[2017] UKUT 180 (TCC)
Appeal number: UT/2016/0099

MONEY LAUNDERING — financial penalty imposed on estate agents reduced by FTT from £169,652 to £5,000 — costs — whether HMRC acted unreasonably in defending or conducting proceedings — costs decision of FTT set aside and remade — appeal allowed but costs direction made

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS — **Appellants**

- and -

JACKSON GRUNDY LIMITED — **Respondent**

TRIBUNAL: Judge Colin Bishopp
Judge Timothy Herrington

Sitting in public at The Royal Courts of Justice, Strand, London WC2A 2LL on 1 February 2017

Peter Mantle, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Alan Bates, Counsel, instructed by Franklins LLP, Solicitors, for the Respondent

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DECISION

Introduction

1. On 9 March 2016 the First-tier Tribunal ("FTT") (Judge Nowlan and Mrs C Debell) released a decision allowing an appeal by Jackson Grundy Limited ("JGL"), an estate agency, against the amount of a penalty imposed under Regulation 42 of the Money Laundering Regulations 2007 ("the Regulations"). In its decision (the "Penalty Decision") the FTT reduced the amount of the penalty from £169,652 to £5,000 on the basis that the original penalty was disproportionate. We will come to the FTT's reasons for reaching that conclusion later.

2. On 29 March 2016 JGL applied to the FTT for a direction that the Appellants ("HMRC") pay its costs incidental to and consequent upon the proceedings before the FTT, pursuant to Rule 10(1)(b) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the "Rules"), on the ground that HMRC "acted unreasonably in … defending or conducting the proceedings." By this time Judge Nowlan had retired and the application came before Judge Brooks.

3. On 24 May 2016 Judge Brooks released his decision on the costs application (the "Costs Decision"). He concluded that HMRC acted unreasonably in defending the appeal against the penalty and directed that HMRC pay JGL's costs of and incidental to the appeal, such costs, in the absence of agreement, to be subject to a detailed assessment pursuant to Rule 10(6)(c) of the Rules. In the same decision notice, Judge Brooks granted HMRC permission to appeal against the Costs Decision; he had previously given HMRC permission to appeal against the Penalty Decision.

4. HMRC do not pursue their appeal against the Penalty Decision and accordingly this decision is concerned purely with HMRC's appeal against the Costs Decision.

The facts

5. In order to put the Costs Decision into context, it is necessary to set out in some detail the events that led to the imposition of the penalty, and the history of the appeal and application to the FTT.

6. Estate agencies are among the businesses required to maintain appropriate procedures pursuant to the Regulations to assist in the combating of money-laundering, investment in real estate being seen both as an investment that those involved in criminal activity might make with "dirty money" and also a possible method of transposing "dirty money" into "clean money" by investing the "dirty money" in real estate which is subsequently disposed of. In the case of JGL, these procedures were only necessary in relation to its activities as a sales agent.

7. The Regulations set out obligations on the part of those who are subject to them to check the identity of clients, to monitor their identity on an ongoing basis, to adopt and circulate written policy statements in relation to money laundering procedures, to train

staff in relation to their responsibilities and to keep records of the identity checks undertaken. It is common ground that a "risk based approach" can be taken to the Regulations; the procedures may be less intensive in cases where the actual risk of money laundering is low. In its Penalty Decision the FTT found that to be the case in relation to JGL, which had offices in small towns in rural Northamptonshire and which acted only for potential vendors, many of whom were well known to its office managers.

8. As we explain in more detail below, the Office of Fair Trading ("the OFT") was responsible for the supervision of estate agents and their compliance with the Regulations until the OFT was abolished on 31 March 2014. Those functions were assumed by HMRC on the following day. HMRC were already responsible for the supervision of other businesses perceived to present a money laundering risk.

9. On 22 June 2012 the OFT undertook a compliance visit to JGL. It produced a report of the visit which concluded that there had been "significant and widespread" failings in JGL's observance of the Regulations. In particular, it found the following failures on the part of JGL:

(1) to apply adequate client due diligence measures when establishing business relationships in respect of properties which it marketed;

(2) to assess the extent of client due diligence measures that it should adopt on a risk sensitive basis and to demonstrate that the extent of those measures was appropriate in the circumstances;

(3) to conduct ongoing monitoring of business relationships to ensure transactions were consistent with knowledge of the client which JGL should have obtained;

(4) to keep required records of clients' identity and supporting records;

(5) to establish and maintain appropriate risk sensitive policies and procedures relating to appropriate client due diligence measures and ongoing monitoring and reporting, record-keeping, internal control, risk assessment and management and monitoring and managing internal communication of and compliance with such policies and procedures; and

(6) to take appropriate measures to ensure that all relevant employees were made aware of the law relating to money laundering and terrorist financing and to give appropriate training, in particular how to recognise and deal with transactions which may be related to money laundering and terrorist financing.

10. There was never any allegation that these failures had led to any actual instances of JGL having facilitated transactions related to criminal activity, money laundering or terrorist financing.

11. In December 2013 the OFT notified JGL that, in the light of its findings, it intended to impose a penalty of £200,000 on JGL pursuant to Regulation 42 of the Regulations.

12. JGL made representations to the OFT as to why it considered that the penalty was excessive. It conceded that there had been failings and that it would accept a penalty of £20,000. JGL contended in its representations that it was inappropriate for the penalty to be 17 times greater than any earlier penalty imposed on estate agents, particularly when earlier penalties had been imposed for repeated failures, following warnings, and it was stressed that JGL never dealt with conveyancing so that other parties involved in the sales of the properties it had marketed, such as solicitors and mortgage lenders who were also subject to the Regulations, would be undertaking the relevant checks as well. It also represented that the directors derived most of their remuneration from dividends taken out of the profits of the business, so that a penalty constituting a very significant proportion of the profits was going to cause considerable hardship to the directors.

13. The Regulations give no guidance as to how penalties should be calculated beyond the requirement in Regulation 42(1C) that a penalty must be "effective, proportionate and dissuasive."

