[2019] UKFTT 0270 (TC)

TC07109

Appeal number: TC/2017/02502

VAT – breach of threshold for mandatory registration – failure to notify liability to register – assessment of arrears by using sector rate under the Flat Rate Scheme ('FRS') – appellant applied to join the FRS – Tribunal lacks jurisdiction in relation to the FRS arrangement – penalty for failure to notify liability under Sch 41 FA 2008 – whether reasonable excuse or special reduction – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PETER HARTIGAN T/A STRIKING IRON **Appellant**

- and -

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

TRIBUNAL: JUDGE HEIDI POON
JAMES ROBERTSON

Sitting in public at Eagle Building, Glasgow on 14 January 2019

On request for a full decision following the summary decision of 22 January 2019

Mr Hartigan in person, for the Appellant

Mrs Elizabeth McIntyre, Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. Mr Hartigan ('the appellant') appealed against the following decisions by the respondents ('HMRC'):

(1) An assessment in respect of VAT arrears in the sum of £21,334; and

(2) An assessment of a penalty for the Failure to Notify ('FTN') a liability under Schedule 41 to the Finance Act 2008 ('Sch 41') in the sum of £5,525.

2. On 22 January 2019, the Tribunal released a Summary decision which upheld the VAT assessment and varied the penalty assessment to £5,356.60. On 30 January 2019, the appellant requested a decision with full written findings and reasons. This is the full decision.

Evidence

3. HMRC officer Fraser McGowan gave evidence on behalf of the respondents. Officer McGowan has been a VAT Compliance Officer for the Hidden Economy Team since October 2014. We find Officer McGowan a credible witness, though we find at times his evidence could be clearer and more precise as to matters of fact.

4. Mr Hartigan gave evidence and answered questions from HMRC and the Tribunal. He also produced a copy of a quotation in September 2018 and invoices in September and December 2018 to illustrate how his business operated in pricing for jobs and invoicing customers. We find Mr Hartigan an honest and straightforward witness, and we accept his evidence as credible without qualification.

Relevant legislation

5. The legislation in relation to the appeal against the Commissioners' decision concerning VAT registration is contained in the VATA 1994, with the relevant provisions being:

(1) Section 3 provides that a person is liable to register for VAT where the conditions set out under Schedule 1 of the Act are met:

(a) Schedule 1, para 1(1)(a) sets out the timing and the income threshold when a liability to register for VAT arises, which is: 'at the end of any month, if the person is UK-established and the value of his taxable supplies in the period of one year then ending has exceeded [the relevant mandatory registration threshold in force]'.

(b) Schedule 1, para 4 sets out the timing and conditions when a trader may be de-registered for VAT purposes;

(c) Schedule 1, para 5 provides for the notification of liability and registration whereby:

> '(1) A person who becomes liable to be registered by virtue of para (1)(a) above shall notify the Commissioners of the liability within 30 days of the end of the relevant month.

> (2) The Commissioners shall register such person (whether or not he so notifies them) with effect from the end of the month following the relevant month or from such earlier date as may be agreed between them and him.
>
> (3) In this paragraph "the relevant month", in relation to a person who becomes liable to be registered by virtue of paragraph 1(1)(a) above, means the month at the end of which he becomes liable to be registered.'

(d) Schedule 1, para 13 provides for the 'Cancellation of registration' where a registered trader can be de-registered if either the business ceases, or if HMRC are satisfied that the trader is no longer required to be registered.

(2) Section 4 of VATA specifies that VAT is chargeable on a supply of goods or services which falls within the scope of being a 'taxable supply'.

(3) Section 73(1) VATA provides for HMRC to make an assessment to VAT where a person has failed to submit a return, within the time limits provided under sub-s 73(6), being:

> '(a) 2 years after the end of the prescribing accounting period; or
>
> (b) one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge.'

(4) Section 77 provides for the time limits for the raising of s 73 assessment, which is within 4 years after the end of the prescribed accounting period or importation or acquisition concerned.

(5) In relation to the right of appeal;

(a) Section 83(1)(a) provides for a right of appeal as respects the Commissioners' decision to register a person for VAT.

(b) Section 83(1)(p)(i) provides for a right of appeal against an assessment under s 73 in respect of a period for which the appellant has made a VAT return.

6. As for the FTN penalty assessment, the relevant provisions are contained in Schedule 41 to FA 2008, of which the following paragraphs are of direct relevance:

(1) Paragraph 1 allows a penalty to be imposed where there is a failure to notify liability to register for VAT as provided under Sch 1, para 5 of VATA.

(2) Paragraph 5 defines the degrees of culpability into categories for the purposes of setting the penalty percentages.

(3) The calculation of a penalty is with reference to 'Potential Lost Revenue' ('PLR') as provided under para 7, the penalty percentage according to the degree of culpability, and any reduction allowed for disclosure as provided under para 12.

(4) Paragraph 14 provides for 'Special reduction' if HMRC think it right because of special circumstances.

(5) Paragraph 17 provides for a right of appeal against a penalty whereby:

'(1) P may appeal against a decision of HMRC that a penalty is payable by P.

(2) P may appeal against a decision of HMRC as to the amount of a penalty payable by P.'

(6) Paragraph 19 sets out the Tribunal's jurisdiction on an appeal under para 17, which is to either 'affirm HMRC's decision', or 'substitute for HMRC's decision another decision that HMRC had power to make'.

