



**TC05344**

**Appeal number: TC/2015/06609**

*Procedure- application for costs- rule 10(1)(b) Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009- whether HMRC acted unreasonably in defending or conducting the proceedings*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**ANTHONY BAYLISS**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL: JUDGE SARAH FALK**

**The application was determined on written submissions only**

**John Cassidy, Crowe Clark Whitehill LLP made submissions for the Appellant**

**Simon Bracegirdle, Officer of HM Revenue and Customs, made submissions for the Respondents**

## DECISION

5 1. This is an application for costs made by the appellant consequent upon the decision of the Tribunal released on 14 July 2016 ([2016] UKFTT 500 (TC)), which found that HMRC had not demonstrated that the appellant acted fraudulently or negligently in delivering an incorrect return, within s 95 Taxes Management Act 1970 (the "Decision"). The dispute related to a capital loss claim made in the appellant's 2006-07 return in respect of a scheme known as the "Pendulum Long" scheme. The  
10 scheme involved the purchase of a contract for difference ("CFD") largely funded by a loan and a disposal of most of the CFD fairly shortly afterwards.

15 2. The appeal proceeded under the standard category. The costs application was made under rule 10(1)(b) of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the FTT Rules"). The appellant argues that HMRC acted unreasonably in defending and/or conducting the proceedings.

### **The statutory provisions and relevant principles**

20 3. Section 29 of the Tribunals, Courts and Enforcement Act 2007 ("TCEA") provides that, subject to a Tribunal's rules, the "costs of and incidental to...proceedings in the First-tier Tribunal" shall be in the discretion of the Tribunal. Rule 10 of the FTT Rules provides, so far as relevant:

"(1) The Tribunal may only make an order in respect of costs (or, in Scotland, expenses)-

...

25 (b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings;"

It is clear that the effect of this is that it is only if a party has acted unreasonably that a discretion to award costs can arise.

30 4. The principles to apply in deciding whether a party acted unreasonably were helpfully summarised by Judge Raghavan in *Market & Opinion Research International Ltd v Revenue & Customs* [2013] UKFTT 475(TC) at [8]:

35 " (1) It was to be noted that the test in the Tribunal Rules that a party or representative had "acted unreasonably" required a lower threshold than the costs awarding power of the former Special Commissioners in Regulation 21 of the Special Commissioners (Jurisdiction and Procedure) Regulations 1994 which was confined to cases where a party had acted "wholly unreasonably". This was discussed in *Bulkliner Intermodal Ltd v HMRC* [2010] UKFTT 395(TC) at [9].

40 (2) It was suggested that acting unreasonably could take the form of a single piece of conduct. I was referred to [9] to [11] of the decision

in *Bulkliner* by way of support for this proposition. In particular at [10] the decision highlights the actions that the Tribunal can find to be unreasonable may be related to any part of the proceedings

“...whether they are part of any continuous or prolonged pattern or occur from time to time”.

(3) The point is I think mentioned in the context of contrasting the Tribunal’s rules in relation to acting unreasonably across the span of proceedings with the former Special Commissioners’ costs power which was in relation to behaviour which was “in connection with the hearing in question”. Having said that there would not appear to be any reason why the proposition that a single piece of conduct could amount to acting unreasonably. It will of course rather depend on what the conduct is.

(4) Actions for the purpose of “acting unreasonably” also include omissions (*Thomas Holdings Limited v HMRC* [2011] UKFTT 656 (TC) at [39].)

(5) A failure to undertake a rigorous review of assessments at the time of making the appeal to the tribunal can amount to unreasonable conduct (*Carvill v Frost* (Inspector of Taxes) [2005] STC (SCD) 208 and *Southwest Communications Group Ltd v HMRC* [2012] UKFTT 701 (TC)) at [45]).

(6) The test of whether a party has acted unreasonably does not preclude the possibility of there being a range of reasonable ways of acting rather than only one way of acting. (*Southwest Communications Group Ltd* at [39]).

(7) The focus should be on the standard of handling of the case rather than the quality of the original decision (*Thomas Maryam v HMRC* [2012] UKFTT 215(TC)).

(8) The fact that a contention has failed before the Tribunal does not mean it was unreasonable to raise it. In *Leslie Wallis v HMRC* [2013] UKFTT 081(TC) Judge Hellier stated at [27]:

“It seems to us that it cannot be that any wrong assertion by a party to an appeal is automatically unreasonable...before making a wrong assertion constitutes unreasonable conduct in an appeal that party must generally persist in it in the face of an unbeatable argument that he is wrong...”

(9) As cautioned by Judge Brannan in *Eastenders Cash and Carry Plc v HMRC* [2012] UKFTT 219 (TC) at [91] Rule 10(1)(b) should not become a “backdoor” method of costs shifting."

