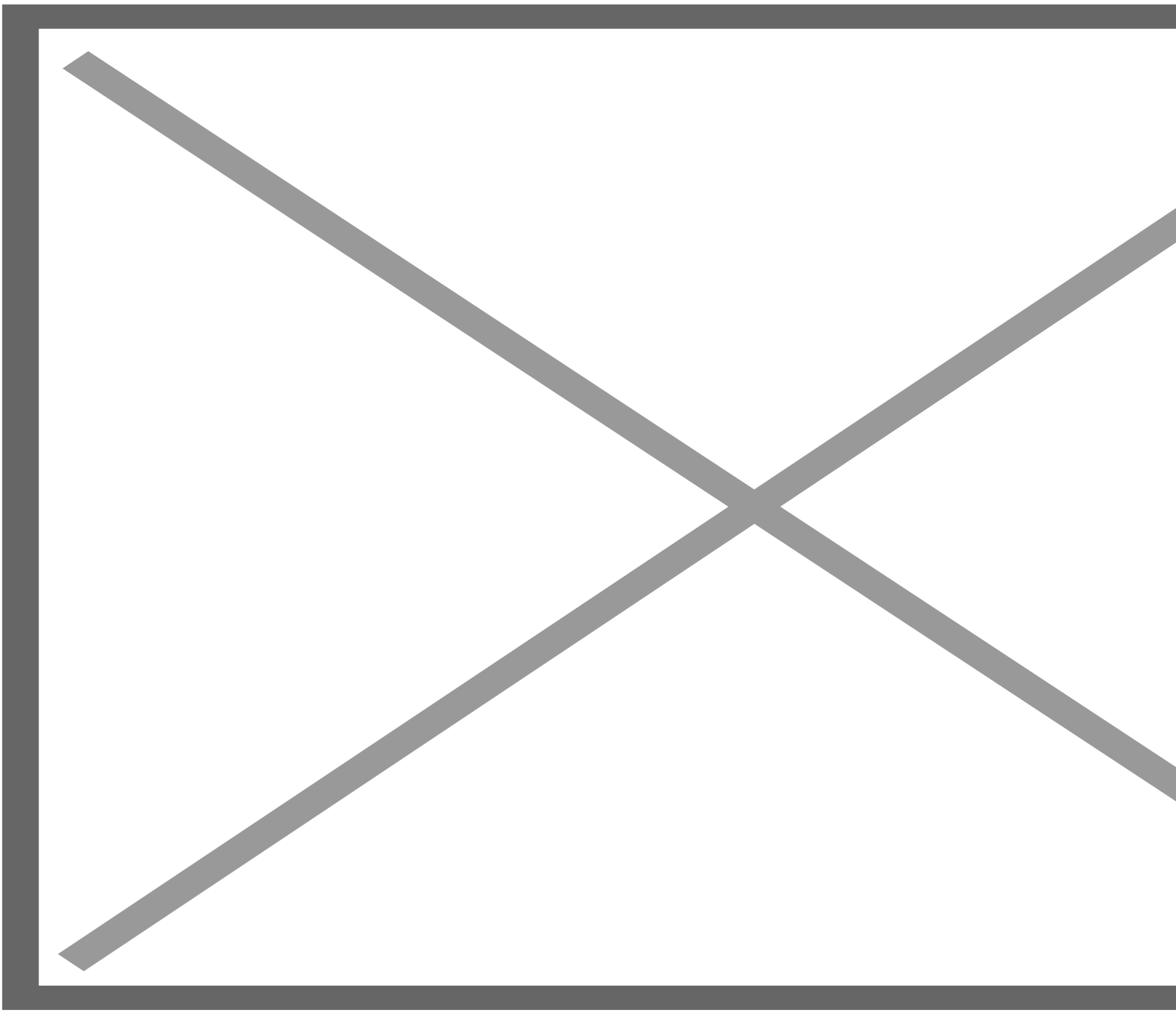
Paper tiger or hidden dragon?

Management of taxes



01 October 2017

Keith Gordon discusses the Supreme Court’s decision in HMRC’s appeal in the BPP case

Key Points

What is the issue?

The case has been considered by four levels of judiciary – these four years have not resolved the underlying question about the correct VAT treatment of BPP's arrangements. Instead, the entire time has been taken up on preliminary procedural matters.

What does it mean to me?

HMRC do not always conduct litigation in a way that comes across as fair to the inexperienced and less well-resourced litigant.

What can I take away?

Whilst it would be inappropriate to run to the Tribunal for a debarring order the minute that HMRC make a mistake, this case should give taxpayers some confidence that the Tribunal has the powers to keep HMRC in line and that the exercise of those powers in a suitable case has now received the highest judicial endorsement.

In the May 2016 issue of *Tax Adviser*, I wrote about the Court of Appeal's criticism of HMRC's handling of an appeal being taken by members of the BPP group of companies.

