TC05101

Appeal number: TC/2015/04387

VAT – Penalty assessment for failure timeously to notify change from sole trader to partnership; Finance Act 2008, Schedule 41; whether penalty should be reduced; yes; appeal allowed in part.

FIRST-TIER TRIBUNAL
TAX CHAMBER

J & W BROWN **Appellant**

- and -

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

TRIBUNAL: JUDGE J GORDON REID QC FCIArb
IAN G SHEARER

Sitting in public at George House, 126 George Street, Edinburgh on 21 March 2016

John Lynch CA, John Lynch & Co, CA, Rosyth, Fife, for the Appellant

Mark Boyle, Officer of HMRC, for the Respondents

© CROWN COPYRIGHT 2016

DECISION

Introduction

5 1. This is a penalty appeal against the technical failure, timeously to notify, under the VAT regime, the change of ownership of a business from sole trader to partnership. The penalty imposed is £582.

10 2. A hearing took place at George House, Edinburgh, on 21 March 2016. John Lynch CA, of John Lynch & Co, CA, Rosyth, Fife appeared on behalf of the appellant partnership. Mark Boyle, presenting officer, appeared on behalf of the respondents (HMRC). A bundle of documents was produced. Mr Lynch produced additional material at the hearing.

Statutory Background

15 3. It was common ground that when a sole trader's business is transferred to a partnership, the partnership is obliged to notify HMRC of the change of ownership by an application for registration within 30 days after the end of the month on which the partnership became liable to be registered.[1]

4. Under Schedule 41 of FA 2008, a penalty is payable for failure timeously to register. It was also common ground that there was such a failure and the Schedule 41 penalty regime was applicable.

20 25 5. The amount of a penalty depends primarily on its category and the potential lost revenue. Here, we are concerned with category 1 (that is to say a domestic rather than an offshore matter).[2] The potential lost revenue (PLR) is the amount of VAT for which the trader would be liable for the relevant period.[3] Here, the relevant period is the period beginning on the date with effect from which the trader required to be registered and ending on the date HMRC received notification of liability to be registered.[4] It is agreed that the relevant period is from 20 November 2012 to 15 July 2014.

6. If the failure is not deliberate, the standard penalty is 30% of the PLR.[5]

30 7. Paragraphs 12 and 13 provide for reductions in penalties where the failure is disclosed. It is disclosed where HMRC are told about it,[6] are given reasonable help in

---

[1] VATA 1994, Schedule 1, paragraphs 1 and 5;

[2] FA 2008, Schedule 41, paragraph 6(1) and 6A(1)(a)

[3] Paragraph 7(6)

[4] Paragraph 7(7)(b)

[5] Paragraph 6(2)(c)

[6] Paragraph 12(2)(a)

quantifying the tax unpaid by reason of the failure,[7] and are allowed access to records for the purpose of checking how much tax is so unpaid.[8]

8. Disclosure may be *prompted* or *unprompted*. It is unprompted if made at a time when the trader making it has no reason to believe that HMRC have discovered or are about to discover the failure. Otherwise, the disclosure is *prompted*.[9]

9. Where the disclosure made is unprompted the standard penalty of 30% of PLR must be reduced and may be reduced down to zero; but may only be reduced to 10% of PLR for prompted disclosure. The reduction must reflect the quality of the disclosure.[10] Quality includes *timing, nature and extent.*[11]

10. Where HMRC become aware of the failure 12 or more months after the time when the tax first becomes unpaid by reason of the failure the penalty may only be reduced to 10% where the disclosure is unprompted and the failure is not deliberate.[12]

11. HMRC may reduce the penalty if they think it right because of special circumstances.[13] Special circumstances do not include ability to pay or the fact that PLR from one taxpayer is balanced by a potential overpayment by another.[14] HMRC may stay the penalty or reach a compromise in relation to proceedings for a penalty.[15] Beyond that, *special circumstances* are not defined.

12. A trader may appeal to the Tribunal against HMRC's decision that a penalty is payable,[16] and/or against the amount of the penalty.[17] The Tribunal may affirm or cancel HMRC's decision or substitute a different decision being one that HMRC had power to make. We have limited power to interfere with any decision HMRC may make in relation to special circumstances.[18]

13. HMRC's Internal Manual (the Compliance Handbook) gives an example of reduction for special circumstances where there is a close association between tax entities (which they illustrate by reference to the father and son succession relationship (CH170800)) where the right tax was paid at the right time which the

---

[7] Paragraph 12(2)(b)

[8] Paragraph 12(2)(c)

[9] Paragraph 12(3)

[10] Paragraph 13(1)-(2)

[11] Paragraph 12(4)

[12] Paragraph 13(3)(b)

[13] Paragraph 14(1)

[14] Paragraph 14(2)

[15] Paragraph 14(3)

[16] Paragraph 17(1)

[17] Paragraph 17(2)

[18] Paragraph 19(3) & (4)

partnership does not wish returned. This example was discussed in *Howells v HMRC*[19]. The tribunal there indicates that HMRC seemed to be saying that the law should not impose tax geared penalties when there is no likelihood of tax not being accounted for because of the close relationship between the partnership and sole trader who succeeded to the partnership's trade and the common participation of one of the partners in both businesses.

