TC03638

Appeal number: TC/2013/03647

VAT – Flat Rate Scheme – Whether Appellant company as mechanical engineers fell to be categorised as "architect, civil and structural engineer or surveyor" – No – Appeal allowed and assessment and penalty set aside – Sections 26B and 83(1)(fza) VATA 1994 and VAT Regulations 1995, nos 55A – 55K

FIRST-TIER TRIBUNAL
TAX CHAMBER

IDESS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE KENNETH MURE, QC
MR PETER WHITEHEAD

Sitting in public at 44 The Parsonage, Manchester on Friday 14 March 2014

Glyn Edwards, AIIT, for the Appellant company

Mrs Lisa Fletcher, Senior Officer of HMRC, for the Respondents

DECISION

Introduction

1. The Appellant company in this appeal applied to join the Flat Rate Scheme ("FRS") with effect from April 2009. It categorised itself as conducting "any other activity not listed elsewhere" in Regulation 55K(4) of the VAT Regulations, 1995, with a consequent liability of 9% on its turnover. Under the FRS there are different rates of tax for various types of business, reflecting the varying amounts of output and input tax likely to be borne by them.

2. The appeal relates to an assessment of £8,891 made by HMRC following on its decision to re-categorise the Appellant's activities as "architect, civil and structural engineer or surveyor" with the higher rate of 12½%. In addition a penalty was imposed. This was reduced from 35% to 15% following an internal review by HMRC on the basis that the error was *careless* rather than *deliberate but not concealed*.

3. Mr Edwards addressed us helpfully at the outset. His stance was that HMRC had incorrectly categorised the Appellant company's business as that of an "architect, civil and structural engineer or surveyor" for the purposes of the FRS. That could be reviewed by the Tribunal in terms of Section 83(1)(fza)VATA. Further, and in any event, if the Appellant company had reasonably categorised its business as "any other activity not listed elsewhere", then that was relevant in considering whether any penalty was appropriate.

4. The Appellant company had registered for VAT in January 2001 as an "Engineering & Design Consultancy" (page 46). In April 2009 it had applied to join the FRS, classifying its main business activity as "any other activity not listed elsewhere" (p44). This had been challenged by HMRC, whose officers carried out an inspection, but the Appellant company maintained its stance. Mr Edwards noted Section 26B VATA which set out the FRS Scheme: that required the relevant activity to have been determined at the outset and then reviewed annually or in the event of a change of business activity.

Evidence

5. The only witness was Mr Neil Harris who read out and explained his Witness Statement. (It is produced at p125-130). He and his wife are the co-directors and shareholders of the Appellant company. After serving an apprecenticeship as a mechanical fitter he completed City & Guilds and ONC and HNC courses in mechanical engineering. After qualifying he worked as a mechanical fitter, also undertaking work of a planning engineer. He is experienced in general maintenance and repair tasks involving machinery. He has not been involved in the repair or maintenance of buildings, however.

6. In about 2000 Mr Harris set up his own business, working mainly for his former employer. He saw scope for developing a design engineering business. In about March 2009 the company secured a contract with a major contractor working at the Sellafield Nuclear site. This related to the detailed design for a vehicle stopping system. Mr Harris contributed to this work by creating animations to illustrate the effectiveness of the design and generally assist the design process. In selecting the appropriate category for FRS Mr Harris had taken the advice of his accountant. He did not consider that the category "architects, civil and structural engineers, and

surveyors" appropriate to his range of activities and, further, he did not consider that animation was part of engineering design and consultancy.

7. Mr Harris disputed the suggestion by HMRC that his company acted as "IT consultants" (p33). He did accept that he used a computer as a work-tool, but that did not render his company an IT consultancy. He himself had not approved his previous agent's letter of 16 October 2012 agreeing to a change of category within FRS (p30-31). He maintained that the original category was correct.

8. In cross-examination Mrs Fletcher asked Mr Harris about paras 12 and 13 of his Witness Statement. He explained that his company was involved with the vehicle stopping system from about March 2009 to June 2010. The animations took about four months of full-time work to develop, and thereafter were "tweaked" on a part-time basis for a period. The animation was a crucial element in developing the system.

9. Mrs Fletcher then asked about HMRC's letter of 7 September 2012 from its officer Mr Sanderson (p33-34). Mr Harris confirmed meeting with him on the occasion of his visit. He explained that after the initial stage of the meeting he had left with Mr Sanderson's approval on the basis that he should return an hour later. When he did return to conclude the meeting, Mr Sanderson had already left.

10. Mr Harris disputed Mrs Fletcher's suggestion that he was an "engineering consultant". He indicated that consultancy denoted expert status. He did not have a degree nor was he a chartered engineer.

