TC02425

Appeals numbers: MAN/2008/671 & MAN/2008/672

VAT - COSTS – transitional appeals being current proceedings under Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 (SI 2009/56) - application by taxpayers for substitution of Value Added Tax Tribunals Rules 1986 (SI 1986/590) for Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273) – application made after conclusion of hearing of appeals – consideration of Upper Tribunal decision in Atlantic Computers Limited – application refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

HILLCRAFT TRADING LIMITED
EXPRESS COMPUTERS UK LIMITED

Applicants

- and -

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

TRIBUNAL: JUDGE PETER KEMPSTER

Sitting in public at Priory Courts, Birmingham on 17 August 2012

Mr Hywel Jenkins of counsel, instructed by CTM Limited, for the Applicants

Miss Laura Mackinnon of counsel, instructed by Howes Percival LLP, for the Respondents

DECISION

Background

1. This is an application by the Applicants for the relevant costs regime in relation to their proceedings before this Tribunal to be Rule 29 of the Value Added Tax Tribunals Rules 1986 (SI 1986/590) ("the 1986 Rules") instead of Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273) ("the 2009 Rules").

2. A chronology of relevant events is as follows:

(1) In April 2008 the Respondents ("HMRC") refused certain repayments of input VAT claimed by the Applicants.

(2) Notices of appeal were filed with the VAT & Duties Tribunal (as then was) in May 2008.

(3) HMRC filed their statements of case in August and November 2008.

(4) On 1 April 2009 the VAT & Duties Tribunal was, in effect, replaced by this Tribunal. Proceedings then before the VAT & Duties Tribunal (including the Applicants' appeals) were continued before this Tribunal as "current proceedings": paras 1 & 6 sch 3 Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 (SI 2009/56) ("the Transfer Order").

(5) From late 2008 to early 2010 there were several sets of case management directions issued by the VAT & Duties Tribunal and this Tribunal, some of which included directions for the costs of such interim matters to be "costs in the case".

(6) In December 2009 the Tribunal notified the parties of hearing dates for the appeals (being May to June 2010).

(7) On 1 April 2010 HMRC's solicitors emailed the Applicants' representative concerning a number of pre-hearing matters including amendments to the case management directions and stated:

> "Please note, [HMRC] will be requesting the Tribunal invoke Rule 29 of [the 1986 Rules] in relation to the costs incidental to and consequent upon defending this appeal."

(8) Also on 1 April 2010 the Applicants' representative replied stating:

> "Many thanks and we agree to the directions which will be with you in a few minutes."

(9) The appeals were heard during May and June 2010, with the last day of the hearing being 9 June 2010.

(10) On 14 June 2010 the Applicants submitted to the Tribunal a formal application ("the June Application"):

> "APPLICATION FOR COSTS IN THE EVENT THE APPEAL IS ALLOWED

> TAKE NOTICE that the [Applicants] make an application for costs on a standard basis and under the Tribunal's old rules.
>
> The decision of the Respondents was appealed in 2008; therefore, the Tribunal's rules that came into effect in April 2009 do not necessarily apply. Discussions between the parties immediately after the trial concluded appeared to indicate that both parties would seek costs if they were successful, although Counsel for the Respondents needed to take instructions. We have copied this application to [HMRC] so that they can confirm their intentions."

(11) The Tribunal's decision allowing the appeals was issued on 21 August 2011.

(12) On 30 August 2011 the Applicants' representative reiterated the June Application.

(13) The matter was then stayed pending the outcome of the proceedings before the Tax & Chancery Chamber of the Upper Tribunal in the case of *Atlantic Electronics Limited ("Atlantic")*. The Upper Tribunal released its decision on 6 February 2012 (FTC/29/2011, [2012] STC 931).

(14) On 5 March 2012 HMRC filed an objection to the June Application.

(15) The disputed June Application now comes before this Tribunal.

