[2017] UKFTT 691 (TC)

TC06110

Appeal number: TC/2015/04250

Costs – Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, rule 10(1)(b) – withdrawal from appeal by HMRC – whether unreasonable conduct – conduct during ADR – whether unreasonable conduct

FIRST-TIER TRIBUNAL
TAX CHAMBER

SUSSEX CARS ASSOCIATION **Appellant**

- and -

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

TRIBUNAL: JUDGE ABIGAIL MCGREGOR

Sitting in public at Taylor House, London on 7 September 2017

George Rowell, of Counsel, for the Appellant

Keith Goulder of HM Revenue and Customs, for the Respondents

DECISION

1. This is an application by the applicants, Sussex Cars Association (**Sussex Cars**) for the costs incurred in relation to an appeal by them concerning the applicability of VAT to certain supplies and, either as part of the same application or separately, of the costs of the alternative dispute resolution (**ADR**) procedure conducted on the same matter.

Background facts and timeline

2. HMRC commenced enquiries into Sussex Cars' VAT position in the tax year 2012-13. These enquiries gave rise to VAT assessments, raised in February 2014 and varied on review in June 2015. The assessments amounted to just under £1.4m.

3. Sussex Cars submitted a Notice of Appeal to the First-tier Tax Tribunal on 9 July 2015 (referred to in this decision as the **Appeal**) alongside an application to enter ADR on the same day.

4. The parties did enter into ADR, which was ultimately unsuccessful (further findings of fact in this regard are set out in the section below on the ADR costs).

5. The Appeal therefore resumed and HMRC served its Statement of Case and list of documents on 1 September 2016.

6. In November 2016, Sussex Cars submitted a claim for Judicial Review in relation to the same VAT matters, claiming legitimate expectation based on the statements of VAT officers in earlier visits to Sussex Cars (referred to in this decision as the **JR claim**).

7. HMRC withdrew its defence of the Appeal on 14 December 2016 (further findings of fact in relation to the reasons for this withdrawal are set out below).

8. Sussex Cars made an application for costs, dated 7 February 2017. Following an exchange of a schedule of costs and HMRC's reply, Sussex Cars requested the application be determined at a hearing. That request was granted.

Evidence

9. The Tribunal was presented with a bundle of documents, including a large amount of correspondence between the parties. No witness statements were served.

Law

10. Rule 10(1)(b) of the Tribunal Procedure Rules provides that the Tribunal can make a costs order:

> "if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings ..."

11. There are a number of case law authorities on the interpretation and application of this legal principle, to which I was referred by both parties, most notably the decisions of the Upper Tribunal in *Shahjahan Tarafdar (t/a Shah Indian Cuisine) v Revenue and Customs Commissioners [2014] UKUT 0362 (TCC)* (***Tarafdar***) and *Cataña v HMRC [2012] UKUT 172 (TC)*(***Catana***).

12. Mr Rowell sought to rely on *Tarafdar* to support Sussex Cars' application, whereas Mr Goulder, on behalf of HMRC, sought to argue that *Tarafdar* cannot apply to a case such as this. I deal with this question first.

Scope of application of Catana and Tarafdar

13. The parts of case law under consideration were:

(1) Dicta of Judge Bishopp in *Catana* at para 14:

> "Mr Catanã has made a number of points about the phrase 'bringing, defending or conducting the proceedings'. It is, quite plainly, an inclusive phrase designed to capture cases in which an appellant has unreasonably brought an appeal which he should know could not succeed, a respondent has unreasonably resisted an obviously meritorious appeal, or either party has acted unreasonably in the course of the proceedings, for example by persistently failing to comply with the rules or directions to the prejudice of the other side."

(2) Dicta of Judges Berner and Powell in *Tarafdar* at para 34

> In our view, a tribunal faced with an application for costs on the basis of unreasonable conduct where a party has withdrawn from the appeal should pose itself the following questions:
>
> (1) What was the reason for the withdrawal of that party from the appeal?
>
> (2) Having regard to that reason, could that party have withdrawn at an earlier 40 stage in the proceedings?
>
> (3) Was it unreasonable for that party not to have withdrawn at an earlier stage?

