[2019] UKFTT 616 (TC)

TC07400

VAT – flat rate scheme – application to backdate to periods for which VAT return already filed – HMRC refusal to exercise discretion to backdate for those periods – held, discretion limited by the statutory purpose of the FRS – Seefe *not followed – appeal refused*

Appeal number: TC/2018/02286

FIRST-TIER TRIBUNAL
TAX CHAMBER

BETWEEN

HOLY COW! ICE CREAM COMPANY LTD **Appellant**

-and-

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

TRIBUNAL: JUDGE ANNE REDSTON
MS REBECCA NEWNS

Sitting in public at the Tribunal Centre, Taylor House, Rosebery Avenue, London on 6 August 2019

Ms Laura Gutane, Director of the Appellant, for the Appellant

Ms Olivia Donovan, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

Introduction and summary

1. The Appellant, the Holy Cow! Ice Cream Company Ltd ("the Company") is owned by Ms Gutane and Mr Sutton, its two directors ("the Directors"). The Company began trading in 2016 and registered for VAT in that year. However, the Directors over-estimated the Company's turnover and profits, and it began to make losses.

2. In August 2017 the Company applied to enter the VAT Flat Rate Scheme ("FRS") with effect from 1 January 2017. HM Revenue & Customs ("HMRC") granted the application on 10 November 2017, but only with effect from 1 July 2017. This was because HMRC's guidance states that backdating is not allowed for VAT periods for which a trader has already calculated its liability, because "the FRS exists to simplify VAT accounting and record keeping for small businesses".

3. However, HMRC's guidance also states that this policy may be disapplied in "exceptional circumstances" such as where "the survival of the business" is in issue. The Company appealed against the refusal to backdate for the first two quarters, on the basis that it was within the "exceptional circumstances" part of HMRC's guidance.

4. The FRS implements Article 24 of the Sixth Directive, which states that Member States can apply "simplified procedures such as flat-rate schemes for charging and collecting the tax provided they do not lead to a reduction thereof". Where, as here, the trader has already filed its VAT returns for an earlier period and is seeking backdating in order to obtain a cash refund, it would have been *ultra vires* HMRC's discretion to backdate. In other words, HMRC do not have the legal power to backdate in order to provide a cash refund to a struggling business.

5. Even if were we wrong, so that HMRC do have the discretion to backdate so as to grant a refund where a business's survival is in issue, those exceptional circumstances were not present in the Company's case.

6. As a result, we refused the appeal. We gave our decision orally at the end of the hearing. The Directors asked for a full decision, and this is that decision.

Late appeal

7. On 10 November 2017, HMRC issued the disputed decision and invited the Company:

   (1) to ask for the decision to be reviewed by writing to HMRC's FRS team at the address provided; or

   (2) to appeal to an independent tribunal, and if so "send them your appeal within 30 days of the date of this letter". The Company was told that it could find out more about appeals using a webaddress. The page to which that address is linked provides general guidance about the work of the FTT, although it is possible to navigate from that page to the FTT's online appeal form. The Company was also provided with a telephone number, which we recognised as being that of the FTT's Birmingham office.

8. On 7 December 2017, Ms Gutane wrote to HMRC's FRS team, explaining why she considered the decision to be incorrect, and ending the letter by saying "thank you for your consideration". In her oral evidence, she explained that she had intended the letter to be a request for the decision to be reviewed by another HMRC Officer. However, she headed the

letter "Appeal to independent Tribunal in relation to retrospective application of Flat Rate Scheme".

9. On 28 March 2018, HMRC advised Ms Gutane that she would have to contact the Tribunals Service and make a late application "due to our department [sic] delay in replying to your query".

10. On 3 April 2018, the Company filed a Notice of Appeal with the Tribunal, and an application to make a late appeal. HMRC did not object to the Company making its appeal late.

