[2014] UKFTT 425 (TC)

TC03554

Appeal number: LON/2008/00439

VAT – VAT incorrectly charged – adjustment to amount of consideration – whether Regulation 38 applies to allow refund of incorrect VAT – no – whether letter from HMRC to adviser is a valid notice of assessment – no – discretion of Tribunal to award costs where notice of appeal was to VAT and Duties Tribunal – Regulation 38, VAT Regulations 1995 - Section 73 VAT Act 1994 - Sch 3 Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009

FIRST-TIER TRIBUNAL
TAX CHAMBER

LEIGH DAY **Appellant**
(formerly LEIGH DAY & CO)
(a firm)

- and -

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

TRIBUNAL: JUDGE NICHOLAS ALEKSANDER
MRS CAROLINE de ALBUQUERQUE

Sitting in public at Bedford Square on 1 July 2013

Phillippa Whipple QC instructed by the Appellant

Michael Jones, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal against the decision of HMRC contained in a letter dated 31 January 2008 upholding on review a decision to amend the Appellant's ("Leigh Day") VAT return for the period 07/07 by £418,313.12, resulting in additional VAT of £193,829.64 being payable.

2. Phillippa Whipple QC represented Leigh Day and Michael Jones represented HMRC. Witness statements of Richard Meeran, a partner in Leigh Day, and Adrian Cole, Finance Manager of Leigh Day was produced in evidence, and Mr Cole gave oral evidence. In addition a bundle of documents was before us.

Preliminary matters

3. With the consent of HMRC, we allowed an application by Leigh Day to amend their Notice of Appeal to include within the scope of this Appeal the issue of whether HMRC's letter of 19 October 2007 was a notification of an assessment for the purposes of section 73(1), VAT Act 1994;

4. However, we refused an application by HMRC to amend their Statement of Case to include a new paragraph relating to the Regulation 38, VAT Regulations 1995 and the requirement the Leigh Day must have carried out the adjustment in their business accounts within three years of the reduction in the consideration (we allowed other amendments with the consent of Leigh Day, and HMRC withdrew an amendment relating to unjust enrichment). However we noted that in relation to Regulation 38, the onus of proof is on Leigh Day to demonstrate that all the requirements of that regulation were met.

5. At the conclusion of the hearing we gave directions to allow Leigh Day to submit evidence to demonstrate that they had complied with all of the requirements of Regulation 38, and for additional submissions to be made in writing by the parties.

The Law

Operation of the legal aid scheme

6. The Community Legal Service (Costs) Regulations 2000 applied to the work done by Leigh Day under certificates of public funding. Regulations 18, 20 and 22 are in point

18.– Money recovered to be paid to solicitor

(1) Subject to the following paragraphs of this regulation, and to regulation 17(2), all money payable to or recovered by a client in connection with a dispute by way of damages, costs or otherwise, whether or not proceedings were begun, and whether under an order of the court or an agreement or otherwise, shall be paid to the client's solicitor, and only the client's solicitor shall be capable of giving a good discharge for that money.

[…]

20.– Solicitor to pay money recovered to Commission

(1) The client's solicitor shall forthwith:

(a) inform the Director of any money or other property recovered or preserved, and send him a copy of the order or agreement by virtue of which the property was recovered or preserved;

(b) subject to the following paragraphs of this regulation, pay to the Commission all money or other property received by him under regulation 18.

(2) Paragraph (1)(b) shall not apply to any money or other property to which the statutory charge does not apply, by virtue of the Financial Regulations.

(3) Where he considers it essential to protect the client's interests or welfare, the Director shall pay, or direct the client's solicitor to pay, to the client any money received by way of any interim payment made in accordance with an order made under CPR rule 25.6, or in accordance with an agreement having the same effect as such an order.

(4) The Director may direct the client's solicitor to:

(a) pay to the Commission under paragraph (1)(b) only such sums as, in the Director's opinion, should be retained by the Commission in order to safeguard its interests; and

(b) pay any other money to the client.

(5) Where the solicitor pays money to the Commission in accordance with this regulation, he shall identify what sums relate respectively to:

(a) costs;

(b) damages;

(c) interest on costs; and

(d) interest on damages.

