TC02151

Appeal number: TC/2011/6291

VAT – Flat rate scheme – Was Commissioners' decision to refuse permission to make a retrospective change in percentage reasonable – Under the circumstances – No – Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

AML CONSULTING LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE LADY MITTING
MICHAEL BLAIN

Sitting in public in Manchester on 26 June 2012

William Morley-Scott, for the Appellant

John Nicholson of HM Revenue and Customs, for the Respondents

DECISION

1. The Appellant ("AML") was appealing against an assessment to VAT issued on 9 June 2011 in the sum of £1,522 plus interest. The assessment comprised an underdeclaration of £2,006 for period 10/08, met in part by two overdeclarations for later periods. It is the assessment for 10/08 which is the subject of this appeal. This assessment was raised pursuant to a decision by the Commissioners that the Appellant had made an unauthorised change in the percentage which it applied in its use of the Flat Rate Scheme ("FRS").

2. AML's case was put jointly by its sole director, Dr Angela Lynch, who also gave oral evidence, and its accountant, Mr William Morley-Scott. The Commissioners called no oral evidence.

Legislation

3. Section 26B of the Value Added Tax Act 1994 ("VATA") provides:

> (1) The Commissioners (HMRC) may by regulations make provision under which, where a taxable person so elects, the amount of his liability to VAT in respect of his relevant supplies in any prescribed accounting period shall be the appropriate percentage of his relevant turnover for that period.
>
> …
>
> (6) The regulations may –
>
> (a) provide for the appropriate percentage to be determined by reference to the category of business that a person is expected, on reasonable grounds, to carry on in a particular period.

Regulation 55H of the Value Added Tax Regulations 1995 ('1995 Regulations') provides:

> (1) The appropriate percentage to be applied by a flat-rate trader for any prescribed accounting period, or part of a prescribed accounting period (as the case may be), shall be determined in accordance with this regulation and regulations 55JB and 55K.
>
> (2) For any prescribed accounting period
>
> (a) beginning with a relevant date, the appropriate percentage shall be that specified in the Table for the category of business that he is expected, at the relevant date, on reasonable grounds, to carry on in that period.

Section 83 of VATA provides:

> (1) Subject to sections 83G and 84, an appeal shall lie to the tribunals with respect to any of the following matters –
>
> …
>
> (fza) a decision of [HMRC] …
>
> (ii) as to the appropriate percentage or percentages (within the meaning of that section) applicable in a person's case.

Section 84 of VATA provides:

> (4ZA) Where an appeal is brought
>
> (a) against such a decision as is mentioned in [section 83(1)(fza)], or
> (b) to the extent that it is based on such a decision, against an assessment,
>
> The tribunal shall not allow the appeal unless it considers that [HMRC] could not reasonably have been satisfied that there were grounds for the decision.

4. The unchallenged facts are as follows. Dr Lynch had been a director in the NHS until she was made redundant in 2007. Given her in-depth knowledge of the workings of the NHS and her management experience, she set up, in September 2007, AML, her purpose being to provide management services and support to the NHS. AML registered for VAT with effect from 21 September 2007, the intended business activity being stated as "Management Consultancy". On 10 December 2007, the company applied to join the FRS selecting the "Management Consultancy" sector.

5. Dr Lynch had anticipated at set up that the majority of her business would derive from the provision of management consultancy services. She was, however, very soon to find out that this was an area dominated by the major firms such as PWC and KPMG. The NHS operated through a system of approved suppliers and it was never, she came to realise, going to be possible for such a small organisation as hers to break into this field. She was not however without work. Through reputation and by word of mouth contracts came her way but these were not consultancy contracts but management contracts. From October to December 2007 she acted as an interim manager, filling a temporary gap, for Bury PCT. From January 2008 to December 2009 she acted as a project manager for Greenwich PCT. Both these roles were part-time for two or three days a week and in between she did a few small jobs such as training. There is, Dr Lynch explained, a major difference between what she had intended to do and what she ended up doing. In Management Consultancy, she would in the main have been collecting data and information and then, from her office,

drafting and providing advisory reports. As a provider of management services, she worked on site, physically performing the role. She was hands-on and not advisory. She also incurred vastly more expenditure in travel and accommodation costs giving rise to a potentially greater claim for input tax.

6. As her first year of trading went on and Dr Lynch stepped back to consider the development of her business she realised that her chosen sector for the FRS had been incorrect. Rather than "Management Consultancy" of which she had, as things turned out, done none, she should have opted for "business services not listed elsewhere". The former sector attracts a flat-rate percentage of 12.5% the latter 11%. As a newly registered trader AML would have been entitled to a 1% reduction in the flat rate for the first year of trading – i.e. until 20 September 2008.