14. Mr Goulder submitted that:

(1) The dicta in *Catana* create two limbs upon which a claim for costs can be made against HMRC as respondents in tax appeals, namely:

> (a) That HMRC has unreasonably resisted an obviously meritorious appeal, and
>
> (b) That HMRC's conduct in the course of proceedings has been unreasonable, including consistent failure to comply with directions;

(2) the three question formulation in *Tarafdar* for establishing liability for costs only applies to claims that fall under the first limb, ie defending obviously meritorious claims; and

(3) since Sussex Cars is not arguing that HMRC was unreasonable defending a meritorious claim, *Tarafdar* cannot apply in this case.

15. Mr Rowell submitted that:

(1) The dicta in *Catana* are helpful statements interpreting the meaning of the statutory words and do not, either explicitly or implicitly, create a two limb test at all, and even if it did, they would not be mutually exclusive; and

(2) While it is true that *Tarafdar* was a case in which the question of the merit of the appeal was core, and indeed most of the other cases were similar, there is nothing in that case or others applying it, that implies it is limited to those circumstances.

16. I agree with Mr Rowell, that the decisions in *Catana* and *Tarafdar* should not be read in the manner suggested by Mr Goulder. The only question for me to determine is whether HMRC acted unreasonably in bringing, defending or conducting the proceedings in question. That is a single test and the comments in *Catana* do not, and do not attempt to, divide it into a pair of mutually exclusive tests. This is supported by the immediately following paragraph in the *Catana* decision, which reads:

> "I cannot see that there is any possible criticism to be made of Judge Kempster's interpretation or application of the phrase. He quite clearly asked himself whether there was anything in HMRC's conduct, in resisting the appeal or in dealing with the matter before the tribunal, which merited the making of a costs direction against them, and decided that there was not. Thus he asked himself the right question, and answered it."

17. In answering the single question that I face, I find the dicta of Judge Bishopp to be helpful as an elucidation of what is meant by 'bringing, defending or conducting'. The words in *Tarafdar* are also, in my opinion, self explanatory. They set out questions to be considered where a party has withdrawn from an appeal. They are not limited to withdrawal on the grounds of merit. As such, I find the 3 questions set out in *Tarafdar* to be a useful way of determining whether the conduct relating to withdrawal in the particular circumstances of this case is unreasonable.

18. In addition, I do not find it remotely surprising that much of the case law on costs applications deals with claims arising out the withdrawal from cases where HMRC has concluded that it cannot defend the case on its merits. That preponderance does not lend any weight to the argument that other types of withdrawal should not also, in theory, give rise to a claim for costs.

19. Having come to that conclusion, I will now consider each of the three questions in *Tarafdar*.

What was the reason for the withdrawal?

20. The question of the reason for the withdrawal is contentious and formed a large part of the submissions made before me.

21. As there were no witnesses or witness statements, I make this decision based on the following pieces of contemporaneous correspondence all dated 14 December 2016:

(1) A letter from Mr Hathaway, a solicitor for HMRC who was dealing with the JR claim, to Sussex Cars (the **Hathaway letter)**;

(2) A letter from Mr Shea, a lay advocate for HMRC who was dealing with the Appeal, to Sussex Cars (the **Shea letter**); and

(3) A letter from Mr Shea to the Tribunal (the **Tribunal letter**).

22. In summary:

(1) HMRC contended that the reason for withdrawal was that, following the issue of the JR claim, HMRC decided that, given the fact that the recovery of the VAT from Sussex Cars was likely to be cash neutral (which I expand upon further below), the costs of defending both the Appeal and the JR claim made it economically unjustifiable to continue; whereas

(2) Mr Rowell submitted that the reason for withdrawal was that HMRC had, newly, realised that the outcome of the appeal would be cash neutral as a result of the section 33/unjust enrichment arguments.

The stated reasons

23. Given the importance of this point and the brevity of the reasons given in the three letters, I set out below the full text of the relevant parts of the three letters, with emphasis added to draw attention to the specific words or phrases highlighted by the parties in their submissions:

(a) The Hathaway Letter

> "Following advice from this office HMRC has decided to withdraw from defending the tribunal proceedings brought by the Assocation. HMRC is required to file its acknowledgment of service and defence to the judicial review proceedings not later than 23rd December but as you will appreciate those proceedings have now become superfluous.
>
> …
>
> "However, we consider that there is an entirely different argument, not identified in the pleadings, which may be capable of providing the Association with a defence in the tribunal. That is that the Commissioners would be unjustly enriched if there were successful in

recovering sums by way of VAT from the Association which the Association is contractually or otherwise unable to recover from the council or councils to which it has provided services. The Commissioners consider that it is HMRC's roles to administer the tax system fairly and to collect tax in accordance with the law, not to take advantage of all possible technical points in order to secure a win in its litigation, and they are bound to take into account an argument potentially available to the Association even if the Association itself has not identified it. For that reason, and for no other, they are withdrawing from the tribunal appeal."

