[2016] UKFTT 81 (TC)

TC04874

Appeal number: TC/2010/07107

PROCEDURE–COSTS - appeal in standard category-appellant's application for costs on the basis that HMRC acted unreasonably in defending or conducting proceedings under Rule 10 (1) (b) of Tribunal Rules-whether HMRC acted unreasonably in defending a point with no realistic prospect of success-no-application for costs dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MERLIN SCIENTIFIC LLP **Appellant**

- and -

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

TRIBUNAL: JUDGE TIMOTHY HERRINGTON

Application decided on the basis of written submissions

Kieron Beal QC and William Frain-Bell , Counsel, instructed by ARIG LLP, for the Appellant

L Bingham, Presenting Officer, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This decision relates to the application of the appellant ("MSL") for an order that HMRC pay the appellant's costs on the grounds of HMRC acted unreasonably in conducting and defending proceedings. The costs are in relation to two appeals in the standard category, one relating to a VAT assessment which disallowed input tax on the purchase of corporate meeting costs on the basis that it related to the provision of disallowable business entertainment and the second of which related to HMRC's decision to disallow those same expenses as deductions in the computation of profits for income tax purposes.

2. I do not intend to set out in detail in this decision the underlying facts relating to the substantive appeals or the basis of the decision to allow the appeals. This decision should therefore be read in conjunction with the substantive decision in respect of the two appeals. Words and phrases defined in the substantive decision bear the same meanings in this decision.

3. In summary, the Tribunal found that the services supplied by MSL to MBL, consistent with the terms of a Consultancy Agreement and evidence from Sir Christopher Evans as to how the contractual arrangements between those two entities operated, was a composite supply of services. That single, composite supply consisted of a principal supply of consultancy services and an ancillary supply of corporate meeting services. The Tribunal accepted MSL's submission that no separate charge for the ancillary services needed to be specified on MSL's invoices as there was a composite supply for a single price, MSL having chosen to treat the onward supply of corporate meeting services as ancillary to the principality supply of consultancy services. Any supply of business entertainment was of a minimal amount which was provided by MSL to MBL as part of the onward supply of the facilities made available to MSL by Glebe Corporate and MBL paid for that business entertainment by settling MSL's invoices which included sums in respect of the onward supply of the meeting facilities and accordingly it was not provided by MSL free of charge.

4. Accordingly, the Tribunal decided that MSL should be given full credit for the input tax on the Glebe Corporate invoices and the VAT assessments which were the subject of MSL's appeal were discharged. Consequently, the same expenses were allowable in full for income tax purposes as they had been wholly and exclusively incurred the purposes of MSL's trade for the year in question.

5. At [54] of the substantive decision, the Tribunal found that Officer Hawes, the HMRC officer who conducted the assurance audit into MSL which gave rise to HMRC's decision on the VAT dispute, was, and continued to be, overly influenced by the documentation in the form of the relevant invoices and what was written on them and did not engage with the explanations that were provided either during correspondence prior to the relevant decisions being made by HMRC or at the hearing when cross-examined by Mr Beal.

6. MSL contends that HMRC acted unreasonably in proceeding on the basis of facts which they ultimately accept, or could only reasonably have accepted were wrong. It contends that in the final analysis, Officer Hawes refused, without a rational basis, to accept the version of events put forward by Sir Christopher Evans. Officer Hawes was unable, on the basis of that stance, to put forward a cogent reason as to why MSL's evidence was not to be accepted. On the basis of that evidence, HMRC's defence of the appeal had no realistic prospect of success.

Extension of time

7. Pursuant to Rule 10 (4) of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Rules"), as set out below, MSL's application for costs should have been made no later than 28 days after the date on which the Tribunal sent it the decision notice regarding the substantive decision. However, the application was made two months out of time, on 2 September 2015. Accordingly, I may not admit the application unless I extend time.

