[2015] UKFTT 0405 (TC)

TC04582

Appeal number: TC/2014/01572

Value Added Tax - VAT Group registration - Second challenge of a refusal on the part of HMRC to admit two group companies into the VAT group on a retrospective basis - problems created by errors made by companies in the Appellant group, particularly during a period where there had been numerous changes of personnel in the finance department - Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

COPTHORN HOLDINGS LIMITED

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: JUDGE HOWARD M. NOWLAN

Sitting in public at the Royal Courts of Justice in London on 30 March to 1 April 2015

David Southern, counsel, instructed by Allen & Overy LLP, for the Appellant

Christiaan Zwart, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This was an Appeal in which the Appellant was challenging, for the second time in relation to the same circumstances, the refusal by HMRC to exercise their discretion, conferred by section 43B (4) Value Added Tax 1994, to concede the retrospective inclusion of two group companies into the Appellant's VAT group.

2. The dispute resulted from several related and relatively elementary administrative errors made by the various companies involved, the result of which was that the group suffered one very serious forfeiture of what should have been a legitimate and routine deduction for input tax in an amount in excess of £2 million. Other more minor but similar charges and forfeitures of input tax were also suffered.

3. The mistakes in question were occasioned initially by the fact that during a period of 18 months the group had had four different individuals in charge of the administration of either finance generally or the group's VAT affairs, and matters were in some chaos. This was not disputed by the Respondents. The mistakes were not, in other words, situations where one decision had deliberately been made in relation to which companies should be included within the VAT group, with the group wishing to change that selection retrospectively at a later date. The situation was one where it had mistakenly been believed that two companies were members of the VAT group when in fact they were not; seemingly all transactions were then recorded consistently with that mistaken assumption; the consequences of the mistakes were the various forfeitures and charges referred to above, and the request for retrospective inclusion of the two relevant companies in the VAT group was designed to conform the VAT treatment to the way in which matters had been reported, and thereby to eliminate the somewhat incoherent VAT treatment that the actual mistakes had occasioned.

4. As I indicated, this was the second of the challenges made by the Appellant to the decisions by HMRC not to exercise their discretion to sanction the retrospective inclusion of the two companies into the relevant VAT group. On the occasion of the first refusal, the Appellant appealed to the First-tier Tribunal and in a most careful and comprehensive 60-page decision, the Tribunal (Judge John Clark and Elizabeth Bridge) decided in the case of *Copthorn Holdings Limited v. HMRC* [2014] SFTD 1, that one claim in relation to a different matter should be rejected, but concluded in relation to the claim for retrospective inclusion of the two companies in the VAT group that the matter should be remitted back to the Commissioners for reconsideration. The prime ground for this decision was that the statutory power conferred on HMRC to backdate the inclusion of companies in the VAT group was a general and "open" discretion, such that it was wrong for HMRC to have evolved and publicised a policy that prescribed the only limited circumstances in which they would exercise this power, thus altogether precluding backdating in all other situations.

5. Approximately one year later, HMRC completed their reconsideration of the earlier decisions, and the consideration of the relevant FTT decision and other information that had been provided, and they issued decision letters in relation to the claimed retrospective inclusion of the two companies in the VAT group, again refusing both applications. The Appellant now contends that the very minor changes that have been made to the announced policy as to how HMRC will exercise their discretion to concede retrospective inclusion

within VAT groups have either further added to the bar on making retrospective applications or, in one case, have provided a theoretical but almost illusory chance of backdating being conceded in circumstances other than those very limited cases originally specified. Accordingly, the Appellant's complaint remains the same before me as it did before the earlier Tribunal. As a secondary matter, there is the further claim that the discretions have not been exercised reasonably, largely because of the restrictive terms of the announced policy, and that it was unreasonable not to have conceded the inclusion of the two companies into the VAT group.

6. I have found this decision difficult, because it is obviously futile for the matter to be remitted to and fro between the Commissioners and the Tribunal continuously. I am, however, persuaded that the announced policy is still too restrictive of the open discretion conferred on HMRC by Parliament, notwithstanding the very marginal change that has been made to the policy. I am also persuaded that the actual decision letters (in relation to the two most recent applications) divulge certain supporting reasons that seem to me to be highly suspect. I will explain why in detail below. I accordingly allow the Appeals in relation to both applications and remit the matter again for reconsideration by HMRC. While I accept that it is certainly not for the Tribunal to suggest or dictate to HMRC the general policy that HMRC might adopt and publicise in relation to retrospective applications, I will certainly make a number of points in relation to what should and should not be considered in dealing with retrospective applications.

7. The facts are regrettably somewhat complicated. While they were fully described in the earlier decision I will summarise the facts that are relevant to this decision now in as concise a way as is possible.

The facts

8. The Copthorn group is a house building group. Its activity may have been largely in the north west of England. Certainly the two sites that have occasioned the two present disputes with HMRC are in the north west of England.

9. It appears to have been the group practice to procure that each development was undertaken by a separate special purpose vehicle or SPV. This was for the reason that, while another group company would normally have purchased the land destined for development outright, there was always the possibility that the development might later be undertaken alongside a joint venture partner, and that could most easily be accomplished by ensuring that each site was in, or was transferred to, a separate SPV so that the joint venture for the particular project could take the form of a sale or issue of shares in the relevant SPV to the eventual joint venture partner.

10. So far as VAT was concerned, third party vendors of land would sometimes have elected for VAT purposes to tax land sold to the group. In those cases it naturally followed that the purchase price would be paid on a VAT-inclusive basis. Such VAT was, however, unlikely ever to constitute a cost to the Copthorn group since, following the construction of new dwelling houses, all of the group's supplies would be zero-rated and therefore input VAT would all be recovered. I was told that none of the group companies rendered exempt supplies, and that all the supplies were taxable.