Legislation

3. The relevant legislation is set out in detail in ¶¶ 4 to 16 of the Upper Tribunal's decision in *Atlantic*, which I respectfully adopt here. In summary, appeals pending before (but not fully heard by) the VAT & Duties Tribunal as at 1 April 2009 continued before this Tribunal as "current proceedings" (paras 1 & 6 sch 3 Transfer Order). This Tribunal may give a direction disapplying any provision of the 2009 Rules and applying any provision of the 1986 Rules to ensure that such proceedings are dealt with fairly and justly (para 7 sch 3 Transfer Order). However, any order for costs may only be made if, and to the extent that, an order could have been made under the 1986 Rules (para 7(7) sch 3 Transfer Order).

4. The significance is that in practice costs under Rule 29 of the 1986 Rules normally followed the event, while no costs can be awarded under Rule 10 of the 2009 Rules (for "current proceedings") unless the respondent party has acted unreasonably in the proceedings (Rule 10(1) of the 2009 Rules and ¶ 14 of the Upper Tribunal's decision in *Atlantic*).

Submissions

5. For the Applicants Mr Jenkins submitted as follows:

(1) It would be fair and just for the Tribunal to direct, pursuant to para 7(3) sch 3 Transfer Order, that Rule 29 of the 1986 Rules should apply instead of Rule 10 of the 2009 Rules. It was accepted that a formal direction to that effect was required.

(2) The whole case had proceeded on the basis that the 1986 Rules would apply and there would be costs-shifting. Interim orders and directions had provided for "costs in the case" and, while the Applicants accepted that was not determinative (see ¶ 70 of the Upper Tribunal's decision in *Atlantic*), it was consistent with the common intention of both parties that the 1986 Rules should apply. In their email of 1 April 2010 HMRC's solicitors stated their intention that the 1986 Rules should apply to all costs, and the reply the same day from the Applicants' representative took no issue with that. The June Application was made within one week of the end of the hearing. It was clear that both parties intended throughout that the 1986 Rules would apply.

(3) While the Applicants did not take issue with HMRC wishing to stay progress of the matter until the outcome of *Atlantic* in the Upper Tribunal, the fact was that HMRC's formal objection to the June Application was only made some two years after they had stated their intention for the 1986 Rules to apply. If HMRC really felt substitution of the 1986 Rules was unjust then they should have objected when the June Application was first made, in June 2010. It was not the Applicants who had waited to see how matters would develop, but instead HMRC.

(4) Although the Tribunal had jurisdiction to make an order splitting the relevant rules between costs incurred pre and post 1 April 2009 (see ¶¶ 45 & 46 of the Upper Tribunal's decision in *Atlantic*), that was not appropriate here as the large majority of the Applicants' costs were incurred after 31 March 2009.

6. For HMRC Miss Mackinnon submitted as follows:

(1) There has been no disapplication of the 2009 Rules and thus the 2009 Rules apply: *Atlantic*. It would not be fair and just to exercise the power under para 7(3) sch 3 Transfer Order so as to substitute the 1986 Rules.

(2) The 1 April 2010 email exchange did not constitute an acceptance by HMRC that the 1986 Rules should apply. The Applicants agreed to certain directions but did not respond to the comment on costs.

(3) It was true that both parties had to some extent considered the matter of costs but neither side made any formal application for disapplication of the 2009 Rules, and there was a considerable lapse of time between the 2009 Rules coming into force (on 1 April 2009) and the June Application.

(4) The Applicants had decided to apply only after feeling for the mood of the Tribunal at the hearing, having heard all the arguments and evidence advanced. It was not acceptable for the Applicants to "wait and see", and that was supported by *Atlantic*.

(5) HMRC agreed that the bulk of the costs were incurred after March 2009. That pointed to the 2009 Rules being more relevant than the 1986 Rules.

(6) The Applicants were attempting to capitalise on their success before the Tribunal, rather than any legitimate expectation in relation to their incurring their costs.