(7) Paragraph 20 provides that a liability to a penalty under Sch 41 does not arise in relation to '*an act or failure which is not deliberate*' if the taxpayer satisfies HMRC or (on appeal notified to the tribunal) the tribunal that there is a reasonable excuse for the act or failure. The provisions specifically exclude 'insufficiency of funds' and 'reliance on a third party' from being a reasonable excuse.

The facts

The enquiry into VAT registration

7. In November 2015, Officer McGowan carried out a check into the appellant's VAT registration position, since his Self-Assessment ('SA') returns for 2012-13 and 2013-14 showed his turnover to have breached the relevant registration threshold.

8. On 8 December 2015, Officers McGowan and Shepherd visited the appellant at his home address, and the following information was gathered:

(1) Mr Hartigan traded as a sole-proprietor since 2005-06; that his business deals mostly with repairs and fitting gates, with no new-build housing work.

(2) Mr Alan Henderson of Rock Line Accountants acted as his accountant.

(3) The online accounting system accessed by the appellant showed his trading result for the year 1 April 2014 to 31 March 2015 as having a turnover of £89,635; a printout of the trading account is included in the bundle.

(4) Mr Hartigan had never been VAT registered before; that his accountant might have mentioned VAT to his partner (Ms Kate Lyon) but he did not know the context.

(5) When asked of his understanding of VAT, Mr Hartigan said he believed VAT was to be taken into account when *profit* (not turnover) is over a certain threshold; that he had never charged VAT on his jobs.

9. On 9 December 2015, HMRC wrote to the appellant to request details of his income and expenditure and a copy of his bank statements. There followed responses from Mr Hartigan in December 2015 and January 2016, giving the requested information to cover the period from April 2011 to March 2014.

The Pre-decision letter

10. On 12 January 2016, HMRC issued the findings in a pre-decision letter:

(1) From HMRC's schedule listing the *actual* monthly sales from April 2011 onwards, the appellant's rolling 12-month turnover was at £78,486.50 by October 2012, when the registration threshold stood at £77,000;

(2) The Effective Date of Registration ('EDR') was established to be 1 December 2012, based on the breach being at the end of October 2012;

(3) The monthly sales figure from April 2014 to March 2015 was listed at £7,469.59 every month, and was calculated as the average (not the actual) of the total sales income for 2014-15 from the trading account that shows annual turnover of £89,635 (from the printout of the online accounting system);

(4) From April 2015 to November 2015 (the month the enquiry was opened), the schedule listed monthly sales at £8,020.50 every month and was the average (not actual) monthly sales of an annual gross turnover estimated at £96,321.55;

(5) The Flat Rate Scheme for the trade sector at 9.5% was used to allow for the input VAT on purchases and expenses (i.e. at 10.5% of turnover as input);

(6) The Potential Lost Revenue ('PLR') was calculated by applying 9.5% to the turnover so established;

(7) A different schedule to estimate the VAT arrears contains two periods:

(a) From 1 December 2012 to 31 March 2015 on total turnover of £224,574.36 at 9.5% to arrive at £21,334.56;

(b) From 1 April 2015 to 31 March 2016, on an estimated gross turnover of £96,321.55 at 9.5% to arrive at **£9,150.55**.

Contact with the appellant's agent

11. On 22 January 2016, Mr Henderson telephoned Officer McGowan, advising that he had been instructed by Mr Hartigan to put together accurate VAT figures for the years in question and asked for an extension of time to produce them. Mr Henderson added that he was not surprised about the intervention check and that he had warned Mr Hartigan 'several times' about VAT.

12. Officer McGowan emphasised to Mr Henderson that he could neither disclose nor discuss the case without an authority mandate in place. Mr Henderson was asked to send in a form 64-8 as soon as possible. (Mr Henderson was registered to be an agent for Mr Hartigan's Self-Assessment, but the mandate did not extend to cover VAT matters.)

13. On 9 February 2016, Mr Henderson returned the call from Officer McGowan (of 3 February). The 64-8 was still outstanding. Mr Henderson advised that he would have final figures ready for 7 March 2016. Officer McGowan asked if he could disclose that Mr Henderson had warned Mr Hartigan about VAT registration, and Mr Henderson gave his consent for the disclosure.

14. On 14 March 2016, Officer McGowan telephoned Mr Henderson as the final figures had not yet been received. Mr Henderson advised that he would provide this by 30 April 2016, and that he was waiting on Mr Hartigan to complete the 64-8. Officer McGowan allowed the extension of time, as the first VAT return would not yet be due by 30 April 2016.

15. On 15 March 2016, Officer McGowan wrote to Mr Hartigan with a copy of his 12 January 2016 letter. He confirmed that Mr Henderson had contacted him and was aware that Mr Hartigan wanted to use actual figures to calculate PLR, and that if the

actual figures remained unavailable by 30 April 2016, the assessment would proceed by using the Flat Rate Scheme 9.5% as an estimate to give relief for input VAT.

16. On 17 March 2017, Mr Hartigan phoned Officer McGowan to explain that the failure to notify was not deliberate; that he relied on his accountant to advise him, and insisted that he had never been advised to register. Mr Hartigan stated that if he had known about the VAT threshold, he would not have taken jobs to avoid breaching it.

17. Mr Henderson did not produce the promised figures by 30 April 2016. Further attempts to obtain the actual figures from Mr Henderson followed:

(1) On 4 May 2016, HMRC phoned Mr Henderson and received no response.

(2) On 5 May 2016, Mr Henderson returned the call and said he had been in hospital and would provide the figures the following week.

(3) On 17 May 2016, Officer McGowan phoned Mr Henderson and left a voice message, stating the VAT return was now late and an assessment would need to be raised, based on estimates unless actual figures were provided by the end of the day.