The facts in relation to the Unity Mill site

11. The more material dispute in this Appeal related to the purchase of land at a site referred to as the Unity Mill site. The intended SPV for the purposes of the development of this site was a company referred to throughout the hearing as C28. This company had been formed in early 2007 and had performed no activity until the transactions that I will now describe.

12. On 27 July 2007, the group company referred to throughout the hearing as "CPUKL" contracted with the third party vendor to purchase the Unity Mill site. Since the vendor had elected to tax the site, the price was £12.5 million plus VAT of £2,187,500. Completion took place on 30 July and also on 30 July CPUKL effected a sub-sale of the land to C28 for £12.5 million, the price being left outstanding as an inter-company debt, and no reference being made, in the case of the sub-sale, to VAT. Financing requirements may have explained why the third-party purchase had to be made by CPUKL, rather than simply by C28. Why this was so is now immaterial, since it was clear that, for whatever reason, the land was purchased by CPUKL and sub-sold to C28.

13. On 26 July 2007 there had been a high-level meeting at which it had been decided that the steps just indicated would be implemented, and it was also decided that as CPUKL was to on-sell "elected" land to C28, CPUKL should elect to waive VAT exemption in relation to this site. There was a certain amount of dispute in the earlier hearing as to whether this decision was in fact made by the correct company (i.e. CPUKL), and whether the decision was a decision to elect, or simply a decision that in due course a decision to elect would be made. The earlier Tribunal decided that the decision at the meeting had been made on behalf of the appropriate company, and that the decision did constitute a decision to elect. In order for that election to be effective, however, there is also the requirement that it should be notified to HMRC and it became clear (almost certainly not until enquiries from HMRC in relation to C28 in 2010 revealed this point) that no notice of election to tax had been given to HMRC.

14. Since CPUKL had failed to give notice of the election to tax the Unity Mill site, its disposal to CP28 would necessarily have been an exempt disposal of land unless it could be disregarded as being a disposal between two companies within the VAT group. The consequence of it being an exempt disposal would of course have been that input tax of in excess of £2 million would be attributable to the exempt disposal and so would be disallowed, and C28 (on buying land in an exempt transaction), would never later be able to recover the earlier input tax. While, as I will address below, it may have been thought that C28 was a member of the VAT group, such that the sub-sale to C28 would have been altogether disregarded with there thus being no fatal exempt transaction, in fact CPUKL was in the VAT group but C28 was not. This was not appreciated until 2010 and so initially the Appellant, as the representative member of the VAT group, recovered the whole of the input VAT, the sub-sale being disregarded. In 2010 enquiries from HMRC led to the realisation that C28 had neither been a member of the VAT group, nor been registered on a stand-alone basis. Since this meant that the 30 March sub-sale had been an exempt transaction, the Appellant was assessed to VAT in order to recover the input tax that had wrongly been refunded. That tax was duly paid and the main consequence of the Appellant's present

endeavour to achieve retrospective inclusion of C28 into the VAT group from 30 March 2007 would be that the relevant input tax would again become recoverable.

15. Deferring the issue of who assumed that C28 had been a member of the VAT group at the time of its purchase of the land, it was claimed by the Appellant, and accepted by the Respondents, that for at least 18 months around the transactions in relation to the Unity Mill site, there had been "instability" in the group's department that dealt with finance and VAT matters, four people serving in senior roles in that period, for much of that time working out their notice periods since they had not proved to be successful appointees. I will now address other factors that rather suggest that there had been a widespread misunderstanding that C28 had been a member of the VAT group at all relevant times.

16. The first point to note is the very feature that the Appellant itself recovered the input VAT following CPUKL's purchase of the Unity Mill site, and its sub-sale. That treatment was only explicable on the basis that the sub-sale fell to be disregarded, in other words that C28 was a member of the VAT group. Had it been appreciated that that was not the case, there would only have been two remaining possibilities. If the sub-sale had been taxable (assuming the election to tax), then C28 rather than the Appellant (as the representative member of the group in which CPIKL was clearly a member) should have recovered the VAT. If the sub-sale had been exempt, nobody would have recovered the VAT. It therefore seems that the feature that the Appellant in fact reclaimed the input tax was consistent only with the assumption that the on-sale was disregarded by virtue of C28 having been assumed to be a member of the VAT group.

17. Similar conclusions are suggested when we consider the treatment accorded to the supply to C28 of later services geared presumably to planning the construction works and in due course the various supplies obtained for the construction of houses. It was apparently the group practice that when services were obtained by group companies from third-party suppliers (for example, a building supply company supplying bricks), the third party contract would be with CPUKL, with CPUKL being invoiced by the third party supplier, and then there would seemingly be an on-supply from CPUKL to the appropriate operating company that would actually be using the relevant supplies. I said "seemingly" because there was no written contract between CPUKL and the operating companies (i.e. C28 for present purposes), but since it seems that the building operations were conducted solely by C28, and that the inter-company indebtedness from C28 to CPUKL increased on a month by month basis as third party supplies were received, it seems obvious that the arrangement was simply that the third party supplies were on-supplied to the operating company, i.e. in this case C28.

18. Once again, until it emerged in 2010 that C28 was not in the VAT group, the recording of the relevant month-by-month supplies for VAT purposes appeared to have been that they were claimed as inputs in the hands of the Appellant. Had there been a taxable supply by CPUKL to C28 and had the relevant individuals dealing with the VAT affairs realised that C28 was not in the VAT group, the on-supplies would of course have nullified the net deduction for the supplies in the hands of the representative member, and the relevant net input deduction would have been deductible in the hands of C28. Had that been the right treatment, one can only suppose that those responsible in the group for VAT affairs would have noted that C28 was not, and never had been, separately registered for VAT purposes. As it was, it seems reasonable to observe that as the third-party supplies were simply treated

as generating input deductions in the hands of the representative member, this must suggest that those responsible for VAT affairs in the group continued to operate in the belief that the on-supplies were disregarded for VAT purposes, by virtue of C28 being a member of the VAT group.

