied that the appeal could proceed to the Tribunal without a requirement to pay the outstanding tax. This was because the only outstanding tax assessment was the fuel costs assessment for £69.

69. The letter ends with a homily from the Hardship Officer about directors' duties under the Companies Act 2006 and the Insolvency Act 1986 and says that directors may be personally liable for losses suffered by creditors such as HMRC if they have not acted in the best interests of creditors.

Law

70. As almost the whole of Schedule 24 FA 2007 is engaged in this case we have set it out, so far as relevant, in the Appendix. Other law (and other paralegal material) is quoted at the relevant place in the discussion.

Discussion

Burden of proof

71. The Statement of Case, prepared by Miss Hickey, shows correctly that in relation to the penalties HMRC has the burden of showing that the penalties were correctly imposed and the assessment valid. If HMRC can do that then the burden is on the appellant to show why the penalties should be altered.

72. In relation to the fuel input tax assessment the burden is on the appellant.

Are there valid penalty assessments?

73. Before Miss Hickey began to present HMRC's case, we asked her to show us where in the bundle the replacement notice of assessment to penalties was. We noted that HMRC had accepted that the notice of assessment made on 11 December 2015 should be withdrawn (§49).

74. Miss Hickey referred us to Miss Pearce's letter of 21 April 2016 and the documents which it seems were attached and which were dated 18 April. We had noted that the contents schedule of HMRC's list of documents shows against these 18 April documents "Re-issued Notice of Penalty Assessment". However the first of those documents clearly says "This is not a penalty assessment" and refers to a notice of penalty assessment as something that will be issued in the future.

75. Miss Hickey could not find in the bundle any assessments or copy notice of assessment. Mr Rushworth informed us that his bundle of papers contains nothing of that description and his evidence on this was that the appellant had received no such notice of assessment after 20 April 2016.

76. There is nothing in the bundle of documents that suggests that any such assessments were made or any notice of it issued. In view of this there can be no suggestion that service of the notice can be deemed to have been made by virtue of s 7 Interpretation Act 1978 ("IA78"). And in any event Mr Rushworth's evidence is that no such notice was served on the appellant, and had it been necessary to do so we would have held that the appellant has proved the contrary as required by 7 IA78, ie that no service is to be deemed to have been made. We accept Mr Rushworth's evidence on this point, and find as fact that no revised assessments were made and no notice of such assessments was issued to the appellant.

77. Miss Hickey, recognising that this placed her in some difficulty, suggested that the position reverted to the original assessments of December 2015 but that she would suggest amending the figures to reflect what was proposed in April 2016 by Miss Pearce. We did not think that was the correct position as the December 2015 had been accepted by HMRC as invalid. That being so no penalties had been validly imposed.

78. We agree with Miss Hickey that HMRC are now out of time to make a new assessment.

79. In the light of Mr Matthews' statement in his review letter of 7 April 2016 that "… the *Notice* of Penalty will need to be cancelled and reissued correctly" [*Our emphasis*] we have examined the papers in depth since the hearing, having reminded ourselves of the fact that there is a distinction between an assessment and a notice of assessment

80. Schedule 24 FA 2007 applies to a large number of taxes, including income tax, corporation tax, inheritance tax, a variety of excise taxes and VAT. For procedural matters it uses a mixture of its own rules and the application of the procedural rules applying to each of the taxes covered by it when that tax is the one concerned. What the question for us is is whether the error identified by Mr Matthews in the notice of assessment must lead to the conclusion that the assessment itself is invalid. In terms Mr Matthews has impugned the *notice* of assessment and said it needs to be cancelled and reissued, not that the *assessment* is invalid and thus needs to be replaced by a new assessment.

81. Paragraph 13 Schedule 24 provides:

> "(1) Where a person becomes liable for a penalty under paragraph 1 ... HMRC shall—
>
> (a) assess the penalty,
>
> (b) notify the person, and
>
> (c) state in the notice a tax period in respect of which the penalty is assessed.
>
> …
>
> (2) An assessment—
>
> (a) shall be treated for procedural purposes in the same way as an assessment to tax (except in respect of a matter expressly provided for by this Act),
>
> (b) may be enforced as if it were an assessment to tax, and
>
> (c) may be combined with an assessment to tax.
>
> (3) An assessment of a penalty under paragraph 1 ... must be made before the end of the period of 12 months beginning with—
>
> (a) the end of the appeal period for the decision correcting the inaccuracy
>
> …
>
> (5) For the purpose of sub-paragraphs (3) and (4) a reference to an appeal period is a reference to the period during which—
>
> (a) an appeal could be brought, or
>
> (b) an appeal that has been brought has not been determined or withdrawn."

82. The notice of assessment dated 11 December 2015 clearly falls foul of paragraph 13(1)(c). The effect of an invalid notice is that the penalty charged by an

assessment cannot be enforced, and that invalidity in the notice may be cured by the issue of a fresh notice that is without the error making it invalid. The question though is whether an error in complying with paragraph 13(1)(c) necessarily invalidates the assessment.

83. There are clear indications in Schedule 24, including paragraph 13, that it does. Paragraph 13(1)(c) itself requires the notice to state the tax period "in respect of which the penalty is assessed". That makes it very difficult to imagine that the assessment is not itself required to state that period. It is also necessary for the period for which an assessment is made to be known and obtainable by HMRC from their computer record of it to enable the time limits in paragraph 13(3) to be workable. In addition paragraph 6 of Schedule 24 can only work on the basis that the period is assessed as well as notified.

84. Support for this view can be found in HMRC's Compliance Handbook at paragraph 83030. There is also some support in Miss Pearce's acts following the review. She did not simply reissue a notice or notices showing the correct period, even in respect of the periods where there was no suggestion of a change in the figures. She went again through the pre-assessment procedures of notifying the appellant of the penalties she was intending to assess. Nothing in the papers suggested she was seeking merely to amend the original assessment. She was obviously intending to make a fresh assessment for each period.

