TC01496

Appeal number: TC/2009/15444

VAT – flat rate scheme – application for retrospective entry into scheme – appellant argued that amount of VAT overpaid was significant when compared to retained profits – whether HMRC decision to refuse backdating reasonable

FIRST-TIER TRIBUNAL

TAX

ANYCOM LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ROGER BERNER
MRS R A WATTS DAVIES (Member)

Sitting in public at 45 Bedford Square, London WC1 on 30 September 2011

Mr Roland Mitchell, R A Mitchell & Co, for the Appellant

Mrs Gloria Orimoloye, HMRC advocate, for the Respondents

DECISION

1. This is an appeal by Anycom Limited ("Anycom") against the refusal by HMRC to allow the Appellant retrospective entry into the Flat Rate Scheme ("FRS") with effect from 1 April 2005.

2. Section 26B of the Value Added Tax Act 1994 ("VATA") makes provision for the flat-rate scheme, including, in s 26B(8)(a) provision for regulations which themselves make provision in turn enabling HMRC to authorise a person to participate in the scheme from a date earlier than the date of his application. Under those regulations, which are set out in Part VIIA of the VAT Regulations 1995, reg 55B provides that HMRC may, subject to the detailed requirements, authorise a taxable person to account and pay VAT in accordance with the scheme with effect from:

(a) the beginning of his next prescribed accounting period after the date on which HMRC are notified of his desire so to be authorised, or

(b) such earlier or later date as may be agreed between him and HMRC.

3. This appeal is made under s 83(1)(fza) VATA, on a refusal to authorise Anycom's retrospective participation in the FRS. By s 84(4ZA) it is provided that the tribunal shall not allow the appeal unless it considers that HMRC could not reasonably have been satisfied that there were grounds for the decision. Our jurisdiction is therefore one of review only; in particular we cannot substitute our own decision for that of HMRC.

4. In carrying out this review we should consider this matter according to the tests set out by the Court of Appeal in *John Dee Limited v Customs and Excise Commissioners* [1995] STC 941. The tribunal has to consider whether HMRC have acted in a way in which no reasonable panel of commissioners could have acted or whether they have taken into account some irrelevant matter or have disregarded something to which they should have given weight. The tribunal may also have to consider whether HMRC have erred on a point of law.

The facts

5. We heard no oral evidence, but there was no dispute on the facts. We therefore find them as follows.

6. Anycom has been registered for VAT since 30 April 2004. Mr Mitchell said, and it was not disputed, that Anycom has always complied with its obligations with regard to VAT.

7. Mr Mitchell was appointed as accountant to Anycom on 27 March 2009. He advised Anycom about the existence of the FRS, and on 23 May 2009 Anycom applied to use the FRS with effect from 1 April 2009. That application was granted and notified by letter dated 3 June 2009.

8. On 23 July 2009 Mr Mitchell wrote to HMRC with a request on behalf of Anycom retrospectively to enter the FRS with effect, according to that letter, from 1 October 2004. (This was subsequently amended to 1 April 2005; nothing turns on this change.) In that letter Mr Mitchell referred to the tribunal case of *C J Anderson* (28 June 2007, no 20255) to which we shall refer later. He stated that Anycom's circumstances were similar to those in *Anderson*. His letter sets out a comparison in percentage terms between the amount of VAT that would be reclaimed for the relevant period were the retrospective application of the FRS to be allowed and the aggregate retained profits for the period. We will not refer here to the figure set out at this stage by Mr Mitchell, as it was varied in subsequent correspondence, and HMRC took a different view of the calculation. But Mr Mitchell made a comparison between the percentage he said was applicable to Anycom with that which formed the basis of the tribunal decision in *A and C Wadlewski* (22 February 1995, no 13340. Mr Mitchell asserted that the tribunal in *Wadlewski* had considered an overpayment of 40% of business profits to be an exceptional circumstance, and that Anycom's overpayment should therefore be similarly regarded.

9. By reference to the *Anderson* decision, Mr Mitchell's letter set out the reasons why he suggested that retrospective application of the FRS should be permitted. Excluding those reasons which Mr Mitchell accepts are not relevant to the period in question, those reasons were:

(1) Anycom has an unblemished VAT compliance record.

(2) Despite wide publication of the FRS, Anycom only became aware of the possibility of back dating at an ACCA sponsored CPD event on 1 March 2009 and had been registered under the scheme from 1 April 2009.

(3) Anycom did not adopt a "wait and see" approach before applying for retrospection.

(4) The potential saving of VAT was £17,735.29.

(5) Anycom had at all times in the relevant period been eligible for the FRS.

Mr Mitchell enclosed with his letter copies of the accounts of Anycom for the years ended 31 March 2006 to 31 March 2009.

10. By letter dated 3 August 2011 addressed to Anycom HMRC refused the request to backdate the FRS. The reasons given were expressed as follows:

> "Section FRS3300 of the FRS guidance states 'The policy is to refuse retrospection where the business has already calculated its VAT 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.
>
> Section FRS3300 of the guidance also states 'In line with the rationale of the scheme, the fact that a business will pay, or would have paid, less tax, is not sufficient reason to authorise retrospective use of the FRS.'