19. Before dealing with the ways in which the group sought to rectify the VAT problems that had resulted from the dual feature that the option to tax had not been notified on behalf of CPUKL in relation to the Unity Mill site, and that C28 had not been added as a member of the VAT group, I will deal with the facts and the broadly similar problem that arose in relation to another site and another SPV.

The facts in relation to the Queen Street property

20. In April 2008, the group acquired another site, the acquisition principally consisting of the purchase of a company from a third party. The acquired company was called Lakenmoor Ltd ("LL), and LL was purchased for £100, along with the commitment to discharge the substantial indebtedness of LL. The purchaser of the shares was C26, a similar SPV to S28. The overall purchase included the purchase of two minor parcels of land, one of which had been elected for VAT purposes, but during the hearing before me no reference was made to these minor purchases and I will ignore them. I do not understand them to have any bearing on the present problems.

21. Following C26's purchase of the shares in LL, LL's land was transferred to C26 for consideration, left outstanding on inter-company account, of £7,722,175.

22. No VAT was returned or accounted for in relation to the land sale by LL to C26. This was principally because the Copthorn group had been unaware that back in 2002 LL had elected to tax the relevant Queen Street property. The Copthorn group had wrongly therefore supposed that the transfer was an exempt transfer for VAT purposes. When in 2010 the fact that LL had elected to tax the Queen Street property came to light, and it also emerged that C26 had also not been included in the membership of the VAT group, LL (which had been made a member of the group a few days after its purchase by C26) became liable for the VAT on the sale of the elected land to C26, the liability in fact falling on the Appellant as the representative member of the group.

23. In the event the problem in relation to this liability to tax was later resolved because when C26 was eventually included in the VAT group (never having been registered on a stand-alone basis), the Appellant made a claim under Regulation 111 of the VAT Regulations 1995 to recover the pre-registration VAT suffered on C26's purchase of the land from LL. This was conceded and therefore the great majority of the problem in relation to the mistakes concerning C26 was solved, and there remains only a minor issue in relation to C26. That minor problem relates to the on-supply on a monthly basis of post-acquisition services to C26, to which I will now turn.

24. The treatment of the monthly supplies of services made to C26 was identical to that in relation to the services on-supplied to C28 that I described in paragraphs 17 and 18 above. In other words, the third parties supplied services to CPUKL, CPUKL on-supplied the services to C26 and on a month by month basis the inter-company indebtedness owing from C26 to CPUKL escalated as services were passed on to C26. Again for VAT purposes, the on-supplies had been completely ignored (only cogently on the basis of the same assumption

that C26 was a member of the group) and the input deductions were claimed by the Appellant as the representative member of the group in which CPUKL was plainly a member.

25. As matters were explained to me, when all the problems emerged, the first step was for the representative member to refund the reclaimed input tax because the right analysis was that it had received and passed on taxable services (otherwise than to a member of the VAT group), such that it was not entitled to retain the net deduction for input tax that it had initially claimed and received. When C26 was then finally included as a member of the VAT group, and a claim was made for the input deduction in respect of the land purchase under Regulation 111 (as mentioned in paragraph 23 above) a similar claim was made for the recovery of the input deductions in relation to the services passed on to C26 on the monthly basis. The problem with this was that, in contrast to the rule in relation to goods purchased before the acquirer became registered or registered in the group return, Regulation 111 only permitted a recovery of the input tax in relation to those services received in the 6-month period prior to registration. The result of this, I was told, was that the Appellant, as the representative member of the group, did recover the VAT in relation to C26's receipt of services in the 6-month period (apparently $10/39^{th}$ of the total cost of services to that date). Accordingly the only matter that remains in dispute is that if HMRC were to grant retrospective inclusion of C26 into the VAT group (as requested) back to the April 2008 date when C26's activity commenced, all the on-supplies of services would retrospectively be disregarded, full input deductions would be due to the Appellant in relation to the original invoices for third-party supplies, and in effect the input deduction for the remaining 29/39ths of the services would be recoverable. I imagine that a similar point may apply to the monthly services passed on to C28 but this was not mentioned during the hearing before me.

Ms. Colgrave's evidence

26. No evidence was given by anybody in the hearing before me, and the debate focused entirely on the documents and the evidence that had been given at the earlier hearing.

27. At the earlier hearing, the Finance Director, Ms. Colgrave had indicated in her Witness Statement, and had confirmed in oral evidence, that she had believed that C28 and C26 had been members of the VAT group from some date prior to the activation of either company. In the hearing before me, the Respondents' counsel said that he did not challenge the proposition that this is what Ms. Colgrave herself had genuinely believed, but he appeared to question whether others had shared that belief, and whether whoever had made the various filings to which I have now referred made them on the basis of sharing the same belief.

28. In the absence of anyone having given any evidence at all before me, and in the light of the fact that the first Tribunal expressly accepted Ms. Colgrave's evidence, it does seem to me that the filings that were initially made can only be explained on the basis that others responsible directly for making the VAT filings did share the same belief. For had they had to consider the implications of on-supplies (particularly of all the monthly supplies) being made to companies outside the VAT group, they would surely have realised that the receipt of services by such companies would have some VAT implication, and once they had then noted that neither subsequent recipient of services was registered on a stand-alone basis, so that neither had a VAT registration number, something plainly needed some attention.