14. The OFT had adopted what it described as an "interim penalty policy" (IPP) in relation to the imposition of penalties on estate agents, which was based to a large extent on the policy adopted in relation to breaches of competition law. The policy followed a four step approach as follows:

> Step 1: the turnover of the firm was calculated. In relation to an estate agency, the relevant turnover was its entire gross turnover, excluding that from letting activities. Initially, the OFT had failed to deduct JGL's income from lettings; the correction of that omission led to the reduction of the proposed penalty from £200,000 to £169,652.
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> Step 2: a percentage multiplier was then applied to the turnover figure, that multiplier being either 0%, 5%, 10% or 15% depending on the seriousness of the misconduct in question. The highest percentage was reserved for the most serious cases, being said to include behaviour such as the direct involvement of the business itself in money laundering, terrorist financing or other financial crime. The 10% figure applied to "breaches committed deliberately or recklessly" or cases where senior management were aware of, or should have been aware of the breaches. The 5% figure applied to less serious breaches, and 0% to minor breaches attributable to inadvertent error.
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> Step 3: this step made provision for either an increase or reduction in penalty where there were either mitigating or aggravating circumstances. Mitigating factors were said to be cooperation of the business with the OFT after breaches had been identified and the fact that remedial action had been taken.
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> Step 4: this step directly raised the issue whether the penalty initially calculated under the first 3 steps was appropriate, that is whether it could be said to be "effective, proportionate and dissuasive." Therefore, this step allowed an adjustment where the application of the purely mechanical processes of Steps 1 and 2, as adjusted after Step 3, did not in all the circumstances produce an appropriate result.

15. Following consideration of JGL's representations, the penalty was imposed in a decision letter dated 26 March 2014. Having adjusted the turnover figure to exclude the lettings turnover, a 10% figure was applied under Step 2, a 10% reduction was applied under Step 3 for cooperation, but no adjustment was made to the calculated figure under Step 4. The OFT expressed the view that Step 4 was of principal relevance "in relation to unusual circumstances" and that there were no unusual circumstances in JGL's case.

16. The transfer of the responsibility for the supervision of estate agents pursuant to the Regulations to HMRC with effect from 1 April 2014 brought with it a right to an internal review of the penalty, including any penalty imposed prior to 1 April 2014 by the OFT, in advance of any possible appeal to the FTT. Accordingly, on 2 May 2014 JGL's solicitors wrote to HMRC requesting a review of the penalty.

17. At the time of the review HMRC had their own penalty policy which was applied in relation to those industry sectors for which they had supervisory responsibility under the Regulations. Penalties were calculated by HMRC on a quite different basis from that used by the OFT. HMRC started with a fixed penalty of £5,000. That was then increased to reflect how many relevant transactions the party in breach had undertaken in the period during which the breaches occurred and further adjustments were made according to how many different failings the firm had been responsible for. In its Penalty Decision the FTT explained that a penalty imposed by reference to HMRC's guidelines would have produced a penalty of £22,500, subject to adjustment to make it "effective, proportionate and dissuasive". It is inherent in what else the FTT said in that decision that it expected that any further adjustment which might have been made would have led to a reduction, rather than an increase, in the calculated amount.

18. It is also worth observing that the Financial Conduct Authority, which has amongst its functions supervision of compliance with the Regulations by those operating in the financial services sector, has a penalty policy which has some similarity with that of the OFT in that it is based on a four step approach which applies a percentage multiplier to the relevant revenue of the firm, the result of which is adjusted to take account of mitigating or aggravating circumstances and an overall assessment as to whether the result achieves the Authority's objective of credible deterrence. However, unlike the IPP, the Authority's policy makes it clear that it recognises that there may be cases where revenue is not an appropriate indicator of the harm or potential harm that a firm's breach may cause, and in those cases the Authority will use an appropriate alternative.

19. On 17 September 2014 HMRC wrote to JGL to say that the conclusion of the reviewing officer was that the penalty was properly issued and should be upheld in full. HMRC declined to apply their own guidelines, but said in the review letter that as HMRC did not have a policy in place for fixing appropriate penalties in the estate agency sector at the time the breaches occurred it would not be appropriate to apply retrospectively the policies HMRC have formulated to deal with the sectors and types of business for which they were the regulatory authority at the relevant time. It appears that HMRC adopted the guidelines that they applied to other businesses prior to 1 April 2014 when imposing penalties on estate agents after that date, at least in relation to behaviour that occurred after that date; the position with respect to behaviour which

occurred before that date but led to the imposition of a penalty thereafter is unclear to us.

20. Accordingly, HMRC reviewed the penalty by reference to the IPP. The review letter recognised that step 4 of the IPP was intended to be a "check" to ensure the resultant penalty is appropriate for the business in question; that is, it meets the requirement to be effective, proportionate and dissuasive. HMRC concluded that although the resultant penalty was substantial in absolute terms it was an appropriate one, observing that the penalty had to be large enough to be dissuasive when set against any actual or potential profits of the supervised activity of the business and to act as a deterrent to other similar businesses in the UK market.

21. On 17 October 2014 JGL gave notice of its appeal to the FTT. In that notice, it suggested that a penalty of between £15,000 and £20,000 would be "appropriate" and therefore compatible with Regulation 42(1C), and it identified that as the result sought by its appeal. In its skeleton argument before the FTT, £15,000 was referred to as the amount that JGL considered to be appropriate.

22. On 15 January 2015 HMRC filed their statement of case. In essence, HMRC defended the penalty set by the OFT on the basis of the reasoning in the review letter, largely on the basis that the OFT had followed its established policy when considering the level of penalty. There was little explanation as to why HMRC considered the penalty to be proportionate, although the statement of case did contend that even if HMRC's penalty regime had been applied instead "it is not necessarily the case that a relatively low penalty would have been imposed given the gravity and protracted nature of the breaches here and hence the difference between the OFT and [HMRC's] regimes may not be as marked as is suggested." HMRC observed that their own regime allowed the penalty framework to be suspended in cases where there is reason to believe that the level of the penalty calculated using the penalty framework would not be dissuasive. In other words, HMRC were clearly intending to defend the full amount of the penalty imposed rather than accept that any lesser amount might be appropriate.

23. Until a very late stage there was no attempt on the part of either party to initiate settlement discussions. HMRC have some doubt whether settlement of an appeal of this type is possible once a penalty has been imposed, a point that we return to later. HMRC accept, however, that JGL would have agreed to settle the appeal (assuming that were possible) on the basis that the penalty be reduced in amount to a figure between £15,000 and £20,000.

24. On 17 February 2016, one week before the hearing of the appeal against the penalty commenced, JGL's solicitors in responding to HMRC on other matters attempted to persuade HMRC not to defend the full amount of the penalty. Having observed that HMRC's case appeared to be solely that the penalty was appropriate because it was set by application of the IPP but that such an approach could not be reconciled with an acceptance by HMRC that it was now for the FTT to determine the appropriate amount of the penalty afresh, the letter said:

> "Our client is a relatively small estate agency business operating within the county. It is emerging from a period of acute financial difficulties. The costs of these

> ongoing proceedings therefore represent a very heavy burden for our client. Accordingly, we call upon HMRC to consider whether its continued resistance of this appeal represents action to be expected of a responsible public authority, or whether HMRC should instead agree to itself set an appropriate penalty amount in this case (therefore doing what will otherwise anyway be the FTT's task next week) rather than continuing to try to defend the decision of another, now abolished, public body which is not compatible with HMRC's own guidelines."