8. It is well established that the principles that I should apply in deciding whether to extend time are those identified by the Upper Tribunal in *Data Select v HMRC* [2012] UKUT 187, namely the purpose of the time limit, the length of the delay, the explanation for the delay and the impact of granting or not granting the extension sought. I should then consider whether, applying the overriding objective in Rule 2 of the Rules whether it is in the interests of justice to grant the extension.

9. HMRC opposed the granting of an extension in this case.

10. As regards the first principle, they submit that the time limits are there to ensure finality and certainty in litigation. It is not automatic that the losing party in an appeal before this Tribunal is liable to costs and it is fair and just for that party to have finality and certainty with regard to its exposure to costs when the other party failed to make an application within the permitted period without good reason.

11. As regards the second principle, the application was submitted two months late which was not an insignificant delay. MSL said that it was deliberately held back until after the 56 day deadline for an appeal to the Upper Tribunal and expired on 30 July 2015 but the application was not made even within 28 days of the later date.

12. As regards the third principle, the only reason given for the delay was that MSL considered it appropriate to wait to see whether or not any appeal would be brought by HMRC against the Tribunal's decision before making the application for costs. It says that it wished to see whether or not HMRC would accept the Tribunal's criticisms of their conduct before embarking on their costs application and since it became apparent that HMRC have accepted the criticisms the application has now been made. HMRC submit that is not a good reason for the delay and that if MSL believe that HMRC had acted unreasonably in defending or conducting the proceedings there was a separate and distinct issue as to whether HMRC may or may not appeal the Tribunal's decision. It did not justify MSL holding back its costs

application until after the appeal period expired and it could reasonably have made a timely application to protect its costs position.

13. As far as the fourth principle is concerned, HMRC submit that they will be prejudiced if the application is allowed late because they will lose the certainty and finality to which they are entitled in accordance with the Rules and they will be obliged to commit resources that would otherwise be deployed elsewhere to defending the application.

14. I agree with HMRC that the delay is not insignificant and that the delay continued without good explanation beyond the period allowed for the filing of an application for permission to appeal. Neither do I regard the reasons given for the delay as amounting to a good explanation. As HMRC submit, the question of appeal is entirely separate from the question whether a party has acted unreasonably in relation to the proceedings. Filing a costs application is not an onerous task as shown by the commendable brevity of the application that was finally made. I accept that the delay arose as a result of a deliberate decision on the part of MSL. Had it thought that there was merit in delaying the application beyond the time limit then the proper course would have been to have applied to the Tribunal for an extension of time in respect of the period for filing an application rather than simply ignore the time limit and presume that an extension would be granted in any event.

15. As far as the finality point is concerned, despite the delay, in my view there is no risk of the claim being stale or of the Tribunal not being familiar with the facts given the passage of time. Neither is there a risk of the ability of witnesses to recall the events concerned relevant as there is no witness evidence to be heard. On the other hand, as MSL submits, its claim for costs would be dismissed without consideration of its merits if an extension were refused. As far as the point HMRC make about its need to devote resources to the application, HMRC did in fact engage with the merits of the application in full detail in the response it made to the application so that it is done all the necessary work in respect and the Tribunal is in a position to decide the matter without troubling the parties further.

16. Therefore, despite there being a lack of a good explanation for the delay and the delay not being insignificant, the factors mentioned at [15] above in my view way heavily in favour of granting the extension of time and I conclude that it is in the interests of justice to do so. Accordingly, I extend time and admit the application.

Relevant Law

17. The power of this Tribunal to award costs derives from s 29 (1) of the Tribunals, Courts and Enforcement Act 2007 (" TCEA") which so far as relevant provides:

> " (1) The costs of and incidental to (a) all proceedings in the First-tier Tribunal, and[...] shall be in the discretion of the Tribunal in which the proceedings take place.(2) The relevant Tribunal shall have full power to determine by whom and to what extent the

costs are to be paid.(3) Subsections (1) and (2) have effect subject to Tribunal Procedure Rules."