[...]

22.– Retention and payment out of money by the Commission

(1) The Commission shall deal with the money paid to it under this Part in accordance with this regulation.

(2) The Commission shall retain:

(a) an amount equal to the costs incurred in taking steps under regulation 23;

(b) an amount equal to that part of the funded sum already paid to the supplier in respect of the relevant work; and

(c) where costs are paid to the Commission together with interest, an amount equal to that interest, less the amount of any interest payable to the supplier under paragraph (3)(b)(ii).

(3) The Commission shall pay to the supplier:

(a) any outstanding amount of the funded sum payable to him in respect of the relevant work;

(b) where costs are ordered or agreed to be paid to the client, and those costs are received by the Commission, and those costs (less any amount retained under paragraph (2)(a) or payable under paragraph (5)) exceed the funded sum:

(i) an amount equal to the amount of the excess; and

(ii) where those costs are paid to the Commission together with interest, an amount equal to the interest attributable to the excess referred to in sub-paragraph (i).

[…]

(8) The Commission shall pay all the money paid to it under this Part, which is not paid or retained under paragraphs (2) to (5), to the client."

7. The analysis of these provisions is that, in cases where a legally aided claim succeeds and funds are received from the opposing party, the solicitor looks to the opposing party to pay his costs. The solicitor obtains payment from the other side in the amount that is assessed or agreed, and any interim payments previously made by the LSC to the solicitor are repaid back to the LSC.

Liability for VAT on legal services supplied to non-UK resident individuals

8. Paragraph 16 of the VAT (Place of Supply of Services) Order 1992 (SI 1992/3121) provided as follows:

16. Where a supply consists of any services of a description specified in any of paragraphs 1 to 8 of Schedule 5 to the Act, and the recipient of that supply—

(*a*) belongs in a country, other than the Isle of Man, which is not a member State; or

(*b*) is a person who belongs in a member State, but in a country other than that in which the supplier belongs, and who—

(i) receives the supply for the purpose of a business carried on by him; and

(ii) is not treated as having himself supplied the services by virtue of section 8 of the Act,

it shall be treated as made where the recipient belongs

9. Paragraph 3, Schedule 5, VAT Act 1994 provided as follows:

Services of consultants, engineers, consultancy bureaux, lawyers, accountants and other similar services; data processing and provision of information (but excluding from this head any services relating to land).

10. The effect of these provisions is that the provision of legal services by solicitors (other than legal services relating to land in the UK) are outside the scope of VAT if provided to an individual who belongs in a country outside the EU. It is not in dispute that the legal services supplied by Leigh Day to South African residents were outside the scope of VAT.

Repayment of overstated or overpaid VAT

11. Section 80, VAT Act 1994 provided as follows:

(1) Where a person—

(*a*) has accounted to the Commissioners for VAT for a prescribed accounting period (whenever ended), and

(*b*) in doing so, has brought into account as output tax an amount that was not output tax due,

the Commissioners shall be liable to credit the person with that amount.

[…]

(4) The Commissioners shall not be liable on a claim under this section—

(*a)* to credit an amount to a person under subsection (1) or (1A) above, or

(*b*) to repay an amount to a person under subsection (1B) above,

if the claim is made more than 3 years after the relevant date.

[…]

12. The following were the relevant provisions of the VAT Regulations 1995 (SI 1995/2518):

32 The VAT account

(1) Every taxable person shall keep and maintain, in accordance with this regulation, an account to be known as the VAT account.

(2) The VAT account shall be divided into separate parts relating to the prescribed accounting periods of the taxable person and each such part shall be further divided into 2 portions to be known as "the VAT payable portion" and "the VAT allowable portion".

(3) The VAT payable portion for each prescribed accounting period shall comprise—

(a) a total of the output tax due from the taxable person for that period,

(b) a total of the output tax due on acquisitions from other member States by the taxable person for that period,

(ba) a total of the tax which the taxable person is required to account for and pay on behalf of the supplier,

(c) every correction or adjustment to the VAT payable portion which is required or allowed by regulation 34, 35, 38, or 38A, and

(d) every adjustment to the amount of VAT payable by the taxable person for that period which is required, or allowed, by or under any Regulations made under the Act.