The VAT assessment and the original FTN penalty assessment

18. On 18 May 2016, Officer McGowan wrote to Mr Hartigan explaining no figures had been received and the first VAT was now overdue. A VAT assessment was raised in the sum of £30,485.11 based on best estimates.

19. On 19 May 2016, a penalty explanation was issued on the basis that the disclosure was prompted, and the behaviour leading to the failure was deliberate. Officer McGowan stated in evidence that it was largely due to Mr Henderson’s statements that he had warned the appellant ‘several times’ about VAT registration that the original penalty calculation was made in the sum of £11,119.91.

20. On 19 May 2016, Mr Hartigan telephoned Officer McGowan, expressing his concern that he had not heard from Mr Henderson for a while and was worried and unsure about the situation. Mr Hartigan said he thought Mr Henderson was dealing with the actual figures submission. Officer McGowan advised him to contact Mr Henderson as soon as possible to get an update.

The revised penalty assessment

21. By email dated 29 June 2016, Mr Hartigan disputed the penalty decision, and gave the following facts as his reason for wanting to appeal:

(1) That his only communication regarding VAT with Mr Henderson was in 2015 when he asked his partner Ms Lyon: ‘Is Pete registered for VAT?’ Ms Lyon replied in the negative and nothing more was said on the matter.

(2) That Mr Henderson never discussed registration threshold with him; that the threshold was breached only by £1,486.50 in 2012; that he would have sought further advice if he was aware of it.

(3) That it had been agreed with Mr Henderson actual figures would be prepared for calculating PLR, but Mr Hartigan had not heard any further from Mr Henderson since the confirmation email to indicate his agreement.

(4) That Mr Henderson had never told Mr Hartigan that he should be registered for VAT.

(5) That Mr Hartigan had used the service of Mr Henderson ever since he began self-employment in 2005-06; that his skills are in steel manufacture and ironmongery, and he has no knowledge of financial matters and had employed a professional to guide him, but that he had chosen the wrong accountant.

(6) That he has engaged the service of a new accountant, a Mr Tom Murray.

(7) That his failure was not deliberate but he had trusted Mr Henderson who has let him down.

22. By letter dated 30 June 2016, Officer McGowan set out his revised conclusion on the penalty assessment, with the key reasons being:

(1) When Mr Henderson called HMRC on 22 January 2016, he had said: 'I am not surprised by this [enquiry], I have told him several times to register'. At this point, HMRC 'would take an accountant at their word'.

(2) On further consideration, Officer McGowan accepted that Mr Henderson did not tell the appellant to register for VAT, giving his reasoning as follows:

> 'After further consideration I am prepared to accept that Mr Henderson did not tell you to register for VAT. I am now of the understanding you employed Mr Henderson to not only act as your accountant in terms of making and completing returns, but also to make you aware of any arising tax implications of your business. It would appear he did not do this. I now consider the behaviour leading to the failure to be prompted, non-deliberate.'

(3) In respect of reduction for quality of disclosure:

> 'I now believe you should be given full reduction for all matters of Telling, Helping and Giving. Normally HMRC would not give full reduction if records and figures had not been provided. However, I see no need to penalise you further for delay caused solely by a third party.'

The VAT return submitted

23. The following communications with HMRC took place that led to the application by Mr Hartigan to join the Flat Rate Scheme ('FRS'):

(1) On 20 July 2016 Mr Murray emailed HMRC identifying himself as Mr Hartigan's new accountant, and advised that Mr Hartigan had started trading as a company: Striking Iron Limited from 1 July 2016. The email continued:

> 'As a consequence of late registration, it will now be necessary to revise our client's SA tax returns since he will now have overpaid tax.
>
> […]
>
> It is fair to say our client has been treated abominably by certain section of the accountancy profession, but it is our opinion that he is

> anxious to put all of this behind him and not fall into a repeat situation.'

(2) Officer McGowan replied on the same day to relate that his involvement was with the registration enquiry, and would end if no appeal was sought; that he would keep the case open to check the company was registered as a TOGC (transfer of a going concern) and explained how to apply for de-registration if the intention was to trade below the threshold by monitoring turnover.

(3) On 31 August 2016, Officer McGowan emailed Mr Hartigan to advise:

> 'I am currently processing your review request to send to an officer who has not been involved in the case.
>
> In doing so I have noticed that your first VAT return for the period 01 December 2012 – 31 March 2016 has now been submitted at the amount of £5,449.
>
> This is £25,036 lower than expected. Due to this I have issued an assessment for the remaining £25,036 today.'

(4) On 31 August 2016, Mr Murray telephoned HMRC to explain that he submitted a VAT return with figures in relation to only the year from 1 April 2015 to 31 March 2016, with a net VAT liability of **£5,449,** on the assumption that a separate VAT assessment covering the period from 1 December 2012 to 31 March 2015 had already been raised. (This was from Officer McGowan's evidence; there is no note of the telephone call included in the bundle.)

(5) On 31 August 2016 (at 16:08) Officer McGowan emailed Mr Hartigan to advise that:

> 'After further conversation with Mr Murray today I have established that the difference between the VAT submitted and that which should have been submitted' was actually £21,334.'

The application to join the Flat Rate Scheme

24. An application signed by Mr Hartigan to join the Flat-Rate Scheme ('FRS') dated 1 September 2016 was received by HMRC VAT Registration Service on 6 September 2016. The business activity was stated as 'Metal Fabricator', and the FRS rate applied for was 9.5%, with retrospective effect from 1 December 2012.