> Where a trader has already calculated their VAT liability using normal accounting, retrospective use of the Flat Rate Scheme would be authorised only where justified by exceptional circumstances."

11. Mr Mitchell replied on 25 August 2009 disagreeing with HMRC's decision, and asking for a review. He attached a schedule summarising the comparison between the effect of the FRS and the normal VAT accounting regime for each year from 1 April 2005 to 31 March 2009, and argued that the retrospective use of the FRS was justified because the difference in the amount of VAT to be accounted for over the whole period was 86% of the aggregate annual retained profits after adding back mainstream corporation tax. The calculation on an after-tax basis gave rise to a percentage figure of 63.88%

12. This rather counter-intuitive result is explained by a review of the figures. Over the period in question, after taking account of dividends paid by the company, effectively in lieu of salary to the sole proprietor, the aggregate profits of Anycom converted to an aggregate loss. Adding back the corporation tax produced a profit, which when compared to the VAT saving gave rise to the 86% figure. The figure of 63.88% for the after tax profits was obtained by comparing the VAT saving with the overall loss after dividends.

13. In their letter of 15 October 2009 upholding the original decision on review, HMRC reiterated their policy to refuse retrospection where the business has already calculated its VAT liability for the relevant periods. It was stated that exceptions are made only if a taxpayer has been misdirected by an officer or the business is under threat. No evidence had been provided that either situation applied.

14. HMRC had considered the schedule produced by Mr Mitchell. The review officer commented that the retained profits figure in some instances showed a loss, but that dividends were not an expense of the business and the way in which the proprietor chose to take remuneration was a business decision. The *Anderson* case was also considered, but the review officer found no evidence that the situation of Anycom was similar to that of the appellant in that case. The review officer then went on to refer to the *Wadlewski* case, noting that the case itself did not relate to the FRS, but to a retail scheme no longer in existence and that it had not been followed in similar tribunal cases. After making reference to the High Court case of *Revenue and Customs Commissioners v Burke* [2011] STC 625 (to which we shall also return), the review officer concluded that on the information held she did not consider that exceptional circumstances existed in Anycom's case, and she upheld the original decision.

15. Mr Mitchell replied on 20 October 2009 reiterating the points he had made concerning the calculation of the percentage of the retained profits of Anycom that was represented by the prospective VAT saving, and arguing that the calculation on the basis of adding back the dividends was appropriate as this was effectively director's remuneration. In a subsequent letter dated 28 October 2011 (the day after the notice of this appeal was sent to the tribunal) he enclosed the accounts of Anycom for the year ended 31 March 2009 and the corporation tax computation for that year. By reference to the tax owing for that year (£6,927.06) and the amount owed for the

previous year (£2,409.26), and comparing that to the prospective VAT saving of £17,735.29, Mr Mitchell argued that the company was suffering hardship.

16. On 16 November 2009 HMRC replied to say that the fact that Anycom owed other taxes did not constitute an exceptional circumstance which amounted to a threat to the business.

Subsequent material supplied

17. At a later stage, after HMRC had taken the relevant decisions, and in the course of the appeal process, Mr Mitchell had supplied HMRC with a copy of a mortgage statement dated 31 May 2009, which, amongst other details, set out an amount of available reserve of £27,000.96. Mr Mitchell told us that the proprietor of Anycom had had difficulty in making his mortgage payments. He had in May 2009 borrowed a further £20,000 on mortgage to put into the business.

18. We had no evidence to support these claims. The evidence we had from the accounts of Anycom for the period 1 April 2009 to 31 May 2010 instead show no increase in the share capital of the company and a decrease in the overall creditors, in particular under the heading Other Creditors. A dividend of £30,000 was paid, and at the balance sheet date the profit and loss account had increased over the year from £5,248 to £12,472.

Discussion

19. In *Burke* Henderson J had to consider a case where the decision of HMRC refusing to permit retrospective application of the FRS was in substantially similar terms to the wording of the decision of 3 August 2011 which we have quoted above. The learned judge commented (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."

20. In argument before us Mr Mitchell criticised the decision of HMRC in three ways. He said that, firstly, HMRC had not considered the industry in which Anycom was engaged, and the difficult economic circumstances being suffered by that industry. Secondly he said that HMRC had not taken account of the percentage of profits that would be represented by the prospective VAT saving, and that this was an exceptional circumstance. Finally he argued that HMRC had not looked at the question of hardship.

21. Dealing with the first and third points first, there was nothing in the correspondence and materials before HMRC at the times the decision and review were taken that came anywhere close to being factors of economic difficulty or financial hardship capable of being taken into account by HMRC. It is not reasonable for a taxpayer to expect, as Mr Mitchell suggested, that HMRC should be able to take a general overview of the economics of a taxpayer's business sector when coming to a conclusion on whether to grant retrospective application of the FRS. As regards hardship, what information was provided was sent to HMRC after the decision and review conclusions hade been sent to Anycom. But HMRC did consider the representations made concerning the company's corporation tax liabilities. They could not have taken into account the submissions concerning the proprietor's mortgage, as those were not available at the material times. In any event, the material that was ultimately produced does not, as we have found, show any hardship that could approach exceptional circumstances that ought to have been considered.