Consideration

7. The recent Upper Tribunal decision in *Atlantic* addresses most of the issues I need to consider in relation to the June Application. The Upper Tribunal (Warren J) (at ¶ 1) made clear that its decision was addressing principles "beyond matters which are strictly necessary in the determination of the present appeal". In that case HMRC filed (with the VAT Tribunal) their statement of case in relation to the appeal on 8 August 2008 and it included a statement that HMRC would ask for costs if the appeal was dismissed. On 6 April 2010 the First-tier Tribunal consented to a stay application which included, "Costs to be in the cause." On 21 October 2010 (ie over 18 months after the 2009 Rules came into force) the taxpayer's solicitors applied for a direction that the 2009 Rules should not be disapplied; and a week later HMRC objected to that and responded with an application that the 1986 Rules should be applied. So the stance of the parties was the reverse of the current case, where it is the Applicants who seek the application of the 1986 Rules. The First-tier Tribunal granted the taxpayer's application and refused that of HMRC; and that decision was upheld by the Upper Tribunal.

8. Warren J describes (in ¶ 14) the application of Rule 10 of the 2009 Rules from 1 April 2009 as "the default regime". Warren J defines (in ¶ 21) a "prospective direction" as "a prospective direction fixing the costs regime which is to apply." I take "prospective" as meaning an application by either party in advance of the point at which the Tribunal considers an award of costs under the default regime. Rule 10 permits costs applications during the course of the proceedings (Rule 10(4)) and the Tribunal may make an order of its own initiative (Rule 10(2)), but normally the award would be made on the application of the winning party after the Tribunal has issued its decision to the parties. I consider that is in accord with Warren J's comments at ¶ 21 – especially his use of the words "following the conclusion of the appeal" – and ¶ 54 (quoted below). In the current case the June Application was filed after conclusion of the oral hearing but before the decision was issued to the parties, and I consider that in the terminology of *Atlantic* it constitutes an application for a prospective direction.

9. Warren J considered three different chronologies of events that might arise in transitional cases (ie "current proceedings" under paras 1 & 6 sch 3 Transfer Order), the third of which most closely covers the current case:

> **"[34]** This leads to a third example where the proceedings were commenced in the VAT Tribunal and straddle 1 April 2009 in a substantial way, as in the case of Atlantic's appeal. It is to be assumed for the purposes of this example that substantial work has been carried out and considerable expense incurred over a significant period before that date and that substantial work will be carried out and considerable expense will be incurred over a significant period after 1 April 2009. The issue then is how costs are to be dealt with. A number of questions arise including these: If a party seeks a prospective direction, how should that be resolved? Does it make any difference when the application for such a direction is made? How is the relative amount of work and expense in the first period as compared with the second period to be taken into account, if at all? If neither party makes an

application to the tribunal for some sort of prospective direction, how should the tribunal deal with costs at the end of the day?"

10. Warren J states (emphasis added):

> **"[44]** When one comes to the third example, one question facing the tribunal dealing with an application for a prospective direction will be whether to make one at all. There are good arguments for doing so, although it will always be a matter of discretion. In particular, both the 1986 Rules and the 2009 Rules satisfy the second policy which I have identified, that of providing certainty. The 1986 Rules provide certainty in that it is known that a costs-shifting regime will apply; the 2009 Rules provide certainty in that the costs regime will be identified at an early stage depending on whether the taxpayer elects to opt out of costs shifting. *If either party seeks to depart from the default regime, they ought, for reasons I will explain, to make an application at an early stage for a prospective direction*."

11. Warren J elaborates on the need to make an application for a prospective direction at an early stage, and the reasonable expectations of the parties:

> **"[50]** Ideally, any application to depart from the default regime ought to be done within a reasonable time of 1 April 2009. If an application were made shortly after 1 April 2009, and if the tribunal were to reject the idea of a direction applying different regimes, then it would have to attempt to resolve the tension as best it can. But if the application were delayed for some time, the passage of time will make it more difficult, I consider, to obtain a prospective direction disapplying r 10 and applying r 29. This is not, in my view, because of any reasonable expectation on the part of the taxpayer that the default regime will apply, but rather because this is what the second policy, the policy of certainty which lies behind the 2009 Rules, requires. If neither party makes an application for a prospective direction, that certainty is to be found in the default regime and the passage of time renders a departure from that regime more difficult to justify.
>
> **...**
>
> **[54]** A party to a tax appeal, whether the taxpayer or HMRC, has not only a reasonable expectation that the relevant procedural rules will be applied, but also the right to have them applied in fact. In the case of current proceedings, the relevant rules are to be found in the 2009 Rules read with para 7 [of sch 3 Transfer Order]. Neither a taxpayer nor HMRC are entitled to have the 2009 Rules applied as if para 7 did not exist. But unless a direction is made under para 7, whether a prospective direction or a direction at the time when a costs order comes to be made, then r 10 will apply. In that sense, it is perfectly true that a taxpayer has a reasonable expectation that r 10 will apply, indeed he has a right to that effect.
>
> **[55]** But that is not to say that there is some justified expectation of the taxpayer (or indeed of HMRC) that the default regime will apply which is, of itself, a factor which should be taken into account in the exercise of the discretion. If it is suggested that the tribunal should exercise its

discretion by declining to apply r 29 *because* there is a reasonable expectation that r 10 will apply, I do not agree with it. When it comes to exercising the discretion under para 7, whether in making a prospective direction or in making an actual order for costs, the tribunal must, of course, act judicially applying the correct principles whatever they may be. In the case of an application for a prospective order, the passage of time since 1 April 2009 will be a relevant factor, as I will explain, in how that discretion should be exercised. The taxpayer has not only a reasonable expectation, but also a right to insist, that the discretion will be exercised in accordance with those principles; and if it is the case that those principles result in the passage of time making it more difficult for HMRC to obtain a prospective direction that r 29 should apply, then the taxpayer can be said to have a reasonable expectation that it will be correspondingly more likely that r 10 will apply. The reasonable expectation arises because of the way that the taxpayer is entitled to expect that the discretion will be exercised; it is not the case that the discretion must be exercised in favour of the application of r 10 because there is a reasonable expectation that it will be. As with cause and effect, the relationship between the exercise of discretion and the reasonable expectation of a taxpayer goes in only one direction and is important to remember which way the arrow of the relationship, like the arrow of causation, points.

[56] Accordingly, a tribunal must be careful to take account of the expectations of a taxpayer only as a reflection of the factors which lead to those expectations and must be careful not to give separate weight to those expectations (unless, of course, there are expectations generated by other matters, such an express representation by HMRC that it would not seek to impose a costs-shifting regime)."

12. Warren J gives further guidance on the need to make an application for a prospective direction at an early stage:

"[68] It will be apparent from what I have already said that I agree broadly with the view that delay beyond a reasonable time after 1 April 2009 is relevant to the exercise of the discretion. And I would agree with Judge Wallace [in the First-tier Tribunal] to this extent namely that, after a reasonable time has expired, parties who wait and see how a case develops before making an application should not ordinarily expect their application to succeed.

[69] In [54] Judge Wallace stated what for him, on the facts of the case, was the decisive factor against applying r 29. It was the lapse of time since 1 April 2009 until the making of the application by HMRC on 28 October 2010, some 19 months later adding that 'there has been nothing in the conduct of the appellant or otherwise to make it necessary to apply those rules [the old costs rules] in order to ensure that the proceedings are dealt with fairly and justly'. He went on to express full agreement with the reasoning of Judge Berner in *Hawkeye*. It was implicit in what Judge Wallace was saying there that r 29 ought not to apply at all; in other words, he was deciding that it would not be appropriate to make a costs order in favour of HMRC at the end of the

> appeal if it was successful even in relation to the costs incurred in the VAT Tribunal; and that, no doubt, is why he effectively acceded to Atlantic's application to confirm the application of Rule 10.
>
> **[70]** I consider that it was within the range of reasonable decisions open to him for him to have reached the conclusion that the lapse of time in the present case was such that HMRC should not obtain the prospective costs order which they sought in relation to the entire proceeding including the costs in the VAT Tribunal. In particular, he was entitled to reach that conclusion notwithstanding that HMRC had indicated, early in the proceedings, that they would be seeking a costs order if successful. That indication was given before the jurisdiction of the VAT Tribunal had been transferred to the Tax Chamber and before the 2009 Rule were in force. HMRC's indication that it would seek costs under rules, the 1986 Rules, which gave them a right to do so is not to be taken as an indication about how costs would be dealt with under the entirely different regime found in the 2009 Rules. Further, he was entitled, in my view, to reach that conclusion notwithstanding earlier orders on interim applications that costs should be 'in the case' or 'in the cause'. The particular circumstances of those orders cannot be taken as an acceptance by Atlantic that a costs-shifting regime was to apply to the entire proceedings."