11. In deciding that application, we took into account the relevant case law, in particular in *Martland v HMRC* [2018] UKUT 0178 (TCC), which sets out a three stage test for deciding whether to give permission for a late appeal:

(1) establish the length of the delay and whether it is serious and/or significant;

(2) establish the reason(s) why the delay occurred; and

(3) evaluate all the circumstances of the case, using a balancing exercise to assess the merits of the reason(s) given for the delay and the prejudice which would be caused to both parties by granting or refusing permission, and taking into account "the particular importance of the need for litigation to be conducted efficiently and at proportionate cost, and for statutory time limits to be respected".

12. In relation to step 1, the delay was over three months, which the Upper Tribunal held was serious and significant in *Romasave v HMRC* [2015] UKUT 254 (TCC).

13. The delay occurred because (a) Ms Gutane thought she was asking for a review, but headed her letter "appeal"; (b) HMRC, in reliance on the heading to Ms Gutane's letter, understood the Company to be intending to appeal to the Tribunal, but took some time to reply, and (c) although HMRC's letter provided signposts about how to file an appeal, the guidance was not as clear as it might have been.

14. Taking all the circumstances into account, we found that it was in the interests of justice to give the Company permission to make a late appeal. The factors we considered included the need for litigation to be conducted efficiently and at proportionate cost, and for statutory time limits to be respected, and also HMRC's acceptance of their own share of the blame; the prejudice to the Company if the appeal was not heard; and the speed with which the appeal was made after Ms Gutane was informed of the position by HMRC.

The evidence

15. The Tribunal was provided with a Bundle of documents containing:

(1) correspondence between the parties;

(2) correspondence between Mr Hale, the Company's accountant, and HMRC; and

(3) HMRC's Notice 733, entitled "Flat Rate scheme for small businesses".

16. During the hearing Ms Donovan handed up a schedule setting out the Company's historic VAT return details for all relevant periods. Ms Gutane did not object to that document being provided, and it was admitted into evidence.

17. At the beginning of the hearing Ms Donovan accepted that certain documents provided by the Company had been overlooked when the Bundle was prepared, namely emails about the increasing costs, and an email between Mr Hale and Ms Gutane. However, we decided that this did not result in any prejudice because: the parties had copies of those documents; further copies were provided for the Tribunal; the emails were short and straightforward; and we had sufficient time to consider them in the course of the hearing.

18. The Bundle also did not contain a copy of HMRC's guidance on when to allow retrospective backdating, which is set out at in their Flat Rate Scheme Manual at FRS3200 to 32500. Again, Ms Donovan apologised for this. However, both parties were familiar with that guidance, and had referred to it in correspondene; the Tribunal had also brought copies to the hearing on a precautionary basis. We provided these to the parties so they were able to make reference to the wording during their submissions.

19. Ms Gutane and Mr Sutton gave oral evidence; the Tribunal found them to be honest and credible witnesses.

20. On the basis of the evidence summarised above, we make the findings of fact in the next part of this decision, none of which was in dispute.

The facts

21. The Company was established in February 2016 and began trading in April 2016. It was funded by two bank loans, one of which was used to buy equipment. Its income for the first two months was £25,099 and the Directors expected that its annual turnover would be significant, and the business profitable. However, after six months it became clear that their expectations were overly optimistic. Sales were below projections, and profitability was significantly affected because most of the Company's supplies were purchased from the EU, and sterling had lost value against the euro following the Brexit vote.

22. In August 2017 Mr Hale advised the Company to consider the FRS. He said that the rate would be 12.5%, reduced to 11.5% for the first year, and added "I am sure we could find a lower percentage, or a quick call to HMRC to ask for a lower percentage could be tried".

23. On 22 September 2017, Mr Hale applied to HMRC for the Company to join the FRS with effect from 1 January 2017, on the basis that it was entitled to the 4% rate which applies to retailing of food and confectionery. Having not received a response, he followed up with an email on 2 November 2017. He told HMRC that refusing the application "may have a catastrophic effect" on the Company's business, and that it might have to cease trading. He attached a cashflow forecast.

24. On the basis of that forecast and the evidence of the Directors, we find that:

(1) For the month of August 2017, the Company made a small loss of £39. The Directors asked one of the two employees to leave in order to reduce outgoings. A cleaner was also told that her services were no longer required.