85. We consider therefore that not only was Mr Matthews right to say that the notice was ineffective, but also that the consequence is that the assessment that gave rise to the ineffective notice must also be invalid. We make the assumption that the notice faithfully reflects the assessment.

86. We did wonder about the documents dated 6 January 2016 which do show separate periods for the penalties. But there was no indication in the papers of the status of these documents and certainly none that they had been issued to the appellant.

87. It follows from this that, strictly, we do not need to go further into the penalties. But because we said at the hearing that it was possible that we might be wrong about the invalidity on the basis that the period was wrong, we considered the penalties on the basis that they had been validly assessed, even if not notified.

88. We also point out that for HMRC to succeed in having the fuel input penalty upheld they must succeed in having the Tribunal uphold the assessment to VAT, so what we say about that penalty is contingent on our decision about the assessment.

Were there inaccuracies?

89. A penalty under paragraph 1 Schedule 24 may only be imposed if there is a "document which contains an inaccuracy which amounts to, or leads to … an understatement of a liability to tax."

90. In relation to Ferry Lane, there clearly was. The sale of the land took place in June 2011 and so the relevant output tax should have been included in the return for 06/11 but was not.

91. In relation to fuel the Penalty Explanation Schedule of 18 May 2015 says the inaccuracy is "input tax – not relevant to this legal entity and insufficient supporting evidence". The reference to a legal entity is an error and relates to Fellands Gate so we ignore it. "Insufficient evidence" to allow HMRC to accept the input tax claim is not a description of an inaccuracy. It is a reason why HMRC do not accept the claim and it may be that on an appeal the Tribunal would consider that there was sufficient evidence. Later in this decision we deal with the assessment to VAT to recover input tax, but as to the penalty in relation to fuel we hold that the penalty assessment is invalid because there was no inaccuracy in the return for the period.

92. In relation to Fellands Gate the inaccuracy is "input tax – not relevant to this legal entity". The grounds for HMRC saying this are that the land was in the joint ownership of Mrs Rushworth and the appellant and that HMRC treat joint ownership as a partnership. They say that because Mrs Rushworth included all the rent received from the land in her income tax return it is only she who can claim as input tax the electricity bill payments made by the appellant.

93. The fact remains that joint ownership of land does not have the inevitable consequence that there is a partnership. The appellant informed HMRC on 8 June 2015 that there was no partnership, but that fell on stony ground. HMRC do not know and did not enquire whether Mrs Rushworth returned all the rents because she was their beneficial owner or whether she did so as trustee for the joint owners. Nor did they ask themselves why a partner in a two person partnership would receive and pay tax on all the rents, not just her share, unless it is HMRC's view that the deemed partnership is one with profit sharing arrangements which permit this. On the deemed partnership basis HMRC should at the very least have allowed 50% of the payments.

94. There are legitimate questions that HMRC could ask in a situation where a joint owner pays all the utility bills and another receives all the rent. But they were not articulated. The reasons HMRC give for there being an inaccuracy simply do not stand up to scrutiny.

95. We hold that the penalty assessment is invalid because there was no inaccuracy in the return for the period.

What is the potential lost revenue ("PLR")?

96. In the case of Fellands Gate and the fuel claim, the answer is clear – it is the amount of the input tax claimed (assuming for the moment that there was an inaccuracy) and the amount assessed. This follows from paragraph 5 Schedule 24 FA 2007.

97. As to Ferry Lane we asked Miss Hickey why Miss Pearce had said that the PLR was £5,200 obviously based on paragraph 5 when the case appeared to fall squarely within paragraph 8. This says:

"**Potential lost revenue: delayed tax**

8—(1) Where an inaccuracy resulted in an amount of tax being declared later than it should have been ("the delayed tax"), the potential lost revenue is—

(a) 5% of the delayed tax for each year of the delay, or

(b) a percentage of the delayed tax, for each separate period of delay of less than a year,

equating to 5% per year."

98. Miss Hickey agreed that this paragraph, of which she was personally unaware, seemed to apply. She agreed that Miss Pearce had not considered it.

99. The effect of this paragraph is to make the PLR 15% of £5,200 which is £780, as there were exactly three years between the period of the return that the sale should have been declared in and the one in which it was declared.

Should paragraph 6 have applied?

100. We noted at §27 that an invoice for estate agent's commission on the sale of Ferry Lane was included in the 06/14 return but was relevant to 06/11. It was not however taken into account in that part of the original assessment which related to 06/11.

101. Paragraph 6 Schedule 24 provides (relevantly):

"**Potential lost revenue: multiple errors**

...

(2) In calculating potential lost revenue where P is liable to a penalty under paragraph 1 in respect of one or more understatements in one or more documents relating to a tax period, account shall be taken of any overstatement in any document given by P which relates to the same tax period.

(3) In sub-paragraph (2)—

(a) "understatement" means an inaccuracy that satisfies Condition 1 of paragraph 1, and

(b) "overstatement" means an inaccuracy that does not satisfy that condition."

102. It follows from this that there was an overstatement in 06/14 and an understatement in 06/11 of the input tax of £320 on the estate agent's commission, so assuming paragraph 8 did not apply, the PLR would have been not £5,200 but £4,880.

Was the omission of the Ferry Lane sale VAT prompted or unprompted?

103. In her Penalty Schedule of 11 December 2015 Miss Pearce said that she accepted that the disclosure was "unprompted" because the appellant had told HMRC about it before the appellant had reason to believe HMRC had discovered it or were about to. In an email of 27 May 2016 to the appellant she confirmed that the

appellant's accountant had told her about the circumstances regarding Ferry Lane at the start of their meeting.

104. In our view this was clearly a correct view of the matter. Arguably HMRC had been told about the deferred declaration of the sale when the return for 06/14 was made because it was included there. But if that did not amount to an unprompted disclosure (it was clearly unprompted) then HMRC did not know before the accountant told them that the declaration was late nor did they have any reason to suspect that it had been late.