25. In evidence, Mr Hartigan acknowledged that the form was signed by him, but was unable to explain how he came to join the Flat Rate Scheme in terms of knowledge and understanding, other than to say that he was guided by Mr Murray.

26. We understand, from Officer McGowan's evidence, that Mr Murray had used the FRS rate of 9.5% to calculate the VAT liability for the year to 31 March 2016. Officer McGowan told us that he pointed out to Mr Murray that Mr Hartigan was not in the Flat Rate Scheme. We infer that Officer McGowan highlighted to Mr Murray that he could not use the 9.5% to submit the VAT return without Mr Hartigan being in the Scheme. Whatever the substance of the exchange between Mr Murray and Officer McGowan on 31 August 2016 was, it would appear to have prompted the FRS application, (the form being dated 1 September 2016).

27. Officer McGowan also said that Mr Murray confirmed £21,334 to be the correct amount for the period 1 December 2012 to 31 March 2015. There is no direct documentary evidence to that effect, other than that the confirmation would seem to be Officer McGown's inference from his own email on 31 August 2016 to update Mr Hartigan, after having spoken to Mr Murray (see 23(5)).

Cancellation of VAT registration

28. Soon after the submission of the VAT return (for the year to 31 March 2016) in August 2016, followed by joining of the FRS in September 2016, Mr Murray applied to cancel Mr Hartigan's VAT registration.

29. The registration cancellation took effect from 30 June 2016, and a final online VAT return was to be submitted by 24 November 2016.

Alternative Dispute Resolution ('ADR')

30. In November 2016, Mr Hartigan's application for ADR was accepted.

31. In January 2017, the ADR exit document evidenced that the parties had failed to resolve the disputed issues regarding the VAT and the penalty assessments. Mr Hartigan did not sign the exit document, giving his reason as follows:

> 'I do not understand the terminology used on this exit documents and feel it irresponsible for me to sign the section above. However, I do wish to proceed with the exit of ADR so as to move on to First-tier Tribunal as most matters are unresolved.'

The appellant's business margin

32. During the hearing, the Tribunal asked questions concerning the pricing and invoicing practice in Mr Hartigan's business. Specifically, we asked Mr Hartigan to explain how he marked up his quotations based on his material costs.

33. Mr Hartigan did not seem to understand the question on 'mark-up' at all. He explained to us the way he quoted for a job: he would work out how long the job would take him, and apply his hourly rate of £12 per hour in the earlier periods, rising to £15 per hour for the later periods. He would then add any material costs; that he would not be making a whole gate from raw materials, but would ask a customer to choose from catalogues for a pre-fabricated gate to be fitted; that the gate would be ordered by Mr Hartigan at cost (inclusive of the VAT) and re-charged to the customer at cost as part of the overall price for the job.

34. When asked what his profit margin was, Mr Hartigan referred to the price he put on his labour hours as his 'profit'. He also told the Tribunal that if he has to redo a piece of ironmongery because it is not up to standard, he will bear the loss of his time.

35. By profit margin, or 'mark-up', in terms of pricing for a product, the Tribunal meant the extra in pricing *after* direct costs (inclusive of labour). For example, if the direct costs of a job total £1,000, a mark-up at 40% would make the overall quotation £1,400. The mark-up or margin is considered necessary in most businesses to cover overheads such as motor expenses, equipment depreciation, premises costs (insurance,

heat and light, rate, etc), financial costs (bank charges and interest), professional fees (legal and accountancy), and incidental costs in running a business.

The fair estimate of VAT due as a percentage of turnover

36. During the lunch-time recess, the Tribunal reviewed the printout with the trading account for the period from 1 April 2014 to 31 March 2015. This would have been the account used for the SA return filing for 2014-15. Our observations are:

(1) The total income was stated at £89,635, and total expenses of £70,854, with 'net income' being £18,781.

(2) Total output VAT due on turnover of 89,635 (taken as inclusive of VAT at 20%) would be £14,939, as a fraction of 1/6 of the turnover;

(3) Of the list of expenses, we estimated only £1,212 would be expenses that were outwith the VAT regime, being motor insurance of £332, tools at £818, and the remaining balance being transport by train and underground.

(4) Total input VAT estimate was £11,606 on expenses of £69,641 (being the difference of £70,854 less £1,212, and taken as inclusive of VAT at 20%);

(5) VAT due calculated as £3,333, being the difference between output and input VAT (£14,939 minus £11,606).

(6) The estimated VAT liability, as a percentage of turnover, being £3,333 over £89,635, is at 3.7%; less than half of the 9.5% under the FRS.

(7) If the labour cost of £15,349 is removed from being an item of expenditure carrying any input VAT, then the overall expenditure would be reduced to £54,292, with a corresponding reduction in input VAT to £9,049, and an estimated net VAT liability of £5,890, being at 6.5% of the turnover.

37. After the lunch-time adjournment, Mr Hartigan produced a quotation dated 19 September 2018 and the corresponding invoice rendered on 22 December 2018 on completion of the job. (The invoice post-dated the cancellation of VAT registration, and therefore did not charge any output VAT.) The total invoiced amount was £13,480, and £6,545 had been paid as deposit on acceptance of the quotation. The deposit represented 50% of the quotation accepted, and the final invoiced amount included some incidental extras in addition to the remaining balance of 50% payable.

