[2019] UKFTT 607 (TC)

TC07390

VAT – breach of registration threshold – failure to notify liability to register – penalty under Sch 41 FA 2008 – goods supplied to non-EU countries – mistaken belief that supplies were 'exempt' – whether reasonable excuse – whether excuse continued – whether disclosure 'prompted' or 'unprompted' – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/07773

BETWEEN

ALAN & CAROLYNDA MACDONALD **Appellant**

-and-

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

TRIBUNAL: JUDGE HEIDI POON
IAN SHEARER

Sitting in public at Caledonian House, Dundee on 26 November 2018

Ms Fiona Ferrol of Murray Taylor (Scotland) Ltd for the Appellant

Mrs Elizabeth McIntyre, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

Introduction

1. The appellant, 'Alan and Carolynda MacDonald' is a partnership. On behalf of the partnership, Mr Alan MacDonald, appeals against the penalty of £1,226.06 imposed under paragraph 1 of Schedule 41 to the Finance Act 2008 ('Sch 41 FA 2008') in consequence of failure to notify HMRC of its liability to be registered for VAT when its turnover had exceeded the compulsory registration threshold.

2. The principal issue for determination in this appeal is whether there was a reasonable excuse for the failure. In particular, whether the alleged 'conflicting advice' given by HMRC, or the mistaken belief held by the appellant in relation to the treatment of supplies to non-EU countries, gave rise to a reasonable excuse.

Evidence

3. For the respondents, HMRC Officer Cherry Dolan of 'Hidden Economy Team' gave evidence as the decision maker who imposed the penalty under appeal. We find Officer Dolan to be a credible witness, and accept her evidence as to matters of fact without qualification.

4. Mr MacDonald, as a partner of the appellant, gave evidence of his understanding in relation the appellant's liability to be VAT registered. We find Mr MacDonald to be honest and straightforward, and accept the truthfulness of his understanding as recounted to us.

Relevant legislation

5. The relevant provisions under Sch 41 FA 2008 are the following:

> (1) The 'standard amount' of penalty is set by the statute under para 6 in accordance with the category of behaviour, as defined by 'Degrees of culpability' under para 5. Against the standard amount of penalty so determined, HMRC may apply 'Reductions for disclosure' as provided under para 12, whereby 'unprompted' disclosure is defined under sub-para (3) as follows:
>
>> '(3) Disclosure of a relevant act or failure –
>>
>>> (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 relevant act or failure, and
>>>
>>> (b) otherwise, is "prompted".'
>
> (2) Paragraph 14 provides for 'Special reduction' whereby:
>
>> '(1) If HMRC think it right because of special circumstances, they may reduce a penalty under any of paragraphs 1 to 4.
>> …
>> (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.'
>
> (3) An appeal against a penalty imposed under Sch 41 can be brought by provision under para 17, whereby:
>
>> '(1) P may appeal against a decision of HMRC that a penalty is payable by P.

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

(4) The Tribunal's jurisdiction is provided under para 19, which states:

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

(2) On an appeal under paragraph 17(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 First-tier tribunal substitutes its decision for HMRC's, the tribunal may rely on paragraph 14 – […]'

(5) Paragraph 20 of Sch 41 provides that a liability to a penalty under Sch 41 does not arise in relation to 'an act or failure which is not deliberate' if the taxpayer 'satisfies HMRC or (on appeal notified to the tribunal) the tribunal that there is a reasonable excuse for the act or failure'.

The Facts

Mr MacDonald's evidence

6. Mr MacDonald studied art and worked in Dundee for a brief period before moving to London, where he worked for 15 years before returning to Scotland to set up his own studio to become a full-time artist. Apart from painting and drawing, Mr MacDonald also undertakes decorating in the form of wall murals, screen-painting, and stained glass painting.

7. Mrs MacDonald is a medical micro-biologist and worked at the University College Hospital in London before the couple moved to Scotland. She has since developed her own line of art and has held her own exhibitions. Mrs MacDonald keeps the accounts for the partnership; and the couple work 'as a team'.

8. Mr MacDonald spoke of the fact that none of his artist friends are full-time; that they do their art part-time or paint in their spare time; that it is 'a rare thing' to be making art full-time, and that his income in the first few years of turning full-time was 'unbelievably low'.

9. Mr MacDonald explained that when he first started selling art works, he did not have an accountant. He gave various examples of his dealings with art galleries, in London as well as in Scotland; that the sale price of a piece of work would be agreed with the gallery, which would take 50% of that price and add VAT on the 50%. He said that when he exhibited with a more prestigious gallery, he would get only 40% of the sale price; that on his father's advice, he sought advice from an accountant in year 2000, as his father thought that he was being 'ripped off' by galleries.

10. Mr MacDonald returned time and again to what he claimed to be advice from the local VAT office in London. It was not clear in what format was the advice received, whether by letter or over the phone. It is clear that Mr MacDonald did not receive the advice first-hand, but via his accountants in London. The advice, as Mr MacDonald understood it, was that he needed only to calculate the sales in the UK and to the EU for VAT registration purposes. Mr MacDonald gave the name of his London accountants as 'Defries and Weiss', and that he was advised by its founder that was the VAT position. When asked if he had looked into the matter

himself since, he replied in the negative, and said that he trusted what he was told: that only sales made in the UK and to the EU count as turnover for VAT registration purposes.