105. Why then did Miss Pearce change her view? It was not because the reviewing officer, Mr Matthews, had suggested it. Miss Pearce's explanation was that the decision to change the penalty to "prompted" was based on Public Notice 700/45. In particular it was based on paragraph 4.3 which, she said, says that correcting the error on a subsequent return is not a disclosure for the penalty rules. Because separate notification was not received by HMRC, the disclosure in this case was viewed as prompted.

106. What paragraph 4.3 of VAT Notice 700/45 says (relevantly) is:

> **Method 1: for errors of a net value that do not exceed £10,000, or errors of a net value between £10,000 and £50,000 that are within the limits described below**
>
> You can use this method to adjust your VAT account and include the value of that adjustment on your current VAT return …:
>
> …
>
> Correcting errors using Method 1 is not a disclosure for the purposes of the new penalties rules described at paragraph 4.1 above. If you consider that the error corrected using Method 1 was a result of careless conduct you will not be able to gain the maximum reduction of the penalty unless you also notify us separately in writing, either by letter or by completion of the form VAT652, of both:
>
> - the error
> - your grounds for seeking a reduction to the penalty
>
> This will be an unprompted or prompted disclosure depending on the circumstances."

107. What HMRC are saying here is that the entry in the 06/14 of the error does not, in their view, amount to a disclosure of it. The reference to "maximum reduction" is to the reduction to the minimum amount for a penalty as a result of the quality of the disclosure. A person makes a disclosure by among other things "telling HMRC about it" (paragraph 9(1)(a) Schedule 24). There is obviously some room for argument about a declaration in a return. If there is no accompanying material that identifies the late declared amount as late declared then we would tend to agree that that is not something which qualifies for a reduction for "telling".

108. What the last paragraph of 4.3 clearly means is that it is the letter or Form VAT652 that is the "disclosure" that is to be judged as prompted or unprompted according to its circumstances. If the letter was sent at a time when HMRC had reason to know about the error or were on the point of finding it out, then the letter etc would amount to an prompted disclosure; otherwise it would be unprompted.

109. But here there was no such letter or Form VAT652. The disclosure was made by the accountant in 2015. Paragraph 4.3 of VAT 700/45 has no bearing on the matter at all.

110. Miss Pearce's explanation is simply wrong. It is more than that: it is inexplicable given that in the same email, in the line immediately before she mentions 700/45, she confirms that Mr Apthorpe (the accountant) told her about Ferry Lane at the start of the meeting.

111. We can only assume that this was not her work. She says "The decision" to change, not "My decision".

112. We have absolutely no hesitation in saying that in our view this was an unprompted disclosure. It follows that the penalty range is that for an unprompted disclosure where the behaviour was careless (as HMRC now agree), that is from 70% to 0% (of £780, not £5,200 – see §98 or, given what we say in §101 of £732, not £4,880). As HMRC have given the maximum reduction for the quality of disclosure the penalty would be £0 were the assessment valid.

113. Whether there was ever any basis for alleging that the conduct of the appellant in this matter was deliberate is something we do not need to decide, though we rather doubt it. Mr Rushworth came armed with a lot of documents to support the appellant's argument that it was not deliberate, nor even careless. In view of our decision on the issues relating to Ferry Lane we do not need to consider those. Nor do we examine whether there were special circumstances that would justify a special reduction.

The suspension of the penalties

114. Penalties for careless, but not those for deliberate, inaccuracies may be suspended. The law here is simple and is in paragraph 14 Schedule 24:

> "(1) HMRC may suspend all or part of a penalty for a careless inaccuracy under paragraph 1 by notice in writing to P.
>
> (2) A notice must specify—
>
> (a) what part of the penalty is to be suspended,
>
> (b) a period of suspension not exceeding two years, and
>
> (c) conditions of suspension to be complied with by P.
>
> (3) HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy.

(4) A condition of suspension may specify—

(a) action to be taken, and

(b) a period within which it must be taken.

(5) On the expiry of the period of suspension—

(a) if P satisfies HMRC that the conditions of suspension have been complied with, the suspended penalty or part is cancelled, and

(b) otherwise, the suspended penalty or part becomes payable.

(6) If, during the period of suspension of all or part of a penalty under paragraph 1, P becomes liable for another penalty under that paragraph, the suspended penalty or part becomes payable."

115. The law then is unilateral: HMRC have complete discretion. In practice the position is more complicated. In the penalty explanation schedules attached to the letter of 18 May 2015, the pre-assessment letter, Miss Pearce set out the conditions of suspension that HMRC were minded to set and the period over which they would be suspended and sought the appellant's agreement by the signature and return of the form NPPS101, together with a commitment to meet the conditions.

116. On 6 October the appellant explicitly consented to the suspension, but did not complete NPPS 101. The appellant also sought clarification of what the conditions were. On 9 October 2015, five months later, Miss Pearce informed the appellant that the conditions were as shown on page 3 of schedules 2 and 3 but did not say of what numbers 2 and 3 were schedules.

117. This was it seems enough for Miss Pearce because the notice of assessment does show the penalties for Fellands Gate as suspended, and it appears implicitly the penalty for fuel, with the period of suspension being from 6 January 2016 to 5 July 2016.

118. On 21 April 2016 Miss Pearce included in her pre-assessment letter proposals for another penalty assessment including suspension of the Ferry Lane penalty but with further conditions beyond the two already proposed and agreed. However she also included proposals for the suspension of the Fellands Gate and fuel penalties even though more than half of the suspension period agreed for them had passed.

119. That was the end of the correspondence on penalties and on suspension. HMRC seem to have taken the view that the previous agreement on suspension had come to an end with the decision of the reviewing officer and no later conditions had been agreed. Certainly the fact that the previous agreement had ended on 6 July 2016 was not mentioned at all in subsequent dealings. The Statement of Case is silent on the matter.