29. I therefore conclude that as a result of this period of apparent chaos in the finance department, there must have been a general belief that C28 and C26 had been members of the VAT group at all relevant times.

30. In giving this conclusion, I have not lost sight of the fact that the other (if not the principal) explanation for why the initial mistakes were made in relation to each company was that in the case of C28 the intention had been to ensure that CPUKL notified the election to tax, and in the case of C26, the group had not known that LL had elected to tax the Queen Street property back in 2002. I nevertheless consider that there must have been a widespread assumption that the two companies were members of the VAT group.

The notifications of the composition of the membership of the VAT group by HMRC

31. On four occasions between the April 2008 date when C26's activity commenced and the 2010 date when all the problems came to light, HMRC had sent a list to the Appellant of the group companies that HMRC considered to have been included in the VAT group. On all four occasions the list did not include the names of C28 or C26. I should also mention that while the "instability", as it was described, in the group's finance and VAT department, had subsisted for an 18-month period, this period had probably ended prior to the date when the four lists of members of the VAT group had been sent to the Appellant by HMRC. It therefore seemed to follow that, even when matters had become more organised, the significance of C28 and C26 not being shown on these lists was still not noted because no action was taken to modify the VAT filings that I have described or to unearth the problems that had, by the occasion of the receipt of each list, already occurred.

32. The Appellant's counsel suggested in his submissions that once a wrong assumption had been made, that assumption would very often not be questioned, and that it was understandable that nobody in the group had spotted the mistakes that had been made in assuming that C28 and C26 had been included in the group registration. I was shown a chart of group companies (of which there were a great many) and lists, from time to time, of those subsidiaries included in the group registration and I accept that the omission of the two companies from the lists could relatively easily have been missed. It would certainly have been easier, even if a cross-checking exercise had been done, to have gone down the list of companies supplied and check that each company on the lists was indeed meant to be in the group registration, and rather more understandable to miss the fact that companies not mentioned should indeed have been on the lists. In any event, the only other possible explanation for the fact that no action was taken by the group when each of the four lists was provided was that the errors were spotted and the group decided just to try to bury the problem and ignore it. The Respondents' representative accepted that he was not suggesting that this had been done. I accordingly attach little significance to the fact that the errors in relation to C28 and C26 were not spotted by the group.

The various efforts to solve the problem

33. The first expedient designed to solve the group's problems (at least the much more serious problem in relation to C28) was to seek to make a belated notification of CPUKL's option to tax. It seems that those responsible within HMRC for dealing with such notifications, and in particular those made out of time, would have conceded retrospective notification of CPUKL's option to tax, save for HMRC's general policy condition that the

relevant supplier must have acted in conformity with the un-notified election to tax. CPUKL had not of course paid the tax in relation to the on-sale of the Unity Mill site, but if this had been because of the simultaneous error that C28 was thought to have been a member of the VAT group, such that the on-sale would have been disregarded, it was not as if CPUKL had just deliberately disregarded its option to tax. The refusal on the part of HMRC to accept the late notification of the option to tax thus seems somewhat regrettable, but the first Tribunal concluded that the decision had been reasonable, and this issue is not raised in the present Appeal.

34. Having failed to obtain retrospective notification of the option to tax on the part of CPUKL, the group later turned to the only other possible solution to its problems, namely to request retrospective inclusion of C28 and C26 into the VAT group from 27 March 2007 in the case of C28 and 14 April 2008 in the case of C28. Were this to be conceded, of course, it would have eliminated all the problems, including those related to the provision of services on the monthly basis, and in particular those services passed on to C26 (and presumably C28 as well) in the periods more than 6 months before the two companies were actually included into the group registration.

35. HMRC refused both applications in identical *pro forma* letters that quoted HMRC's policy in relation to retrospective inclusion of companies into VAT groups.

36. The terms of section 43B(4) VAT Act 1994 that conferred the power on HMRC to accept the inclusion of companies into a VAT group simply provided that:

> *"Where this section applies in relation to an application, it shall .. be taken to be granted with effect from:*
>
> *(a) the day on which the application is received by the Commissioners, or*
>
> *(b) such earlier or later time as the Commissioners may allow."*

Notwithstanding the quite general manner in which this provision gave HMRC a general discretion whether to backdate the effect of applications for inclusion in VAT groups, HMRC had announced the policy that backdating would only be considered for a period of up to 30 days preceding the date of the application, or else where there were exceptional circumstances. Exceptional circumstances were stated to involve some form of administrative error on the part of HMRC. It was for this reason that both applications were rejected. The applications were incidentally dealt with on the erroneous basis that they were just rejected. When the relevant companies satisfied the "control" links required for inclusion in the VAT group, and when applications were not rejected *"for the protection of the revenue"*, and they were not, HMRC should in fact have accepted inclusion in the VAT group on the date of the applications, rather than simply refused the applications altogether. This minor mistake was however of no great consequence, other than in indicating that other people can make mistakes even when the sole focus of the HMRC officials in question was that of dealing with this limited feature of VAT law.

37. In a most careful and comprehensive decision, the earlier Tribunal remitted the issue of the applications for retrospective inclusion in the VAT group by C28 and C26 to the Commissioners on the basis that it had been quite wrong of HMRC to surrender their open

discretion, conferred by section 43B(4), to backdate applications for admission to VAT group membership in the way that had been done in the published policy.