7. On 7 October 2008, Dr Lynch therefore wrote to the Commissioners in the following terms:

> "When this company was incorporated and application was made to join the flat rate scheme, it was anticipated that the majority of its turnover would accrue from the provision of management consultancy services. Consequently, up until the last filed VAT return, a flat rate of 11½% (being the rate applicable to management consultancy of 12½ less the first year incentive of 1%) has been applied to its receipts to arrive at the VAT liability.
>
> It is now evident that by far the major part of the companies turnover has accrued from the provision of interim management services, against which a flat rate of 10% would be applicable for the first year. This is based the assumption that interim management services would fall within the category of "Business services that are not listed elsewhere" against which a flat rate of 11% would ordinarily apply.
>
> It is proposed to calculate the next VAT liability using the 10% flat rate which I trust will be acceptable. A completed form VAT 652 is enclosed covering the overpayments for the quarters ended 31st January and 30th April 2008."

The Voluntary Disclosure (VAT 652) attached to the letter described the error as:

> "Flat rate of 11½% applied (rate management consultancy) – should have been 10% (rate for interim management)"

The form then sets out the associated amendments for three periods namely 01/08, 04/08 and 07/08.

8. The response from the Commissioners, and the decision letter which is at the core of this appeal, was written by one Rebecca Nally and was dated 14 November 2008 and reads as follows:

> "You have stated you think your business, "Interim Management", should come under "Business Services that are not listed elsewhere" at 11%. I have updated your records to show you will be using 11% from 1st August 2008.
>
> As the Flat Rate Scheme is self-assessing it is ultimately up to the trader to make an informed choice, which trade sector percentage they apply to their business, and they will be held accountable if the choice isn't correct.
>
> This being the case, it is the policy of HM Revenue and Customs not to back date percentage changes and therefore no claims can be made for past overpayments."

9. In November 2008, various phone calls took place between Dr Lynch and the Commissioners which were the subject of some dispute. We saw a Contact Centre Enquiry note of a call dated 10 November 2008 which merely summarises the gist of the call. The enquiry type was shown to relate to the Flat Rate Scheme and the note recorded "caller has made error on previous VAT returns. Advised to adjust on next return. Advised as a change FRS percentage to Fax FRS unit". A further call took place on 13 November 2008. The Electronic File note recorded "trader called regarding fax – explained that we cannot backdate percentage changes as traders' choice what FRS percentage. Advised that as she thinks she should be under 11% - can use this rate from 1/08/08." Dr Lynch's understanding of the advice she was given however was that she was able to make a retrospective amendment. She made a note of the call which includes the wording "October VAT return use 10%". Given her understanding that she was allowed to make a retrospective amendment, she duly did thus giving rise to the alleged underdeclaration.

10. Dr Lynch's note can in fact be read in two ways. It can be read as being entirely consistent with the advice she was given namely that for the quarter ending 10/08 she was allowed to use the 10% rate as the flat rate amendment had been made and accepted by the Commissioners as from 1 August 2008. The note does not however make it clear that she had been told unequivocally that she could in that return include retrospective amendments for the earlier periods. This is not to say that we do not believe Dr Lynch's evidence which we accept in its entirety. She clearly believed she could make the retrospective change which is why she did it. We do not however believe that the contents of these phone calls are central to the issue before us.

11. In April 2011, the Commissioners carried out a routine VAT inspection, during the course of which the operation of the FRS was checked and the retrospective amendment contained in period 10/08 was noted and the corrective assessment duly raised.

Submissions

12. Mr Nicholson's submission was that it was not HMRC's policy to backdate a change of business activity categorisation. We were referred to paragraph 4.2 of Public Notice 733 which read as follows:

> **4.2 What if I get the sector wrong?**
>
> We will not normally check your choice of sector when we process your application. So if you have made a mistake you may pay too much tax or too little. Paying too little could mean that you are faced with an unexpected VAT bill at a later date.
>
> However, if we approve you to join the scheme, we will not change your choice of sector retrospectively as long as your choice was reasonable. It will be sensible to keep a record of why you chose your sector in case you need to show us that your choice was reasonable.

The publication to which we were referred was the August 2011 edition. We asked for a copy of the Notice which would have been in force in 2008. Mr Nicholson could not produce a copy but assured us that it would have been in the same wording as the current one. Mr Nicholson submitted that it was unlikely that HMRC would have drawn any distinction between "Management Consultancy" and interim "Management Services". The choice of business activity was up to the trader and HMRC would only look closely at the choice where it was clearly incorrect. It was Mr Nicholson's contention that the choice made at the outset was a reasonable choice and therefore could not be altered retrospectively. He drew on the wording of the letter of 7 October 2008 which clearly stated that at the time of application it had been anticipated that that would have been the correct sector. The legislation made no provision for a retrospective change where the choice was made on reasonable grounds. Mr Nicholson drew heavily on the tribunal decision of *Archibald & Co Ltd v HMRC* [2010] TC00336. In this case the tribunal upheld the Commissioners' decision to refuse an application to backdate a change in trade classification commenting that (paragraph 27):

> "The legislation relating to the Flat Rate Scheme does not place any obligation on HMRC to backdate any change of category nor is there any provision whereby a taxpayer can insist on having a change backdated".