25. HMRC, in an email of 23 February 2016, confirmed that they did not intend to withdraw the decision in dispute. That remained their position when the hearing before the FTT began.

The Penalty Decision

26. At no stage in the proceedings did JGL contest the OFT's findings that there had been serious breaches of the Regulations on its part, findings which the FTT indicated, in the Penalty Decision, were justified. The FTT did however, make a number of observations as regards the manner in which JGL carried on its business and its approach to its responsibilities in respect of money laundering.

27. The FTT found at [8] that at its regular meetings of office managers JGL would have discussed any concerns about the identity of particular vendors. At [13] the FTT said that a very considerable majority of potential clients were going to be well known to the office managers anyway, with the result that the managers did not ask to see evidence of identity of people whom they already knew. The FTT also found that JGL did not keep copies of evidence of identity, in those cases when it had felt it necessary to identify clients formally, that is vendors who were not already well known to the office manager.

28. The FTT was clearly impressed with the evidence of JGL's managing director, Mr Jackson, and at [35] accepted his evidence that he had familiarised himself with the requirements of the Regulations and had always endeavoured to ensure that JGL's business was conducted in a professional way, and with a high degree of integrity. The FTT also accepted at [36] that all of JGL's office managers were aware of their money laundering responsibilities and, although recognising that it was not in conformity with the Regulations, understood why proof of identity was not sought by JGL from potential clients known to the branch managers and why JGL did not keep copies of identity documentation obtained from potential clients the branch managers did not know because of their concerns about loss or compromise of documents that could lead to identity theft. The FTT also found that virtually the entire burden of complying with the obligations fell on the office managers because it was they who invariably conducted the first meeting with potential clients, with the result that the training of other employees was less relevant.

29. At [37] the FTT found, on the strength of Mr Jackson's evidence, that JGL's failings were "more technical than substantive". It then made this finding at [38]:

> "We consider that the visiting officer's judgment on and after 22 June 2012 was rather clouded by failings of recording and documentation, and that insufficient

> attention was given to the fact that in reality [JGL's] conduct would have been most unlikely to allow a fraudster to proceed unchecked, at least in the cases where none of the more formal procedures would have identified anything anyway."

30. At [39] the FTT criticised the OFT for having made just one visit, for not having spoken to a single office manager, and for being ready to impose a highly significant fine on the basis of inadequate information.

31. Turning to the calculation of the penalty, the FTT considered that, bearing in mind the nature of the breaches, the 5% multiplier of step 2 would have been more appropriate than the 10% multiplier and it was highly critical of the way that the OFT dealt with step 4. It said at [46]:

> "Our main criticism relates, however, to the way in which Ms Johnson [the OFT officer who imposed the penalty] decided, without any direction in the IPP to do so, to assume that step four was only designed to modify the earlier mechanical calculations where there were 'unusual circumstances'. She eventually conceded in a question from us that the rigid principles of the first three steps would only lead to the imposition of reliable and proportionate penalties if step four was applied in a flexible manner. By that we mean that at the very least the officer considering the application of what might be 'effective, proportionate and dissuasive' could hardly consider a penalty on a relatively small firm of then struggling estate agents to be proportionate when it represented roughly half of the firm's net profits, and profits largely destined to satisfy the ordinary and fairly modest remuneration expectations of the directors. Furthermore, when the failings were in fact more failures of recording, rather than substantive failings likely to enable fraudsters and terrorists to invest in real property in Northamptonshire villages and to slip through the net of protection, the feature that the penalty was 17 times higher than any earlier penalty imposed on a firm of estate agents seems to us to have been outrageous."

32. The FTT then concluded at [54] that the penalty would be reduced to £5,000, based on a modified application of the current HMRC guidelines. In that regard, it declined to add anything to the basic penalty to take account of the number of transactions involved during the relevant period because most of the clients concerned were already known to JGL's office managers. It also treated the failings as only amounting to a single composite failing of dealing appropriately with documentation and made a further reduction to reflect the damage to JGL's business caused by the unwelcome publicity which occurred when details of the original penalty were published by the OFT. In its summary of findings at [4] the FTT stated that it considered that the initial calculation of the penalty "for failings that were more trivial than substantive (largely being related to record-keeping and documentation) was wholly disproportionate and unjust."

33. The FTT made some observations at [55] about the manner in which HMRC had dealt with the appeal as follows:

> "We also record that we consider that it was improper for the Respondents to have persisted in defending the OFT level of penalty and to have rejected the Appellant's suggestion that the Respondents should accept a penalty offer of £15,000, and settle the case, so avoiding the costs of litigation. We have not considered the professional costs incurred by the Appellant in fixing the level of penalty, since this is a case in which we can only award the Appellant their costs if

> they establish unreasonable conduct. We understand that the Appellant will be making a written application for costs on that basis and that the Respondents will have an opportunity to oppose it. Our present tentative conclusion is that it would be wrong to take the professional costs into account, as a back-door manner of effectively granting the Appellant its costs, by further reducing the penalty, as fixed by us. We doubt, in any event, whether the level of penalty would enable the claimed costs to be fully recovered. We confirm however that that approach in relation to the calculation of the penalty is one that the parties (particularly of course the Appellant) may wish to submit further representations upon, and we also clearly indicated to both parties that each would have an opportunity to make representations in relation to a wasted costs order."

34. We interpose that the reference to "a wasted costs order" appears to be a slip of the pen; it has never been suggested that such an order might be made in this case.

35. The FTT had made similar observations in its summary of its findings at [4] where it said:

> "Furthermore, in the light of the plea made on behalf of the Appellant (made shortly before the commencement of the hearing) that the Respondents should abandon their defence of the present Appeal, and accept the Appellant's offer to pay a penalty in settlement of £15,000, in order to save the still financially stretched Appellant from the very considerable costs of the Appeal, we consider that it was improper for the Respondents to continue their defence of the Appeal as they did."

36. Finally, the FTT said at [56]:

> "We conclude by saying that we consider that the Appellant has suffered a very considerable injustice in this case. The worry that Mr. Jackson will have suffered as a result of the imposition of the excessive penalty, the embarrassment that he may have felt viz a viz his fellow directors and office managers, as the person in the business principally responsible for attending to the Appellant's money laundering responsibilities, and the resultant freezing or reductions of remuneration that all have suffered will all have imposed a heavy burden on Mr. Jackson. We greatly regret this."

37. JGL had stated in its skeleton argument before the FTT, submitted in advance of the hearing of its appeal against the penalty, that it would be seeking its costs in relation to the appeal on the basis that HMRC had acted unreasonably in resisting the appeal.