38. Nearly a year elapsed between the release of the earlier decision by the First-tier Tribunal and the decisions later made by the Commissioners on reconsidering the applications. During this period there were exchanges of correspondence, principally seeking to clarify the treatment of the monthly supplies that had been made to each of C28 and C26 in the way described above. The Respondents' counsel criticised the Appellant for not having clarified the contractual arrangements between the various companies (i.e. between CPUKL and the companies to which it was or was not on-supplying services) and also criticised some slight inconsistencies in the figures relating to these monthly supplies. One change to those figures resulted certainly from the correction of what everyone accepted was a simple slip (in that an input deduction had been claimed by the Appellant for the SDLT paid in respect of the Unity Mill site), and it is entirely possible that the other minor changes to the figures in relation to the monthly services resulted again from the correction of minor errors. Since no evidence was given before me, and since the later decision letters, to which I will turn shortly, made no mention of these exchanges of correspondence, and these very minor amendments to figures, and the changes were in any event a very minor matter, I will ignore them.

The modifications to the terms of HMRC's announced policy

39. Following the earlier decision by the First-tier Tribunal, HMRC announced three changes to their policy in relation to dealing with applications for retrospective inclusion in VAT groups.

40. The first was to cut down the 30-day period for which it was suggested that applications might be backdated, in that backdated applications were not to be accepted to any date (even within the 30-day period) prior to the end of the last VAT period of either the applicant or the representative member of the group. This amendment was of course entirely consistent with the obvious policy underlying the general refusal to admit backdating for more than 30 days, namely to avoid the complication of having to amend pre-existing filings.

41. The second change to the announced policy was to preclude other applications for backdating save for where they were made "*in the most exceptional circumstances*", rather than the earlier wording that had just referred to "*exceptional circumstances*".

42. The third change was to change the wording that had earlier defined "exceptional circumstances" simply to be mistakes on the part of HMRC, and to insert the following wording:

> *"For the purposes of retrospective group treatment, exceptional circumstances* ***include*** *[my emphasis] those where the application for retrospective group treatment is being made as a result of an error on the part of the Department, i.e. as a result of the actions of, or the lack of action of, an officer of the Department.*
>
> *Ignorance or misunderstanding of the law governing group treatment do not of themselves constitute exceptional circumstances. Also "reasonable excuses", which*

might be accepted by Tax tribunals in belated notification cases, do not constitute grounds for allowing retrospective group treatment.

The significant point for present purposes is the inclusion of the word *"include"*, which opens, or maybe the point is that it theoretically opens, the possibility of backdating applications in circumstances having nothing to do with Department error.

The later decision letters

43. I will not quote the two decision letters in full but will describe the points raised as follows.

44. The first point made in the letters, prior to quoting HMRC's published policy, was that it was entirely proper for HMRC, in exercising their open discretion, to announce a policy that sought to ensure that the decisions in relation to retrospective grouping were made in a rational and consistent manner. Nobody can argue with that.

45. Having quoted the policy about the 30-day rule, and the further qualifications about not backdating from a date earlier than the most recent VAT returns, the obvious point was made that:

"The reason for this policy is to avoid the need to amend or replace VAT returns for periods which have already finished."

The letter then said that, as well as that reason, *"the policy also exists to avoid changing the nature of supplies which have already been made and accounted for and to prevent a means by which taxpayers can rewrite their tax histories."*

46. In giving my Decision, I will refer to the points made in paragraph 45 in due course.

47. The letters in relation to both applications then contained identical text concerning the issue of what might be "exceptional". I will quote this in full, and will not seek to amend a couple of apparent slips in the text. It read as follows:

"Whilst almost all applications received by the Commissioners are made out-of-time, in hindsight, with a view to correcting administrative errors, change the nature of supplies which have already been made and accounted for (often on VAT returns which no longer exist on HMRC' systems) and effectively with a view to seeking assistance from HMRC in facilitating a rewrite of taxpayers' history, it cannot be argued that applications made under such circumstances are in any way exceptional, rather, they are common. By their nature exceptional circumstances will be rare. The fact that a company does not apply for grouping and this later results in an unfortunate outcome for the business is not on its own sufficient to justify a departure from normal policy as applied to other taxpayers."

48. Reference was then made to the four lists of companies that HMRC had believed to be included in the VAT group that HMRC had sent to the Appellant; to the earlier application to backdate the option to tax election (which process had itself delayed the application for retrospective inclusion into the VAT group), and to the anyway considerable delay that had occurred before the application was made (in November 2010) to include C28 in the group registration. I have already commented on the failure of the group to spot the

administrative errors when they were sent the lists of VAT group membership on four occasions, and will comment below in relation to the delays referred to in the decision letters.

49. There was then a concluding paragraph which purportedly summarised the reasons for rejecting the option to backdate the application. I will quote the one material to the far more significant application, i.e. that in relation to C28. It read as follows:

> *"It is for the above reasons: (i) the fact that you were issued documentary evidence which clearly shows that C28 was not a member of the VAT group on four separate occasions prior to when you claim to have become aware, (ii) the fact that the submission of the application was delayed even though by then you were clearly aware of the VAT position of the company and (iii) because I have been unable to identify any "exceptional circumstances" surrounding your application that I regret to inform you that I am choosing not to exercise my discretion to allow your request in accordance with section 43B(4)(b) of VATA 94, and as such, your application has been given effect in accordance with s.43B(4)(a), "the day on which the application is received by the Commissioners" being 29 November 2010."*

The contentions of the parties

50. The Appellant contended that the stated and published policy was still exceptionable in that the addition of the word *"include"*, followed by the examples and the factors that would not be taken to be "exceptional", still left the policy fettering the open discretion given by Parliament to HMRC in section 43B. The Appellant then suggested that when the group's administrative errors had occasioned significant and broadly incoherent liabilities to tax for a house building group, and indeed liabilities that breached the principle of neutrality, it was unreasonable that HMRC had not conceded the retrospective inclusion of the two companies into the group registration. That could have been achieved "at the stroke of a pen", and that would have solved the problems fairly, in the Appellant's interest and in the public interest as well.