38. The job to which the quotation and invoice related was in Edinburgh, while Mr Hartigan lives in Glasgow, but there was no additional cost for transport. While the invoice matched closely to the quotation, and supplies were itemised in some detail, for example: (a) one pair of Stirling cast iron gates from catalogue at £3,120; (b) gate posts from catalogue at £2,010; (c) labour to prepare/fabricate plates and bracketry to accommodate motor boxes, install posts, gates, tracks and drainage at £1,380.

39. Mr Hartigan said he would have included around £2,800 for his labour on the job, £2,500 being the overall charge for fitting a pair of gates with an automatic control system, and £300 for sundry extras.

40. Mr Hartigan said the job took him two and a half weeks to complete. He would have worked Saturdays as well, with most of the work carried out in his workshop and

a couple of days for fitting on site. The job duration would therefore be 15 working days, giving an average daily labour rate of around £186, and around £18 per hour for a 10-hour day.

The appellant's case

41. By notice dated 20 March 2017, the appellant notified his appeal to the Tribunal, with his grounds of appeal being:

(1) Referring to Officer McGowan's letter of 30 June 2016, and of those paragraphs quoted under §22, Mr Hartigan put as his first ground of appeal that 'these statements are obviously laying blame with Mr Henderson', but HMRC then issued 'another penalty called "prompted"', which Mr Hartigan said:

> '… I genuinely did not and still do not understand how, when, where and what to send, what question etc need asking regarding VAT, tax and incidentally most other academic issues in life. Therefore, how could I have let HMRC know something that I genuinely did not know about? It would be impossible until I knew or had this information in my head, the "prompted" part does not make any sense. If for example I purposely tried to avoid VAT and then got a sniff of HMRC were going to give me a visit if I had then called them and told them "Oh I'm so sorry I must tell you something', then that would have been ok by them. Fraser McGowan of HMRC confirmed this to me and no penalty would be issued. I'm sure anyone would agree that would not be morally correct. When I first started self-employment I had on a few occasions had to ask tax questions on HMRC, and general enquiries advice lines I could not understand most of their terminology and when I question certain things I would be met with cold response without any further help … This was why I had to employ a specialist/professional ie Mr Henderson who was accounting for a company I knew of, yet still they penalise me.'

(2) The second ground of appeal concerns Mr Hartigan's business prospect if the VAT assessment and the penalty of nearly £30,000 were to be upheld:

> '… my small business does create a good amount of revenue but not high profit for myself just a living with no reliance on state benefits. … I would like to trade for the next 25 years can HMRC not do the best thing for all concerned and let me trade. My business without doubt would create much more revenue than £30,000 and bankruptcy. HMRC by their own admittance (sic) … have had my full cooperation …'

HMRC's case

42. HMRC consider that the appellant was required to be registered for VAT with effect from 1 December 2012 when his turnover, according to the Self-Assessment ('SA') returns submitted, breached the threshold for mandatory VAT registration. The assessment, as amended in the amount of £21,334 was issued within the time limits and made to best judgment.

43. The FTN penalty under Sch 41 is correctly assessed and calculated according to the legislation. HMRC consider that the actions leading to the failure were prompted

as the appellant did not contact HMRC to register for VAT following the submission of his SA returns, nor make any contact with HMRC to check if he was liable to be registered for VAT.

44. The Sch 41 penalty is correctly treated as being a domestic matter and therefore falls to be treated under Category 1 penalty meaning that the maximum penalty is 30% of the Potential Lost Revenue ('PLR').

45. As the failure to notify lasted for more than 12 months from the date of breach, the Sch 41 penalty falls to be treated as within the range of a minimum penalty of 20% and a maximum penalty of 30%.

46. As to reasonable excuse, the fact that the appellant had not charged his customers VAT is not a reasonable excuse for the failure to notify his requirement to be registered.

47. Reliance on his accountant is not a reasonable excuse either, since a prudent taxpayer wanting to comply with his obligations would have checked the position in relation to his requirement to be registered. The appellant has not provided any evidence to show that he took actions to check on the advice of his accountant.

48. HMRC consider that there were no special circumstances for any special reduction to the penalty, and there is no provision under Sch 41 FA 208 to allow suspension of a penalty levied for a Failure to Notify.

49. HMRC made oral submission that the application to account for VAT under the FRS was binding on HMRC and the taxpayer upon the approval of the application. The rate of 9.5% was used to raise the VAT assessment and was the rate applied for to take effect retrospectively from 1 December 2012.

Discussion

50. The disputed decisions concern: (a) the VAT assessment in the sum of £21,334; and (b) the FTN penalty under Sch 41 of £5,525.

The right of appeal against the VAT assessment

51. The right of appeal under s 83(1)(p)(i) VATA against an assessment under s 73 VATA is predicated on a VAT return having been submitted for a period. The corollary is, where no VAT return has been submitted, an assessment under s 73 VATA is not an appealable matter. In other words, a submitted return for a VAT period activates the right of appeal against any subsequent assessment for that period.

52. For the avoidance of doubt, the Tribunal considers that there was a VAT return submitted for Mr Hartigan, which gave him the right of appeal against the s 73 VATA assessment in the sum of £21,334. Notwithstanding the fact that the submitted return covered only one year out of the overall period of arrears (of three years and four months), it is taken that the return represented an 'under-declaration' of his overall VAT arrears, and that the under-declaration was made good by raising the VAT assessment to cover the shortfall of £21,334.

53. By defending the VAT assessment in this appeal, HMRC have acknowledged that Mr Hartigan does have a right of appeal against the quantum of the VAT assessment raised in relation to the earlier periods of arrears.