120. There is in law no requirement for the appellant to agree to suspension or to the conditions. HMRC have an absolute discretion to decide if the conditions have been met, and if they decide they haven't there is no appeal, as Miss Pearce pointed out. Having offered to suspend the two original careless inaccuracy penalties and having received the appellant's agreement HMRC's persisting in seeking in the appeal

proceedings to impose the penalties without suspension seems to us to be unfair, unless they had evidence to show that in the period of 6 months to 6 July 2016 the conditions has not been met.

121. In view of the fact that the appellant was not legally represented, in accordance with the Tribunal's normal practice on penalty appeals we are prepared to take the appeal of 12 June 2016 as an appeal under paragraph 15(3) Schedule 24 against HMRC's decision not to suspend the penalties.

122. Under paragraph 17(4) the Tribunal may order suspension if it thinks HMRC's decision not to suspend was flawed in the judicial review sense. The problem we have is that there is no evidence that HMRC did not suspend the penalties: indeed they appeared to have done so by a notice dated 6 January 2016. The real complaint the appellants have is that HMRC have made no decision under paragraph 14(5) about whether the appellant has satisfied the conditions, or perhaps that they have, by their neglect to say anything, implicitly decided that the conditions were not met. We have no jurisdiction to declare whether that decision was flawed or otherwise unreasonable and so we cannot say that the penalties should be cancelled on the basis that the conditions have been met.

123. It may be HMRC's position is that the suspension simply ceased to operate when the original assessment was cancelled. That is a reasonable position (and supports our view of what happened to the original assessment). But it was not explained to the appellant that a suspension period would have to start again irrespective of whether they had complied with the original conditions in the period starting with 6 January 2016 and ending on 6 July. That is poor practice and arguably maladministration but not something the Tribunal can make any decision on.

Hardship

124. HMRC raised the question of the need for the appellant to make a hardship application if an assessment to VAT was in issue, and it was eventually established it was. The application was determined on 4 January 2017 by the anonymous Hardship Officer.

125. That officer quoted the law from s 84 VATA:

> "(3) Subject to subsections (3B) and (3C), where the appeal is against a decision with respect to any of the matters mentioned in section 83(1) … (p) …, it shall not be entertained unless the amount which HMRC have determined to be payable as VAT has been paid or deposited with them.
>
> …
>
> (3B) In a case where the amount determined to be payable as VAT or the amount notified by the recovery assessment has not been paid or deposited an appeal shall be entertained if—
>
> (a) HMRC are satisfied (on the application of the appellant), or

(b) the tribunal decides (HMRC not being so satisfied and on the application of the appellant),

that the requirement to pay or deposit the amount determined would cause the appellant to suffer hardship."

126. This makes it clear that the tax, in this case £69, has to be paid unless HMRC is satisfied it would cause the appellant hardship to pay it. HMRC did not decide that it would cause hardship, we imagine for the obvious reason that it would not. Instead they said that they were satisfied that the appeal should proceed without consideration of the hardship position. That is a very sensible course of action, but is not what the law requires. HMRC give no justification for not sticking to the letter of the law in these circumstances. We have no jurisdiction to overturn that decision even if we were inclined to do so.

Summary of our alternative decisions

127. On the basis that the appeals need to be decided, contrary to our decision at §85 that the assessments are invalid and that the appeals against penalties succeed as a result, we would have held that:

(1) The appeal against the Ferry Lane penalty of £780 should be reduced to £0, because the behaviour was careless but the disclosure was unprompted and a 100% reduction was due. In any case the PLR was £780 (not £5,200) reduced under paragraph 6(2) Schedule 24 by 15% of £320, ie £48 for the estate agent's commission.

(2) The Fellands Gate penalty should be cancelled because there was no inaccuracy.

(3) The fuel penalty should be cancelled because there was no inaccuracy.

The appeal against the fuel assessment

128. Some recapitulation and amplification of the facts is needed here.

129. The issue was first raised by Miss Pearce as a result of her visit to the accountant. She noted in her record of the visit that in the 06/14 return input tax of £81 was claimed which the records showed was VAT in respect of fuel. [*In all subsequent correspondence the figure is £88. We do not know which is right*]

130. In her follow up letter she sought information about the vehicles the claim related to, their owner and the use in the business.

131. In an email of 17 March 2015 the appellant told Miss Pearce that the fuel was used by Mr and Mrs Rushworth and Mrs Rushworth's stepfather in their own cars. The email said that the claim was a general one relating to fuel for various site visits.

132. In oral evidence Mr Rushworth indicated that the claim covered more than just visits in the 06/14 period, but also covered earlier periods.

133. On 18 May 2015 Miss Pearce wrote to the appellant setting out the conclusions of her compliance check.

134. On motoring expenses Miss Pearce referred the appellant to Public Notice 700/64 which she said details various methods available to enable input tax to be claimed for fuel costs. She said that when mileage records have not been kept, the options are not to claim input tax or to apply a fuel scale charge to account for private use, and that she intended to disallow the input tax of £88 for the period 06/14.

135. We pause the recitation of the facts here to say that we can find no hint in the papers that Miss Pearce was ever told by the appellant whether mileage records were kept or not (nor any hint that she asked for them).

136. As to PN 700/64 we assume that Miss Pearce was referring to paragraph 8.1:

> "**Road fuel bought for business**
>
> 8.1 My business pays for road fuel, what can I do about the VAT incurred
>
> There are 4 options but please note that you may need to restrict the amount of VAT you deduct if your business is not fully taxable:
>
> - claim the VAT charged - but strictly subject to paragraphs 8.2 and 8.3
> - claim the VAT charged - subject to paragraphs 8.2 and 8.3 and apply the fuel scale charge
> - use detailed mileage records to separate your business mileage from private mileage - see paragraph 8.4 and section 10
> - claim no input tax - see paragraph 8.6"

137. Miss Pearce did not offer the first option. As to that, paragraph 8.2 is not relevant. Paragraph 8.3 says:

> "You can claim all the VAT on road fuel … if your business funds:
>
> - fuel bought for business motoring only"

138. The penalty explanation schedule attached to the 18 May letter shows the behaviour Miss Pearce alleges:

> "As a general claim for fuel costs there is insufficient evidence that business and private use of the vehicles has been considered".