38. There was some discussion at the end of that hearing as to whether the FTT should deal with the question of costs in its substantive decision. The transcript of the hearing shows that, after some discussion, the FTT decided that the appropriate way to proceed was for JGL to apply for costs in writing once the substantive decision had been released and that it would be appropriate for HMRC to be given time to respond to the application. Mr Peter Mantle, counsel for HMRC before the FTT and before us, pointed out to the FTT that in that event it might be necessary for there to be a further hearing on the costs application. The FTT accepted that point.

39. After the hearing had concluded, there was a short adjournment following which the FTT returned to communicate its decision on the appeal. The FTT then set out brief reasons for concluding that the right penalty in the case was £5,000. The FTT observed

that the fact that JGL's "offer", which we take to be its indication in its notice of appeal that it would accept a penalty of £15,000, was three times the amount of the penalty actually imposed, which may be a factor in relation to the question of costs.

40. These points on costs are reflected in the Penalty Decision at [55], as quoted at [33] above.

The Costs Decision

41. JGL made its application for costs pursuant to Rule 10(1)(b) of the Rules on 29 March 2016. The basis of the application was that HMRC adopted an unreasonable stance in relation to the appeal by defending it and persisting in doing so purely on the basis of the fact that the penalty was the amount decided upon by the OFT under the IPP, without giving any real consideration as to whether that amount could be justified under the legislation, or what penalty the FTT (which of course was not bound by the IPP) would be likely to consider to be appropriate. JGL contended that it was unreasonable for HMRC "to reject [JGL's] offer to accept a penalty of £15,000 (or £20,000) in order to spare both parties the costs of the appeal hearing." It also contended that, as they had assumed responsibility for monitoring estate agents, and were undertaking a review of the OFT's decision with the consequence that they had the opportunity of reconsidering the proper approach, they should instead have adopted their own policy. JGL relied too on the FTT's finding at [55] of the Penalty Decision that HMRC's defence of the appeal was "improper". The application attached a schedule showing that the costs incurred by JGL in pursuing the appeal amount to £55,887.17, excluding VAT.

42. HMRC made lengthy written submissions in response to the application on 6 May 2016. In summary, they resisted the application on the following grounds:

(1) The FTT had already prejudged the matter on the point of acting unreasonably in defending the appeal, without giving HMRC the opportunity to make representations on it;

(2) HMRC, having upheld the penalty on a statutory review, did not have any power under the Regulations to remake or vary the amount of the penalty;

(3) JGL did not initiate any negotiations with HMRC in an attempt to settle the appeal, although HMRC accepted that JGL would have agreed to settle the appeal if that were possible on the basis that the penalty be reduced in amount to something between £15,000 and £20,000;

(4) HMRC did not regard a penalty of that amount as appropriate; although the FTT reached a different conclusion after hearing Mr Jackson's evidence it was not unreasonable for HMRC to consider that a penalty of between £15,000 and £20,000 was too low to be appropriate;

(5) it was reasonable to take the view that a penalty of £20,000 was too low to be appropriate and that there was a reasonable prospect of the FTT fixing a penalty significantly above that amount;

(6) JGL admitted breaching the Regulations and accepted that the breaches were serious; in those circumstances by defending the appeal HMRC was legitimately and reasonably seeking the verdict of the FTT on the appropriate amount of the penalty; and

(7) JGL took no steps to have HMRC barred from taking part in the appeal on the basis that there was no reasonable prospect of HMRC's case succeeding.

43. Judge Brooks proceeded to decide the application on the papers and directed that HMRC pay the costs of JGL incidental to and consequent upon its appeal on the standard basis with such costs being subject to a detailed assessment if not agreed.

44. Having reviewed the relevant authorities, and having referred to HMRC's submission that they had not been unreasonable in defending the appeal because the penalty could not be reduced after it was upheld following the statutory review (but not HMRC's other submissions) Judge Brooks concluded at [7] and [8] as follows:

> "7. That said, it is clear from the decision of the Tribunal that it considered, at [4], that 'it was improper for the Respondents to continue their defence of the Appeal as they did' and at [55] it recorded that:
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>> '… We consider that it was improper for the Respondents to have persisted in defending the OFT level of penalty and to have rejected the Appellant's suggestion that the Respondents should accept a penalty offer of £15,000, and settle the case, so avoiding the costs of litigation.'
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> 8. Such findings by the Tribunal lead me to the inevitable conclusion that HMRC did act unreasonably in defending the appeal. In its response to the application HMRC concedes that if the Tribunal concludes that it acted unreasonably in defending the appeal it should order the costs of the appeal against HMRC."

The Law

45. Section 29 (1) of the Tribunals, Courts & Enforcement Act 2007 ("TCEA") provides that "the costs of and incidental to" all proceedings in the FTT shall be in the discretion of the Tribunal in which the proceedings take place.

46. Rule 10(1)(b) of the Rules gives the FTT jurisdiction to make an order in respect of costs:

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

47. There was no dispute between the parties as to the correct approach to be followed when considering the application of Rule 10(1)(b). The following principles are to be derived from the authorities:

(1) The rule is a threshold condition. It is only if the tribunal concludes that a party has acted unreasonably in the relevant respect that the question of the exercise of a discretion to award costs can arise. A determination of the question whether a party has, or has not, acted unreasonably is, accordingly, not the exercise of a discretion, but a matter of value judgment: see *Marshall & Co v*

HMRC [2016] UKUT 0116 (TCC) at [30] citing with approval *Market & Opinion Research International Limited v HMRC* [2015] UKUT 12 (TCC);

(2) Accordingly, on appeal against a costs direction the appeal should only be allowed if the tribunal failed to apply the correct law, took into account the irrelevant, ignored the relevant or reached a conclusion which no judge, properly exercising his discretion, could reasonably have reached: see *Catana v HMRC* [2012] UKUT 172 (TCC), [2012] STC 2138 at [16];

(3) The phrase "bringing, defending or conducting the proceedings" is 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 proceedings, for example by persistently failing to comply with the rules and directions to the prejudice of the other side: see *Catana* at [14];

(4) HMRC would be acting unreasonably in defending an appeal if they ought to have known that their view of the case had no reasonable prospect of success but not otherwise; it cannot be that any wrong assertion by a party to an appeal is automatically unreasonable: see *Roden and Roden v HMRC* [2013] UKFTT 523 (TC) at [12] to [15];

(5) The restriction in s 29 TCEA to the recovery of costs "of and incidental to" the proceedings means that there is no power to make an order in respect of anything else and, particularly, in respect of any investigation or decision made which preceded the institution of the proceedings or the preparation of those proceedings before the tribunal: see *Catana* at [7] and [8]; and

(6) Nevertheless, although it is not possible for a party to rely upon the unreasonable behaviour of the other party prior to the commencement of the appeal, nor can costs incurred before that period be ordered, behaviour of a party prior to the commencement of proceedings might well inform actions taken during proceedings: see *Catana* at [8] and [9] approving *Bulkliner Intermodal Limited v HMRC* [2010] UKFTT 395 (TC).