11. Mr MacDonald retained the service of Defries when he moved to Scotland. It was only when his turnover started to increase steadily that he disengaged with Defries for 'someone more professional' and changed to Murray Taylor in 2010.

12. In terms of sales to the US, Mr MacDonald had understood the sales to be 'exempt' and not zero-rated. In relation to the letters from HMRC, Mr MacDonald said that he understood there was 'uncertainty' as regards how to treat the sales to the US, whether it should be 'exempt' or 'zero-rated'; that Murray Taylor has mentioned to him that with their various clients working overseas, the question sometimes comes down to whether it is 'the place of supply' as against what is being supplied.

13. Mr MacDonald said that he has tried 'to conduct [himself] in an honest way'; that he found doing the accounts and painting at the same time 'too difficult'; that it 'stifles the art'; that he is 'particularly stubborn' when it comes to painting; that 'mentally [he has to be] in the right place', and attending to the accounting and the administrative aspects of the business, as inferred by the Tribunal, would get in the way of his creativity.

The VAT enquiry

14. On 23 January 2015, HMRC wrote to enquire if the partnership should be VAT registered as the turnover figures on the partnership's Self-Assessment ('SA') returns show:

(a) Tax year 2010-11: turnover £78,218 when VAT threshold was £70,000;

(b) Tax year 2011-12: turnover £86,842 when VAT threshold was £73,000;

(c) Tax year 2012-13: turnover £51,719 when VAT threshold was £77,000;

(d) Tax year 2013-14: turnover £80,811 when VAT threshold was £79,000.

15. By letter dated 28 January 2015, Mr MacDonald referred to his telephone conversation with HMRC of the same day regarding the business turnover for the partnership, and advised 'the amount of income received from non-EU countries, chiefly the USA' as follows:

(a) Tax year 2010-11: non-EU income £27,642.80;

(b) Tax year 2011-12: non-EU income £24,115.10;

(c) Tax year 2012-13: non-EU income £38.575.29;

(d) Tax year 2013-14: non-EU income £30.761.25.

16. On 23 February 2015, Murray Taylor, chartered certified accountants and registered auditors, wrote to HMRC on the appellant's behalf, advising 'that a number of sales were undertaken outwith the EU and as such they fell below the VAT registration threshold'. In support of the non-EU sales, the following documents were enclosed:

(1) Breakdown of monthly sales for the four years ended 5 April 2011 to 2014;

(2) Shipping documents detailing the location of the artwork that was supplied outwith the EU.

17. On 15 March 2015, HMRC Officer Daly replied to Mr and Mrs MacDonald, stating that:

> 'The figures you have provided have shown the income for the partnership is over the VAT registration threshold. However due to the fact there is a large amount of VAT zero rated exports I have passed the records to our exemption

> team to make a decision as to whether the partnership needs to be registered for VAT.'

18. On 26 May 2015, the VAT Registration Service responded directly to Mr and Mrs MacDonald in relation to Officer Daly's referral, which was considered in terms of the partnership 'requesting possible exemption from registration'. The letter continued by advising that in order for the 'application' to be considered, the following conditions must be met:

> '[i] your taxable supplies are and will continue to be wholly or mainly zero-rated;
>
> [ii] if you were registered, your input tax would be more than your output tax in any 12 month period; and
>
> [iii] you have exceeded the registration threshold.'

19. The 26 May 2015 letter also requested supporting documents to establish that the stated conditions were met. The documents requested were: (a) the value and details of standard-rated supplies in the next 12 months; and (b) third party documentary evidence to support the zero-rated nature of supplies or services, to include examples of customer's order or purchase invoice, sales invoice, extracts from books and records to evidence export. The requested documents were provided, by Murray Taylor on 17 June 2015, along with replies to the enclosed questionnaire as follows:

> (a) The value of the standard rated supplies in the next 12 months are estimated to be £20,000.
>
> (b) The income received from UK and EU countries for the years:
>
> 2012-13 was £27,783.60;
>
> 2013-14 was £53,167.23;
>
> 2014-15 was £18,708.64.

The letter of 10 July 2015 by VAT Registration Service

20. On 10 July 2015, the VAT Registration Service issued its decision in the following terms:

> 'Based on the information that you have provided to us, *we are not satisfied that your client is liable to register for VAT. For this reason, we have not granted them exemption from VAT registration, but we have not registered them for VAT.*
>
> Your client must inform [HMRC] promptly if their circumstances change and they start to make taxable supplies and/or the value of their taxable supplies exceeds the VAT registration threshold.
>
> If their taxable supplies should exceed the VAT registration threshold in the future they should either reapply for exemption from VAT registration (if their supplies are wholly or mainly zero-rated) or apply to register for VAT.
>
> If they do not tell us at the right time, they may have to account for VAT they have not collected and may also incur a financial penalty.' (emphasis added)

The rolling 12-month turnover figures

21. On 16 September 2015, Murray Taylor wrote to HMRC compliance team to 'enquire about the status of [the] enquiry', stating that the last letter received from HMRC was dated 10 July 2015, and that there had been no correspondence since.