18. Rule 10 of the Rules gives effect to the discretion to order costs, pursuant to the authority given in Section 29 of TCEA. This rule so far as relevant provides as follows:

" (1) The Tribunal may only make an order for costs (or, in Scotland,expenses)-

(a) […] ;

(b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings;

(c) if-

(i) the proceedings have been allocated as a Complex case under rule 23 (allocation of cases to categories); and

(ii) the taxpayer (or, where more than one party is a taxpayer, one of them) has not sent or delivered a wriiten request to the Tribunal, within 28 days of receiving notice that the case had been allocated as a Complex case, that the proceedings be excluded from potential liability for costs or expenses under this sub-paragraph ; or

[…]

(2) The Tribunal may make an order under paragraph (1) on an application or of its own initiative.

(3) A person making an application for an order under paragraph (1) must-

(a) send or deliver a written application to the Tribunal and to the person against whom it is proposed that the order be made; and

(b) send or deliver with the application a schedule of the costs or expenses in sufficient detail to allow the Tribunal to undertake a summary assessment of such costs or expenses if it decides to do so.

[…]

(6) The amount of costs (or,, in Scotland, expenses) to be paid under an order under paragraph (1) may be ascertained by –

(a) summary assessment by the Tribunal;

(b) agreement of a specified sum by the paying person and the person entitled to receive the costs or expenses (the " receiving person"); or

(c) assessment of the whole or a specified part of the costs or expenses incurred by the receiving person, if not agreed.

(7) Following an order for assessment under paragraph (6) (c) the paying person or the receiving person may apply(a) in England and Wales, to a county court, the High Court or the costs office of the Supreme Court (as specified in the order) for a detailed assessment of the costs on a standard basis or, if specified in the order, on the indemnity basis; and the Civil Procedure Rules shall apply, with necessary modifications, to that application and assessment as if the proceedings in the tribunal had been proceedings in a court to which the Civil Procedure Rules 1998 apply;[…] "

19. The question as to whether the power in s 29(1) TCEA extends to costs incurred prior to proceedings being commenced in the FTT was considered by Judge Bishopp in the Upper Tribunal in *Catana v HMRC* where he noted at [7] :

" …the tribunal may only 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 Catana' s tax affairs which proceeded the proceedings."

20. He agreed, at [8], with the following observation of Judge Berner at [11] in *Bulkliner Intermodal Ltd v HMRC* [2010] UKFTT 395 (TC) that :

" …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 it 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,* and *Carvill v Frost* [2005] STC (SCD) 208 remain good law. That is not to say that the 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."

21. Consequently, Judge Bishopp concluded at [10] :

" …It follows that so much of Mr Catana' s application as respects any costs he incurred before the proceedings before the First-tier Tribunal were

brought cannot succeed, irrespective of its underlying merits which, consequently, I shall not explore."

22. The question as to what is unreasonable behaviour in the context of Rule 10 of the Rules has been considered by this Tribunal in a number of cases. In particular, in *Leslie Wallis v HMRC* [2013] UKFTT 081 (TC) Judge Hellier stated at [27]:

> "It seems to us that it cannot be that any wrong assertion by a party to an appeal is automatically unreasonable... Before making a wrong assertion constitutes unreasonable conduct in an appeal that party must generally persist in it in the face of an unbeatable argument that he is wrong..."

23. In agreeing with this test in *Roden and Roden v HMRC* [2013] UKFTT 523 (TC) Judge Mosedale, having observed that the Tribunal in *Wallis* was of the opinion that a party would not be acting unreasonably when pursuing a case without merit unless he ought to have known his case was without merit, stated at [15]:

> "... The Tribunal should not be too quick to characterise pursuing what is found to be an unsuccessful case is unreasonable behaviour: the Tribunal rules provide for a no-costs regime in virtually all tax cases (and the exception for complex cases does not apply in this case). So if in this case HMRC's view had no reasonable prospect of success, HMRC would have been acting unreasonably if they ought to have known this but not otherwise. In considering whether HMRC ought to have known whether the case had a reasonable prospects of success, I consider that I should consider HMRC as a whole and not just the individual officer presenting the case."