14. Liability to penalty does not arise in relation to an act or failure which was not deliberate if a trader can satisfy HMRC (or, on appeal, the Tribunal) that there is a reasonable excuse. Reliance on another person is specifically excluded from being a reasonable excuse unless the trader took reasonable care to avoid the relevant act or failure.[20] In this appeal, we are not concerned with the question of *reasonable excuse*.

Facts

15. On or about 13 July 2014, the appellant applied for registration. It estimated its turnover at £90,000 per year. It stated that it was registering for VAT because it had taken over a going concern, which took place on 20 November 2012. The partners were disclosed as being John Brown and his son, Kenneth. Mr John Brown had in effect assumed his son as a partner in the business, as plumbers. Mr John Brown had been in business since about 1976 and was then approaching 60 years of age. They planned to carry on business together in partnership until John Brown retired. Thereafter, his son intended to continue the business. This was the typical process of transferring the family business to the next generation. As part of that process John Brown's VAT registration number was transferred to the new partnership in about September 2014. Prior to July 2014, Mr John Brown always himself prepared and submitted his VAT returns. Mr Lynch was involved in the annual accounts and also helped with income tax returns.

16. By letter to the appellant dated 20 October 2014, HMRC intimated that having regard to its application to register and reallocate the VAT number, the appellant had failed to notify HMRC of its liability to be registered as a partnership and that failure rendered it liable to a penalty. It sought information about the appellant's net VAT liability between 20 November 2012 and 15 July 2014; it was pointed out that these were not the same as standard VAT return periods and this was why HMRC were unable to derive the exact figure from the returns themselves. However, HMRC did not seek access to the appellant's records for checking purposes.

17. By letter to HMRC dated 28 October 2014, Mr Lynch responded. He pointed out that the appellant had mistakenly thought that Mr Lynch was intimating the change, VAT returns had been lodged and all fiscal liabilities settled on time. He also pointed out that this was an administrative error causing no loss to the Crown. He also submitted the usual agent authorisation form.

[19] [2015] UKFTT 0412 (TC) at paragraphs 132-136

[20] FA 2008, Schedule 41, paragraph 20

18. For some reason HMRC did not respond to that letter. On 10 December 2014, they wrote again to the appellant. Mr Lynch responded by fax dated 22 December 2014 with a further copy of his letter dated 28 October 2014. The bundle shows that HMRC received the fax and copy letter on 23 December 2014.

5 19. By what appears to be a standard form letter, dated 8 January 2015, to the appellant (ignoring the agent mandate), HMRC set out information about the penalty of £582 they proposed to charge.

20. In a schedule to the letter, HMRC described the system of disclosure. They stated that the failure to notify was not deliberate and was unprompted but made *more than* 10 *12 months after the tax becomes paid.* They stated that the penalty range was from a maximum of 30% and a minimum of 10%.

21. They assessed the quality of disclosure at 60% being 30% for *telling,* 30% for *giving* (access to records), but 0% for *helping,* as the appellant had not provided details of net VAT liability between 20 November 2012 and 15 July 2014.

15 22. They then calculated 60% of the difference between the minimum and maximum % reduction, namely 20% [30-10%] to arrive at 12% [60%x20%]. They then deducted 12% from the maximum of 30% to reach a final reduction of 18% [30-12].

23. They stated that the PLR was £10,789.79. How that was calculated is not clear beyond being based on turnover of £90,000. They took 18% of £10,789.79 to 20 produce £1,942.00. That sum was further reduced by 70% (£1,360) to produce £582 (£1,942-1,360). (The 70% decrease was explained by HMRC at a later stage of the process, and to us during the hearing, as a 'special reduction' because they accepted that 4 out of 6 (66%, which was 'rounded up' to 70%) of the returns during the penalty period had been submitted on time).

25 24. HMRC now accept that the PLR is £8,076.98. This is based on a calculation produced at the hearing by Mr Lynch. The appellant's current annual turnover is in the order of £110,000. Accounts for a four-month period to 5 April 2013 show turnover of £25,296, gross profit of £13,121 and profit before appropriation of £4,016.

25. Mr Lynch responded by letter dated 14 January 2015. He pointed out that HMRC 30 had ignored the circumstances set out in his letter dated 28 October which he eventually had to send by recorded delivery. He said that the suggested penalty was 'wholly disproportionate' and disputed it in its entirety.