Mr Nicolson's submission was that as there were no grounds for backdating the change the appeal should be dismissed.

13. Dr Lynch and Mr Morley-Scott contended that the initial choice of a sector was not reasonable because when the business made its first and subsequent supplies it was of interim management services. Dr Lynch contended that most companies had an "ideal initial focus" for their business when starting up but due to economic conditions they are forced to take on whatever work is available which may well not

be what they had first intended to do. Dr Lynch waited a year to gain comprehensive retrospective data and applied for the change once it was clear that the business would continue to supply interim management services rather than acting as a management consultant. Because the bulk of the business could not have been known at the stage of initial application, the initial choice as a sector could not be said to be reasonable. Dr Lynch made further complaints about the general conduct of HMRC in that they had failed to process the voluntary disclosure and she highlighted, what she saw as, contradictory telephone advice. This we have dealt with earlier in this decision. Dr Lynch concluded her submission by stressing that she had always acted in a fair, open and honest way in her dealings with the Commissioners. She had been an exemplary taxpayer and indeed on the VAT audit was praised by the visiting officer.

14. Mr Morley-Scott in his closing submission distinguished the Appellant's case from that in *Archibald*. He suggested that the Commissioners' policy had no basis in law and thus neither had the decision letter.

Conclusions

15. It was accepted by both parties that the jurisdiction of the Tribunal was limited to considering the reasonableness of the Commissioners' decision. We can only allow this appeal if we consider that Ms Nally could not reasonably have arrived at her decision. To consider the reasonableness of the decision we have to look not only at the decision which she made but at her decision making process. Examining, first, the decision made – i.e. that AML should not be allowed to make the retrospective change of sector, this was, in our view, probably the right decision. Regulation 55H(2)(a) provides that the appropriate percentage shall be that which is attached to the category of business which the trader "is expected, at the relevant date, on reasonable grounds, to carry on in that period". It is quite clear, and indeed accepted by Dr Lynch, that her original intention was to provide management consultancy services. This is clear from both the application to register for VAT and the application to join the FRS. It is apparent in the title of the business. Dr Lynch told us that she entered into competition for consultancy work and applied to tender but, for the reasons given above, this came to nothing. Fortunately her competence and good reputation saved the day and she was able to diversify but this does not mean that her original choice of sector was not reasonable. A decision which is reasonable at the time it is made cannot be rendered unreasonable in the light of subsequent events, or, as in this case, when things did not turn out quite as envisaged at the time of choice. It might prove to have been the wrong decision but if there were reasonable grounds for making the decision in the first place, subsequent events do not change that. At the time of her application, Dr Lynch, experienced in the ways of the NHS, sincerely believed that she could make a go of management consultancy and that is what she intended to do.

16. However, if we look at the decision making process, matters are not so clear cut. The first problem we have is that we have no idea what factors Ms Nally took into account. She was not present to give evidence before us and her letter of 14 November 2008 gives no indication of what she took into account. The letter baldly

asserts that "it is the policy of HMRC not to back date percentage changes …". This in itself would not appear to be a correct interpretation of the Commissioners' policy if Mr Nicholson is correct in his assertion that the policy in 2008 was as it is in 2012. The Commissioners' current policy is quite clearly to allow a change if the original choice was unreasonable. There is no indication that Ms Nally took any account of the reasonableness of the original choice. We know from Dr Lynch's evidence that Ms Nally never made any enquiries of Dr Lynch. Dr Lynch never spoke to Ms Nally. Dr Lynch was never given the opportunity to explain to Ms Nally the distinction between management consultancy and the provision of management services which she has so articulately set out for us. Looking at the tone of Ms Nally's letter, it would appear (again subject to the proviso that Mr Nicholson's assertion is correct) that she misapplied the Commissioners' policy. Now it may well be that had the policy been correctly applied and had Ms Nally had the benefit of all the information which we have, she would have made the same decision but we cannot be certain. We do not know what she would have made of the facts had they been known to her. For this reason we are unable to find that the decision to refuse the retrospective change of category was a reasonable decision and the appeal is allowed.

17. We would make one plea for future cases. Where a decision of the Commissioners is based upon an interpretation of policy, it is imperative that the tribunal has before it a copy of the policy which was current at the time the decision was made. It is of no use to the tribunal to have before it a policy which post dates a decision by some three years unless there is quite clear and incontrovertible evidence that the policy is unchanged.

18. For the reasons given above this appeal is allowed.

19. 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.

LADY MITTING
TRIBUNAL JUDGE

RELEASE DATE: 24 July 2012