5. The summary was approved by the Upper Tribunal in that case, [2015] UKUT 0012 (TC) at [23]. The Upper Tribunal added:

“We would add only what this Tribunal (Judge Bishopp) said in *Catanã v Revenue and Customs Commissioners* [2012] STC 2138, at [14] concerning the phrase “bringing, defending or conducting the proceedings” in rule 10(1)(b):

5                   ‘It is, quite plainly, an inclusive phrase designed to capture cases in which an appellant has unreasonably brought an appeal which he should know could not succeed, a respondent has unreasonably resisted an obviously meritorious appeal, or either party has acted unreasonably in the course of the proceedings, for example by persistently failing to comply with the rules or directions to the prejudice of the other side.’”

6.       The Upper Tribunal went on to describe the test as follows at [49]:

10                   “‘It would not, we think, be helpful for us to attempt to provide a compendious test of reasonableness for this purpose. The application of an objective test of that nature is familiar to tribunals, particularly in the Tax Chamber. It involves a value judgment which will depend upon the particular facts and circumstances of each case. It requires the tribunal to consider what a reasonable person in the position of the party concerned would reasonably have done, or not done.’”

15       7.       I also note the approach taken by Judge Mosedale in *Roden and Roden v HMRC* [2013] UKFTT 523 (TC) at [15], which was to determine whether HMRC ought to have known whether its case had a reasonable prospect of success, and in doing so to consider the position of HMRC as a whole and not just the individual officer presenting the case.

20       8.       It is also clear from the Upper Tribunal judgment in *Market & Opinion Research* at [55] and [56] that the attributes of the party concerned should be taken into account:

25                   “55. There is one point we should make in this respect. In his skeleton argument, Mr Bremner submitted that if it were suggested that HMRC should be subjected to some higher standard than other litigants, then HMRC would submit that such a suggestion was wrong. There was, it was argued, no justification for subjecting different litigants to different standards.

30                   56. To the extent this argument is concerned with the application of a test of reasonableness, and not some different or higher standard, we agree. However, the test of reasonableness must be applied to the particular circumstances of a case, which will include the abilities and experience of the party in question. The reasonableness or otherwise of a party’s actions fall to be tested by reference to a reasonable person in the circumstances of the party in question. There is a single standard, but its application, and the result of applying the necessary value judgment, will depend on the circumstances.”

35                   9.       There are important limitations on the Tribunal’s powers under s 29 TCEA and rule 10(1)(b). Any power to award costs is limited to costs “of and incidental” to the proceedings, rather than costs in respect of anything else, such as a prior investigation by HMRC: *Catanã v HMRC* [2012] STC 2138 at [7]. In this case this issue does not arise since it is clear that the costs claimed relate to the period after the notice of appeal was lodged in November 2015.

40                   10.       In addition, the power to award costs under rule 10(1)(b) relates to unreasonable conduct in bringing, defending or conducting proceedings. As explained in *Catanã* at

[8] and [9], whilst conduct or actions prior to commencement of an appeal might inform actions taken during the proceedings, unreasonable behaviour prior to commencement of proceedings cannot be relied upon to claim costs (see also *Thomas Maryan t/a Hazeldene Catering* [2102] UKFTT 215 (TC) at [86] to [91]).

## 5 **The parties' submissions**

11. Mr Cassidy submitted that HMRC based their case on unjustifiable allegations of fraud, and that the 35% penalty sought was based on fraud, not negligence. He submitted that it was clear throughout the proceedings that there was never any real basis to accuse the appellant of fraudulent behaviour. The allegations were  
10 unreasonable as well as very serious, and it was not right for the appellant to bear the costs.

12. Mr Bracegirdle submitted that following receipt of the appeal papers in November 2015 he had undertaken a review of the enquiry papers and HMRC's own statutory review, and was in regular contact with HMRC's witness. The review  
15 included the fact that Mr Cassidy had made a direct approach to the director of HMRC's Special Investigations Section about HMRC's conduct of the enquiry, which had itself resulted in an internal review by a senior officer who was not part of the investigating team, and which had resulted in no change to HMRC's proposed action, the penalty decision being issued shortly thereafter. Mr Bracegirdle also considered  
20 letters from HMRC's witness to Mr Cassidy in September and December 2014 which HMRC submitted made it clear that the penalty decision was not taken lightly or without full consideration of the evidence. There had also been a statutory review of the decision which concluded in October 2015.