22. On 17 September 2015, Officer Daly wrote to advise that the purchase figures she had requested from Murray Taylor on 27 July 2015 over the phone for the period from 1 May 2010

remained outstanding. Officer Daly requested the purchase figures to be sent to her by 1 October 2015. (This letter was crossed with the Murray Taylor's letter of 16 September 2015.)

23. On 28 September 2015, Murray Taylor provided the purchase figures for the four years from 6 April 2010 to 5 April 2014.

24. By letter dated 13 November 2015, Officer Daly wrote to Murray Taylor, attaching the spreadsheets with the appellant's rolling turnover for the relevant periods to support her conclusions in relation to the matter of VAT registration. In summary, the conclusions were:

(1) The rolling 12-month turnover of the partnership breached the registration threshold during two separate periods: (a) from 1 January 2011 to 30 November 2011; and (b) from 1 February 2012 to 31 October 2012.

(2) The partnership should have been registered for VAT in relation to each period of breach, and with the VAT liability arising for each period being:

(a) from 1 April 2011 to 31 December 2011 with a liability of £4,357.56; and

(b) from 1 April 2012 to 30 November 2012 with a liability of £1,215.31.

(3) The combined total VAT liability for the two periods was stated at £5,572.87.

(4) From the figures supplied for the year 6 April 2014 to 5 April 2015, the annual turnover suggested that it was over the relevant registration threshold, specifically:

(a) From 1 December 2014 to 31 March 2015, the rolling 12-month turnover consistently breached the relevant threshold of £79,000 in force;

(b) The rolling turnover figures were at £85,339 (December), £85,315 (January), £88,850 (February), and £79,660 (March).

(5) Up-to-date figures of the level of exports at the zero-rate were required to determine if a current exemption to VAT would be applicable.

25. By letter dated 23 December 2015, Murray Taylor advised HMRC that: 'Upon further discussions with our clients it has become apparent that they had been selling their art work (sic) on a sale or return basis' through art galleries, which 'have informed [the appellant] that the majority of the paintings were shipped to non-EU customers and were zero-rated'.

26. There was an acknowledgement that the income spreadsheets prepared for the appellant had 'mistakenly' treated the sales to non-EU countries, though it is unclear to the Tribunal what exactly was the nature of the mistake in the preparation of the income schedule. The letter of 23 December 2015 continued as follows:

> 'When [the MacDonalds] prepared their income spreadsheets, they mistakenly, just included their dealings with the galleries as UK income, when, in fact, items were sold to non-EU countries. They now believe that any income to UK galleries should be zero-rated.'

27. On 23 June 2016, after a lapse of six months, HMRC responded to Murray Taylor's letter of 23 December 2015. By then, the case was reallocated to Officer Cherry Dolan, who wrote to ask for an update of the current position from Murray Taylor.

28. On 30 June 2016, Murray Taylor replied to Officer Dolan with the following details:

(1) That the MacDonalds had always been advised by the galleries that they were not required to charge VAT, as the gallery would record the VAT due.

(2) Officer Daly had advised that 'this was maybe an old practice', and that she would look further into the rules.

(3) An 'invoice' from the Royal Scottish Academy ('RSA') was enclosed to illustrate the VAT position on a transaction.

29. While the document from RSA was referred to as an 'invoice', it would be more suitably described as a remittance advice, which was itself undated, and would most probably have been accompanied by a covering letter bearing the date. The buyer's contact information was stated as to be on the reverse, while the face of the document shows the details of the painting sold (catalogue number and title), the sale price, the percentage of commission deducted with VAT at 20% thereon, leaving the balance of remittance due to the artist.

30. On 21 July 2016, Officer Dolan acknowledged the letter of 30 June 2016, and asked for confirmation of the application for VAT exemption referred to in Murray Taylor's letter of 23 December 2015 to Officer Daly.

31. On 4 August 2016, Murray Taylor replied by enclosing the letter from HMRC VAT Registration Service dated 10 July 2015, with a request for comments on HMRC Notice 703 on 'Export of goods from the UK'.

32. On 15 August 2016, Officer Dolan wrote again to request a response by 5 September to her letter dated 21 July 2016. (The letter of 4 August 2016 was not received by Officer Dolan.) On 25 August 2016, Murray Taylor replied, enclosing the letter that was dated 4 August 2016.

33. For whatever reasons, the letter from Murray Taylor to Officer Dolan would appear to have failed to arrive a second time, even though the correspondence with the correct case references was sent to HMRC address at 'PO Box 168 Bootle L30 4WN' as stated on Officer Dolan's letters. There followed a chain of email communications between Officer Dolan and Ms Ferrol of Murray Taylor, and the original letter of 4 August 2016 eventually reached HMRC on 3 November 2016 by as an email attachment.

The letter of 23 November 2016

34. By letter dated 23 November 2016, Officer Dolan wrote to relate her conclusions on the VAT registration matter of the appellant.

> 'My understanding is that the non-EU exports will be zero-rated not exempt and will, as such, form part of your clients' turnover when deciding whether VAT registration would be appropriate.
>
> With regard to the exemption (from registration) requested, I do not consider that this would be granted because more than 50% of the sales are standard rated so Mr and Mrs MacDonald would be unlikely to be in a repayment situation.
>
> I am therefore of the opinion that they ought to have been registered for the period 1 March 2011 to 31 January 2012 and 1 April 2012 to 31 December 2012. Assessments would be raised for these periods on a Liable No Longer Liable (LNLL) basis.'