139. In response by email on 8 June 2015 the appellant said that mileage records had never been requested and could be provided.

140. Miss Pearce wrote on 17 June 2015 and asked for details of the claim to include dates, comprehensive mileage records, details of the business use, evidence that payment has been made to the directors etc for the fuel, and receipts for the fuel.

141. On 22 July the appellant sent by email "mileage records as requested". This was a list of site visits with the actual mileage and the purpose of the visit. The number of miles in total is multiplied by .45 as representing a mileage rate of 45p per

mile (to give an amount of £967.37). A note adds that the amount claimed on the VAT return was considerably less as not all receipts could be located.

142. Two points should be noted. The mileage figures are one-way (as a quick check on Google Maps as well as common sense shows) and the actual claim represents fuel costs of £440.

143. Miss Pearce's reply on 10 August now sought the remaining details other than mileage records, plus the cylinder capacity of the cars. She added that she could see no fuel expenditure in the accounts nor any payment of mileage allowance in the bank account, and so as a result she could not allow the claim.

144. On 13 August 2015 the appellant told Miss Pearce that payment was made by crediting the directors' loan accounts. She added that the claim covered a number of trips to sites acquired in the 2014/15 tax year, and gave the cc details.

145. In a letter of 22 August the appellant enclosed the fuel receipts which had details of the total mileage at the point of purchase.

146. On 18 September Miss Pearce sought yet further information to enable her review of the issue to be concluded. These were details of which trips were made during 2014/15 with a list of the journeys and dates and the type of fuel used.

147. On 6 October the appellant told Miss Pearce that she had had all the information about the trips and gave details for the fuels used by each car.

148. On 9 October Miss Pearce sought more detailed explanations. On 13 November she said she could allow the fuel for five trips, and she calculated the amount of allowable VAT by applying the "fuel advisory rate" of 0.17 to the mileage of the trip to give the fuel amount and hence the VAT element. These five trips produced allowable VAT of £18.34.

149. In his review of the matter Mr Matthews referred to the fuel claim and referred to HMRC's Guidance in VIT 55400 which refers to the four options available if "business pays for the road fuel", and he highlights the third option of using detailed mileage records.

150. He also refers to paras 8.4 and 8.9 of PN 700/64. These say:

> "**8.4 In what circumstances do I need to separate my business mileage from private mileage**
>
> If your business funds both business and private motoring and you wish to recover some of the VAT, but do not want to apply the fuel scale charge you must keep detailed mileage records to enable you to calculate how much fuel is used for business and private motoring."

and

> "**8.9 Do I need to keep records of my employees' mileage**

If they are paid a mileage allowance you must have records for each employee showing:

- the mileage travelled
- whether the journey is both business and private
- the cylinder capacity of the vehicle
- the rate of mileage allowance
- the amount of input tax claimed"

151. What neither Miss Pearce or Mr Matthews referred the appellant to was the paragraph in VAT 700/64 that applies to the situation here. That is paragraph 8.10:

"**Do I need to keep invoices when I wish to recover VAT on fuel purchased by employees on my behalf and used for business purposes**

Yes, unless your employee purchases the road fuel using fuel card, credit card or debit card provided by you as the employer.

You can recover VAT where road fuel is delivered to your employees and paid for by them on your behalf for use in your business. You must reimburse your employees for the cost of this fuel either on the basis of actual cost or by means of a mileage allowance.

From 1 January 2006, you must retain invoices issued to your employees when the fuel is delivered to them. This can be a full VAT invoice or a less detailed VAT invoice. Input tax may only be claimed on the cost of fuel for business use in making taxable supplies. As such, the invoices only need to cover this amount.

HMRC accept that the amount of the invoice in many cases will not match the input tax claim in respect of business fuel in any one claim period and invoices may cover more than one period, particularly where fuel is purchased towards the end of a period.

Clearly, a claim cannot be supported by a VAT invoice which is dated after the dates covered by the claim. This means, in practice, that it may be advisable for employers to arrange for their employees who use, or may use, their cars for business purposes to retain all fuel invoices. This will ensure that, at the end of the claim period, the value of business fuel is covered by an invoice.

The input tax deduction rules with regard to PE are unaffected by these changes.

The fuel prices per mile rates used to determine the business fuel cost remain unaffected. HMRC publish their own rates Company Cars - Advisory Fuel Rates for Company Cars [*hyperlink to a webpage*] but also accept rates set by recognised motoring agencies, for example, RAC, AA."

152. Paragraphs 8.1 to 8.9 are concerned solely with the case where it is the business that pays for the fuel, and are not relevant.

153. It seems Miss Pearce recognised this, eventually, because her proposal to allow £18.34 was based on a rate of 17p per mile which is the rate for diesel cars at the time of the claim as shown on the webpage to which the last paragraph of paragraph 8.10 refers.

154. The appellant's schedule and subsequent information including receipts for fuel seem to us to amply satisfy the evidential requirements of VAT 700/64 paragraph 8.10. But two adjustments need to be made to them. First the mileage must be doubled to cover the return trip and secondly the rate to be applied is 17p. On this basis the mileage is 4,300 which at a rate of 17 per mile gives £731. The VAT element is therefore £121. As only £88 was claimed we cancel the assessment.

Decision

155. We cancel the assessment to VAT for the period 06/14.

156. We cancel the penalty assessment for 06/11.

157. We cancel the penalty assessment for 06/13.

158. We cancel the penalty assessment for 06/14.

Costs

159. At the end of the hearing we informed the parties that on the basis of what we had read and heard we were minded to make an order for costs against HMRC. This was classified as a standard case and we can only make an order for costs if we consider that "a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings" (Rule 10(1)(b) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273 (L. 1)) ("the FTT Rules").