(2) For the month of September 2017, the Company made a loss of £2,382. Ms Gutane stopped drawing her salary of £663pcm, with the expectation of resuming in March 2018.

(3) Ms Gutane's mother worked part-time without payment throughout 2017 and maybe beyond.

(4) The Company sustained a further loss of £1,106 in October 2017, followed by a small profit of £250 in November.

(5) Mr Hale's forecast predicted that losses would continue for the following five months, with the Company moving into profit in April 2018.

(6) In fact, the Company made an overall loss in its first year of trading of £8,000; it made a loss of £5,000 in its second year, and in the third year it made a loss of £500. As at the date of the hearing its balance sheet remained in deficit.

25. On 10 November 2017, HMRC accepted the Company into the FRS with effect from 1 July 2017. However, HMRC refused to backdate to 1 January 2017, because the Company had already filed its VAT returns for the 03/17 and 06/17 quarters. HMRC's decision letter quoted the following passage from FRS3300:

> "The policy is to refuse retrospection where the business has already calculated its VAT liability for the period(s) using a different accounting method…The reason for this is that the FRS exists to simplify VAT accounting and record keeping for small businesses, so that they are able to spend less time on VAT."

26. In March 2018 the Directors took out a personal loan and invested the money in the Company. Had HMRC agreed to backdate the application to 1 January 2017, as requested, the Company would have received a repayment of £2,023.35.

27. During 2018 the Company purchased an "ice-cream bike" from which the Company's ice-cream was sold at events and similar; this was used to increase sales. In the same year, the Company also deregistered from VAT.

The law on the flat rate scheme

28. Article 24 of the Sixth Directive is headed "Special scheme for small undertakings" and paragraph 1 begins:

> "Member States which might encounter difficulties in applying the normal tax scheme to small undertakings by reason of their activities or structure shall have the option, under such conditions and within such limits as they may set.., of applying simplified procedures such as flat-rate schemes for charging and collecting the tax provided they do not lead to a reduction thereof."

29. This provision was implemented in the UK by Finance Act 2002, s 23, which inserted section 26B in the Value Added Taxes Act 1994 ("VATA"). For the purposes of this case, the relevant provisions are:

> "(1) The Commissioners 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…
>
> (2)-(3) …
>
> (4) The regulations may provide for persons to be eligible to participate in the flat-rate scheme only in such cases and subject to such conditions and exceptions as may be specified in, or determined by or under, the regulations.
>
> (5)-(7)…
>
> (8) The regulations may make provision enabling the Commissioners
>
> (a) to authorise a person to participate in the flat-rate scheme with effect from
>
> (i) a day before the date of his election to participate, or

(ii) a day that is not earlier than that date but is before the date of the authorisation;…"

30. The VAT Regulations 1995 include Reg 55B, which provides:

> "(1) The Commissioners may, subject to the requirements of this Part, authorise a taxable person to account for and pay VAT in respect of his relevant supplies in accordance with the scheme with effect from
>
> (a) the beginning of his next prescribed accounting period after the date on which the Commissioners are notified of his desire to be so authorised, or
>
> (b) such earlier or later date as may be agreed between him and the Commissioners…"

31. Reg 55L states that the threshold for inclusion in the FRS is £150,000 ("the FRS threshold").

32. The Sixth Directive has been replaced by Directive 2006/112/EC (the Principal VAT Directive or the "PVD"). Article 281 of the PVD provides:

> "Member States which might encounter difficulties in applying the normal VAT arrangements to small enterprises, by reason of the activities or structure of such enterprises, may, subject to such conditions and limits as they may set, and after consulting the VAT Committee, apply simplified procedures, such as flat-rate schemes, for charging and collecting VAT provided that they do not lead to a reduction thereof."