35. The letter also requested information regarding the partnership's turnover since May 2014 for the purposes of assessing its liability to register for VAT. The request for information was made again in the form of an Information Notice under Schedule 36 to the Finance Act 2008 on 23 December 2016.

36. On 20 January 2017, Ms Ferrol telephoned Officer Dolan to say that:

(1) Murray Taylor accepted HMRC's position as the correct treatment, but had had difficulty explaining the position to Mr and Mrs MacDonald;

(2) That Mr MacDonald seemed to have 'a light bulb moment' on 19 January 2017 and the agent was hopeful that the case would conclude;

(3) Agreed that HMRC should look at figures with a view of raising assessments for the two LNLL periods.

The notices for the Sch 41 penalties

37. On 23 January 2017, Officer Dolan wrote to the MacDonalds to advise that she would be reviewing the position as regards raising a penalty under Sch 41 for failure to notify a liability to register for VAT. The letter was accompanied by a questionnaire for disclosure, and was completed and returned on 22 February 2017. Some of the questions and replies are:

(1) How did the failure to notify HMRC occur?

> 'We have always been under the impression from Art Galleries that they had agreements in place with HMRC to pay the VAT on behalf of un-registered artists.'

(2) If there was an uncertainty about notifying HMRC, what advice was available to you and what was sought? If so, from whom was the advice sought and what was that advice?

> 'Calculations were prepared by our advisers, Murray Taylor, on the basis that sales the USA were exempt, and not zero rated.'

(3) Did you follow the advice given? If not, why not?

> 'Yes, advised not to register.'

38. On 26 April 2017, Officer Dolan wrote to advise, among other matters, that penalties of £958.76 and £267.30 would be issued in relation to the liabilities for the two LNLL periods; that there would be a notice to follow with a penalty explanation, and warned of the likely 'delay in the issue of the penalty letters as there [was] a slight backlog in that section'.

39. On 16 May 2017, a penalty notice was issued, together with the penalty explanation which records the factors having been taken into account in assessing the penalties, namely:

(1) The behaviour leading to the failure was categorised as 'non-deliberate' as explained by Officer Dolan:

> 'I consider you were unaware that you had liability to notify for VAT because you incorrectly believed that the galleries were responsible for VAT in connection with your paintings.
>
> Furthermore I consider you were of the opinion (wrongly) that sales outside the EU were exempt from VAT rather than zero rated. …'

(2) The disclosure was 'prompted' because the appellant did not tell HMRC about the failure to notify before it had reason to believe HMRC had discovered it, or were about to discover it.

(3) For non-deliberate failure to notify with a prompted disclosure made more than 12 months after the tax becomes unpaid, the penalty range is 20% to 30%.

(4) Reductions were given for the quality of disclosure at 20% for Telling, 30% for Helping, and 30% for giving access, which made the total reduction to be 80%.

(5) Officer Dolan explained why she had only given half of the maximum 40% reduction for Telling:

> 'I have given a reasonable but not full reduction for this as liability was not accepted until later in my enquiry although there has been no concealment.'

(6) The total reduction of 80% was applied to the difference in the penalty range of 10% (being the difference of 20% and 30%) to arrive at the overall reduction of 8%.

(7) The difference between the maximum penalty of 30% less the 8% overall reduction is 22%, which was the rate to be applied to the Potential Lost Revenue ('PLR'), being the VAT liability arising from each of the two LNLL periods.

40. However, instead of assessing the penalties for the two LNLL periods, the notice issued on 16 May 2017 covered only the later LNLL period from 1 April 2012 to 30 November 2012, which had a PLR of £1,215, giving rise to a penalty at 22% of £267.30. (The penalty assessment in relation to the earlier period from 1 March 2011 to 31 December 2011 was omitted.)

41. On 19 July 2017, Officer Dolan wrote to advise that she had arranged for an amended notice to be issued, which would include the PLR for 1 March 2011 to 31 December 2011 that had been omitted. The combined PLR was £5,573 and the overall quantum of penalty at 22% was stated at £1,226.06.

On the issue of 'prompted' or 'unprompted' disclosure

42. Following the issue of the penalty notice on 13 May 2017, Murray Taylor wrote to object that the penalty should be assessed for 'prompted' disclosure. It was argued that the penalty range should be 0% to 30%, for the disclosure was 'unprompted'. Further, it was argued that the penalty should be reduced to nil because:

> 'If our clients had been aware that they were in fact meant to be registered for VAT then they would have been. They have always been led to believe that the galleries accounted for VAT as it is well known that most artists are not VAT registered.
>
> This was coupled with the fact that there was conflicting advice given throughout the enquiry, with the VAT exemption office stating that they did not believe that our clients should be registered for VAT.
>
> The only reason that the disclosure was unprompted is simply to do with the fact that our clients were unaware of the VAT registration requirements. Throughout the enquiry our clients were open and honest about why they had not registered.'