48. Regulation 42(1) of the Regulations gives a "designated authority" power to impose a penalty "of such amount as it considers appropriate" on a person who fails to comply with any relevant requirement of the Regulations. Regulation 42(1C) states that "appropriate" means "effective, proportionate and dissuasive."

49. Regulation 43 of the Regulations gives a person who is the subject of a decision to impose a penalty under the Regulations a right of appeal to the FTT.

50. Article 5(2) of The Public Bodies (Abolition of the National Consumer Council and Transfer of the Office of Fair Trading's Functions in relation to Estate Agents etc) Order 2014 (the "Transfer Order") transferred to HMRC the functions exercisable by the OFT under the Regulations by virtue of its role as the supervisory authority for estate agents. That transfer came into effect on 31 March 2014.

51. Schedule 3 to the Transfer Order makes various consequential, supplementary, incidental and transitional provisions and savings relating to the transfer of those functions. In particular:

(1) Where the OFT has issued a notice of a decision to impose a penalty pursuant to Regulation 42 of the Regulations and an appeal has not been started before the commencement of Article 5(2) of the Transfer Order, a person who is the subject of such a decision may appeal to the FTT;

(2) HMRC may offer a review of such a decision prior to an appeal against the decision being started;

(3) If the offer of a review is accepted an appeal may not be made until after the conclusion of the review; and

(4) any appeal started against such a decision following such a review or in cases where no review is undertaken is to be treated as an appeal under Regulation 43 of the Regulations.

52. These provisions applied in relation to JGL's appeal and accordingly its appeal against the OFT's decision was by virtue of the transitional provisions in the Transfer Order treated as an appeal made to HMRC under Regulation 43 of the Regulations. Regulation 43(4) gives the FTT the following powers on hearing an appeal:

> (a) to quash or vary any decision of the supervisory authority, including the power to reduce any penalty to such amount (including nil) as it thinks proper, and
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> (b) to substitute its own decision for any decision quashed on appeal.

53. It was common ground that Regulation 43 gives the FTT a full merits jurisdiction rather than a supervisory jurisdiction.

54. Regulation 43(3) of the Regulations provides that the provisions of Part 5 of the Value Added Tax Act 1994 ("VATA") relating to appeals, subject to the modifications set out in paragraph 1 of Schedule 5 to the Regulations, apply in respect of appeals to the FTT made under Regulation 43 of the Regulations.

55. As a consequence, because an appeal made pursuant to the transitional provisions contained in the Transfer Order is by virtue those provisions treated as an appeal brought under Regulation 43 of the Regulations, section 85 VATA, which is a provision contained in Part 5 of that Act, applies to such an appeal, including JGL's appeal in this case. Paragraph 1 of Schedule 5 to the Regulations does not exclude the application of section 85 VATA in relation to such an appeal.

56. Section 85 VATA provides that where HMRC and an appellant to an appeal before the FTT come to an agreement under the terms of which the decision under appeal is to be treated, inter-alia, as varied, the like consequences shall ensue for all purposes as would have ensued if, at the time when the agreement was come to, the FTT had determined the appeal in accordance with the terms of the agreement.

Grounds of appeal and issues to be determined

57. HMRC attached ten grounds of appeal against the Costs Decision to their notice of appeal dated 21 June 2016, which overlap to a material extent. In summary, HMRC contend that the FTT made the following errors of law:

(1) in the Penalty Decision the FTT acted unjustly and unfairly by reaching the conclusions set out at [55], that HMRC had acted unreasonably in defending the appeal, without first having heard submissions from HMRC;

(2) in the Costs Decision the FTT committed a serious, unjust and unfair procedural irregularity by concluding that the conclusions at [55] of the Penalty Decision made it inevitable that a costs order should be made against HMRC;

(3) in the Costs Decision the judge failed to consider whether or not there was a reasonable prospect of HMRC's defence of the appeal succeeding in the sense of successfully resisting the result sought by JGL in its notice of appeal, namely that the penalty be reduced to a sum of between £15,000 and £20,000;

(4) in the Costs Decision the judge erred in concluding that HMRC was in effect bound to settle the appeal, accepting a reduced penalty of £15,000 where JGL did not initiate any negotiations with HMRC in an attempt to settle the appeal and in failing to have regard to the fact that HMRC, having upheld the penalty on a statutory review, did not have any power under the Regulations to re-make or vary the amount of the penalty;

(5) in the Costs Decision the judge failed to appreciate that reasonable people could take different views on matters such as the seriousness of the breaches of the Regulations committed by JGL and the relevance and significance of matters relied on by JGL in mitigation; and

(6) in both decisions the FTT failed to take into account that certain evidence relied on by JGL at the hearing, and treated as significant by the FTT in the Penalty Decision, was given for the first time in the oral evidence of Mr Jackson at the hearing.

58. JGL resists the appeal, arguing that HMRC acted unreasonably by seeking to maintain the penalty at nearly £170,000 solely on the basis that that was a figure arrived at by the OFT under its own penalty guidelines, notwithstanding that HMRC accepted that the FTT had to exercise its discretion to decide afresh the appropriate amount of penalty and a lawful penalty could not exceed the minimum amount judged by the FTT to be necessary to serve as an "effective, dissuasive and proportionate" penalty in the circumstances of this case. JGL contends that it was not procedurally unfair for the FTT to have observed that it was improper for HMRC to continue their defence of the appeal as they did, having listened to the case over three days of hearing and found HMRC's explanations of their position to be unsatisfactory. Further, given JGL's indication that it would be content to accept a penalty in the order of £15,000 to £20,000 it was all the more unreasonable of HMRC to persist in defending the original penalty amount dogmatically, notwithstanding the very much lower penalty amount that would have been produced under HMRC's own penalty guidance.

59. In the light of the way in which HMRC's grounds of appeal are expressed, it is convenient to deal with the issues arising on appeal as follows:

(1) We shall first consider whether either or both of the Penalty Decision and the Costs Decision involved the making of errors of law on the part of the FTT in the manner in which they reached the conclusions they did on the question of costs;

(2) If we conclude that either or both of those decisions disclose an error of law we shall consider whether to exercise our powers under s 12 TCEA to set aside the relevant decisions in so far as they relate to the costs of JGL's appeal and whether, if we decide to exercise those powers, we should remake the decision or remit it to the FTT; and

(3) If we decide to remake the decision, we shall at that point consider HMRC's further grounds of appeal relating to the question of whether HMRC could be said to have acted unreasonably in defending the appeal or conducting the proceedings.