The quantum of the VAT assessment

54. In relation to the VAT assessment, the sum is determined by applying the flat rate of 9.5% to the gross turnover in the period from 1 December 2012 to 31 March 2015. As explained to Mr Hartigan at the hearing, the figure of the gross turnover for the period was as derived from the income declared for self-assessment purposes, while the FRS rate of 9.5% was used to calculate the VAT liability by Officer McGowan in the absence of any actual analysis of input VAT being available.

55. The Tribunal is, however, of the view that Mr Hartigan's VAT liability to best estimate should be around 40% lower than the assessed total of £21,334 because:

(1) Based on the figures in the trading account for the year from 1 April 2014 to 31 March 2015, it would appear that the actual input VAT for Mr Hartigan's business was higher than the 10.5% offset given under the FRS (see 36).

(2) The FRS sector average of 9.5% for net output VAT would have included a percentage of gross profit margin, or mark-up on costs. We conclude that Mr Hartigan's gross profit margin was, on the balance of probabilities, lower than the sector average.

(3) HMRC have accepted the submitted VAT return covering the year to 31 March 2016, which stated the net liability at £5,449.

(4) HMRC's estimate for the year to 31 March 2016 was £9,150, by using 9.5% and an annual gross turnover based on average monthly sales of £8,020.

(5) £5,449 per the VAT return submitted by Mr Murray for the identical period was 60% of the £9,150 estimated by Officer McGowan.

56. From Officer McGowan's evidence, we were given to understand that Mr Murray would have prepared the VAT return by applying the FRS rate at 9.5% to calculate the liability of £5,449, and was the reason why Officer McGowan advised Mr Murray to apply for FRS for Mr Hartigan.

57. We did not have the benefit of Mr Murray's evidence as to the basis he prepared the figures for the VAT return submitted for the year to March 2016. However, we do not find Officer McGowan's explanation satisfactory because:

(1) If HMRC have accepted £5,449 as the fair liability for that period, it is improbable that Mr Murray's calculation would have used 9.5%.

(2) On the basis that the actual gross turnover was not too far out from the annual estimate derived from HMRC's average monthly turnover at £8,020, then the variance must have been attributable to the input VAT allowable, being much higher than the 10.5% under the FRS rate.

(3) It is most probable that Mr Murray had used the actual expenses to calculate the overall input VAT claimable for the year, which then supports the Tribunal's view that the VAT assessment at £21,334 was 40% higher than if it had been based on actual input VAT borne.

(4) If we were wrong on this inference, and if Mr Murray really had used the 9.5% to calculate the net liability of £5,449, that would have equated to an overall gross annual turnover of £57,357 for the year to 31 March 2016.

(5) If the gross turnover for the year to March 2016 had fallen to only £57,357, then at some point during the year, the rolling 12-month turnover would have fallen below the VAT registration threshold. It follows that no VAT assessment should have been raised in relation to the period of time after the end of the breach.

58. Furthermore, if the annual turnover had fallen to £57,357, then Mr Hartigan should be eligible to apply for *exception* from VAT registration in accordance with the provision under para 1(3) of Schedule 1 to VATA 1994. The decision of *Geoffrey Lane v HMRC* [2016] UKFTT 007 (TC) explains the exception provision, and can be applicable to exempt a trader from VAT registration in relation to a period of trading that has breached the threshold, but is immediately followed by a period with the rolling 12-month turnover staying below the registration threshold.

59. A consistent interpretation of the evidence is that Mr Murray had prepared the VAT return for the year to 31 March 2016 based on the actual expenditure incurred. The Tribunal finds it to be highly probable that Mr Hartigan's VAT liability from 1 December 2012 to 31 March 2015, if fairly calculated by using figures for actual expenditure, would have resulted in a VAT assessment closer to £12,800 (at 60% of the £21,334).

60. It was unfortunate that the expenditure analysis, promised by Mr Henderson, was never undertaken. Mr Murray, on being engaged as the new accountant, did not seem to have revisited the past years. As said, we did not have a record of the note of telephone conversation with Officer McGowan that caused Mr Murray to advise Mr Hartigan to join the FRS.

61. While the Tribunal could have the power to vary the VAT assessment by reducing its quantum, which would have a knock-on effect on the penalty assessment, this power to vary the assessment is overridden by the fact that Mr Hartigan had elected to join the FRS at 9.5%, and that HMRC had in turn approved the application.

The limited scope of the Tribunal's jurisdiction

62. The relevant legislation affecting 'Flat-Rate Traders' is under Regulation 55 of the VAT Regulations 1995; and Reg 55Q(1)(e) provides that withdrawal takes effect from the time HMRC being so notified 'or from such earlier date as may be agreed'.

63. The case law authorities in respect of the curtailment of the Tribunal's jurisdiction in relation to a taxpayer's election to join the FRS include: *Revenue and Customs Comrs v Burke* [2009] EWHC 2587 (Ch)('*Burke*'); *David Leslie Skinner trading as DLS Packaging v HMRC* [2010] UKFTT 64 (TC); and *Yeabsley Financial Solution Limited v HMRC* [2012] UKFTT 358 (TC) ('*Yeabsley*').