160. In coming to our decision we had regard to the decision of the Upper Tribunal in *Catană v HMRC*[4] [2012] UKUT 172 (TCC) (Judge Colin Bishopp) where he says:

> "7. First, the tribunal may make an order in respect of costs 'of and incidental to' the proceedings. There is no power to make an order in respect of anything else, and particularly, in the context of this case, in respect of the investigation into Mr Catanã's tax affairs which preceded the proceedings. …
>
> 8. The question whether the transfer of the Special Commissioners' jurisdiction to the First-tier Tribunal and the consequent re-writing of the relevant legislation had the result of changing the power to make a costs direction in any significant way was considered by the First-tier Tribunal in *Bulkliner Intermodal Limited v Revenue and Customs Commissioners* [2010] UKFTT 395 (TC), in which it said, at [11],

[4] The spelling of the appellant's name in the report of the case in the Upper Tribunal has a tilde (~) above the final a in the appellant's name. His name is obviously Romanian and there is no tilde in Romanian orthography. We have used what we believe is the correct diacritic.

> '... one thing that has not changed is that the Tribunal's jurisdiction continues to be limited to considering actions of a party in the course of 'the proceedings', that is to say proceedings before the Tribunal whilst it has jurisdiction over the appeal. It is not possible under the 2009 Rules, any more than in was under the Special Commissioners' regulations, for a party to rely upon the unreasonable behaviour of the other party prior to the commencement of the appeal, at some earlier stage in the history of the tax affairs of the taxpayer, nor, even if unreasonable behaviour were established for a period over which the Tribunal does have jurisdiction, can costs incurred before that period be ordered. In these respects the principles in *Gamble v Rowe* ... remain good law. That is not to say that behaviour of a party prior to the commencement of proceedings can be entirely disregarded. Such behaviour, or actions, might well inform actions taken during proceedings, as it did in *Scott and another (trading as Farthings Steak House) v McDonald* [1996] STC (SCD) 381, where bad faith in the making of an assessment was relevant to consideration of behaviour in the continued defence of an appeal.'"

161. It is clear from Rule 20 of the FTT Rules (including the heading – "Starting appeal proceedings") that in a VAT case the proceedings start when the appeal is made to the Tribunal. In this case that was on 12 June 2016. We consider that HMRC acted unreasonably in defending the proceedings, ie seeking to resist the appeal and not coming to an agreement with the appellant or withdrawing under Rule 18 of the FTT Rules, for the reasons set out below.

162. HMRC has a "Code of governance for resolving tax disputes[5]" and within that a Litigation and Settlement Strategy ("LSS")[6].

163. Paragraph 6 of the LSS says:

> "The LSS applies to all tax disputes resolved through civil procedures and to all decisions taken by HMRC in relation to such disputes, at whatever level.
>
> - Specific disputes governance arrangements within HMRC are there to give effect to the principles of the LSS in particular cases or for particular issues."

164. Paragraph 8 says:

> "**Engaging in disputes**
>
> 8. HMRC seeks to secure the best practicable return for the Exchequer, and to do that it must apply the law fairly and even-handedly. Entering into, or taking forward, disputes can contribute to maximising overall revenue flows in a fair and even-handed way.

[5] https://www.gov.uk/government/publications/resolving-tax-disputes

[6] https://www.gov.uk/government/publications/litigation-and-settlement-strategy-lss

- The objective of maximising revenue flows involves considering not only the tax at stake in the dispute itself but also – in circumstances where a precedent may be set, or where HMRC is seeking to influence customer behaviour – potential tax liabilities of the same or other customers.
- In general, HMRC will not take up a tax dispute unless the overall revenue flows potentially involved justify doing so."

165. Paragraph 15 says:

> "HMRC will aim to work disputes to the same professional standard whether or not the disputes are ultimately resolved by agreement or through litigation. *Furthermore, HMRC will not usually persist with a tax dispute unless the revenue flows potentially involved justify doing so and HMRC has a case which it believes would be successful in litigation*." [Our emphasis]

166. Paragraph 17 says:

> "Tax disputes may be resolved either by agreement or through litigation, depending on which is likely to secure the right tax most efficiently. Where there is a range of possible figures for tax due, the terms on which HMRC will settle by agreement will also take into account which outcome secures the right tax most efficiently.
>
> - In considering how to secure the right tax most efficiently, HMRC's objectives of maximising revenue flows and reducing costs will have regard to future as well as immediate revenue flows, costs and the deterrent effect on customer compliance.
> - In considering settlement terms for one dispute, HMRC will take account of the potential read across to other open or prospective disputes as well as the impact which settling the dispute could have in releasing HMRC resources to work on other disputes.
> - In order to ensure that overall current and future revenue flows and HMRC costs are not prejudiced, the terms on which disputes are resolved will take into account their likely impact on customer behaviour both generally and in relation to the customer concerned, including any question of avoidance, evasion, or a failure to take reasonable care.
> - In most cases, resolution by agreement is likely to offer the most effective and efficient outcome. However, HMRC will not compromise on its view of the law to secure agreement, and in that context there will be cases where litigation offers the most effective and efficient means of resolving disputes. In such circumstances, HMRC will seek to reach resolution of the dispute by litigation as quickly as possible."

167. In our view a failure to abide by the LSS (and in particular paragraph 15) in a material way would be unreasonable conduct by HMRC. There is one event in this case which we have found very disturbing in the context of the LSS.

168. Mr Matthews reviewed the case in accordance with s 83F VATA. His conclusions letter informed the appellant that the assessment of penalties must be cancelled and reissued. He also said that the caseworker, Miss Pearce, should reconsider her characterisation of the error relating to Ferry Lane as deliberate and consider whether it should instead be careless.

169. Although this was not an instruction as such we do not imagine that caseworkers would ignore such a heavy hint, and indeed Miss Pearce did not: she explained in the penalty explanation letter of 21 April 2016 and the schedule with it that she now characterised the inaccuracy as careless.