(4) The VAT allowable portion for each prescribed period shall comprise—

(a) a total of the input tax allowable to the taxable person for that period by virtue of section 26 of the Act,

(b) a total of the input tax allowable in respect of acquisitions from other member States by the taxable person for that period by virtue of section 26 of the Act,

(c) every correction or adjustment to the VAT allowable portion which is required or allowed by regulation 34, 35 or 38, and

(d) every adjustment to the amount of input tax allowable to the taxable person for that period which is required, or allowed, by or under any Regulations made under the Act.

[…]

34. Correction of errors

(1) Subject to paragraph (1A) below this regulation applies where a taxable person has made a return, or returns, to the Controller which overstated or understated his liability to VAT or his entitlement to a payment under section 25(3) of the Act.

(1A) Subject to paragraph (1B) below, any overstatement or understatement in a return where—

(a) a period of 3 years has elapsed since the end of the prescribed accounting period for which the return was made; and

(b) the taxable person has not (in relation to that overstatement or understatement) corrected his VAT account in accordance with this

regulation before the end of the prescribed accounting period during which that period of 3 years has elapsed,

shall be disregarded for the purposes of this regulation; and in paragraphs (2) to (6) of this regulation "overstatement", "understatement" and related expressions shall be construed accordingly.

(1B) Paragraph (1A) above does not apply where—

(a) the overstatement or understatement is discovered in a prescribed accounting period which begins before 1st May 1997; and

(b) the return for that prescribed accounting period has not been made, and was not required to have been made, before that date.

(2) In this regulation—

(a) "under-declarations of liability" means the aggregate of—

(i) the amount (if any) by which credit for input tax was overstated in any return, and

(ii) the amount (if any) by which output tax was understated in any return;

(b) "over-declarations of liability" means the aggregate of—

(i) the amount (if any) by which credit for input tax was understated in any return, and

(ii) the amount (if any) by which output tax was overstated in any return.

(3) Where, in relation to all such overstatements or understatements discovered by the taxable person during a prescribed accounting period, the difference between—

(a) under-declarations of liability, and

(b) over-declarations of liability,

does not exceed £2,000, the taxable person may correct his VAT account in accordance with this regulation.

(4) In the VAT payable portion—

(a) where the amount of any overstatements of output tax is greater than the amount of any understatements of output tax a negative entry shall be made for the amount of the excess; or

(b) where the amount of any understatements of output tax is greater than the amount of any overstatements of output tax a positive entry shall be made for the amount of the excess.

(5) In the VAT allowable portion—

(a) where the amount of any overstatements of credit for input tax is greater than the amount of any understatements of credit for input tax a negative entry shall be made for the amount of the excess; or

(b) where the amount of any understatements of credit for input tax is greater than the amount of any overstatements of credit for input tax a positive entry shall be made for the amount of the excess.

(6) Every entry required by this regulation shall—

(a) be made in that part of the VAT account which relates to the prescribed accounting period in which the overstatements or understatements in any earlier returns were discovered,

(b) make reference to the returns to which it applies, and

(c) make reference to any documentation relating to the overstatements or understatements.

(7) Where the conditions referred to in paragraph (3) above do not apply, the VAT account may not be corrected by virtue of this regulation.

35. Where a taxable person has made an error—

(a) in accounting for VAT, or

(b) in any return made by him,

then, unless he corrects that error in accordance with regulation 34, he shall correct it in such manner and within such time as the Commissioners may require.

[…]

38. Adjustments in the course of business

(1) Subject to paragraph (1A) below, this regulation applies where—

(a) there is an increase in consideration for a supply, or

(b) there is a decrease in consideration for a supply,

which includes an amount of VAT and the increase or decrease occurs after the end of the prescribed accounting period in which the original supply took place.

(1A) Subject to paragraph (1B) below, this regulation does not apply to any increase or decrease in consideration which occurs more than 3 years after the end of the prescribed accounting period in which the original supply took place.