HMRC's guidance

33. HMRC's guidance is set out in their FRS Manual and includes the following paragraphs::

> **"FRS3200 Treatment of Applications: Can HMRC allow a retrospective start date for FRS?**
>
> Yes. Regulation 55B(1)(b) of VAT Regulations 1995 allows for a start date that is earlier than the date of application. This is a power which the Commissioners must use reasonably in the circumstances of each case. Your duty as the decision maker is to consider all the relevant facts and not make a decision on the basis of any irrelevant facts. If you do refuse to allow retrospection, you should explain the reason and indicate the main factors you took into account in reaching your decision…
>
> **FRS3300 Treatment of Applications: Considering requests for retrospective use of the FRS**
>
> …Once the business's basic eligibility for the FRS has been established, you should then take into account the following:
>
> - Each case should be considered on its own merits. Consider all relevant facts relating to the request, including the business's overall compliance record. In line with the rationale of the scheme, (see next but one bullet) the fact that a business will pay, or would have paid, less tax, is not sufficient reason to authorise retrospective use of the FRS.
> - Belated notification of a liability to register for VAT including trader liable no longer liable cases is not a reason to disallow retrospection automatically. This is because use of the scheme may help both the business and HMRC to calculate the arrears more quickly and easily. However, if you have further reason to doubt the business's compliance

(for example, there is other evidence that allowing the scheme would present a revenue risk) then retrospection should be disallowed.

- The policy is to refuse retrospection where the business has already calculated its VAT liability for the period(s) using a different accounting method (but see next bullet, below). The reason for this is that the FRS exists to simplify VAT accounting and record keeping for small businesses, so that they are able to spend less time on VAT. If allowing retrospection will enable the business to benefit in this way, then you should consider granting the request.
- The proper exercise of the power to allow retrospection means that we should be prepared to recognise there may be exceptional circumstances where the policy described in the previous bullet should be set aside. In principle, such cases are likely to involve compassionate circumstances, or the survival of the business, but we have not identified to date any case where such circumstances justify a departure from the normal policy. If you think that there are such circumstances, the case should be reported to Accounting, Registration and Exports, 4th Floor SW Queens Dock, Liverpool, with a recommendation."

The law on appeal rights and jurisdiction

34. VATA s 83(1)(fza) states that a person may appeal against an HMRC decision which refuses to allow "a person's liability to pay VAT (or entitlement to credit for VAT) to be determined as mentioned in subsection (1) of section 26B". However, VATA s 84(4ZA) provides that where an appeal is brought against such a decision "the tribunal shall not allow the appeal unless it considers that the Commissioners could not reasonably have been satisfied that there were grounds for the decision."

35. In *Burke v HMRC* [2009] EWHC 2587 (Ch), Henderson J (as he then was) considered the nature of the Tribunal's jurisdiction. He said:

> "This provision imposes a high threshold and confines the jurisdiction of the tribunal to allow the appeal to cases where it considers that the commissioners could not reasonably have been satisfied that there were grounds for the decision under appeal. In other words, although the jurisdiction is an appellate one, its content is, in essence, a supervisory one and it differs little, if at all, from the grounds upon which judicial review might otherwise be available in the absence of an express right of appeal. Compare *John Dee Ltd v Customs and Excise Commissioners* [1995] STC 941 at 950 per Neill LJ, with whom Roch and Hutchison LJJ agreed."

36. When *John Dee* was heard before the VAT Tribunal, it was common ground that the appeal was based on what are called *Wednesbury* grounds (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223) as set out by Lord Greene MR at p 229:

> "It is true the discretion must be exercised reasonably. Now what does that mean? Lawyers familiar with the phraseology commonly used in relation to exercise of statutory discretions often use the word 'unreasonable' in a rather comprehensive sense. It has frequently been used and is frequently used as a general description of the things that must not be done. For instance, a person entrusted with a discretion must, so to speak, direct himself properly in law. He must call his own attention to the matters which he is bound to consider. He must exclude from his consideration matters which are irrelevant to what he has to consider. If he does not obey those rules, he may truly be said, and often is said, to be acting 'unreasonably'."

37. When *John Dee* reached the Court of Appeal, Neil LJ said that it was "more satisfactory to avoid references to *Wednesbury* itself and to follow the guidance given by Lord Lane in the *Corbitt* case", namely *C&E Commrs v Corbitt (Numismatists)* [1980] STC 231 and referred to p 239 of that case, where Lord Lane had stated that the tribunal could only properly review the discretion:

> "... if it were shown the commissioners had acted in a way in which no reasonable panel of commissioners could have acted; if they had taken into account some irrelevant matter or had disregarded something to which they should have given weight."