170. Treating the inaccuracy as careless coupled with continuing to treat the disclosure as unprompted and continuing to give the maximum reduction for the quality of disclosure would have reduced the penalty to nil.

171. The penalty for Ferry Lane at £1,040 was by far the largest element in the dispute. Tax and penalties on the other three totalled less than £100. We understand from what Miss Hickey told us that a figure of less than £100 was below, and well below, the kind of figure which HMRC view as one which would comply with the last sentence of paragraph 15 of the LSS.

172. The dispute was not however settled by agreement or withdrawal of the assessments once this was realised. Instead Miss Pearce said that HMRC's view of the disclosure had changed and it was now considered to be "prompted". Such a characterisation would give a penalty of £780 which was clearly sufficiently high to meet the requirements of paragraph 15 of the LSS.

173. HMRC is probably entitled to take the view that when raising a new assessment it can reconsider its position. This particular change of position is disturbing for two reasons.

174. One is that it was not explained to the appellant. In her letter of 21 April 2016 Miss Pearce's refers clearly to the change to "careless". She does not mention the change to "prompted". Instead it was apparent only from a close scrutiny of the single penalty explanation schedule where it is contained in one line "The information was given to HMRC with prompting". There is no explanation as there was in the separate detailed penalty schedules attached to the original pre-assessment letter of 18 May 2015 (see §18) and which detailed schedules are the invariable norm in all Schedule 24 FA 2007 cases we have seen. We could perhaps have understood the failure to send detailed schedules if the proposed assessments would be the same in all respects as the impugned ones, but they weren't.

175. The other reason we find what happened disturbing is that when the appellant spotted the change they were given an explanation which simply beggars belief as an appropriate response (see §109). It involves a flagrant misreading of a passage from a

VAT Notice and a complete ignoring of an admission Miss Pearce had made in the previous line.

176. As Miss Pearce seems to have distanced herself from this explanation, we can only assume that it was dictated to her by her superiors.

177. We consider, having thought about this long and hard, that there are two possible explanations for this volte face. One is that there was incompetence on a grand scale. The other is that there was a deliberate decision to keep the dispute alive, when on the basis of the reviewing officer's remarks it would have been discontinued, by seeking to revisit the "prompted" issue. The facts that have caused us not to dismiss this possibility include the minimal information about the change with no explanation and the hopelessly muddled response with its spurious justification that Miss Pearce sent when the appellant spotted the change. Of course we have had no evidence from those involved and do not intend in this decision to make any findings about the matter. But it is something we have to take into account in deciding whether HMRC's conduct in this case was unreasonable.

178. The change of mind about whether the disclosure was "prompted" happened between 7 and 18 April 2016 ie before the start of proceedings. But we consider that once proceedings started HMRC were bound to ask themselves if the proceedings should be defended and to take the LSS into account. At that point Miss Pearce or those superior to her, knowing that the disclosure of Ferry Lane had been properly classified by Miss Pearce as unprompted, should have asked themselves whether it was proper for a department that prides itself on its dispute governance procedures to continue to defend these proceedings and should have come to the view that it shouldn't.

179. We also considered whether Miss Hickey or those superior to her should have unilaterally (ie overriding Local Compliance) decided to withdraw. Miss Hickey told us that she had reservations about the case but was told that it was a decision for Local Compliance whether to defend or not. Miss Hickey did her best to put HMRC's case and did so in a professional manner. We have no criticism of her personally.

180. Under Rule 10(5) of the FTT Rules we:

> "may not make an order under paragraph (1) against a person (the "paying person") without first—
>
> (a) giving that person an opportunity to make representations;"

181. If HMRC wish to make representations they must do so by 31 October 2017 (we have taken into account here the future commitments of Miss Hickey which she informed us of).

182. We would expect that any representations would include a full account (with copies) of all communications within HMRC following the receipt by Local Compliance of a copy of Mr Matthews review conclusions (including any communications from Mr Matthews to Local Compliance) that discussed in any way

the recharacterisation of the disclosure to "prompted" and the behaviour to "careless" in relation to Ferry Lane, including in particular those relating to the formulation of the response to the appellant's email of 22 May 2016. It should also include any communications within and between Local Compliance and Solicitor's Office concerning the recharacterisation at any time up to the date of the hearing.

183. 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.

RICHARD THOMAS
TRIBUNAL JUDGE

RELEASE DATE: 27 JULY 2017

SCHEDULE 24

PENALTIES FOR ERRORS

PART 1

LIABILITY FOR PENALTY

Error in taxpayer's document

1 (1) A penalty is payable by a person (P) where—

(a) P gives HMRC a document of a kind listed in the Table below, and

(b) Conditions 1 and 2 are satisfied.

(2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to—

(a) an understatement of a liability to tax,

…

(3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.

(4) Where a document contains more than one inaccuracy, a penalty is payable for each inaccuracy.

Tax	*Document*
VAT	VAT return under regulations made under paragraph 2 of Schedule 11 to VATA 1994.
VAT	Return, statement or declaration in connection with a claim.

Degrees of culpability

3 (1) For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is—

(a) "careless" if the inaccuracy is due to failure by P to take reasonable care,

(b) "deliberate but not concealed" if the inaccuracy is deliberate on P's part but P does not make arrangements to conceal it, …

…

(2) An inaccuracy in a document given by P to HMRC, which was neither careless nor deliberate on P's part when the document was given, is to be treated as careless if P—

(*a*) discovered the inaccuracy at some later time, and

(*b*) did not take reasonable steps to inform HMRC.

PART 2

AMOUNT OF PENALTY

Standard amount

4 (1) This paragraph sets out the penalty payable under paragraph 1.

(2) ... the penalty is—

(a) for careless action, 30% of the potential lost revenue, ...

(b) for deliberate but not concealed action, 70% of the potential lost revenue, …

…

Potential lost revenue: normal rule

5 (1) "The potential lost revenue" in respect of an inaccuracy in a document ... is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy ... .