64. In *Yeabsley*, the taxpayer elected to join the FRS, which had proved to be financially disadvantageous. He then sought to have his company's registration under

the FRS withdrawn retrospectively. The position of HMRC in respect of a retrospective withdrawal is at [9] of *Yeabsley*:

> '… it was HMRC's policy to allow backdating of withdrawal from the Scheme only *exceptionally*. No exceptional reasons had been shown in the present case. The taxpayer complained simply of the Scheme having proved financially disadvantageous. That was not enough. The purpose of the FRS was to simplify administration for the taxpayer, not to give him a financial benefit. To allow backdating of withdrawal would in the present case undermine the purpose of the Scheme. The decision to register was the responsibility of the taxpayer: Mr Yeabsley had been referred to Notice 733 detailing the nature of the FRS: presumably he made a considered decision to have his company join.' (emphasis added)

65. In *Burke*, the taxpayer applied to join the FRS retrospectively and the application was refused by HMRC. Mr Burke's appeal was dismissed by the Tribunal and the High Court. Concerning the scope of the courts' jurisdiction, Henderson J stated at [44] the following:

> 'I begin by reminding myself of the very limited scope of the appeal to the Tribunal. As they correctly recognised, they could allow Mr Burke's appeal only if they considered that the Commissioners could not reasonably have been satisfied that there were grounds for the decision to refuse Mr Burke's application for retrospective entry into the scheme. The duty of the Tribunal was to review by referent to that test the decision which was actually taken … It was not their function, and they had no jurisdiction, to substitute their own assessment of the relevant facts for HMRC's.'

66. In the present case, Mr Hartigan would need to withdraw from the FRS he had elected to join in order that the VAT assessment can be re-calculated using figures for actual expenditure. However, his wish to withdraw from the FRS *retrospectively* can only be allowed by HMRC's discretion. If it had been a situation in which the appellant wanted to withdraw from the FRS *prospectively*, then it would have been for the taxpayer to notify HMRC his wish to withdraw, and would not have been subject to HMRC's discretion (because the withdrawal was not retrospective).

67. As stated in *Yeabsley*, HMRC have the discretion to allow backdating a withdrawal under exceptional circumstances. The Tribunal is of the view that the circumstances leading to the failure of actual figures being provided to Officer McGowan to raise an assessment were exceptional: it was due to a failure by a professional to carry out his duty towards his client, especially given the clear wish expressed by Mr Hartigan during the enquiry that he would like the assessment to be based on actual expenditure, and not on the proposed FRS rate, and the unequivocal agreement to carry out the task by Mr Henderson.

68. It appears to the Tribunal that Mr Hartigan had been seriously let down by Mr Henderson, from whom he was quite properly entitled to expect professionalism and integrity in discharging what had been agreed to be undertaken on his behalf.

69. However, for reasons already stated, the decision to allow a withdrawal retrospectively rests firmly within the discretion of HMRC. This Tribunal has no jurisdiction to interfere with the parties' agreement to calculate the VAT liability by

reference to the FRS rate at 9.5%. It would be for Mr Hartigan to make his case to HMRC on exceptional grounds if he wished to backdate his withdrawal from the FRS.

70. What we note here as exceptional circumstances hopefully would be taken into account when HMRC consider whether to allow Mr Hartigan to backdate his withdrawal from the FRS (if he so applied). After all, HMRC have independently concluded that Mr Henderson's claim that he had given advice about VAT registration to Mr Hartigan was not to be trusted.

71. It is not for this Tribunal to ascertain the reasons which caused Mr Murray to advise Mr Hartigan to join the FRS, though it appears to us what exactly was said by Officer McGowan to Mr Murray, and what Mr Murray understood from that exchange could be material.

Conclusions regarding the VAT arrears

72. The Tribunal has much sympathy for the situation in which Mr Hartigan found himself. However, we can only apply the law to the facts of the case. There is no dispute that the income, as analysed on a rolling 12-month basis, meant that the VAT registration threshold was breached by the end of October 2012, making registration compulsory as from 1 December 2012. This is the material fact.

73. Secondly, the Tribunal lacks jurisdiction to vary the 9.5% FRS rate used to calculate the VAT liability. It follows therefore that we have no other option but to confirm the VAT assessment for the period from 1 December 2012 to 31 March 2015 in the sum of £21,334.

The appellant's remedy

74. There are two hurdles to Mr Hartigan's wish to base the VAT assessment on actual expenditure. The first hurdle concerns the FRS rate that stands as applicable, and the second hurdle concerns the re-calculation of the quantum of the assessment.

75. To overcome the first hurdle, Mr Hartigan would need to apply to HMRC to backdate his *withdrawal* from the FRS from 1 December 2012.

76. In the event that HMRC are not minded to exercise their discretion to allow Mr Hartigan to backdate his withdrawal, then Mr Hartigan's remedy would lie with lodging a new appeal to the First-tier Tribunal against HMRC's refusal decision. As set out in *Burke*, the Tribunal's jurisdiction over HMRC's exercise of discretion is only supervisory in nature.

77. If HMRC are open to: (a) allow Mr Hartigan to backdate his withdrawal from the FRS, and (b) apply a lower percentage in the calculation of the VAT assessment, either along the line as estimated by the Tribunal or differently arrived at by the parties, then any reduction in the VAT assessment would be a settlement between the parties without further involvement of this Tribunal or the Upper Tribunal.

78. If no settlement follows soon after this Decision, and if Mr Hartigan wishes to continue his appeal against the VAT assessment, then he must *also* lodge an appeal against this Decision ***within the time limit*** (see the paragraph 97 of the Decision), so

that his right of appeal against the quantum of the VAT assessment can be kept live. His appeal against this Decision can be stayed behind a new appeal against any refusal decision to allow him to backdate his withdrawal from the FRS. (A reduction in the quantum of the VAT assessment, on appeal of this Decision or by settlement, will in turn lead to a corresponding reduction in the quantum of the FTN penalty.)