11. Apart from the controversy about the correct categorisation of Mr Harris' company's business, his evidence was not controversial. The foregoing narrative should to that extent be viewed as our Findings of Fact. In particular we find as fact that the business conducted by the Appellant company was that of a mechanical engineering business. It related to the functioning of plant and machinery.

Submissions

12. We heard in turn from Mrs Fletcher and Mr Edwards.

13. On behalf of HMRC Mrs Fletcher submitted that the Appellant company had not made an informed or considered decision. It had ignored HMRC's guidance and advice. The appeal, accordingly, should be dismissed and the assessment and penalty should be confirmed.

14. HMRC had made further enquiries and had met with the Appellant company's representatives. HMRC had questioned the choice of sector made by the Appellant company. A reasonable businessman would have considered the matter further. The company's response (p42) did not suggest that a considered decision had been made. In particular had reference been made to Notice 733 issued by HMRC the Appellant's representatives would have noted at para 4.4 that "engineering consultants and designers" would ordinarily be classified within the trade sector of "architects, civil and structural engineers" with a flat rate percentage of 12.5%. In their letter of 7 September 2012 (p33) HMRC had referred the Appellant to his provision. The Appellant in its response complained of a lack of clarity in the guidance (p30). The Appellant, Mrs Fletcher continued, had not been pro-active in choosing the correct

category. She noted (p41) that the Appellant company had described itself as a "business consultancy". She noted also that the Appellant's work in relation to the vehicle stopping system was work of an engineering design nature.

15. In reply Mr Edwards submitted that the question for the Tribunal was whether the Appellant company fell into the category chosen by HMRC viz "architect, civil and structural engineer or surveyor". He noted the reference to para 4.4 in Notice 733. That, however, did not have the force of law. The nature of the Appellant company's work and Mr Harris' background was in *mechanical engineering*. He was not a civil or structural engineer. The category selected by HMRC related to work on land, buildings and structures. Mr Harris' experience related to mechanical engineering, involving plant and machinery, as distinct from civil engineering, which relates to roads and buildings, or structural engineering.

16. The relevant date affecting the decision was May 2009 and subsequent anniversaries. The Appellant company's choice of category was at these dates reasonable. The evidence of the meeting with Mr Sanderson in August 2012 had not resulted in any acknowledgement by the Appellant company that its selection of category had been in error. The terms of para 4 in the previous agents' letter of 16 October 2012 (p30) had not been authorised.

17. In short HMRC had selected the wrong category for assessment purposes. It referred to operations affecting land and buildings. That was distinct from work involving plant and machinery, which was the Appellant's field of expertise. Notice 733, including para 4.4, was misleading and it did not have the force of law.

18. For all of these reasons the appeal should be allowed, Mr Edwards concluded.

19. We invited a "final word" from both parties to comment on the status of Public Notice 733. It is accepted that it does not have the force of law and that it is the primary legislation and, in particular, the VAT Regulations which fall to be considered.

Conclusion

20. The Tribunal's role in this appeal is governed by Section 83(1)(fza) VATA 1994. In effect it has to determine whether the decision of the Commissioners in re-categorising the Appellant's business activity with a consequential assessment to VAT is reasonable. This involves determining the nature of the business carried on by the Appellant company and inevitably the trade or profession of Mr Harris. His experience is in the field of *mechanical engineering*, involving the servicing and operation of items of plant and machinery. While he is not a chartered engineer and does not have a university degree, he is trained to a significant level in mechanical engineering.

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

company did not involve land, buildings, or other structures, but rather plant and machinery.

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

23. Mrs Fletcher laid stress on para 4.4 of HMRC's Notice 733. That suggests that "engineering consultants and designers" fall within the category proposed by HMRC in the Appellant's case. It may be that the same percentage rate produces a fair result for all categories of engineers. We do not know. However, Parties both accepted that para 4.4 is of no legal effect. We cannot apply it to extend the sense of the statutory wording of Regulation 55K(4) to introduce a distinct and separate category of engineer, however fair and reasonable a result it might produce. For all of these reasons we consider that the category chosen by the Appellant company was apt to its circumstances. We consider that Mr and Mrs Harris, as the company's officers, acted reasonably and were co-operative with HMRC.

24. Given that both parties acknowledge that para 4.4 is not of legal effect it is not necessary for us to consider exhaustively the sense of the term "engineering consultants and designers". We would hesitate to place the Appellant within that category. While some work of a consultancy or design nature may have been undertaken by the Appellant, that description does not seem apt in relation to its regular work.

25. For these reasons this appeal is allowed. The assessment and penalty fall to be set aside.

26. 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.

KENNETH MURE QC
TRIBUNAL JUDGE

RELEASE DATE: 10 April 2014