13. Mr Bracegirdle's own conclusion had been that there was a greater than 50%  
25 chance of defending the penalty sought. He submitted that the correct test to apply was to consider the conduct of the case before the Tribunal rather than the quality of the original decision- *Thomas Maryan t/a Hazeldene Catering* at [110]. The decision to defend the appeal was not taken lightly or recklessly. The parties were also engaged in discussions about a possible settlement as late as February 2016, which  
30 was not indicative of an unreasonable approach. HMRC's conduct was fair and reasonable throughout, including filing submissions on time and working with the appellant to agree extensions and amend and agree the document bundle.

## **Discussion**

14. I have considered both parties' submissions carefully. As can be seen from the  
35 Decision at [61], HMRC's submissions that the appellant was fraudulent generally appeared weak at the hearing. However, it is important to be mindful of being too ready to resort to the benefit of hindsight (*Invicta Foods Ltd v HMRC* [2014] UKFTT 456 (TC) at [13]), and of the point that it is not right to assume that any wrong assertion is unreasonable (if it were then rule 10(1)(b) would indeed be a back door  
40 method of costs shifting, which was clearly not intended).

15. While the focus must be on HMRC's behaviour in defending or conducting the proceedings, in doing so HMRC clearly paid close attention to the approach taken by HMRC's witness Lorraine Shanks during the enquiry, and Mr Bracegirdle's submissions referred to letters from her in September and December 2014. Regard  
5 was also had to the internal review completed shortly before the penalties were determined, in May 2015. We think it is relevant to consider this correspondence and the review, as well as the arguments put to the Tribunal at the hearing, since they clearly informed HMRC's approach to the proceedings.

16. Starting with the review, the approach from Mr Cassidy that prompted it related  
10 not to the fraud allegation as such but to Miss Shanks' allegedly late attempt to justify the use of the COP 9 procedure by reference to what were largely internal documents between Montpellier staff (Montpellier being the promoter of the scheme) and which did not relate to the appellant. Mr Cassidy's approach was made in February 2015 and HMRC clearly took it seriously by arranging for a senior officer, the Operational Lead  
15 of the Specialist Investigations Fraud & Bespoke Avoidance team, to conduct an internal review. The review culminated in a letter dated 8 May 2015 which said:

“...it is clear that the difference of opinion relates to whether or not Mr Bayliss has made returns to HMRC knowing them to contain inaccuracies at the time he was submitting them.”

17. In broad terms, this was the correct test: it indicates that HMRC was  
20 challenging whether the appellant had an honest belief in the correctness of the return when it was made (see [56] in the Decision). It does not in itself suggest anything unreasonable in HMRC's approach, and the fact that a senior independent officer had reviewed the papers prior to the issue of the penalty determination is clearly of some  
25 relevance to the question of whether HMRC's behaviour in relation to the proceedings was unreasonable.

18. Turning to the letters from Miss Shanks, the December 2014 letter was an  
extremely detailed one which ran to 18 pages and covered the background and both  
30 parties' arguments in detail. The September letter was shorter and concentrated mainly on the loan provided as part of the scheme (described at [8] in the Decision).

19. Putting the two letters together a number of points can be derived. First, Miss  
Shanks made it clear that HMRC had found it difficult to reach a decision as to  
whether the appellant acted fraudulently or was “seriously negligent”. The abatement  
of the penalties by 15% for seriousness was both the maximum for fraud and  
35 minimum for negligence and on either basis HMRC considered 15% to be appropriate. I note that this reflected HMRC's published practice at paragraph 6080 of the Enquiry Manual, which refers to 15% “for the most serious cases in which culpability falls short of fraud”, and says that where fraud can be established “an abatement not normally exceeding 15%... should be given”.

20. Secondly, Miss Shanks also referred to another paragraph of the Enquiry  
40 Manual which reproduced an extract from Halsbury's Laws on what constitutes fraud. This referred to the point that what was needed was proof of absence of actual and honest belief. As already discussed, this was the correct test to apply.

21. It is hard to see how the approach on either of these two points could be viewed as unreasonable. The position on penalty abatement can be argued with but is not obviously wrong, and the correct test for fraud was applied. The area that potentially raises more questions is the basis on which Miss Shanks went on to conclude that when the appellant submitted his tax return “he cannot have had any belief that the loss was true”. The main elements considered in reaching this conclusion appear to have been the following:

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(1) There was a significant focus on the loan arrangements, particularly in the September letter. Miss Shanks referred to the features of it being interest free, unsecured and repayable after 80 years as meaning that the appellant “must have been aware that it was not a commercial loan”, and indeed that the appellant “knew this was not a genuine loan arrangement” but claimed capital losses based on its existence. Miss Shanks relied on the fact that the appellant had run a successful property business to mean that he was experienced in dealing with loan finance. Arranging for 65% of the CFD to be repurchased for a relatively small sum soon after its acquisition meant that, if the CFD was successful, the appellant would have a significant shortfall because the loan would be repayable and fees would be due at that point. Miss Shanks also relied on the appellant’s failure to seek any assurance that the loan would not be treated as breached by selling part of the CFD (although she appeared to acknowledge that the loan terms permitted this). Miss Shanks concluded that the only reasonable explanation was that the appellant knew at the outset that the amount would never have to be repaid.