22. Mr Mitchell's main complaint was that, in not taking account of the significant percentage of retained profits (on his measure of this) that would be represented by the prospective VAT saving over the period in question as an exceptional circumstance, HMRC's decision was unreasonable. He argued that this was inconsistent with authority, relying on *Wadlewski* and *Anderson*, and also with certain other cases he had dealt with where the amounts of VAT saved in comparison with profits had been treated as exceptional circumstances and retrospection had been permitted.

23. As HMRC noted in their decisions, *Wadlewski* was not a case on the FRS, but on the retrospective recalculation of VAT on a change of retail scheme. There the retail scheme operated by the taxpayers, following discussions with Customs & Excise, was found to have given rise to a VAT overpayment over an 8-year period of 40% of the aggregate annual profit over that period. The tribunal took the view that the amount of tax that a taxpayer pays was highly relevant. The tribunal found support in this conclusion by the fact that published Customs guidance provided that the local VAT office would consider applications to recalculate the tax on previous returns after a change of scheme in certain circumstances when a difference of only £100 was found. The tribunal reasoned that it was difficult in those circumstances to escape the conclusion that a much higher difference was also a relevant consideration.

24. Even in the context of retail schemes, the reasoning in *Wadlewski* has not been followed. For example, in *L & P Fryer* (1996, no 14265), the tribunal observed (at p 18) that the amount of VAT overpaid is irrelevant, but they did leave open the possibility of an overpayment being so great as to amount to an exceptional circumstance. In *L & J Lewis v Customs and Excise Commissioners* [1996] V&DR 541, the tribunal also declined to accept that the mere fact that the amount of tax that had been overpaid was significantly in excess of the threshold of £100 was a special circumstance. Nevertheless the tribunal also commented that there may come a point – though the tribunal considered that this would be unusual - at which the difference in the tax payable was so great that it alone could amount to an exceptional circumstance, but that this would have to be by reference to turnover or profit of the business.

25. The significance of *Wadlewski* to Mr Mitchell's argument in this case is that it was referred to by the tribunal in *Anderson*. The tribunal there made a finding of fact that the potential saving of VAT was a material amount, particularly having regard to the profitability and the indebtedness of the business. However, the basis for the tribunal's decision in that case was that HMRC's decision letter did not set out a consideration of the facts put forward by the appellant. HMRC's counsel in that case conceded that the decision did not set out how HMRC's guidance had been applied to the individual circumstances of the appeal, and that the letter required more detailed reasoning. The tribunal then went on to consider whether HMRC's decision in that case would inevitably have been the same, had the relevant facts identified by the tribunal been taken into account. Even there, the tribunal (at para 36) took the view that, although the tax advantage might have had some influence on the eventual decision, that was not a strong reason on its own.

26. In our view, in particular following the judicial approval of the rationale of the policy of HMRC in *Burke*, it is clear that, in light of the simplification policy of the FRS, the fact that there has been an overpayment of tax under the normal regime, even where such an overpayment is large in comparison to turnover or profitability, can reasonably be regarded by HMRC in their assessment of an application for retrospective application of the scheme as of itself not giving rise to exceptional circumstances such that backdating should be permitted. Such an overpayment may have consequences for the business in question which themselves may constitute exceptional circumstances that will fall to be taken into account by HMRC, but in this case no such consequences were drawn to HMRC's attention.

27. In this case, HMRC did clearly consider the overpayment calculations made by Mr Mitchell on behalf of *Anycom*. They disagreed with the way in which the percentage figures had been reached, but the decision was based, not on particular percentages, but on the rationale of the FRS and the consequence that the fact that a business would pay, or would have paid, less tax is not a sufficient reason to authorise retrospective use of the FRS. That conclusion was, in our view, well within the wide discretion given to HMRC on an application for retrospective use of the scheme.

28. HMRC also took into account the figures produced by Mr Mitchell which purported to show the business having losses, after deducting dividends. In the period in question, annual after-tax profits had been £194,966, and dividends of £222,728 had been distributed. In our view it was reasonable for HMRC not to have regarded such circumstances as exceptional, in terms of the financial position of the company, so as to justify retrospective application of the FRS.

29. Mr Mitchell complained, by reference to examples from his own experience that he did not fully detail, that HMRC was guilty of inconsistency in the application of retrospective application of the scheme. As each case must be considered on its own merits, we do not consider this to be a sustainable criticism of HMRC's decision in this case. Where HMRC in an individual case reasonably applies a rational policy that is itself designed to provide a consistent approach to the exercise of a discretion, it cannot be a ground of criticism if in other cases the exercise of that discretion gives rise to different results.

Decision

30. For these reasons, we dismiss this appeal.

Application for permission to appeal

31. 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.

ROGER BERNER

TRIBUNAL JUDGE
RELEASE DATE: 10 October 2011