(1B) Paragraph (1A) above does not apply where—

(a) the increase or decrease takes place during a prescribed accounting period beginning before 1st May 1997; and

(b) the return for the prescribed accounting period in which effect is given to the increase or decrease in the business records of the taxable

person has not been made, and was not required to have been made, before that date.

(2) Where this regulation applies, the taxable person shall adjust his VAT account in accordance with the provisions of this regulation.

(3) The maker of the supply shall—

(a) in the case of an increase in consideration, make a positive entry; or

(b) in the case of a decrease in consideration, make a negative entry,

for the relevant amount of VAT in the VAT payable portion of his VAT account.

(4) The recipient of the supply, if he is a taxable person, shall—

(a) in the case of an increase in consideration, make a positive entry; or

(b) in the case of a decrease in consideration, make a negative entry,

for the relevant amount of VAT in the VAT allowable portion of his VAT account.

(5) Every entry required by this regulation shall, except where paragraph (6) below applies, be made in that part of the VAT account which relates to the prescribed accounting period in which the increase or decrease is given effect in the business accounts of the taxable person.

(6) Any entry required by this regulation to be made in the VAT account of an insolvent person shall be made in that part of the VAT account which relates to the prescribed accounting period in which the supply was made or received.

(7) None of the circumstances to which this regulation applies is to be regarded as giving rise to any application of regulations 34 and 35.

13. Paragraphs (1A) and (1B) of Regulation 38 were inserted by the VAT (Amendment) Regulations 1997 (SI 1997/1086) with effect from 1 May 1997. In the *General Motors Acceptance Corporation (UK) plc* appeal (Decision 17990), the VAT and Duties Tribunal held that the three year limitation imposed by paragraph (1A) was incompatible with the requirements of EU law and should be disapplied. This decision was upheld by the High Court on appeal ([2004] STC 577). Paragraphs (1A) and (1B) were eventually removed from the VAT Regulations by the VAT (Amendment) Regulations 2009 (SI 2009/586) with effect from 1 April 2009.

Assessments

14. Section 73, VAT Act 1994 provides as follows:

(1) Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents

and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.

(2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—

(a) as being a repayment or refund of VAT, or

(b) as being due to him as a VAT credit,

an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly.

[…]

(6) An assessment under subsection (1), (2) or (3) above of an amount of VAT due for any prescribed accounting period must be made within the time limits provided for in section 77 and shall not be made after the later of the following—

(a) 2 years after the end of the prescribed 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,

but (subject to that section) where further such evidence comes to the Commissioners' knowledge after the making of an assessment under subsection (1), (2) or (3) above, another assessment may be made under that subsection, in addition to any earlier assessment.

[…]

15. The relevant provisions of Section 77, VAT Act 1994 provide as follows:

(1) Subject to the following provisions of this section, an assessment under section 73, 75 or 76, shall not be made—

(a) more than 3 years after the end of the prescribed accounting period or importation or acquisition concerned, or

[…]

16. Section 98, VAT Act 1994 provides as follows:

Any notice, notification, requirement or demand to be served on, given to or made of any person for the purposes of this Act may be served, given or made by sending it by post in a letter addressed to that person or his VAT representative at the last or usual residence or place of business of that person or representative.

Background facts

17. The background facts in this appeal are not in dispute and we find them to be as follows.

18. Leigh Day is a firm of solicitors. Leigh Day undertakes work under the legal aid scheme, and this appeal relates to VAT on payments made by and to the Legal Services Commission under the legal aid scheme.

19. Leigh Day seeks repayment of £224,483.48 of VAT plus interest. They assert that they are entitled to the repayment under Regulation 38 of the VAT (General) Regulations 1995 ("Regulation 38").

Cape litigation

20. In summary, Leigh Day were instructed to act for individuals with grievances against Cape plc, an English company. Most of the individuals had worked for Cape, or had lived close to Cape's mines and factories in South Africa and elsewhere and had been exposed to asbestos leading to lung disease and other problems. In some cases the individuals were dependents of former Cape workers.