13. Turning to the current case I have considered carefully the following factors:

(1) In *Atlantic* (at ¶ 70), "HMRC had indicated, early in the proceedings, that they would be seeking a costs order if successful. That indication was given before the jurisdiction of the VAT Tribunal had been transferred to the Tax Chamber and before the 2009 Rule were in force"; that was "not to be taken as an indication about how costs would be dealt with under the entirely different regime found in the 2009 Rules". In the current case, on 1 April 2010 (ie one year after the commencement of the new regime) HMRC stated to the Applicants that they "will be requesting the Tribunal invoke Rule 29 of [the 1986 Rules] in relation to the costs incidental to and consequent upon defending this appeal." There is the difference that in the current case HMRC's indication was made *after* the new regime came into force. Miss Mackinnon for HMRC accepts – and I agree – that both parties had put their respective minds to the matter of costs in the proceedings, but the fact is that HMRC never made the request referred to in the 1 April 2010 email. If at that time the Applicants felt that was the correct course of action then they should have ensured HMRC followed up and made the request or, of course, made an identical application themselves on a timely basis.

(2) In *Atlantic* (also at ¶ 70), there were "earlier orders on interim applications that costs should be 'in the case' or 'in the cause'"; that could not be taken as an acceptance "that a costs-shifting regime was to apply to the entire proceedings". In the current case, from late 2008 to early 2010 there were several sets of case management directions issued by the VAT Tribunal and this Tribunal, some of which included directions for the costs of such interim matters to be "costs in the case". I consider the current case to be on the same footing as *Atlantic* on this factor, and so the interlocutory orders should not be taken as an acceptance that a costs-shifting regime was to apply to the entire proceedings.

(3) In *Atlantic* HMRC's delay in making the application for the prospective direction was almost 19 months whereas in the current case the Applicants' delay was slightly less at 14½ months. The delay in the current case was over one year and no explanation has been given why a formal application for a prospective direction was not made earlier. I acknowledge that the 2009 Rules changed the costs position and parties in ongoing appeals in April 2009 may have needed to absorb the full ramifications of the new legislation; however, it is clear from the facts that some time before the commencement of the oral hearing both parties were alert to the change of law (see for example HMRC's 1 April 2010 email) but neither party chose to make an application for a prospective direction. Also, both parties were at that stage actively preparing for the appeal hearing, so this is not even a case where the files were dormant (which is not to suggest that such a situation would excuse or make reasonable a delay). I consider a delay of over one year in these circumstances not to be reasonable but I comment no further on the length of the delay because I consider the next factor (the stage at which the June Application was made) to be more important.

(4) In *Atlantic* Warren J agreed with the First-tier Tribunal that "after a reasonable time has expired, parties who wait and see how a case develops before making an application should not ordinarily expect their application to succeed." (¶ 68). In the current case the June Application was not made until after the conclusion of the oral hearing (the Tribunal reserved its decision). When referring to "wait and see how a case develops" I consider both the Upper and First-tier Tribunals had in mind (particularly in appeals such as the current case, usually described as MTIC cases) a party choosing to evaluate matters such as witness statements, documents disclosed, facts agreed, issues conceded etc before making an application for a prospective direction. To wait until the hearing has concluded, and all oral evidence (including cross-examination) and submissions heard and closed, is an extreme case of "wait and see". I do not suggest that the Applicants' delay was deliberately for that reason but that is the practical effect, and I conclude that it would not be fair and just for the Applicants' June Application to succeed.

Decision

14. The June Application is REFUSED.

15. 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.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 3 December 2012