Submissions by Ms Gutane on behalf of the Company

38. Ms Gutane said, correctly, that the HMRC decision-maker had referred only to the third bullet in FRS3200. She submitted that HMRC should have applied the fourth bullet, and recognised that there were exceptional circumstances, so that retrospection should have been allowed to 1 January 2017, because the case involved "the survival of the business". She said that:

(1) the Company was only surviving because she and her mother had been working without payment and operating without one of its two employees;

(2) backdating the entry into the FRS to 1 January 2017 would have provided the Company with a further £2,023.35, which would have covered its losses for a three month period;

(3) the Company was unable to purchase the ice-cream bike until the following year and this further depressed their sales; and

(4) the Directors had had to take out a personal loan and invest it in the business, and this might not have been required had the FRS application been backdated.

39. Ms Gutane also relied on *Seefe v HMRC* [2013] UKFTT 335 (Judge Staker and Mrs de Albuqueque). Mr Seefe registered for VAT on 2 January 2007. He did not apply for FRS because he had thought his turnover would be above the £150,000 threshold. As things turned out, his sales were actually below the registration threshold, so he had not been required to register for VAT. On 31 January 2012, Mr Seefe applied both to deregister and to be entered into the FRS from 2 January 2007. The FTT found that the HMRC decision maker had not considered all relevant factors, and in particular had not taken the "exceptional circumstances" guidance into account. Paragraph 26 of the judgment reads:

> "In making its own decision, the Tribunal has regard to the HMRC Guidelines. The guidelines state that the fact that less tax would be paid under the FRS is 'not sufficient reason' to authorise retrospectivity, but do not suggest that this is a wholly irrelevant consideration...The Tribunal is satisfied that in the present case there are exceptional circumstances justifying retrospectivity. It is not a simple case of a business being unaware of the FRS, or simply realising after the event that less tax would have been paid under the FRS. It is a case where reasonable expectations proved unforeseeably to be catastrophically wrong, to the extent that the Appellant fell far short of the threshold for registering for VAT at all, and where the Appellant is now suffering considerable financial hardship."

40. Ms Gutane said that the parallels were obvious. In the Company's case, the Directors' reasonable expectations also "proved unforeseeably to be catastrophically wrong". She asked that this Tribunal take the same approach as in *Seefe*.

41. She added that the Company had not sought back-dating to the beginning of the Company's VAT registration, but only from 1 January 2017, when the Directors had realised that their projections were significantly over-optimistic.

42. Both Directors referred to the fact that it was only in August 2017 that Mr Hale had advised the Company that it could have applied for the FRS, and he initially gave them the wrong percentage. However, they had decided not to seek financial recompense from Mr Hale, because of the stress and costs of a possible further legal action.

Submissions by Ms Donovan on behalf of HMRC

43. Ms Donovan said that the purpose of the FRS was to "simplify the recording of sales and purchases for small business by removing the need to keep detailed records of sales and purchases". It was not designed "as a means of increasing/ensuring the financial viability of a business". Those within FRS can, she said, use fixed percentages which are lower than the standard rate, but they are also unable to recover input VAT on purchases, so on occasion a trader using the FRS may pay more VAT than if he used the normal methodology.

44. Ms Donovan submitted that:

(1) it would be contrary to the purpose of the scheme to backdate the FRS so as to include the two periods where the Company had already submitted VAT returns for two quarters;

(2) HMRC had therefore reasonably exercised its discretion when making the decision which was under appeal; and

(3) in any event the facts showed that the Company's survival was not at risk, and the requested repayment of just over £2,000 was too small to have prevented the redundancies.

Discussion and decision

Whether HMRC acted unreasonably

45. Our starting point was the scope of the discretion given to HMRC. Article 24 of the Sixth Directive allowed Member States to introduce, for small businesses, "simplified procedures such as flat-rate schemes for charging and collecting the tax provided they do not lead to a reduction thereof". VATA s 26B implemented that Article; subsection (8)(a) provides the *vires* for HMRC to backdate the FRS; and Reg 55B(1)(b) provides for the backdating to take effect from "such earlier…date as may be agreed between him and the Commissioners". Although the Sixth Directive has been replaced by the PVD, Article 281 of the PVD is to the same effect.