24. I agree and I will take account of these observations in considering the position in relation to this application.

Discussion

25. MSL submits that HMRC acted unreasonably in the present case proceeding on the basis of facts which they ultimately accept or could only reasonably accepted were wrong. In particular, Officer Hawes refused to accept at the hearing, without a rational basis, the version of events put forward by Sir Christopher Evans. MSL had repeatedly explained in correspondence, in its grounds of appeal and in the written witness evidence of Sir Christopher Evans that Officer Hawes had misunderstood the arrangements which were in fact in place. The fact that Sir Christopher accepted that certain invoices could have been expressed more clearly simply reflected the position which had previously been stated explicitly in correspondence between the parties. His oral evidence confirmed the existing position and did not depart from it. Sir Christopher's written evidence was not substantially challenged in the course of his cross-examination and Officer Hawes was not able to offer a rational critique of that evidence. It was her intransigent refusal to accept that evidence, coupled with her steadfast attachment to a wrong and irrational analysis of the facts, which led to the appeal having to be brought and heard by the Tribunal and her treatment of the

relevant facts was not, in the event, supported by HMRC on their own case in closing submissions.

26. Many of MSL's criticisms are directed towards the approach of Officer Hawes during the period of dialogue between MSL and HMRC prior to proceedings being commenced by the notice of appeal. As is clear from the authorities, the unreasonable behaviour which is relevant to the purposes of this application is the behaviour that occurred after commencement of proceedings through the filing of the notice of appeal.

27. In my view it was not unreasonable for HMRC to wait and review Sir Christopher's written evidence before deciding whether to defend the appeal, also taking into account the arguments made in the notice of appeal.

28. It is correct that HMRC's case proceeded primarily on the basis of the documentary evidence that had been provided during the course of the investigation but the Tribunal observed at [51] of the substantive decision that the manner in which the arrangements were ultimately found by the Tribunal to operate were adequately reflected in the narrative on the relevant invoices. The Tribunal also recorded that Sir Christopher accepted that with hindsight it would have been better to have made matters more explicit, so as to include a breakdown of the services actually use rather than, as was done, providing an identical list on each occasion of those facilities that were available. The Tribunal also accepted at [27] and [28] that at first sight the documentary evidence supported HMRC's characterisation of the arrangements.

29. Whilst the Tribunal was critical at [52] of the substantive decision of Officer Hawes's failure to understand the business context in which the facilities were made available, this comment was made with a degree of hindsight having heard Sir Christopher's oral evidence.

30. I therefore accept HMRC submission that the full nature and extent of the arrangements between MSL and MBL, especially with regard to the extent of the services invoiced within the description of "consulting services provided" only became clear from Sir Christopher's oral evidence at the hearing.

31. In the light of that, MSL's criticisms of Officer Hawes's conduct at the hearing can be seen as a criticism of her failure to respond appropriately to Sir Christopher's oral evidence and in my view does not justify the conclusion that it was unreasonable for HMRC not to have conceded the appeal prior to hearing the oral evidence.

32. For these reasons, I conclude that prior to the hearing of the appeal, HMRC should not have known that its arguments were without merit. Therefore, regardless of the conduct of Officer Hawes at the hearing it cannot be said that conduct had any material effect on the costs incurred by MSL. I therefore conclude that HMRC did not act unreasonably in conducting or defending the proceedings.

33. That conclusion is sufficient to dispose of this application. I should however also observe that the application was defective in that a large proportion of the costs claimed clearly related to the period before proceedings were commenced and that

having regard to the magnitude of the costs claimed a summary assessment of costs would not be appropriate in any event.

Disposition

34. The application is dismissed

35. 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.

TIMOTHY HERRINGTON
TRIBUNAL JUDGE

RELEASE DATE: 8 FEBRUARY 2016