21. Leigh Day was initially instructed by a small number of South African individuals for whom legal aid certificates were obtained. Proceedings were commenced in the High Court on behalf of five South African claimants in March 1997. In June 1997 legal aid was obtained and proceedings were commenced on behalf of a sixth claimant, a UK resident who was related to one of the claimants in the original proceedings.

22. In October 1997 Leigh Day was instructed on behalf of four Italian claimants who had been employed in Cape's Italian factory. These proceedings were never consolidated with the other proceedings, and were ultimately settled separately. Any VAT arising in respect of these Italian clients is not subject to this appeal.

23. Cape sought to stay the litigation on the basis of *forum non conveniens*. In December 1998 this issue was resolved in favour of the claimants.

24. Fees in respect of the *forum non conveniens* issue were split between the six legal aid certificates.

25. In January 1999 further proceedings were commended against Cape on behalf of 1538 South African claimants. At this point each

individual claimant had a separate legal aid certificate, but one of the individual claimants – Hendrik Afrika – was nominated as the generic certificate.

26. As the litigation proceeded, more South African individuals were added to the claim. By July 2000 there were more than 3000 claimants, of whom 2400 to 2500 were represented by Leigh Day and the rest by another firm (John Pickering & Partners). By December 2001 there were 7377 claimants, of whom approximately two thirds were represented by Leigh Day and one third by John Pickering & Partners.

27. The LSC made interim payments to Leigh Day during the course of the dispute on an approximately six monthly basis from the commencement of the litigation until mid 2001, when the LSC for various reasons (not relevant to this appeal) decided to suspend funding the litigation. From that point until the conclusion of the litigation in June 2003, no further funding was received from the LSC.

28. Leigh Day reached a settlement of the dispute with Cape on 21 December 2001, but the settlement could not be executed because Cape was unable to obtain shareholder and bank approval to its terms. A second settlement was reached on 13 March 2003, which included provisions as to Leigh Day's costs. The agreement provided that GASA (Cape's insurers) would contribute £2.75 million towards the claimants' legal costs. It was also agreed that 75% of this amount would be paid to Leigh Day, and 25% to John Pickering & Partners.

Costs of the Cape litigation

29. The consequence of settlement of the Cape litigation on terms as to damages and costs, applying the Community Legal Service (Costs) Regulations 2000, was that:

(1) all funds received from Cape or its insurers were required to be paid to Leigh Day;

(2) Leigh Day had a statutory obligation to pay all of those receipts to the LSC;

(3) from those receipts the LSC was entitled to recoup its outlay in full; but

(4) the LSC had power to agree that some separate payment would be made to Leigh Day in respect of Leigh Day's costs, following recoupment of the interim payments.

30. The payment made by the Cape's insurers in respect of the claimants' costs was insufficient to meet Leigh Day's costs. The interim payments were nonetheless repaid to the LSC. But by a separate process of negotiation, an agreement was reached with the

LSC to contribute an amount to Leigh Day in order to meet the significant outstanding shortfall in costs.

31. Leigh Day holds a legal aid franchise, and under the franchise rules, the LSC automatically pays £250 plus VAT to Leigh Day whenever a legal aid certificate is granted to a client. In addition the LSC made interim payments to Leigh Day in respect of the litigation. Initially these payments were paid across the five (subsequently six) legal aid certificates granted to the original clients. However following the nomination of Mr Afrika as the generic certificate, interim payments were made solely in respect of Mr Afrika's generic certificate.

32. In the course of the Cape litigation, the LSC made interim payments totaling £2,808,967.56. On 16 September 2005 £293.75 was refunded by Leigh Day to the LSC. The net amount of interim payments made by the LSC was therefore £2,808,673.81.

33. The interim payments were paid into Leigh Day's client bank account and transferred to its office bank account at or shortly after receipt. Leigh Day did not issue VAT invoices in respect of the interim payments.