79. While Mr Hartigan's income tax liabilities would be adjusted for the four years in question to reflect the fact that the taxable income from his self-employment is consequently reduced by the corresponding net VAT liability for each tax year, the income tax adjustments cannot be quantified until his appeal against the VAT assessment is fully settled. Similarly, any Class IV NIC repayable would be pending on the final disposition of the VAT assessment.

The penalty assessment

80. In relation to the penalty assessment, we note a slight arithmetic irregularity, which we set out as follows for HMRC's revision:

(1) The VAT assessment is for £21,334 for the period 1 December 2012 to 31 March 2015;

(2) A VAT return was submitted for the period 1 April 2015 to 31 March 2016 in the sum of £5,449, (per Officer McGowan's email dated 31 August 2016, p 44 of bundle);

(3) The total PLR is the sum of the two periods: £26,783;

(4) Penalty percentage is set at 30% for prompted disclosure;

(5) The overall percentage is reduced to 20% after giving the maximum deduction for the quality of disclosure;

(6) The penalty is assessed as PLR multiplied by the relevant percentage;

(7) PLR of £26,783 at 20% is £5,356.60.

81. The Tribunal therefore varies the amount of the penalty charged from £5,525 to £5,356.

The penalty percentage is at its lowest as provided by legislation

82. As emphasised to Mr Hartigan at the hearing, the penalty percentage is at the lowest for 'prompted' disclosure, and the meaning of 'prompted' is defined by the legislation under para 12(3) of Sch 41 as follows:

> '(a) [a disclosure] is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the relevant act or failure, and
>
> (b) otherwise, is "prompted".'

83. The statutory definition for 'unprompted' refers to a situation where the taxpayer notifies HMRC of his liability before any actions from HMRC. In the present case, it meant before Officer McGowan carried out the check in November 2015. The breach happenedThere was a window when Mr Hartigan had

84. The Tribunal has no power to reduce the penalty percentage any further, since the percentage is set by the legislation under para 13(3)(b) of Sch 41, which states that for prompted disclosure, case B, the reduction cannot go beyond 20%.

Whether reasonable excuse or special circumstances

85. Reliance on a third party is specifically excluded from being a reasonable excuse under para 20(2)(b) of Sch 41.

86. The law in relation to the liability to be VAT registered is not so complex that only a professional would have the knowledge to advise. Simon Brown J's comment in *Jo-Ann Neal v C & E Comrs* [1988] STC 131 at page 317 is directly relevant:

> 'In this case, however, there could be no doubt. The default was entirely the product of basic ignorance of value added tax law. That cannot be construed as a reasonable excuse. I add only this. Value added tax is surely now well enough established in our daily commerce that anyone, however inexperienced, ought to recognise the need to become acquainted with its basic requirements when embarking upon a career.'

87. We accept Mr Hartigan's evidence that his partner was asked once by Mr Henderson in 2015 whether he was VAT registered. To have asked the question and did nothing to follow up the matter for his client, in view of Mr Hartigan's SA returns having shown income exceeding the registration threshold for over two years (by the time the question was asked), suggests a form of professional negligence that is consistent with Mr Henderson's conduct over the production of figures for actual expenditure. Mr Hartigan paid accountancy fees of £777 for the year to 31 March 2015 in relation to his SA return filing. It was a significant expense for his scale of business, and represented a level of fee that should deliver professionalism.

88. If the failure to notify were in relation to a compliance obligation more complex in nature than observing the VAT registration threshold, the reliance on a professional adviser who had failed in his duty to advise might have given rise to a reasonable excuse. However, we consider that a prudent and reasonable taxpayer, on having been in business since 2005 as Mr Hartigan has, would have acquainted himself with the basic requirements concerning VAT registration.

89. The registration threshold in force at any time is information readily available on the internet or HMRC's official website, and the way to reckon a breach having taken place is not difficult to understand. While we do not doubt that Mr Hartigan had not avoided the registration deliberately, his lack of understanding of this basic requirement as a trader of 14 years, viewed objectively, cannot be regarded as giving rise to a reasonable excuse.

90. As a self-employed trader, Mr Hartigan is obligated to be aware of basic compliance requirements such as the filing of the annual SA return, or the VAT registration threshold. A claim that one lacks this basic awareness cannot be regarded as either a reasonable excuse for the penalty to be vacated, or as giving rise to special circumstances to allow the penalty to be reduced.

91. It is unfortunate that Mr Hartigan has not considered, or been advised, to make labour-only supplies, and to arrange for his customers to be invoiced directly by the suppliers for the materials, especially for the high-value items from catalogues. If he had been so advised, then his invoiced totals would not have pushed him over the VAT registration threshold in force for the relevant periods.

92. That said, the Tribunal can only consider matters as they stand. HMRC have considered and given no special reduction. It is a decision which cannot be viewed as being 'flawed' in the judicial review sense for the Tribunal to substitute it with a different decision.

93. The penalty assessment is therefore also confirmed, save for the adjustment in arithmetic to £5,356.

Disposition

94. The VAT assessment in the sum of £21,334 for the period from 1 December 2012 to 31 March 2015 is upheld.

95. The quantum of the penalty assessment under Schedule 41 FA 2008 is varied to £5,356.60 due to arithmetic error, and is not a variation in substance.

96. The appeal is accordingly dismissed. (The right of appeal against this Decision is set out as follows, and to be read in conjunction with paragraph 78 above.)

Right to apply for permission to appeal

97. 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.

DR HEIDI POON
TRIBUNAL JUDGE

RELEASE DATE: 24 APRIL 2019