51. The Respondents contended that the insertion of the word *"include"* did solve the problem addressed by the earlier Tribunal, and that the reasons given in the letters for the refusal to backdate were perfectly proper reasons for failing to exercise HMRC's general discretion. Furthermore, the Tribunal should bear in mind that its jurisdiction was merely to remit the matter back to HMRC if I concluded that the policy was unacceptable, or the decision unreasonable, with attention having been given to irrelevant matters or not given to relevant matters. Furthermore, there was no jurisdiction in the Tribunal to make up its own suggestion of a policy. The discretion and the plainly required need to exercise that discretion in a coherent and consistent manner were entirely matters for HMRC.

My decision

Jurisdiction

52. I accept that my jurisdiction is the limited jurisdiction, at most to remit the matter back to the Commissioners for reconsideration, with indications of any matters that I consider that they earlier wrongly took into account, or matters that they failed to take into account. I am going to remit the matter back to the Commissioners and I do this with some hesitation because it is obviously futile for this matter to be batted to and fro between the Tribunal and

HMRC. I also accept that if my decision is wrong, then were HMRC to appeal against it and succeed in overturning it, that would of course be one manner in which the "ping-pong", as the parties both described it, could be brought to an end. Having disclosed my hesitation, however, I do consider that when the Appellant has brought a further Appeal, obviously at considerable cost, I must deal with that Appeal properly and cannot just reject it to avoid the slight embarrassment of remitting the matter, for a second time, back to the Commissioners.

The terms of HMRC's announced, and marginally altered, policy in relation to backdating applications for inclusion within VAT groups

53. While I note that HMRC has modified its announced policy in relation to the backdating of applications for group membership, I still consider that the mere inclusion of the word "include", when the whole tenor of the policy remains unchanged, is a somewhat cynical endeavour to leave the policy substantially unchanged, whilst purportedly answering the challenge to it by the earlier Tribunal decision. It is entirely appropriate that there should be a coherent and a consistent policy adopted by HMRC, and certainly acceptable that that should be made public knowledge. There is no reason, however, why a policy that adopted a more balanced approach in relation to the exercise of the discretion should not meet those two requirements, indeed in a rather more convincing manner than the present announced policy achieves them.

54. The following appear to be legitimate criticisms of the present announced policy.

55. It is first entirely understandable that there should be some reluctance to allow retrospective additions to VAT groups where such inclusion would necessitate changes to earlier VAT returns. This key element of the present policy is central, yet no reference is made to the feature that when a retrospective inclusion into a VAT group is designed to validate a group's pre-existing assumption that a company was indeed in the group and when the filings were made on that basis, it is obvious that the grant of the application for retrospective inclusion into the group would not necessitate any changes to the earlier VAT returns. Indeed somewhat perversely, as in the present case, it has been the refusal to concede the retrospective inclusion of C28 and C26 into the group that has occasioned considerable, and complex, revisions to earlier filings. I do of course appreciate that the past returns would strictly have been incorrect, when made on false assumptions, but if the concern relates to adjusting existing returns, it is certainly worth noting that this feature could support the notion of a retrospective inclusion into a VAT group, particularly where the mistake had been honest, even if incompetent, and it had affected several aspects of VAT treatment for some period. This would be particularly compelling if the retrospective inclusion would occasion what might be regarded as an entirely sensible and coherent (and certainly not unusual or artificial) result, and such a result in place of forfeitures of input deductions that can, in common sense terms, only be described as incoherent, occasioned by extraordinary errors.

56. The present announced policy requires applicants for retrospective additions to a VAT group on an earlier date than the 30-day date to be able to illustrate "the most exceptional circumstances". The decision letters in this case make the point that the notion of what is exceptional must require it to be rare, and not common, and it is suggested in a slightly muddled way that taxpayer errors that occasion requests for retrospective inclusion into groups are common, and so cannot be exceptional, and seemingly all taxpayer errors are

classified in a similar manner. By implication, one supposes that the examples given of exceptional circumstances (mistakes of one form or another on the part of HMRC) are so rare as to be "most exceptional", which seems rather unlikely.

57. Addressing, however, the more relevant point of what circumstances relating to taxpayer error might indeed be "exceptional" or indeed "most exceptional", no examples of this are given, and the most obvious errors by taxpayers are stated not to satisfy the test. Quite apart from the unbalanced feature of taxpayers having therefore to show that their errors have led to exceptional circumstances, when any errors by HMRC are deemed to be exceptional, it is obvious that a very high bar, if not an insurmountable bar, has been set before taxpayers can hope to sustain retrospective applications outside the 30-day rule and apart from errors by HMRC.

58. When the discretion granted to HMRC by statute is a perfectly open discretion, I consider that it remains the case that the present published statement significantly fetters that discretion in an unacceptable manner.

Authority

59. There is only one reported case that has any bearing on the present Appeal, and that is the case of *C & E Commissioners v. Save and Prosper Group Ltd* [1979] STC 205. While I accept that the case has only marginal significance, it is worth considering the case because it is High Court authority for the proposition that when the case involved a very similar taxpayer error to that in the present case, and the requested back-dating was also for a three-year period, Mr. Justice Neill did not consider that these facts precluded backdating the inclusion of a company into the group. We do not of course know what decision HM C & E actually took when the case was remitted back to them, but there was certainly not the slightest High Court suggestion that retrospective inclusion in that case would have been in any way improper.