34. The interim payments included an amount on account of VAT at the then rate of 17.5%, and Leigh Day paid to HMRC £418,313.12 in respect of VAT. In fact, VAT was not chargeable on the interim payments, because Mr Afrika (the individual with the generic legal aid certificate) was resident and belonged outside the European Union. The services supplied to him were therefore outside the scope of VAT by virtue of paragraph 16, VAT (Place of Supply of Services) Order 1992. Of the 7377 claimants represented by Leigh Day and John Pickering & Partners, all but one were residents of, and belonged in, South Africa. On any basis, any VAT arising in respect of the supply of legal services by Leigh Day in relation to the Cape litigation must be *de minimis*.

35. Although agreement was reached with the LSC, Cape and the other parties as to settlement of costs in 2003, it took until November 2006 for Leigh Day to reach agreement with the LSC as to the amount that they would contribute. Leigh Day never issued a formal bill for assessment. Instead they submitted samples of their files to the LSC for review. In the end the LSC agree that they would contribute £1,875,000 towards Leigh Day's costs (in addition to the amount paid by Cape's insurers).

36. It is perhaps relevant to note that the LSC was exercising powers under regulation 22(3), which enables it to make payment to a client's

solicitor in relation to any part of the funded sum which is outstanding after the LSC has recouped interim payments already made in full.

37. The contribution from Cape's insurers had been paid into Leigh Day's client bank account. The final payment of £1,875,000 from the LSC was paid into Leigh Day's client bank account on 22 November 2006. Expenses and disbursements were then paid out of the client bank account balance. Of the balance left in the client bank account after these payments, £2,293,016.76 was paid to the LSC to meet the obligation to repay the interim payments previously made by the LSC. Further amounts were then repaid to the LSC either from Leigh Day's client bank account or office bank account between 2007 and 2012, until all the interim payments were recouped.

38. No credit note was issued by Leigh Day in respect of the recoupment of the interim payments, and no VAT invoice was issued in respect of the payment by the LSC to Leigh Day of the agreed contribution.

Reclaiming the VAT incorrectly charged

39. On 20 October 2006, an officer of HMRC visited Leigh Day to undertake a routine VAT inspection. The VAT treatment of the Cape fees was discussed. On 30 April 2007 Leigh Day wrote to HMRC seeking guidance as to how to deal with the VAT adjustments arising from the settlement of the Cape litigation, and suggesting that it should issue a credit note for the interim payments previously invoiced to the LSC, and a new invoice issued for the amount actually received from the LSC. HMRC replied by letter dated 26 June 2007 that Leigh Day should issue a credit note to the LSC, and should then "*make the declaration on your next return to adjust the Input Tax*".

40. Leigh Day credited the LSC with the amount of input tax in question (£418,313.12) by way of an accounting offset in its accounts, creating a credit to the LSC to be used against subsequent claims for payment by Leigh Day. £418,313.12 was then entered as an adjustment to its input tax on its next VAT return for 07/07. The consequence was that the return showed a net repayment due to Leigh Day of £224,483.48.

41. HMRC refused to make repayment of the amount claimed. Correspondence then ensued between Leigh Day, Baker Tilly (Leigh Day's VAT advisors) and HMRC.

42. By a letter dated 18 September 2007, HMRC informed Baker Tilly that they considered that Leigh Day was out of time to make claims under Regulation 34, and that Regulation 38 is not applicable. HMRC asked Baker Tilly to supply details of the precise amount of output tax relating to the LSC payments so that they could issue the appropriate letter adjusting the VAT repayment and confirming the right to appeal. A copy of this letter was sent by HMRC to Leigh Day.

43. Ms McLaren of Baker Tilly replied on 3 October 2007 disputing HMRC's analysis and requesting a review. Ms McLaren confirmed that the output tax in issue is £418.313.12.

44. By a letter to Ms McLaren at Baker Tilley dated 19 October 2007, HMRC directed that the figures on the return be adjusted to reverse the input tax reclaimed. The letter reads as follows:

Dear Ms. McLaren:

Leigh Day & Co

VAT Registration No: 429.7007.45

Thank you for your letter dated 3rd October 2007.