43. On 19 June 2017, Officer Dolan replied to the issue of disclosure in terms as follows:

> 'I note that you wish to appeal the penalty charged, on the basis that the disclosure was described as **'unprompted'** which you feel it was not. [*emphasis added; this would seem to be an error where it should have been 'prompted' instead of 'unprompted'*]
>
> I would explain that there are just 2 categories of disclosure – prompted and unprompted. The former would be where HMRC determines that there has been a failure to notify which may or may not have been admitted but was certainly prompted by HMRC [sic for *HMRC's*] action (this is the higher charge).
>
> The lesser charge (**unprompted**) is when the taxpayer has accepted liability (as in this case) without much if any prompting from HMRC. **I used this category for your client** because I felt (and my manager agreed) that your clients did accept liability without real prompting once the position had been explained to

> them.' [*emphasis added, as this clearly contradicted what was stated in the penalty explanation*]

44. On 13 July 2017, Murray Taylor wrote to appeal against the penalty notice of £267.30, (in accordance with the erroneous penalty notice that omitted the earlier LNLL period). At the same time, Murray Taylor asserted that if the penalty was 'non-deliberate' and 'unprompted' as indicated by Officer Dolan's letter of 19 June 2017, then the penalty range should have been 0% - 30%, and be reduced to nil due to the 'conflicting advice' given by HMRC. The letter concluded with the request: 'At the very least, we would expect the penalty to be suspended.'

45. On 19 July 2017, Officer Dolan replied to reiterate the penalty assessment at £1,226.06 based on a PLR of £5,573 at 22% for non-deliberate behaviour and 'prompted' disclosure:

> 'I have treated the disclosure your client made to HMRC as prompted since it arose as a result of our enquiry – your client did not approach us. (I apologise for the fact that my letter of 19 June 2017 has obviously confused the position).'

46. On 8 August 2017, a revised penalty explanation was issued to include the PLR of the previously omitted period from 1 March 2011 to 31 December 2011. Other aspects of the explanation are otherwise the same as those in the penalty explanation issued on 16 May 2017. A revised penalty notice dated 22 August 2017 for £1,226.06 was issued, which is the appealable decision.

Review conclusion letter

47. By letter dated 6 September 2017, Murray Taylor requested an internal review of the penalty assessment, on the grounds that:

> '… there has been conflicting information given throughout the enquiry, with the most recent being the amount of penalty charged and that you based it on "unprompted" with you giving an explanation of what "unprompted" was. This has been followed up with two recent letters to say that this was in error and should have been based on "prompted" disclosure.'

48. On 10 October 2017, HMRC issued the review conclusion decision, in which the review officer focused on three issues:

(1) Whether the disclosure was 'prompted' or 'unprompted' –

> '… it is clear that the disclosure is prompted as HMRC had made enquiries and I do not see any evidence to suggest that HMRC was approached before any enquiry was opened.'

(2) Whether 'reasonable excuse' –

> 'No grounds for reasonable excuse have been given and I have not seen any evidence that they would apply to this case.'

(3) Whether 'special reduction' –

> '… HMRC may use special reduction to reduce a penalty below the minimum otherwise allowed in law because of "special circumstances". Special circumstances are either uncommon or exceptional or where the strict application of the penalty law produces a result that is contrary to the clear compliance intention of that penalty law.
>
> Having considered the facts of this matter, I am satisfied in respect of this case, that there are no circumstances where special reduction can apply.'

The appellant's case

49. The grounds as stated on the Notice of Appeal are summarised as follows.

(1) That 'conflicting information [was] given throughout the enquiry'; that the MacDonalds were 'told to apply to the VAT exemptions team', and 'received a letter from VAT exemptions to state that they were not satisfied that our clients were liable to register for VAT'.

(2) That the appellant was informed by Officer Daly that she would be seeking technical guidance on the VAT position for artists selling through art galleries, but there was long delay in this and there was a change in the inspector in charge of the enquiry.

(3) The original penalty was calculated incorrectly; the reason given for the error gave rise to another error of stating the disclosure to be 'unprompted'; it is unacceptable that the appellant is being penalised for making a mistake while it has 'no way of penalising HMRC for their mistakes'.

(4) The appellant gave full co-operation throughout the enquiry and was penalised for 'not understanding a complex part of the tax legislation'. The disclosure should be 'unprompted' as the MacDonalds were 'of the understanding that they were not liable to register for VAT as backed up by the exemptions team'.

(5) HMRC did first describe the disclosure as 'unprompted', and the penalty should be overturned or at the very least be lowered to the original penalty of £267.30.

HMRC's case

50. For the respondents, Mrs McIntyre submitted that:

(1) The sale of the art works is by the appellant and the full value of the monies paid to the galleries are the value of the supplies. The works are supplied on a sale or return basis, and as such they remain the property of the appellant's.

(2) The monies paid by the appellant to the galleries, or deducted by the galleries from the monies paid to the appellant are a charge for the supply of selling service made by the galleries.

(3) By virtue of HMRC's letter issued on 23 January 2015, the disclosure has to be treated as 'prompted' with the letter enquiring into the appellant's VAT position.

(4) The penalty range for non-deliberate behaviour and prompted disclosure of more than 12 months after the occurrence of failure is statutorily determined at 20% to 30%.

(5) The 80% reduction for the quality of disclosure is fairly assessed.

(6) HMRC consider that there are no circumstances to give rise to a special reduction.

(7) A complaint made about HMRC's conduct does not fall to be treated as an appealable matter within s 83 VATA 94, and is not within the remit of the Tribunal.