Error of law

60. Mr Mantle contends that in reaching the conclusions that it did at [4] and [55] of the Penalty Decision, as set out at [33] and [35] above, the FTT had concluded that HMRC had acted unreasonably in defending the proceedings without giving them the opportunity of making any representations on the reasonableness issue. Consequently, HMRC were deprived of the opportunity of making submissions that it was not unreasonable to defend the appeal, along the lines of the written submissions they ultimately made to the FTT in response to JGL's costs application on 6 May 2016, as summarised at [42] above.

61. We can accept Mr Mantle's argument that the remarks made by the FTT in the Penalty Decision might indicate that it had formed the preliminary view that HMRC had acted unreasonably in continuing to defend the full amount of the penalty originally imposed by the OFT. That is borne out by the FTT's view, expressed in robust terms, that JGL had suffered a very considerable injustice by the imposition of a penalty which it described at different points in the Penalty Decision as "outrageous" and "wholly disproportionate and unjust" and which had been widely publicised with negative effects on JGL's business. We do not, however, agree that the FTT's remarks at [4] and [55] of the Penalty Decision amount to the FTT having prejudged the issue. As Mr Alan Bates, counsel for JGL, submitted, it is not unusual for a court or tribunal to express strong views about how a party has conducted a case. Despite the critical tone the FTT adopted, there was some discussion after the hearing had concluded but before the FTT had delivered its oral decision on the substantive issue, as we have described at [38] above, about the appropriate way of proceeding in relation to costs, and the FTT accepted that the proper course was for JGL to apply for costs in writing once the substantive decision had been released and that HMRC would have the right to oppose the application and be given time to respond to it. It was therefore quite clear that the FTT had recognised that it could not make a decision on costs without there being a formal application in respect of which HMRC would have the right to make representations.

62. That, in our judgment, was the right approach. Whether what the tribunal perceives as unreasonable behaviour should result in an order for costs is a matter to be considered on the basis of a formal costs application, with the benefit of representations from the party against whom the order is sought. The period of delay to which that course of action leads allows for a suitable time for reflection and, perhaps, the realisation that first impressions are not always reliable. It also enables the FTT to undertake a careful consideration of, in this case, all the circumstances in which HMRC came to defend the proceedings.

63. That conclusion identifies the first of the two reasons why we must allow this appeal. Judge Brooks explained at [8] of the Costs Decision that the observations of the FTT at [55] of the Penalty Decision led him to the "inevitable conclusion that HMRC did act unreasonably in defending the appeal". In other words, he took the observations made by the FTT in the Penalty Decision as its last word on the topic, amounting to a finding that an award of costs under Rule 10(1)(b) should be made. Although it appears that Judge Brooks did not have the benefit of the transcript of the discussions that took place on the question of costs after the conclusion of the substantive hearing, he has regrettably overlooked the statement, in the same paragraph of the Penalty Decision, that the parties would have the opportunity to make representations in relation to any costs application. He has, unfortunately, fallen into the very trap which the first FTT avoided, of deciding the issue without the benefit of time to reflect and without reference to the representations of the prospective paying party.

64. The second reason, although it overlaps to some extent with the first, is that by simply adopting the first FTT's views Judge Brooks seems to have taken the view that he was exercising its discretion, when he was seised of the matter himself and should have exercised his own discretion. It was, in our view, his duty to consider the matter afresh in the light of HMRC's submissions and explain why, if it were the case, he rejected them. His failure to engage with the submissions amounts to a procedural irregularity which is sufficiently serious to amount to an error of law on his part. Mr Bates submitted that there was no substance in HMRC's claim before this Tribunal that they were deprived of the opportunity to make representations in opposition to JGL's application; the fact that Judge Brooks was not persuaded by those representations, he said, does not mean that HMRC did not have a fair opportunity to make their case before the FTT decided the application. However, in our judgment this submission misses the point; HMRC were given the opportunity to make representations, and Judge Brooks referred to them at [7], but it is clear from what follows that he believed he was constrained by the first FTT's observations, and that he was obliged to disregard them. As he said himself, it was the first FTT's observations alone which led him to his conclusion.

65. For those reasons we are satisfied that material errors of law are made out, that the appeal must be allowed and that the Costs Decision must be set aside.

Exercise of discretion under s 12 TCEA

66. Section 12 of TCEA enables, though does not require, us to re-make a decision we have set aside. As we have all the necessary evidence before us and we have heard full

argument on the reasonableness issue, we are satisfied that this is a case where it is appropriate for us to remake the decision without the need to remit the matter to the FTT.

Remaking the Costs Decision: Discussion

67. As the authorities to which we have already referred show, the question relevant to the exercise of the Rule 10(1)(b) jurisdiction is whether HMRC acted unreasonably in conducting or defending the appeal proceedings, and not whether the OFT's decision as to the appropriate penalty to be imposed and HMRC's decision on review of that decision were themselves reasonable. Nevertheless, in the circumstances of a case such as this, where the FTT reduced the penalty imposed and upheld on review by as much as 97%, one has to consider whether HMRC were, as this tribunal put it in *Catana*, unreasonably resisting an obviously meritorious appeal. In that context the reasonableness or otherwise of the original and review decisions is, plainly, an important factor. The question has, of course, to be considered, not with the benefit of hindsight and knowledge of the FTT's conclusion, but from the position in which HMRC found themselves when the appeal was brought and as it progressed. We should add before going further that as HMRC, despite securing permission, have chosen not to appeal against the level of penalty imposed by the FTT, we must and do accept that the FTT's conclusion about the appropriate level of penalty was correct. However, as we are considering a different issue (whether HMRC's conduct was unreasonable rather than the proper amount of the penalty) the FTT's reasoning leading to that conclusion is of incidental rather than direct relevance. We will borrow from it, because we have not been able to hear the evidence as the FTT did, but for the reasons we have already given, in remaking the decision we must exercise our own discretion.

68. As we have mentioned, in its notice of appeal to the FTT JGL suggested (its own term) that "in the particular circumstances of this case, a penalty between £15,000 and £20,000 would have been compatible with" the Regulations. HMRC's response, set out in their statement of case, made the observation that the regulating body at the relevant time was the OFT which had followed its own established policy in determining the penalty, and went on to say that it would not be appropriate for HMRC to apply their own policy, retrospectively, to a business which at the material time was regulated by the OFT. The statement of case added that even had HMRC's policy been adopted it was "not necessarily the case that a relatively low penalty would have been imposed given the gravity and protracted nature of the breaches", and it concluded as follows:

> "50. The penalty of £169,652 has been considered proportionate and arrived at after taking into consideration the seriousness of the offence, the culpability of the Appellant, the risk of the business being used for money laundering or terrorist financing, and the period which it was exposed to that risk [*sic*]. It also recognises the co-operation and response of the Appellant by reducing the penalty by 10%.
>
> 51. The Respondents respectfully submit that the Decision should be upheld and that this appeal should be dismissed."