26. By letter dated 22 January 2015 to the appellant (and not to Mr Lynch), HMRC (confusingly) acknowledged having received letters from Mr Lynch on 31 October, 35 23 December 2014 and 16 January 2015. This is presumably a reference to his letters dated 28 October, and 22 December 2014, and 14 January 2015. The HMRC letter largely ignored Mr Lynch's letters and instead noted that the appellant had not provided the net tax liability figures previously requested and intimated that HMRC intended to charge a penalty of £582.

27. Mr Lynch responded by letter dated 3 February 2015 expressing concern about the mandate still not being recognised and essentially repeating what he had previously argued.

28. By letter to Mr Lynch dated 13 March 2015, HMRC eventually responded to Mr Lynch and engaged in some of the matters he had raised. They stated that although a full reduction had been applied for the *telling* aspect of the quality of disclosure, no reduction could be given for *helping* because the appellant had not provided the PLR for the penalty period. They also stated that not all returns had been received on time, although at that stage they did not specify how many or address the question whether there was any reasonable excuse for their lateness. They stated that they had applied a special reduction percentage for those returns which were on time and had included this in their calculation. No default surcharges appear to have been levied. They offered to reconsider the penalty if the exact PLR for the penalty period were provided.

29. Mr Lynch responded by letter dated 24 April 2015 stating *inter alia* that there was only one late return, 11 days late in June 2014. There was a suggestion during the hearing, which we have no reason to doubt, that Mr John Brown was ill at the time.

30. A penalty assessment was issued on 28 April 2015 in the sum of £582. It was based on turnover of £90,000 given in the appellant's application for registration dated 13 July 2014.

31. By letter dated 22 May 2015, Mr Lynch requested a review. He again explained the circumstances. He again pointed out that the Crown had not lost any income and described what had occurred as a *minor administrative hiccup.* He compared the circumstances to a trader who is late with one return (and who does not suffer a penalty). He also pointed out that Mr John Brown continued to lodge VAT returns for some time as a sole trader even though he had formed a partnership with his son. He enclosed a table showing that between 1 November 2013 and 31 January 2015, the appellant submitted five returns of which one was late by 11 days.

32. By letter to the appellant, dated 24 June 2015, the penalty was upheld on review. HMRC noted the main contentions advanced on behalf of the appellant in the correspondence, namely that the appellant was under the impression that its accountant had notified HMRC, the error was purely administrative causing no loss of revenue, there had been an excellent compliance record and therefore the penalty was disproportionate. They also noted that it had been asserted that the appellant's human rights had been violated as all representations had been ignored.

33. The review stated that there was no reasonable excuse, and therefore further reduction or cancellation of the penalty was not warranted. While the letter expressed some sympathy for the appellant's predicament, HMRC took the view that the penalty was not disproportionate; information about turnover had been requested on two occasions but had not been submitted; four out of six returns had been received on time which justified a 70% special reduction which had been granted. The review stated that default surcharge records indicated that two periods had defaulted, by

implication not accepting Mr Lynch's contention that only one was late. According to HMRC, the appellant had 'failed the basic requirement of *Right tax at right time*'; and the appellant's human rights had not been violated as due consideration had been given to the appellant's contentions.

5 34. By letter to HMRC dated 6 October 2015, Mr Lynch offered to settle at the sum of £261.90 being 45% of the assessed penalty. That offer was increased to £291 in a letter dated 25 February 2016. Neither offer has been accepted.

35. Finally, we note that there has been no criticism of Mr John Brown's fiscal compliance record over the years.

10 **Discussion**

36. A penalty of £500-£600 might be regarded as relatively minor. However, it may be a significant amount to a small business such as the appellant.

37. In the circumstances of this appeal we have no reason to doubt that the appellant's failure, which has attracted a penalty of £582, was one of the merest technicality, a
15 minor administrative hiccup, involving minimal culpability, causing no loss to the revenue, and no administrative inconvenience to HMRC. The transfer of the business and the VAT registration number was carried into effect for VAT purposes later than it should have been. The appellant was voluntarily correcting a genuine oversight, honestly made. What followed after that disclosure has undoubtedly caused the
20 appellant significant inconvenience and expense. In order to resolve this issue, it will have caused the general taxpayer considerable expense far beyond the amount of the penalty.

38. What followed was a surprising failure by HMRC to engage in correspondence and to consider, at least initially, the legitimate points which the appellant's
25 accountants advanced on its behalf. Eventually, they responded to some extent.

39. The failure was disclosed unprompted. It is now agreed that the PLR is £8,076.98, although there was no actual risk to the revenue at any stage.

40. The amount of reduction depends on the quality of disclosure. Part of the assessment of the extent of disclosure depends on the reasonableness of any help
30 provided in quantifying the unpaid tax for which the appellant was liable. Here, there was no actual tax unpaid by reason of the failure to notify although the PLR fell to be calculated by reference to the net tax due over the relevant period. It is therefore difficult to see how the appellant could relevantly help to quantify unpaid tax when there was none.