60. It would be superfluous to consider the case in detail but it is worth noting that a very similar (though probably less serious) administrative slip had been made in the Save and Prosper case; it also appears that the filings will have been made on the basis of the false assumption that the relevant company had been in the group at all times, and finally the statutory wording, permitting retrospective applications, was far less clear in 1976 than it is now under the present wording of section 43B. On one quite tenable interpretation (indeed that initially adopted by HM C & E) the then statute did not permit HM C & E to backdate applications at all. And on these facts, the matter was remitted back to HM C & E to reconsider the application.

The logic underlying any policy in relation to backdating applications for inclusion in the group registration

61. While it is for HMRC and not for the Tribunal to evolve the policy and general guide-lines in relation to backdating applications for inclusion in VAT groups, it is difficult to consider the present issues properly without making one or two general points.

The distinction between cases in which groups simply change their mind, and those where companies are assumed to have been in group registrations when they were not

62. This distinction appears to me to illustrate a fairly obvious distinction that any HMRC policy might reflect. For it would seem to be wholly inappropriate for a group to decide at the outset that it is desirable for a particular company to be included in or excluded from the VAT group (then making all the filings in accordance with whichever choice has been made) only to decide a couple of years later that the other choice would have been more beneficial such that HMRC is asked retrospectively to change the earlier election back to the start of the two-year period. This "change of mind" approach seems to me to be wholly inappropriate because it is inappropriate to give groups an opportunity to seek better treatment than that originally deliberately selected, and on the basis of which all the filings have been made, simply because in retrospect the events have demonstrated that the other choice would have been preferable.

63. The logic of the point just made does not apply, however, in the other scenario where the group will have assumed that a particular company was included in the group, all the filings will have been dealt with accordingly, and the request for retrospective actual inclusion in the group will be simply to conform matters to the assumptions that had prevailed all along.

The logic behind HMRC's general 30 day rule

64. I have already commented on this rule. The logic underlying it is compelling, but it does seem that thought should be given to the distinction between applications that might involve various past VAT returns having to be amended (as would be the case with applications anyway suggested to be unacceptable in paragraph 62 above), and those simply designed to give retrospective validation to the group's assumption that a particular company had always been in the group, such that all the past returns had been made on the basis that HMRC are later requested to validate, without any modifications.

The likely tax and cost significance of mistaken assumptions in relation to inclusion of companies in VAT groups

65. In the case of partially exempt groups, and possibly in a few other situations, the inclusion in or exclusion from VAT groups of a company can affect the overall incidence of VAT, and the deduction given for input tax. In most situations, however, the effect and the intention of VAT grouping will generally not be to alter the overall incidence of tax. If a supply by one company to another is disregarded as being between members of the group, there would be the same incidence of tax if they were not members of the group. One company would have an additional transaction contributing to its outputs, and the other would generally have correspondingly increased inputs. The underlying policy of the group registration provisions is thus generally to achieve simplicity for both taxpayers and HMRC and not to alter the net incidence of tax.

66. In this regard, it seems that the double mistake made in the case of C28 may very well be somewhat exceptional, and its consequences may indeed have been exceptional, and quite different from any normal consequence of errors in relation to group registrations. The result of the double mistake (as regards not filing the option to tax and whether C28 was included in the VAT group) has been to occasion the instant loss of well over £2 million of input tax in the case of a house-building group where input tax would and should generally not amount to any net cost to the group. It may be that the primary mistake made was

more geared to the failure to file the option to tax, but it is still the case that the retrospective inclusion of C28 into the group registration as from 30 March 2007 is now the only way in which that disastrous error can be corrected and eliminated. Even if the failure to file the option to tax was the more obvious error made on 30 March 2007, it is certainly the case that second failure (to account for the VAT on the supply on the basis of the option to tax) almost certainly resulted from the second mistake of treating C28 as having been a member of the group. Furthermore the only reason why those responsible for dealing with accepting or rejecting late filings of options to tax refused to accept the application made by CPUKL was simply that CPUKL had in fact not taxed its supply to C28. When that resulted not from the feature of seeking to ignore, or ignorantly ignoring, the option to tax that had been made but not notified, but it resulted from the fact that under the grouping assumption there was thought to have been a second reason (i.e. grouping) why there was no occasion to account for the tax on the sub-sale, it is clear that in these circumstances, the error made, and the resultant VAT disadvantage, has very plausibly been exceptional. It seems obvious that when the grouping provisions generally have the effect and the much more marginal significance mentioned in the previous paragraph, the double error in this case and the resultant incoherent loss of tax certainly appears "exceptional". The second decision letter in relation to C28 merely equates the error in this case as "just one of many similar type errors made by taxpayers", and in a very unconvincing manner it treats them all as "common", and not "exceptional", while implicitly making the extraordinary suggestion that errors by HMRC are themselves always "exceptional".

Counsel's contentions in relation to adjustments in the figures in relation to the month-by-month services

67. The Respondents' counsel advanced a number of contentions, criticising the lack of information supplied by the Appellant in relation to the various inter-company services, and the precise nature of the contractual arrangements between CPUKL and the subsequent recipients (i.e. C28 and C26) of the services. As I have already said, no evidence was provided to me, absolutely no criticism along these lines was made in either of the decision letters, and the fairly fundamental point appears to remain, namely that the filings that the various companies made (some of them obviously wrongly at the time) were entirely consistent with the outcome that would have been validated had the Appellant's two grouping applications been accepted in full. I can thus pay no regard to those contentions that were made to me. I am virtually satisfied that any minor disparities in the month-by-month figures will have been accounted for by deleting the wrong claim for input tax in relation to the SDLT, and other corrections of minor errors, but none of us had the information in the hearing to confirm or dispute this supposition.