69. Despite those paragraphs HMRC's grounds of appeal and Mr Mantle's submissions before us contend that it would be wrong to characterise their stance as one of seeking only to uphold the original amount of the penalty. Rather, it is said, HMRC

were legitimately and reasonably asking the FTT to determine what the penalty should be, because the FTT's jurisdiction is not limited to determining which of two opposing positions is correct, but extends to determining for itself, unconstrained by the OFT's or HMRC's own policies, what penalty should be imposed.

70. We do not accept that argument. There is no hint in the statement of case that HMRC were inviting the FTT to determine the correct penalty, whether in response to a clear invitation to that effect, as an alternative to upholding the original penalty, or even as a fall-back position should the FTT decide to discharge that penalty. Similarly, Mr Mantle's skeleton argument before the FTT sought to uphold the original penalty in full. It was not until the hearing before the FTT was in progress that the possibility that the FTT might itself determine the correct penalty was actively canvassed. We proceed, therefore, on the footing that HMRC's stance at least until the beginning of the hearing was that the penalty should be upheld in its entirety.

71. Mr Mantle's next point was that no formal settlement offer was made by JGL; its suggestion of a penalty of £15,000 to £20,000 was never more than a suggestion, albeit the approach a week before the hearing to which we have referred was put in more forceful terms. It is in any event, he said, at least doubtful whether it is within HMRC's power to alter a penalty after it has been confirmed following a review; once the appeal process has begun it is for the FTT to resolve the matter.

72. We accept that no formal offer, such as might be made in civil litigation in the courts, was made, but we do not think that is a factor which undermines JGL's case. First, JGL had made its position clear, even if it described it as a suggestion rather than an offer; there was no impediment to HMRC's exploring the suggestion if they had any interest in a possible compromise. We have reached the view that they did not do so, not because the suggestion was put in tentative terms, but because it was their intention, as we have said, to seek to uphold the full penalty.

73. We also reject Mr Mantle's argument that HMRC had no real choice but to defend a decision which had been upheld on review. Our analysis of the transitional provisions contained in the Transfer Order, as set out at [51] to [56] above, has led us to the conclusion that there was a mechanism available to the parties by which the appeal could have been settled without the intervention of the FTT after the notice of appeal had been given. The parties could have come to an agreement to vary the penalty under section 85 VATA and such an agreement would have the same effect as if the FTT had determined the appeal in accordance with the terms of the agreement between the parties. Even if we are wrong on that point and section 85 was not applicable there was no reason, as Mr Bates submitted, why, if they came to the view that the penalty could not be supported, HMRC could not have approached JGL informing them of that view. Such an approach would no doubt have led to the opening of negotiations between the parties following which agreement could have been reached on a reduced penalty. The parties could then have invited the FTT to approve the agreement without the need for a contested hearing. Thus whether or not section 85 is in point, there was in our judgment no impediment to the compromise of the appeal.

74. Mr Mantle also argued that HMRC could not have predicted that the FTT would reduce the penalty by as much as it did. We can accept that there is some force in that

argument, when JGL itself had been willing to submit to a penalty between £15,000 and £20,000. We can accept, too, his argument that the FTT had been impressed and influenced by the oral evidence of Mr Jackson and, in particular, the new evidence which emerged at the hearing about the regular discussions which took place regarding money laundering, about the awareness of JGL's office managers of their money laundering responsibilities and about the damage caused to JGL's business by the publicity relating to the original penalty. This was, as Mr Bates appeared to acknowledge, information hitherto unknown to HMRC. It is true, too, as the FTT recorded at [14], that Mr Jackson was poorly prepared for the OFT's visit because of a misunderstanding about what was required. However, although we accept that all of these points may be factually correct, we are not persuaded that there is much merit in this argument. As the FTT observed, at [39], this was the OFT's only visit to JGL's premises, lasting about 90 minutes, and it is apparent from other observations made by the FTT that thereafter the OFT made little effort to enquire more deeply into JGL's practices and procedures. JGL could, of course, have volunteered the information which emerged from Mr Jackson's evidence, but we can well understand why it did not, until the hearing, because of the largely dismissive attitude of the OFT and, later, HMRC to the information JGL did provide.

75. As we explained at [66], the starting point is the position in which HMRC found themselves when the notice of appeal was served, when they had to decide whether, and if so how, to defend the review decision upholding the penalty imposed by the OFT. The test, as we see it, is not whether HMRC should have foreseen that a reduction as great as that actually made by the FTT would be the result, but whether there was any realistic prospect that the FTT would uphold the penalty assuming the evidence before the FTT was the same as that then available to HMRC.

76. Mr Bates' argument, somewhat condensed, is that as a first step HMRC should have rejected the OFT's approach and should then have started again, applying their own guidance. Although the FTT observed, at [30] and [31], that HMRC's guidance would have led to an appreciably lower penalty than that imposed by the OFT, and at [53] said that its own approach was based, in large part, on that guidance, it did not say, in so many words, that it thought HMRC should simply have discarded the IPP and begun afresh. Mr Mantle argued, as indeed did HMRC's statement of case, that the application of their own policy might have resulted in a penalty of similar size to that actually imposed, but the point was not pursued and in reality it was not seriously disputed that the application of HMRC's guidance would have resulted in a substantially smaller penalty.

77. We do not, however, agree with Mr Bates that HMRC acted unreasonably in declining to conduct a review of the OFT's decision by reference to their own guidelines. It may be thought surprising that different regulators policing the same Regulations with respect to broadly comparable businesses should have divergent policies regarding the scale of penalties to be imposed for essentially the same transgressions, but it is for Parliament to determine the regulatory structure, and there was nothing in that structure to suggest that the different regulatory bodies should have a common policy—indeed, there may have been good reasons why they should not. We do not need to explore that point further. The simple fact is that JGL was regulated at the material time, that is the time at which it was failing to comply with the Regulations,

by the OFT, and it was correspondingly subject to the OFT's regime. One would not argue, had HMRC applied a harsher policy, that the harsher policy should be applied on transfer of the regulatory authority from the OFT to HMRC, and we do not see why, absent a clear indication in the Transfer Order (and there is none), the accident of a transfer to a different regulator with a less harsh regime should bestow an adventitious benefit on a company in JGL's position.