Reductions for disclosure

9 (1) A person discloses an inaccuracy ... by—

(a) telling HMRC about it,

(b) giving HMRC reasonable help in quantifying the inaccuracy ..., and

(c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy ... is fully corrected

(2) Disclosure—

(a) is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy... and

(b) otherwise, is "prompted".

(3) In relation to disclosure "quality" includes timing, nature and extent.

10 (1) If a person who would otherwise be liable to a penalty of a percentage shown in column 1 of the Table (a "standard percentage") has made a disclosure, HMRC must reduce the standard percentage to one that reflects the quality of the disclosure.

(2) But the standard percentage may not be reduced to a percentage that is below the minimum shown for it—

(a) in the case of a prompted disclosure, in column 2 of the Table, and

(b) in the case of an unprompted disclosure, in column 3 of the Table.

Standard %	*Minimum % for prompted disclosure*	*Minimum % for unprompted disclosure*
30%	15%	0%
70%	35%	20%

Special reduction

11 (1) If they think it right because of special circumstances, HMRC may reduce a penalty under paragraph 1 ....

(2) In sub-paragraph (1) "special circumstances" does not include—

(a) ability to pay, or

(b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

(3) In sub-paragraph (1) the reference to reducing a penalty includes a reference to—

(a) staying a penalty, and

(b) agreeing a compromise in relation to proceedings for a penalty.

PART 3

PROCEDURE

Assessment

13(1) Where a person becomes liable for a penalty under paragraph 1 ... HMRC shall—

(a) assess the penalty,

(b) notify the person, and

(c) state in the notice a tax period in respect of which the penalty is assessed ....

(2) An assessment—

(a) shall be treated for procedural purposes in the same way as an assessment to tax (except in respect of a matter expressly provided for by this Act),

(b) may be enforced as if it were an assessment to tax, and

(c) may be combined with an assessment to tax.

(3) An assessment of a penalty under paragraph 1 ... must be made before the end of the period of 12 months beginning with—

(a) the end of the appeal period for the decision correcting the inaccuracy, or

(b) if there is no assessment to the tax concerned within paragraph (a), the date on which the inaccuracy is corrected.

(5) For the purpose of sub-paragraph[.] (3) ... a reference to an appeal period is a reference to the period during which—

(a) an appeal could be brought, or

(b) an appeal that has been brought has not been determined or withdrawn.

(6) Subject to sub-paragraph[ ] (3) ..., a supplementary assessment may be made in respect of a penalty if an earlier assessment operated by reference to an underestimate of potential lost revenue.

Suspension

14 (1) HMRC may suspend all or part of a penalty for a careless inaccuracy under paragraph 1 by notice in writing to P.

(2) A notice must specify—

(a) what part of the penalty is to be suspended,

(b) a period of suspension not exceeding two years, and

(c) conditions of suspension to be complied with by P.

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

(4) A condition of suspension may specify—

(a) action to be taken, and

(b) a period within which it must be taken.

(5) On the expiry of the period of suspension—

(a) if P satisfies HMRC that the conditions of suspension have been complied with, the suspended penalty or part is cancelled, and

(b) otherwise, the suspended penalty or part becomes payable.

(6) If, during the period of suspension of all or part of a penalty under paragraph 1, P becomes liable for another penalty under that paragraph, the suspended penalty or part becomes payable.

Appeal

15 (1) A person may appeal against a decision of HMRC that a penalty is payable by the person.

(2) A person may appeal against a decision of HMRC as to the amount of a penalty payable by the person.

(3) P may appeal against a decision of HMRC not to suspend a penalty payable by P.

(4) P may appeal against a decision of HMRC setting conditions of suspension of a penalty payable by P.

16 (1) An appeal under this Part of this Schedule shall be treated in the same way as an appeal against an assessment to the tax concerned (including by the application of any provision about bringing the appeal by notice to HMRC, about HMRC review of the decision or about determination of the appeal by the First-tier Tribunal or Upper Tribunal).

(2) Sub-paragraph (1) does not apply—

(a) so as to require P to pay a penalty before an appeal against the assessment of the penalty is determined, or

(b) in respect of any other matter expressly provided for by this Act.

17 (1) On an appeal under paragraph 15(1) the ... tribunal may affirm or cancel HMRC's decision.

(2) On an appeal under paragraph 15(2) the ... tribunal may—

(a) affirm HMRC's decision, or

(b) substitute for HMRC's decision another decision that HMRC had power to make.

(3) If the ... tribunal substitutes its decision for HMRC's, the ... tribunal may rely on paragraph 11—

(a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or

(b) to a different extent, but only if the ... tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed.

(4) On an appeal under paragraph 15(3)—

(a) the ... tribunal may order HMRC to suspend the penalty only if it thinks that HMRC's decision not to suspend was flawed, and

(b) if the ... tribunal orders HMRC to suspend the penalty—

(i) P may appeal against a provision of the notice of suspension, and

(ii) the ... tribunal may order HMRC to amend the notice.

(5) On an appeal under paragraph 15(4) the ... tribunal—

(a) may affirm the conditions of suspension, or

(b) may vary the conditions of suspension, but only if the ... tribunal thinks that HMRC's decision in respect of the conditions was flawed.

(5A) In this paragraph "tribunal" means the First-tier Tribunal or Upper Tribunal (as appropriate by virtue of paragraph 16(1)).

(6) In sub-paragraphs (3)(b) ... "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.

(7) Paragraph 14 (see in particular paragraph 14(3)) is subject to the possibility of an order under this paragraph.

...

PART 5

GENERAL

Interpretation

…

22 Paragraphs 23 to 27 apply for the construction of this Schedule.

23 HMRC means Her Majesty's Revenue and Customs.

…

27 An expression used in relation to VAT has the same meaning as in VATA 1994.

28 In this Schedule—

…

(g) "tax period" means a tax year, accounting period or other period in respect of which tax is charged,

...

..."