The delays

68. Considerable emphasis was placed in the decision letters on the feature that HMRC had provided lists on four occasions of the companies believed to be included in the group registration, none of which included C28 or C26, whereupon the Appellant had failed to note the omissions, and the feature that there were considerable delays on the part of the Appellant and the group generally in making the application for retrospective inclusion in the VAT group. I reject all these points as being completely irrelevant for the following reasons.

69. Firstly, I am simply not satisfied that HMRC's treatment of the applications would have been different, had one of these lists prompted earlier attention to the problem and had the applications been made at an earlier date. Any such occasion would have been well after the expiry of the 30-day period. HMRC's fixation at the time with the 30-day rule, albeit largely irrelevant in that no changes to filings were being sought, would have resulted in the much earlier applications still being dealt with as in the event they were dealt with.

70. I have already explained how I do consider it perfectly understandable that anybody who may have received the lists of the membership of the VAT group may not have detected the errors. Mr. Justice Neill seems not to have been too surprised that relatively similar mistakes had been made in the Save and Prosper group for a period of three years.

71. The Appellant's counsel also made the fair point that much of the delay in making the late application for retrospective inclusion in the VAT group resulted from the need to consult PriceWaterhouse Coopers and Allen & Overy, and from the fact that when by far the major problem centred on the day 1 mistake made by CPUKL on its on-sale to C28, the first aim was to solve the problem by seeking to file the option to tax out of time.

72. It is also relevant to note that this is not a case where a company is properly being penalised for a wrong return. The Appellant has admitted that it has made two very serious errors and, once made, it has understandably failed to spot them on later occasions. It has admitted that the only way in which it might solve a severe problem of its own incompetent making has been to ask HMRC to grant the retrospective inclusion into the group and thereby generate a sensible outcome.

The "protection of the revenue", and European principles of neutrality and proportionality

73. HMRC is entitled to refuse admission into a VAT group where this is considered necessary for the protection of the revenue. It was never contended in this case that this was a case where protection of the revenue was an issue. That would be so, for instance, where some artificial structure might diminish net tax in an unrealistic manner, and in turn be dependent on the ability to make and sustain an application for grouping.

74. The Appellant's counsel claimed that the present outcome conflicted with the European principles of neutrality and proportionality. I find this a difficult technical argument. If one addresses the strict treatment of the actual transactions, and the failures to notify the option to tax and to make the applications for C28 and C26 to be members of the group, then the tax results are of course as HMRC contend. On a more common sense approach, however, if one asks whether it is glaringly obvious that very serious mistakes have been made, and that the outcome of those mistakes has been to occasion forfeiture of relief for input tax that would generally be unthinkable in the case of a housebuilding group, it is just perfectly obvious that the group is suffering incoherent treatment in the broadest sense on account of two very serious errors made at a time when there was chaos in the group's finance department, and in particular in the staff then dealing with VAT filings.

Summary

75. My decision is that these applications should be remitted for reconsideration by HMRC for the following reasons, and in the following manner.

76. I still consider the almost impossible task, under HMRC's announced policy for making a successful retrospective application for inclusion in a VAT group, outside the circumstances of the 30-day rule, and errors on the part of HMRC, to be far too restrictive of the open discretion conferred by statute on HMRC.

77. I consider that in reconsidering the applications, attention should be given to the facts that:

- The present applications had implicitly necessitated no remote change to any of the filings originally made by the group companies, and perversely it will have been the fact that the applications have been rejected twice that has occasioned the need to make several changes to the treatment, as originally filed.
- While the original filings were wrong, in that they were made on the basis of two erroneous assumptions made by the group, the treatment that the group is now requesting is, on any sensible approach, the fair and appropriate treatment in relation to input tax incurred by a housebuilding group.
- While HMRC may claim, without much support, that applications for retrospective inclusion in VAT groups are common, and that the present situation is no different from the run-of-the-mill retrospective applications, it must be the case that in most cases there will be little impact on net tax whether companies were or were not included in group registrations. In the present case, the significance of the dual error, and the feature that on 30 March 2007 the mistake made has occasioned a tax loss equal to about half the total economic loss made by the group on C28's housing development may, I suggest, make it very exceptional. The implicit suggestion that errors by HMRC are always "most exceptional" is highly doubtful at the very least.
- The summary by the Appellant's counsel was that HMRC could, at the stroke of a pen, have provided a fair solution, and one that was entirely consistent with the realistically intended treatment of this housebuilding group, had HMRC chosen to do so. That action would have involved no complication and no adjustment to past returns. As matters have emerged to date, the group has been involved in a long and expensive dispute, and still runs the risk of suffering tax treatment that might be strictly correct, but that is in common sense terms wholly unfair.
- HMRC should not give weight to the delays on the part of the Appellant in seeking retrospective inclusion into the VAT group, and to the fact of having failed to spot the group's errors when the Appellant was sent the list of companies believed to be in the VAT group unless these reasons were genuine reasons that led to the decisions. When there is every indication that, under the tightly-defined announced policy, precisely the same decisions would have been reached even disregarding these factors, those factors appear to have been inserted into the decision letter in relation to C28's application to seek to justify the decision, in fact made on other grounds. It is notable that these factors represented two out of the three points made in the summary paragraph, along with the unexplained, and wholly unconvincing suggestion, that there was nothing exceptional about the present circumstances.
- The final matter that I suggest that HMRC should consider is whether it is the proper function of HMRC to seek to retain tax charged solely because of incoherent and understandable errors made by the group and made during a period when the group

has accepted that its finance administration was in some chaos, or whether it would be more appropriate to pay some regard to fairness and common sense.

Costs

78. Neither party was clear whether the Appeal had been classified as Complex or what elections had been made in relation to costs and I was asked to defer any decision in relation to costs.

Right of Appeal

79. 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.

HOWARD M. NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 14 AUGUST 2015