78. We must therefore consider whether HMRC could reasonably have thought, when deciding how to respond to the notice of appeal, that they could realistically defend a penalty of £169,652, determined by reference to the IPP, before the FTT. At this point it is necessary to embark on an analysis of the reasoning which led to that figure, and of the information available to HMRC when the appeal was notified to them.

79. There does not appear ever to have been any dispute that the corrected turnover figure was an appropriate starting point at step 1 of the IPP; although one might debate what it might be, there has to be some measure by reference to which the size of the business concerned can be determined. The FTT was critical, though (by comparison with what else it said) in relatively mild terms, of the OFT's view that the appropriate percentage to be adopted at step 2 of the IPP was 10% rather than 5%. We think it was right to adopt that approach; although we might ourselves consider that 5% was the appropriate figure, the contrary view is not unsustainable. It is plain, indeed it is accepted by it, that JGL's failings, though they may individually have been minor, were multiple and that they extended over a prolonged period. The FTT said very little about step 3 of the IPP. It accepted that it was, in principle, reasonable, and observed at [42] that it "seemed odd that the only examples of mitigating circumstances related to co-operation with the OFT and subsequent improvement of practices, and nothing referred to the circumstances relevant at the time the earlier conduct had been reviewed", but went no further. We agree with the observation, but should add that we would ourselves think that exceptional circumstances (taken into account by the OFT officer at step 4), as well as other factors which might arise in different cases, are matters more relevant at step 3, but it perhaps makes little difference as long as all relevant information is taken into account and given adequate weight at some stage in the process. Despite those comments we do not think that the OFT's interpretation of step 3 could properly be castigated as unreasonable rather than wrong. Moreover, there is nothing before us, and appears to have been nothing before HMRC, beyond the factors which were taken into account, which might have been relevant at this step.

80. The main focus of the FTT's criticism, and what led to its drastic reduction in the penalty, was that step 4 of the IPP had not been properly applied. That, too, is the focus of Mr Bates' argument: that the OFT and HMRC's review officer went so badly wrong at this stage that it should have been plain to HMRC when the notice of appeal was served on them that the penalty was grossly excessive and could not be defended. Despite Mr Mantle's forceful arguments, we have come to the conclusion that Mr Bates is right.

81. As HMRC themselves stated in the review letter, step 4 of the OFT's interim penalty policy was intended to be a "check" to ensure the resultant penalty is "appropriate for that business". As a first step in that process it is, plainly, necessary to consider the nature of that business. Here, the business was a modest rural estate

agency, whose staff knew most of its customers. The risk that any of the customers might engage in money laundering, though it cannot be discounted altogether, was slight, as the FTT found. There was no evidence that any money laundering had in fact occurred as a result of JGL's failings. Although those failings were not minor, and took place over a fairly prolonged period, JGL did not wholly disregard its obligations: as the FTT also found, the appropriate checks were undertaken, at least with respect to customers who were not well known to the managers, but not properly documented. We do not underestimate the importance of record-keeping, but a failure of record-keeping is plainly less serious than a failure to undertake checks at all. The review letter focuses on the nature of the breaches, and the officer's view that they were serious, but no mention is made of the lack of any real risk that they would facilitate money laundering.

82. The legislative requirement, as we have said, is that a penalty imposed for breach of the Regulations must be effective, proportionate and dissuasive. It seems to us that the author of the review letter, and the OFT officer before him, have given significant weight to the first and third of those criteria, but have almost entirely disregarded the second. Indeed, HMRC's review letter, in considering step 4, focused purely on the question whether the penalty was dissuasive and whether the earlier steps had produced a penalty which was sufficiently substantial to meet that requirement. Such discussion as there is on the question of proportionality is focused on the seriousness of the breaches concerned and the risk of the business being used for money laundering or terrorist financing; nothing at all is said about the impact of the penalty on JGL. Rather, the officer, and the OFT officer before him, seem to have applied a mechanical approach to steps 1, 2 and 3, to have concluded that the result was effective and dissuasive, and to have stopped there without carrying out the check to which the review letter referred.

83. It is well-established that while a penalty must be proportionate to the offence, it must also be proportionate to the offender. The review letter recites, in summary form, what JGL had said about the effect of a penalty of the proposed magnitude on it and its directors' incomes. It discounts the effect on the directors' incomes on the ground that the penalty is to be imposed on the company. In our view, in the case of a small owner-managed company, as JGL is, that is a bizarre approach. Moreover, despite the statement that the penalty is to be imposed on the company there is, conspicuously, no examination of its profitability or ability to pay—turnover alone has been used throughout. Likewise, JGL's protest that the proposed penalty was 17 times higher than any other imposed on estate agents was recorded but disregarded. In our view the duties of any public authority when deciding the appropriate level of a financial penalty include the obligation to consider how the penalty it proposes compares with previous penalties imposed in the sector concerned, taking account all of the relevant circumstances and where, as was the case here, it is very substantially out of line with previous penalties imposed what are the distinctive features of the case which justify a much larger penalty. There is no evidence that either the OFT or HMRC carried out such a comparative exercise.

84. Although we might not have used quite such colourful language, and might not have directed so great a reduction as it did, we find it wholly unsurprising that the FTT directed a substantial reduction: £169,652 is manifestly excessive, and we are wholly persuaded that the failings of approach we have identified should have made it clear to

HMRC, by the time they came to prepare the statement of case, that the decision was unreasonable and could not be defended. We do not accept Mr Mantle's argument that the new information which emerged when Mr Jackson gave his evidence is of great significance. It is true that there was some new information, and that the FTT found him an impressive witness, but there is no reason to think that his evidence fundamentally altered the complexion of the case; it may have led the FTT to reduce the penalty to a greater extent than it otherwise might have done, but we do not detect any reason to think that his evidence tipped the balance between upholding and substantially reducing the penalty. It is also to be remembered that it was he who represented JGL on the occasion of the OFT's visit.

85. For the reasons we have given we are satisfied that it should have been apparent to HMRC, reviewing the matter dispassionately, and by reference to the information available to them when the notice of appeal was served on them, that the review decision was so flawed that it could not properly be defended. It follows that HMRC acted unreasonably in "defending or conducting the proceedings".

86. Accordingly we are also satisfied that we should exercise our discretion to make a direction, in accordance with rule 10(1)(b), that HMRC are to pay JGL's costs of and incidental to the proceedings before the FTT. Having rejected Mr Mantle's argument that JGL is to be criticised for not making a formal offer, we see no basis on which we could properly direct that it should receive only a proportion of its costs. However, we are concerned that some elements of what is set out in the schedule may fall outside the confines of what may be directed in accordance with rule 10(1)(b) and for that reason we 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.

COLIN BISHOPP TIMOTHY HERRINGTON

UPPER TRIBUNAL JUDGES
RELEASE DATE: 9 MAY 2017