46. It is true that the wording of both VATA s 26B and Reg 55B(1)(b) describe HMRC's backdating discretion in wide and unrestricted terms, but we find that it must be exercised with reference to the purpose of the FRS, namely as a "simplified procedure for charging and collecting the tax". That purpose is appropriately reflected in the wording of HMRC's guidance, which says that "the FRS exists to simplify VAT accounting and record keeping for small businesses, so that they are able to spend less time on VAT".

47. Moreover, Article 24 of the Sixth Directive (and Article 281 of the PVD) explicitly state that the purpose is not to reduce the amount of VAT payable: as Ms Donovan rightly said, although that may happen, it is an accidental result, and the operation of the scheme sometimes means that more VAT is due.

48. If HMRC were to exercise its discretion so as to put a trader into the FRS for a VAT period in relation to which a return had already been submitted, in order to provide a refund to a trader in difficulties, in our judgment HMRC would have acted *ultra vires* its discretion and unreasonably. In other words, HMRC would have failed to consider a relevant matter, (the purpose of the FRS scheme) and would have taken into account an irrelevant matter (the effect of a cash refund on the trader).

49. Ms Gutane relied on the part HMRC's guidance which states that "there may be exceptional circumstances" when backdating may apply, even though the trader has already submitted his VAT return, and that "such cases are likely to involve compassionate circumstances, or the survival of the business". It is of course true that there *may* be exceptional circumstances when retrospection may properly apply after a trader has filed his VAT return, but any such circumstances must relate to the policy's aim of simplifying the tax collection process. Although we found it difficult to think of any such situations, we accept that they may exist. But they cannot include using the discretion in order to provide funds for a struggling business.

50. We therefore respectfully disagree with the FTT's judgment *Seefe,* which held that:

(1) retrospection should have been granted for all years since Mr Seefe had originally registered for VAT, because he was "suffering considerable financial hardship" having registered and then paid VAT on the basis of incorrect sales forecasts; and

(2) HMRC should have taken into account "the fact that less tax would be paid under the FRS".

51. Our conclusions are entirely consistent with Henderson J's judgment in *Burke,* where he first referred to HMRC's policy of not backdating if a trader has already filed his VAT return for a period, and then said at [25]:

> "I comment that this appears to me to be an entirely rational policy, which reflects the simplification policy of the flat-rate scheme itself. If a taxpayer has already accounted for VAT in the past on the normal basis, and in accordance with the general law then in force, there is no way in which retrospective admission to the scheme can simplify the accounting exercise that he has already carried out. In such cases, the only likely motive for seeking retrospective entry is that the taxpayer would, in fact, have ended up paying less tax had he been a member of the scheme, and that is indeed the position so far as Mr Burke is concerned."

52. We therefore find that HMRC did not act unreasonably in deciding the Company's FRS application. On the contrary, they took into account relevant matters and did not take into account the irrelevant matter of the Company's financial position. It follows that the Company's appeal is refused.

The Company's survival

53. If, contrary to our analysis above, HMRC do have the discretion to backdate entry into the FRS for a period after the filing of a VAT return because "the survival of the business" is in issue, we went on to consider whether the Company came within that "exceptional circumstance".

54. We found that it did not, because the Company's survival was ensured by (a) the personal loan obtained by the Directors and (b) Ms Gutane working without pay for four months. The issue here is the survival of the *Company,* not the earnings of the Directors or those connected

with them. In other words, although the Company was making losses, the Directors were able to ensure that it continued in business.

Decision and appeal rights

55. For the reasons set out above, the Company's appeal is dismissed and HMRC's decision upheld.

56. This document contains full findings of fact and reasons for the decision. If the Company is dissatisfied with this decision, it 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.

57. 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.

ANNE REDSTON
TRIBUNAL JUDGE

Release date: 8 October 2019