35 41. Be that as it may, HMRC were bound, we think, to take account of the particular abilities and circumstances of the trader. Here, the appellant was a small business. It instructed an accountant to help. It seems almost disproportionate to expect a trader to pay someone painstakingly to calculate the PLR on which his penalty liability is to be calculated. It may well have cost the appellant more to have the PLR calculated
40 than the actual penalty ultimately imposed. The possibly onerous task was not one

which HMRC attempted to carry out. They did not seek access to the appellant's books to do so. They already had the appellant's returns over the penalty period.

42. HMRC reduced the standard percentage from 30% to 18%. They did so on the basis that the quality of disclosure for *telling* and *giving* should be given full marks but for *helping* the mark was 0%. We consider that to be incorrect. HMRC should have recognised that the appellant, as a small trader, and as a business of limited means engaged its accountant to liaise with HMRC. As we have explained, the accountant's efforts were largely ignored until very late in the day when he eventually produced a calculated figure for PLR which HMRC did not dispute. From the outset, they should have addressed the points reasonably made by the appellant's accountant in the correspondence.

43. The extent of *giving help* could not reasonably have been assessed at 0% as HMRC assessed it. Having regard to the particular circumstances of this appeal, we consider that the standard percentage of the penalty should have been reduced to a percentage close to the statutory minimum of 10%. Any failure to give help to quantify so-called unpaid tax was, insofar as relevant at all, minimal. The decision to reduce the standard percentage to only 18% was insufficient in our view, and therefore incorrect. HMRC had power to reduce the standard percentage to the statutory minimum. They should have exercised that power to a greater extent. We are entitled to do so now and reduce the standard percentage to 12.5%.

44. We should also consider whether HMRC's decision on the question of special reduction was flawed even although it was a 70% reduction. This is to be determined in accordance with the principles applicable to judicial review. HMRC's decision will be flawed in the judicial review sense if they failed to consider exercising its discretion at all, took into account an irrelevant factor in exercising their discretion, failed to take into account a relevant factor in so doing, fettered their discretion eg by adopting too rigid a policy, or otherwise reached a conclusion that was plainly wrong or perverse on the relevant facts before them.

45. We think that HMRC's decision in respect of the application of paragraph 14 of Schedule 41 was flawed. It was wrong for HMRC to conclude that the appellant failed the basic requirement of *Right tax at right time* on the basis of their records of two late returns in the penalty period. That conclusion could not reasonably have been reached and was plainly wrong. The appellant did not fail. It was contended by the appellant that only one return was late; and there is no evidence that the question of reasonable excuse was considered; there is also no evidence that a surcharge was ever levied. Whether there was one late return or two, does not seem to matter and should not be used in what appears to be an arbitrary manner to justify a further reduction of only 70% when on one view, a 100% reduction might well be contemplated.

46. The fiscal record and VAT history of the appellant and Mr John Brown appeared to be good. There was no risk to the Crown. There was a close association between the transferring trader and the new partnership, one of HMRC's own illustrations for making a special reduction. These circumstances are relevant and special to this

appeal and justify a reduced penalty. HMRC failed or failed properly to take them into account when making their assessment.

47. We were referred to several authorities of which *Hillis v HMRC*[21] concerned a penalty for failure to notify liability for VAT registration. There, the tribunal observed the penalty regime was not intended for taxpayers who make a genuine mistake about their liability and disclose it to HMRC[22]. However, we have noted that the dicta in *Hillis* was expressly not followed in *Green Bungalow Settlement v HMRC*[23] The better view may be that expressed in *Howells,* and the HMRC Compliance Handbook referred to above.

48. While it may be going too far to make a special reduction of 100%, we consider that 90% is appropriate and produces a penalty in a sum which reflects all the relevant statutory circumstances in a case where what occurred was an innocent, administrative error, involving minimal culpability, conferring no benefit on the appellant (or Mr John Brown) and no disadvantage to HMRC.

49. Using the figures in the HMRC penalty schedule (Bundle 3/35), the penalty is reduced as follows:-

PLR	PENALTY at 12.5%% instead of 18%	SPECIAL REDUCTION at 90% [instead of 70%]	BALANCE OF PENALTY PAYABLE
£8,076.98	£1009.62	£908.65	£**100.97**

50. The appeal is allowed in part and the penalty is therefore reduced to **£100.97**.

51. 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

[21] [2013] UKFTT 196 (TC)

[22] Paragraphs 25 and 26

[23] [2016] UKFTT 0132 (TC) at paragraph 11; *Hillis* is mentioned in *Howells;* see above.

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

5

J GORDON REID QC FCIArb

TRIBUNAL JUDGE
RELEASE DATE: 16 MAY 2016

10