Discussion

The burden of proof

51. The following facts in relation to this appeal are not in dispute.

(1) The sale of art works to non-EU countries (such as the US) is zero-rated, which means that the net value of the sales must be included for the purposes of determining whether the mandatory VAT registration threshold has been breached.

(2) By reckoning turnover on such basis, the appellant's rolling 12-month turnover figures for the years concerned gave rise to two periods when the relevant registration threshold was breached. The calculation of the VAT liabilities totalling £5,573 from the two LNLL periods are not in dispute, which fixes the quantum of the PLR for penalty purposes at £5,573.

52. Given that the appellant does not contend the veracity of these two facts, there is a prime facie case that the appellant had failed to notify its liability to register for VAT for the wo LNLL periods. Based on these facts, the respondents have met the burden of proof that a penalty is imposable on the appellant under Sch 41 in relation to its failure to notify its liability.

Issues for determination

53. The principal issue for determination in this appeal is whether the appellant had a reasonable excuse for its failure to register for VAT in relation to the two LNLL periods. If there was no reasonable excuse, or if the excuse did not exist for both periods, then we consider whether the quantum of the penalty set with reference to the disclosure being 'prompted' is correct, and whether HMRC's decision regarding special reductions is 'flawed'.

Whether reasonable excuse

54. The grounds of appeal as stated for the appellant appear to be various criticisms of HMRC's conduct and communications during the enquiry, which may be valid in a complaints procedure but are not relevant to considering whether the appellant had a reasonable excuse.

55. The appellant has not explicitly pleaded reasonable excuse, but in the interests of justice, we consider the stated grounds as best we can in the light of reasonable excuse, in terms of: (a) the appellant's reliance on HMRC's advice which was 'conflicting'; and (b) that the appellant had entertained a mistaken belief that it had no obligation to register for VAT.

Conflicting advice

56. In relation of the first ground for reasonable excuse concerning the 'conflicting advice' given by HMRC, our findings of fact are restricted to the documentary evidence, and our conclusions thereof are as follows.

(1) The advice referred to by the appellant as being conflicting would seem to arise during the course of the VAT registration enquiry. In other words, the so-called conflicting advice post-dated the instances of failure to register for VAT.

(2) For this reason alone, it cannot be argued that the conflicting advice had caused the failure to register in the first place. The failure occurred at the juncture when the mandatory threshold was breached, namely: at 1 March 2011 or 1 April 2012.

(3) Specifically, the alleged advice contained in HMRC's letter of 10 July 2015 (at §20) seems to focus on one statement; namely: 'we are not satisfied that your client is liable to register for VAT'. The statement was made more than four and three years after the respective breaches.

(4) For this reason, what was construed to be HMRC's advice during the enquiry period, whether indeed conflicting or otherwise, could not have given rise to a

reasonable excuse for the appellant's failure to register for VAT in March 2011 and April 2012 as a matter of timing.

(5) Furthermore, the letter of 10 July 2015 continued by stating: '… we have not granted exemption from VAT registration, but we have not registered them for VAT'. Read in context, the statement which had given rise to 'conflicting advice' as alleged would appear to be a *prospective* ruling by the VAT Registration Service as at July 2015; it was not a *retrospective* ruling to be applied to March 2011 or April 2012.

(6) The letter of 10 July 2015 continued by stating that: 'Your client must inform [HMRC] promptly if their circumstances change', and that to 'either reapply for exemption from VAT registration' or to apply to register if the taxable supplies 'should exceed the VAT registration threshold *in the future*' (emphasis added).

(7) We are of the view that the letter of 10 July 2015 is to be read in the context of HMRC giving a prospective ruling. If the letter gave rise to 'conflicting advice' as relevant to this appeal, it was due to a misconstruction by interpreting the statement – 'we are not satisfied that your client is liable to register for VAT' as having any retrospective effect.

57. In these circumstances, we dismiss the first ground of reasonable excuse, since there could be no causation between HMRC's views stated during the enquiry period and the failures that pre-dated the enquiry.

58. For completeness, we have also considered whether the 'conflicting advice' assertion extended to include what Mr MacDonald referred to as advice from the local VAT office in London, which pre-dated the failures. In essence, Mr MacDonald asserted that he had acted on that advice and had failed to register as a result. However, since we have no evidence of what advice had actually been given by the VAT office in London, we have no basis to consider this ground under the heading of 'conflicting advice'. Instead, we consider what has been asserted by Mr MacDonald under the heading of 'mistaken belief' (however formed).

Mistaken belief

59. Mr MacDonald was clear in his evidence that he obtained this so-called advice from the VAT office second-hand via his former accountant, and that he understood the advice to mean that the sales made to buyers in the US were to be excluded from his turnover in reckoning the threshold for VAT registration purposes. Regardless of what the actual advice consisted of, it would seem to have crystallised into an understanding on Mr MacDonald's part that supplies to non-EU countries were 'exempt' from VAT.

60. Furthermore, for the appellant, Ms Farrol submitted that this was a 'complex' area of law, and that Murray Taylor has dealt with clients where the VAT treatment can differ depending on 'the place of supply' rather than on what is actually supplied. It was also stated in correspondence that Mr MacDonald was under the impression from the galleries that any VAT due was dealt with by the galleries. For present purposes, we focus on the mistaken belief regarding the VAT status of supplies made to non-EU countries, since the VAT position in relation to the arrangements with the galleries has not been fully contended.