(b) The Shea Letter

We have reviewed our position on this case and formed the view that there could be two practical conclusions to the litigation before the tribunal.

1. The Association may be able to re-charge VAT to the council on its supplies. In that case Section 33(1) VATA 1994 enables the council to reclaim that VAT from HMRC. This results in no net gain to the public revenue.

2. The Association may be unable to re-charge the VAT to the council, wholly or in part, either because there is no contractual entitlement to do so, or because of limitation periods. Hence there would be no repayment claim from the council because it will not have paid the VAT. In that case, any VAT recovered by HMRC would result in a net windfall to HMRC that the legislation does not contemplate it getting. This potentially gives rise to the defence of unjust enrichment. We observe in passing that at no time have your clients put forward such a defence; it is however HMRC's role to administer the tax system fairly and to collect tax in accordance with the law, not to take advantage of all possible technical points in order to secure a win in its litigation.

It remains our view that the Association is correctly chargeable to VAT on the supplies to the council. However the Respondents have decided that it is not economically justified in the circumstances to continue to defend the appeals before the Tribunal at the current time.

(c) The Tribunal Letter

> Having considered new arguments that have occurred to the Respondents; the Respondents have decided that they no longer wish to defend the appeal and to withdraw.

24. Both parties asserted that these statements supported their opposing contentions.

25. In particular, Mr Goulder submitted that:

(1) Mr Hathaway had no responsibility for the Appeal and therefore his letter referred only to the JR claim and is not relevant to the question of the reason for withdrawal from the Appeal;

(2) The Shea letter was the vital letter and the words 'economically justified' were the vital words, which explained the real reason for the withdrawal;

(3) The reference to 'the appeals before the Tribunal' in the Shea Letter included the JR claim as well as the Appeal and therefore supported his argument that it was the combination of costs that arose because of the two sets of litigation that had driven the decision; and

(4) The section 33/unjust enrichment argument was only one of the matters taken into consideration in the decision in HMRC and that it had 'perhaps been given too high a prominence' in the written correspondence.

26. Mr Rowell, on the other hand, submitted that:

(1) Both the Hathaway letter and the Shea letter were important explanations of the reasons for withdrawal from the Appeal;

(2) The statements in the Hathaway letter set out above clearly relate to the Appeal, rather than the JR claim, which was the subject of the rest of the letter, and the statement 'for this reason and no other' is unequivocal;

(3) The statement in the Shea letter about 'economically justified' relates to the cash neutral point, rather than the extra costs of the JR claim; and

(4) The Tribunal letter reference to 'new arguments that have occurred to the Respondent' can only relate to the section 33/unjust enrichment argument and not to commercial decisions relating to extra costs of the JR claim.

27. I find Mr Goulder's attempts at interpreting the clear words in the three letters at best to be forced, but more likely, a disingenuous attempt to undermine the importance of the section 33/unjust enrichment argument in HMRC's decision to withdraw. The suggestion that Mr Hathaway, in the second paragraph quoted above, is somehow still referring to the JR claim when he says "For that reason, and for no other, they are withdrawing from the tribunal appeal" is absurd. The first paragraph of the same letter quoted above clearly sets out that the advice in relation to the Appeal is being given by the Solicitors office and that Mr Hathway has a clear grasp of the difference between judicial review proceedings and tribunal appeals.

28. Similarly the suggestion that Mr Shea was referring to both the JR claim and the Appeal in his statement 'the appeals before the Tribunal' is also absurd, not least because at the date of the letter, the position on the JR claim was that HMRC had requested Sussex Cars to withdraw their claim, not that HMRC had decided not to defend it.