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(2) Miss Shanks also referred to the issue with the date of the loan discussed at [29] in the Decision: Miss Shanks clearly believed that the loan documents were not sent to the appellant for signature until 28 March 2007, by which date the loan draw down period had expired and the date to pay the margin call balance that the loan was intended to fund under the scheme had also passed. She also relied on the appellant’s denial of knowledge of the loan at the October 2013 meeting, noting Mr Cassidy’s correction of the note of meeting to refer to a denial of knowledge of the “nuts and bolts” (see [43] in the Decision). She concluded that claiming losses knowing they were based on “such a dubious loan” was fraudulent, and if he signed the loan document without reading it then that was at the very least “seriously negligent”.

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(3) Miss Shanks relied on the point that the only documentary evidence of advice that they had seen (the Montpelier document referred to at [17] in the Decision) did not match the scheme undertaken because the appellant knew its purpose was to create a tax loss, rather than to seek a FTSE exposure as the document suggested, and the short period for which the CFD was held before disposal was not consistent with a capital transaction as contemplated by that document. There was no evidence that the appellant had been advised that it was legal to disguise the arrangement as a capital transaction or to claim losses of £539,000 in circumstances where the real cost was £40,000. He had knowingly misrepresented the position to HMRC.

22. Reading the letters carefully, and taking account of the internal review, I have concluded that HMRC did not act unreasonably in defending the proceedings, or in conducting them in a way that continued to maintain a claim of fraudulent behaviour. The correct legal test was considered and, I think, applied by HMRC. Miss Shanks' letters make it clear, in particular, that HMRC was relying on the argument that the various issues over the loan, the short period for which the CFD was held and the apparent absence of any advice that fitted the transaction in question, meant that the appellant did not have an honest belief that his tax return was correct. Whilst issue can be taken with some of Miss Shanks' statements, and HMRC's allegation that the appellant did not have an honest belief in the accuracy of the return ultimately proved to be wrong, the fraud allegation was not an unreasonable one to maintain in the circumstances, bearing in mind also the alternative allegation of negligence.

23. It is the case that by the time we heard HMRC's submissions at the hearing its position on fraud appeared weak. Some of the submissions, in particular in relation to the relevance of lack of economic loss, were put in a way that did not fully bring out points that Miss Shanks had made in the correspondence. The decision not to assert sham also put HMRC in a difficult position with some of the submissions. But the crucial point is that by the stage that the submissions were made we had heard the appellant's oral evidence which led us to conclude that the appellant had relied on advice from his accountant and assurances from Montpelier, in particular at a meeting in May 2007, that the scheme had been fully implemented and that the loss was available (see [27] in the Decision). The evidence therefore did not support HMRC's argument. However, not managing to put the case as well as it might have been in other circumstances, and not successfully challenging the appellant's evidence, is not itself unreasonable behaviour if HMRC's stance of defending the fraud allegation, and continuing to do so up to the date of the hearing, was reasonable.

24. I appreciate that the appellant will doubtless consider that he made it clear during the enquiry that he had relied fully on his accountant and Montpelier and on that basis believed the tax return to be correct. However, in my view HMRC were not unreasonable in seeking to test that in the Tribunal given the lack of documentary evidence of any such advice, the concerns about the Montpelier document that purported to cover the tax position, and given the particular issues relating to the loan, including the apparent difficulty with the dates. It was also not unreasonable to think that, as a successful property investor, the appellant would have paid some attention to the loan and, for example, whether there was a risk that he could have to repay it before the 80 year maturity date, if he had had a real belief in the transaction having been implemented.

25. Overall, therefore, I have concluded that HMRC did not act unreasonably within rule 10(1)(b). The appellant's appeal against a 35% penalty was not obviously meritorious, and I do not consider that HMRC should have concluded that its defence of the appeal had no reasonable prospect of success.



**Decision**

26. Accordingly the appellant’s application for costs is refused on the basis that the Tribunal has no power to award costs in this case.

27. This document contains full findings of fact and reasons for the decision. Any  
5 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  
10 “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)”  
which accompanies and forms part of this decision notice.

**SARAH FALK  
TRIBUNAL JUDGE**

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**RELEASE DATE: 6 SEPTEMBER 2016**