61. While we do not doubt that Mr MacDonald held an honest and genuine belief that his supplies to the US were exempt, that belief cannot, of itself and without more, amount to a reasonable excuse, as the line of authority in this respect has made clear.

(1) In *Garnmoss Ltd v HMRC* [2012] UKFTT 315 (TC), where there was a *bona fide* mistake made, it is stated at [12] that while the mistake 'was not a blameworthy one, the Act does not provide shelter for mistakes, only for reasonable excuse'.

(2) Similarly, in *Coales v HMRC* [2012] UKFTT 477 (TC), Judge Brannan stated at [32]: 'The test contained in the statute is not whether the taxpayer has an honest and genuine belief but whether there is a reasonable excuse.'

(3) The test for reasonable excuse in relation to a mistaken belief was set out by Judge Medd in *The Clean Car Company Ltd v C&E Comrs* [1991] VATTR 239:

> '… can the fact that the taxpayer honestly and genuinely believed that what he did was in accordance with his duty in relation to claiming input tax, by itself provide him with a reasonable excuse. In my view, it cannot. … In my judgment it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?'

(4) In similar terms, the Upper Tribunal decision in *Perrin v HMRC* [2018] UKUT 156 (TCC) sets out the correct test for reasonable excuse at [71]:

> 'In deciding whether the excuse put forward is, viewed objectively, sufficient to amount to a reasonable excuse, the tribunal should bear in mind all relevant circumstances; because the issue is whether the particular taxpayer has a reasonable excuse, the experience, knowledge and other attributes of the particular taxpayer should be taken into account, as well as the situation in which that taxpayer was at the relevant time or times …'

(5) As to the issue whether ignorance of the law can amount to a reasonable excuse, the Upper Tribunal decision in *Perrin* gives helpful guidance at [82] as follows:

> '… It is a much-cited aphorism that "ignorance of the law is no excuse", and on occasion this has been given as a reason why the defence of reasonable excuse cannot be available in such circumstances. We see no basis for this argument. Some requirements of the law are well-known, simple and straightforward but others are much less so. It will be a matter of judgment for the FTT in each case whether it was objectively reasonable for the particular taxpayer, in the circumstances of the case, to have been ignorant of the requirement in question, and for how long. The *Clean Car Co* itself provides an example of such a situation.'

62. In summary, the correct legal test for deciding whether the facts in question gave rise to a reasonable excuse is the one as stated at [88] by the FTT in *Perrin v HMRC* [2014] UKFTT 0488 (TC), and approved by the Upper Tribunal: 'to be a reasonable excuse, the excuse must not only be genuine, but also objectively reasonable when the circumstances and attributes of the actual taxpayer are taken into account'.

63. Having regard to Mr MacDonald's oral evidence, and his replies to HMRC's questionnaire as detailed at §37, our findings of fact and conclusions thereof are as follows.

(1) The point of law in question is the VAT treatment of supplies made to the US. Goods supplied to the US are at the zero rate for UK VAT purposes, which means while output VAT is not charged on the value of the goods, the value of the supplies is included as part of the trader's turnover for VAT registration purposes.

(2) Mr MacDonald held the belief that the supplies he made to the US were 'exempt' for VAT purposes, which means taking the supplies outside the VAT regime. Output VAT is not chargeable on exempt supplies, and the value of the exempt supplies is not included as part of the trader's turnover for VAT registration purposes.

(3) From the perspective of Mr MacDonald as a supplier, the effect of making zero-rated or exempt supplies would appear to be identical; that is, no output VAT is charged.

(4) Mr MacDonald's mistaken belief was to equate not charging output VAT with making exempt supplies, while as a matter of law, he was making zero-rated supplies.

(5) In the light of the subjective attributes of Mr MacDonald, being an artist with limited expertise in accounting and taxation matters, against the objective factual matrix of the point of law at issue, the mistaken belief he had held was objectively reasonable.

64. We also have regard to the fact that the point of law at issue is neither well-known, simple or straightforward. Administrative delays apart, the length of the enquiry itself is indicative of the complexity involved behind reaching the final conclusion as communicated in the letter of 23 November 2016 regarding the two LNLL periods. From the enquiry correspondence, it is evident that the VAT registration position is further complicated if a trader's supplies of goods are not exclusively to non-EU countries, but also include supplies to the UK and the EU. A trader making supplies in part to non-EU countries can be excepted from registration by meeting certain conditions, which are outlined in the letter of May 2018 by the VAT Registration Service (see §18).

65. In other words, even though the 12-month rolling turnover of the appellant during the two LNLL periods had breached the relevant mandatory registration thresholds at the time, if the appellant had met the exception conditions for those two periods, VAT registration could have been excepted. The 'exception' from mandatory registration is conditional, which means it needs to be monitored to establish that the exception conditions continue to obtain.

66. Furthermore, the Tribunal is of the view that HMRC's use of terminology in this area can easily give rise to confusion to a layman. The term 'exception' from registration should be used instead of 'exemption' from registration: 'exception' connotes that VAT registration is applicable as a matter of law to the fact in question but in particular instances, the registration requirement can be *excepted* (such as when para 1(3) of Sch 1 to VATA conditions are met). The use of the term 'exemption' in the context of VAT registration has no doubt contributed to the matter being confused with making exempt supplies by a layman such as Mr MacDonald.