29. The wording of those letters is clear: someone in HMRC, most likely Mr Hathaway, had realised that the combined effect of section 33, the concept of unjust enrichment and their own policy where an appeal is likely to result in a cash neutral situation, meant that HMRC should not continue to defend the Appeal. I find that this was the reason that the defence of the Appeal was withdrawn and that, while it might be true that the bringing of the JR claim had caused HMRC to reconsider its position, the potential for additional costs arising in relation to the JR claim was not the overriding reason for the withdrawal.

Could the withdrawing party have withdrawn at an earlier stage in proceedings?

30. Mr Rowell submitted that there were no new facts or developments on which the section 33/unjust enrichment argument arose and that it had always been clear that the counterparty to the arrangements was a local authority that fell within VATA 1994, s 33. He submitted, therefore, that HMRC could have withdrawn the defence of the Appeal at any time since the Notice of Appeal was given.

31. He also noted that the section 33 point had been raised by Sussex Cars at the ADR process, albeit only in passing since it is not (and all parties appeared to accept this) a defence for Sussex Cars against the VAT assessments because it is a claim for repayment by the local authority, not by Sussex Cars.

32. Mr Goulder submitted that HMRC could not have withdrawn earlier because the reason to withdraw only arose once the JR claim had been filed. As noted above, I do not accept that the reason for withdrawal was the additional costs associated with the JR claim, I therefore cannot find that the withdrawal was necessarily linked to the JR claim.

33. I do accept that the section 33/unjust enrichment point was not understood by HMRC until after the JR claim was filed, but I find that that was not because of the increased costs arising from defending a JR claim, but rather because the case was finally considered by a legally qualified member of staff, Mr Hathaway, because there had been a JR claim. Mr Goulder accepted at the hearing that that was the case, because JR claims automatically get sent to a legally qualified member of staff, whereas tribunal appeals can be managed, as in this case, by a lay advocate.

34. Therefore I find that HMRC could have withdrawn its appeal earlier if it had sought legal advice earlier in the process of the Appeal.

Was it unreasonable for the withdrawing party not to have withdrawn at an earlier stage?

35. Having made the finding at paragraph 34, the question to be considered here was whether it was reasonable for HMRC not to have sought legal advice, whether internally or externally, before early December 2016, following the filing of the JR claim and approximately 16 months after the Notice of Appeal was filed.

36. Mr Rowell submitted that this was a case of considerable value, being just under £1.4m VAT at stake, and a reasonable level of complexity and therefore it was not a reasonable course of action for HMRC to take. He submitted that in assessing the reasonableness of HMRC, the relevant characteristics of HMRC as a litigant should include its substantial experience in conducting litigation and ready access to advice from specialist solicitors and counsel.

37. He also submitted that HMRC are under an obligation to make a rigorous assessment of whether to defend an appeal when it is brought and continue to keep that assessment under review as the appeal progresses, relying on paragraph 73 of *Carvill v Frost (Inspector of Taxes) [2005] SCD 208*, in which the Special Commissioners stated:

> "It seems to us, however, at least in the circumstances of this case, that where we are required to determine the reasonableness or otherwise of the Revenue's conduct in pursuing a case from which it eventually decided to withdraw, internal action, such as the adequacy or otherwise of a review of the issues on which the Revenue's case is founded and which is carried whilst the appeal is within the jurisdiction of this Tribunal, is directly relevant to the findings we are required to make as to the Revenue's conduct."

38. HMRC's only argument on these grounds was that, since it submitted that it could not have withdrawn earlier, it cannot have been unreasonable. However Mr Goulder did assert that a party to litigation should always be free to walk away from it and that is particularly true of HMRC, which has to consider the additional question of its use of public funds in pursuing litigation.

39. The reason for withdrawal in this case is not the 'usual' reason that arises in costs applications, where one party or the other concludes at some point in the run up to a hearing that they are unlikely to win because the grounds put forward by the other side are so strong, ie a withdrawal based on the merits of the other party's case.

40. In this case, the reason for withdrawal did not concern the merits of Sussex Cars' case, in fact HMRC continues to assert that its assessment of the VAT liabilities on the supplies in question is and always has been correct. Instead it was based on HMRC's internal processes, which in some circumstances require it to withdraw from proceedings because it would not be a good use of public funds.

41. I do not agree with Mr Goulder's submission that HMRC are somehow a special case because it needs to consider the use of public funds. A taxpayer bringing an appeal has to make exactly the same assessment regarding funds, i.e. is the money it

would save on winning an appeal be enough to justify the expenditure on securing the victory.