As most readers will know (many with first-hand experience), BPP provides professional training. In the period under review, it was arranged by BPP for students to be supplied with books by one company and education by another. The apparent purpose of the arrangement was for part of the supply (the books) to qualify as zero-rated as opposed to a single standard-rated supply of education.

This led to a disagreement with HMRC which then proceeded to the First-tier Tribunal. Although BPP's appeals were notified to the First-tier in May 2013 and, in the meantime, the case has been considered by four levels of judiciary, these four years have not resolved the underlying question about the correct VAT treatment of BPP's arrangements. Instead, the entire time has been taken up on preliminary procedural matters.

The Tribunal procedural rules

Although the Tribunal portrays itself as a relatively informal way of resolving tax disputes (and, despite the many impressions to the contrary, it is), it is governed by a set of rules (the Tribunal Procedure Rules) which provide a framework within which a case will progress from the initial notification of the dispute to the Tribunal all the way through to the Tribunal's decision (and, in fact, a little beyond).

The rules are drafted in a relatively broad fashion so as to recognise the diverse caseload of the Tribunal – ranging from £100 penalties cases to those concerning multi-million carousel frauds. However, whatever the nature of the case, the Tribunal is obliged to act in accordance with what is known as the Overriding Objective which is 'to deal with cases fairly and justly' (Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 SI 2009/273 rule 2(1), (3)). Under rule 2(4), the parties are obliged to help the Tribunal to further this overriding objective. Avoiding delay is one aspect of dealing with a case fairly and justly (rule 2(2)(e)).

Although, as a matter of law, it is usually the case that the taxpayer has the burden of proof in an appeal, this does not mean that the taxpayer will have to do all the running before the final hearing. Indeed, appeals – by their very nature – are challenges undertaken by taxpayers against decisions made by HMRC. Consequently, the

rules provide that, at an early stage in proceedings, HMRC are meant to set out a statement of case – explaining the factual and legal basis for the decision under appeal. It is that statement of case which will govern the future handling of the case.

Where a party's conduct in the course of the litigation has fallen below the expected standards, the Tribunal rules provide for a number of remedies. Ordinarily, missed (or about-to-be-missed) deadlines can be overcome by an extension being granted (prospectively or retrospectively); where further information is required from one of the parties, the Tribunal can direct that this be provided within a specified period. Furthermore, if a party's conduct is deemed unreasonable then the Tribunal can make a costs award to the other side. The Tribunal's ultimate sanction, however, is to strike out a party's case (or, in the case of HMRC, the potentially lesser sanction of debarring HMRC from future participation in the appeal).

Under rule 8(3)(a), this is a discretionary sanction which may be used if a party has failed to comply with a direction that included a warning that non-compliance could lead to a strike-out (or debarring). In addition, rule 8(1) provides for what are often known as 'unless' orders: that is a direction that provisionally and prospectively strikes out a party's case (or, in HMRC's case, debars them) automatically, unless they comply with the Tribunal's direction by the set time.

These powers are in practice reserved for those cases where a party has missed a deadline at least once (but usually more than once) and the Tribunal feels that firm pressure needs to be put on them to comply, so as to ensure that the case is not bogged down with unnecessary and often prejudicial delays.

Of course, the Tribunal's decision to impose either of these sanctions is to be governed by the overriding objective.

Facts of the case

My May 2016 article explained the facts of the case in some detail. To summarise, however:

- HMRC's statement of case was late and lacking sufficient detail.
- BPP requested further clarification of HMRC's case. Whilst HMRC accepted the need for this, they initially refused to be governed by any timescale.
- BPP then applied for an unless order and the Tribunal agreed that HMRC needed to comply with the request within a specified period. However, rather than grant the unless order sought, the Tribunal merely warned that non-compliance might lead to HMRC being debarred from continued participation in the appeal.
- HMRC responded on the last date for compliance, but their response was inadequate.
- BPP therefore made the application that the Tribunal debar HMRC in accordance with rule 8(3)(a).
- It was only shortly before the hearing of that application that HMRC finally clarified their case to the extent originally needed. This was eight months after the statement of case was first due to be served.

Judge Mosedale decided that HMRC should be debarred from future participation and therefore granted BPP's application. HMRC successfully appealed against that decision in the Upper Tribunal, but BPP's appeal to the Court of Appeal was successful. HMRC decided to appeal against the Court of Appeal's decision and were given permission to do so by the Supreme Court.

The Court's decision

The judgment was given by Lord Neuberger in one of his last judgments as President of the Supreme Court. Early on in his judgment, he made it clear that the ultimate question for the Court was whether or not Judge Mosedale's decision could be justified. Therefore, it is not whether the judges in the Supreme Court would necessarily have reached the same decision, but simply whether the approach taken by her can be faulted. Consequently, the judgment focused predominantly on Judge Mosedale's decision rather than on how it was later analysed by the Upper Tribunal and the Court of Appeal.