67. For these reasons, we conclude that the appellant did have a reasonable excuse for its first failure to register for VAT, by virtue of the mistaken belief held by Mr MacDonald that its supplies to the US were exempt from VAT. The penalty of £958.76 in relation to the first LNLL period, on the sum of PLR of £4,358 at 22%, is discharged.

68. Paragraph 20(2)(c) of Sch 41 provides that a taxpayer 'is to be treated as having continued to have the excuse if the relevant act or failure is remedied without unreasonable delay after the excuse ceased'. For the following reasons, we conclude that the reasonable excuse did not continue to cover the second LNLL period.

(1) Mr MacDonald changed his accountants in 2010 to 'someone more professional'. The phrase 'someone more professional' was used by him in evidence, which suggested to us that he had an inkling that the appellant required a higher level of expertise to advise it fully on its business and on its compliance and statutory obligations.

(2) However, it would appear that incomplete information was given to Murray Taylor, which meant that they could not advise the appellant properly on its VAT position.

(3) In their letter to HMRC dated 23 December 2015 (at §25), Murray Taylor remarked that it was '[u]pon further discussions with our clients' that 'it has become apparent that they had been selling their art work on a sale or return basis'.

(4) In that letter, Murray Taylor also advised that 'the galleries have informed [the MacDonalds] that the majority of the paintings were shipped to non-EU customers and were zero-rated'.

(5) The remittance advice from the Royal Scottish Academy suggests that the destination of the supplies would have been stated (on the reverse side) for such information to be collated at the time.

(6) As remarked in the letter of 23 December 2015, the spreadsheets provided to Murray Taylor would appear to have been prepared incorrectly, and that the MacDonalds have 'mistakenly, just included their dealings with the galleries as UK income, when, in fact, items were sold to non-EU countries'.

(7) From the evidence we heard, Mr MacDonald, while having decided to change his accountants to 'someone more professional', did not seem to have taken the opportunity to re-examine the VAT position. If he had done so, those facts that only transpired in December 2015 would have been made available earlier to Murray Taylor.

69. We are of the view that Murray Taylor is adept at advising on the VAT positions on exports, as Ms Farrol mentioned that some of their clients exporting to the US have complex VAT positions. We infer from her submissions that the firm is conversant with the general and specific rules in relation to the supply of *services* (as distinct from *goods*) whereby the VAT treatment varies according to the place of supply, and whether the supply is to a 'consumer' or to a 'business'. Had Mr MacDonald taken the care to provide full information to Murray Taylor, he would have been properly advised of the VAT position of the partnership.

70. We also infer from the note of telephone call (at §36(2)) that it had taken time and some effort from Ms Farrol to dislodge the mistaken belief held by Mr MacDonald before he had his 'light bulb moment' in January 2017. It seems to us that once the belief was formed, Mr MacDonald did not re-examine his premises, nor consult 'someone more professional' (even when such a professional was engaged) to review the matter. We conclude that this was not what a prudent taxpayer, intent to comply with his compliance obligations, would have done, especially in view of his conclusion that he needed 'someone more professional' to advise him.

71. For these reasons, the penalty of £267.30 for the second LNLL period is upheld.

Other matters

Whether disclosure prompted or unprompted

72. Parties have expended much time during the hearing in arguing the meaning of 'unprompted' disclosure, which is statutorily defined under sub-para 12(3) of Sch 41. An unprompted disclosure was made 'at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the relevant act or failure'. The matter is to be determined as a matter of fact, and we find as a fact that the failure was 'disclosed' in the course of HMRC enquiry. As such, the disclosure does not fall within the meaning of 'unprompted' as defined under Sch 41; the plain fact is that the disclosure was 'prompted'.

73. The fact that HMRC had made a mistake in their correspondence referring to the disclosure as ‘unprompted’ does not detract from our finding of fact. The penalty range is therefore correctly determined according to the percentages set down by the statute.

No statutory provision for suspension

74. There is no statutory provision to suspend a Sch 41 penalty, as proposed by Murray Taylor at one stage of the correspondence. As a form of relief, suspension of a penalty is expressly provided for in the legislation, such as under para 14 of Sch 24 to FA 2007. Instead of ‘suspension’, para 14 of Sch 41 provides for ‘staying a penalty’ only, which falls under the heading of ‘Special reduction’. The legal meaning of ‘staying’ a penalty does not equate to ‘suspending’ a penalty, and relates to the proceedings for a penalty. In the present appeal, had the liability to register for VAT been a matter in dispute, the penalty imposed in relation to the failure to notify could be stayed until the matter on registration had been determined. There is no such dispute, and the consideration of staying the penalty is not in point.

Special reduction

75. HMRC’s review conclusion refused special reduction, having considered the facts available at the time of the review. We do not consider the decision on special reduction to be ‘flawed’ in the judicial review sense for the Tribunal to substitute its own decision.

Disposition

76. The penalty in the sum of £958.76 is discharged; the penalty in the sum of £267.30 is confirmed. The appeal is allowed in part.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

77. 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.

DR HEIDI POON

TRIBUNAL JUDGE

RELEASE DATE: 30 SEPTEMBER 2019

Amended pursuant to Rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 15 November 2019 to correct the name of the respondents’ representative.