42. I agree with Mr Goulder that a party to litigation should always be free to walk away, but I also agree with Mr Rowell that that freedom does not release the person from the consequences of doing so, i.e. the possibility of costs if the conduct in coming to that conclusion is unreasonable.

43. While it is unusual for HMRC to withdraw from an appeal on grounds unrelated to the merit of the appeal, I do not consider that this makes the decision somehow automatically reasonable because it relates to pragmatism or economic considerations. The economic and pragmatic considerations in the Appeal, in particular the potential for the outcome to be cash neutral for HMRC (ignoring costs of course) were matters that were just as relevant at the date the Notice of Appeal was issued as they were at the date HMRC withdrew their defence. In a case of this size, and where the matters at hand were certainly not plain and simple, it was not reasonable for HMRC not to obtain appropriate legal advice to enable these issues to be identified earlier.

Decision

44. Accordingly, I am satisfied that I should exercise my discretion, in accordance with rule 10(1)(b), to make a direction that HMRC are to pay Sussex Cars' costs of and incidental to the proceedings before the FTT, including the ADR process. HMRC had raised some concerns about the quantum of costs and the dates on which they were incurred and that they should therefore fall outside the confines of what may be directed in accordance with rule 10(1)(b). For that reason I direct that the costs shall be the subject of detailed assessment, on the standard basis, by a costs judge of the Senior Courts, if they cannot be agreed between the parties.

ADR costs

45. Given the decision made above, it is not strictly necessary for me to make a separate decision in relation to the ADR costs. However, having heard submissions on it, I set out briefly my thoughts on the ADR costs.

46. As noted above, Sussex Cars and HMRC entered an ADR process in the early stages of the Appeal and the progress to litigation was suspended while this occurred.

47. The basic facts were agreed by both parties:

(1) An ADR meeting lasting approximately 4 hours took place, at which the HMRC officers present were unable to:

(a) Consider the complex contractual matters in dispute or any case law; or

(b) Make any agreement other than that set out in the HMRC decision on review that was under appeal.

48. At the end of the ADR meeting, an exit agreement was signed in which HMRC committed to send submissions to its policy team, after having sent the draft submission to Sussex Cars' representative "for her comments".

49. The draft submission was sent to Sussex Cars' representative, who made comments on it.

50. When the submission was made to the HMRC policy unit, it included none of Sussex Cars' comments, rather attaching the opening statement that had been exchanged in advance of the ADR meeting.

51. Sussex Cars made a formal complaint about HMRC's handling of the ADR process, which was partly upheld. The complaint upheld was that the wrong HMRC representatives were sent to the meeting and it would have been more beneficial if a technical lead officer had attended instead. The complaint regarding the implementation of the exit agreement was not upheld.

52. HMRC submit that sending the wrong officers to the ADR meeting had no detrimental effect on Sussex Cars and that the submission to policy afterwards meant that any issues raised during the ADR process were fully considered by HMRC. The fact that the outcome of that process was no movement on HMRC's side does not mean that the process was futile.

53. Mr Rowell submits, on behalf of Sussex Cars, that:

(1) sending officers without the necessary expertise to address the key issues of the case and who did not have any power to depart from the review decision rendered the whole meeting futile and doomed to failure;

(2) HMRC failed to comply with the exit agreement by not taking into account the comments made by Sussex Cars' representatives, and

(3) The policy decision in response merely restated the substance of the review decision.

54. The costs of ADR are simply a subset of the costs of conducting proceedings since they all occurred after the filing of the Notice of Appeal (hence there is no need to make a separate decision on these points, save for the reasons highlighted above). The question to be assessed therefore remains the same, that is whether HMRC's conduct was unreasonable. If I had to make a separate decision I would find that the decision of HMRC to send officers who were unable to engage in the technical subject matter of the case or vary the position of HMRC in any way is effectively failing to engage in the ADR process at all, while at the same time putting Sussex Cars to the cost and effort of engaging in it. That is not reasonable and therefore, if it had been necessary, I would make the same direction as to costs as I make above in relation to the wider FTT proceedings.

Rights of appeal

55. 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.

ABIGAIL MCGREGOR
TRIBUNAL JUDGE

RELEASE DATE: 13 September 2017