HMRC put forward seven reasons why Judge Mosedale had taken a flawed approach. Many of these were quickly rejected by the Court. The most interesting, however, was the suggestion that the Judge's reliance on the Court of Appeal's decision in the case of *Mitchell v News Group Newspapers Ltd* [2014] 1 WLR 795 was undermined by the subsequent Court of Appeal decision in *Denton v TH White Ltd* [2014] 1 WLR 3296 which came out after Judge Mosedale's decision and which sought to clarify certain misconceptions arising from the Mitchell case. Those two cases (and the relationship between them) are discussed in a little more detail in my earlier article.

Lord Neuberger's judgment makes clear that this raises an important point of principle: *Mitchell* and *Denton* concern the application of the Civil Procedure Rules, which govern the civil courts in England and Wales and which therefore have no relevance to Scotland and Northern Ireland, whereas the First-tier operates throughout the country. The Tribunal should be guided as much by the approaches of the Scottish and Northern Ireland courts as they are by the courts in England and Wales.

Nevertheless, his Lordship recognised the guidance given in the Upper Tribunal in the case of *McCarthy & Stone (Developments) Ltd v HMRC* [2014] STC 973 which noted that, whilst the CPR does not directly apply to the Tribunals, the Tribunals should not 'adopt a different, i.e. more relaxed, approach to compliance with rules, directions and orders than the courts that are subject to the CPR'.

Lord Neuberger suggested that the Supreme Court should not interfere with the guidance given by the Upper Tribunal and the Court of Appeal as to the proper approach to be taken by the First-tier (except where, exceptionally, that guidance might be wrong). Nevertheless, he was seemingly happy to endorse it in this case, summarising that Tribunals should generally follow a similarly firm approach to non-compliance.

Returning to the challenges mounted by HMRC in relation to Judge Mosedale's reliance on *Mitchell*, the Court was not impressed. The Court considered that Judge Mosedale had not expressly relied upon Mitchell but independently carried out a balancing exercise. Furthermore, it should be noted that *Denton* did not set aside *Mitchell* and indeed the Court of Appeal had accepted that the guidance given in *Mitchell* 'remained substantially sound': *Denton* merely clarified the earlier case. The Supreme Court considered that Judge Mosedale's decision should be set aside only if she had misinterpreted the guidance given in *Mitchell*, but this was considered not to have happened.

For these reasons, the Supreme Court dismissed HMRC's appeal.

Commentary

At the end of the day, the Supreme Court had little sympathy with HMRC's arguments. From a legal perspective, it appears that the main purpose of the further hearing (or at least its main outcome) was a UK-wide perspective as to how the Tribunals should deal with non-compliance by a party. In short, at least in its current form, the CPR as applicable in England and Wales (and how it has been interpreted) should be respected in the First-tier throughout the nation.

However, other nuggets can be taken from the Court's decision.

HMRC had argued that a debarring order would prevent them from discharging their public duty and harm the public interest of protecting the Exchequer. However, Lord Neuberger considered that such an argument 'would set a dangerous precedent … as it would discourage public bodies from living up to standards expected of individuals and private bodies in the conduct of litigation'. Indeed, Lord Neuberger was attracted to the argument that the courts should expect higher standards from public bodies than from private bodies or individuals.

On a similar theme, HMRC had argued that a debarring order could lead to a windfall for BPP. However, Lord Neuberger recognised that this was a consequence of the sanction rather than a reason not to exercise it. For the effect to be taken into account in the way argued for by HMRC 'would appear to undermine the utility of the sanction' and should be given no weight 'save perhaps in exceptional circumstances'. Although the Court considered that there must be a limit to the permissible harshness (or indeed the permissible generosity) of a decision relating to a debarring order and that this case was borderline, it was on the right side of the line and therefore the decision should not be interfered with.

Finally, the Court remarked that, as Judge Mosedale herself recognised, she was left with two unattractive options: the draconian step she opted for or letting HMRC get away with it. Lord Neuberger wondered whether the Tribunal rules ought to provide for a more nuanced alternative. However, he recognised that this idea might be more easily formulated in theory than in practice.

Finally, what to do next

The circumstances of this case were exceptional, but come as no surprise. As previously remarked, HMRC do not always conduct litigation in a way that comes across as fair to the inexperienced and less well-resourced litigant. Whilst it would be inappropriate to run to the Tribunal for a debarring order the minute that HMRC make a mistake, this case should give taxpayers some confidence that the Tribunal has the powers to keep HMRC in line and that the exercise of those powers in a suitable case has now received the highest judicial endorsement.

However, it cuts both ways. The Tribunals are meant to be accessible to all and legal training is not a prerequisite for representing a client in Tribunal litigation. Nevertheless, litigating a case is very different from routine correspondence with HMRC. In the latter, time limits can often be treated as advisory rather than mandatory (and, indeed, HMRC are very capable of letting months pass by before responding to correspondence). In contrast, the Tribunal expects a higher degree of professionalism from both sides and a *laissez faire* approach by a taxpayer can well lead to HMRC seeking a direction under rule 8.