Your letter will now be passed to our reconsideration and appeals team, so they may carry out the reconsideration of my ruling given on this matter in my letter dated 18th September 2007. Pending the completion of their review of my ruling on this matter, the ruling I have given in my letter will stand. Therefore, the VAT repayment claimed on Leigh Day & Co's 07/07 return will be amended so that the VAT amount of £418,313.12 is excluded from their 07/07 VAT repayment claim.

The Commissioners of HM Revenue & Customs deem it appropriate at this time to amend the figures declared on your 07/07 return to:

Box: - 1 & 3: - No Amendments to: - £249,249.64

Box: - 4: - Reduced to: £55,420 – (£473,733.12 - £418,313.12)

Box: - 5: - Reduced to: £193,829.64 – Payment to HM Revenue & Customs

The net amount considered on present evidence to be properly payable to HM Revenue & Customs in respect of this period (subject to outstanding debits or credits in respect of other period(s) is thus £193,829.64 and you should render this amount to HM Revenue & Customs. When you make the payment, please attach the copy of this letter marked "Duplicate" to your payment.

As you have already notified HM Revenue & Customs of your disagreement with my decision in your letter dated 3rd October 2007, your

request for a reconsideration of my ruling on this matter will be carried out by HM Revenue & Customs Reconsiderations & Appeals Team.

Also, you have the right of appeal to an independent Value Added Tax Tribunal. The procedure and the time limit for making an appeal are set out in section 28 of Notice 700: The VAT Guide, obtainable from HM Revenue & Customs National Advice Service (tel. 0845 010 9000) and in the explanatory leaflet: Value Added Tax – Appeals and Applications to the Tribunals available from the Tribunals Service and by download form their internet site.

Yours Sincerely

John Newey

Higher Officer

HM Revenue & Customs

45. HMRC assert that this letter is an assessment for VAT purposes, Leigh Day assert that it is not.

Accounting entries

46. The accounting entries in Leigh Day's ledgers in respect of the payments were as follows.

47. As regards the initial fixed payment and interim payments, the amounts received from the LSC were initially paid into Leigh Day's client bank account, and then transferred to the office bank account. On the funds being transferred to the office bank account, the corresponding bank account ledger would have been debited and the corresponding double entry would be that the receipts were accounted for as turnover and credited to profit and loss account.

48. The treatment of the final contribution by the LSC is less clear. Appropriate debits and credits were made in the relevant client bank account or office bank account ledgers to reflect the cash movements in the corresponding bank accounts. Mr Cole's unchallenged evidence was that

"the receipt of the £1.875m was only entered in the client account and did not require to be entered in the office account at that time because we had already recorded income in excess of this amount in the office account and in the P&L for earlier years. What really needed to be entered in the office account and taken to the P&L was the write off of the extra amounts refunded to the LSC above and beyond the £1.875m credited to [Leigh Day] from the LSC. This amount was not finalized until some years after 2006 when the various adjustments to counsels' fees and to the LSC had been worked out."

49. When Leigh Day filed its 07/07 VAT return, it recorded a credit in its office bank account ledger of £2,390,360.69 plus VAT of £418,313.12 (totalling £2,808,673.81) and a debit in the same ledger of £2,390,360.69 (without VAT). Following these entries, there was a credit of £319,366.38 showing in the office bank account ledger against the Cape matter, and this amount was transferred from the office bank account to the client bank account on 30 July 2007 (with corresponding entries reflecting this transfer in the client bank account and office bank account ledgers).

50. In the end £197,265.78 was written off to Leigh Day's profit and loss account on 18 February 2013. We had no evidence of, and it is unclear how, this difference between the interim payments actually received and the final amount agreed as payable by the LSC was treated in Leigh Day's accounting records between November 2006 (when the amount that would be paid by the LSC was finally agreed) and February 2013 when it was finally written off.

Appeal

51. HMRC's decision that the VAT in issue was not refundable was confirmed on review by HMRC by a letter dated 31 January 2008.

52. Leigh Day appealed to the (then) VAT and Duties Tribunal on 21 February 2008.

53. The appeal was transferred to the Tax Chamber of the First-tier Tribunal on 1 April 2009 by virtue of the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 (SI 2009/56).

54. It is Leigh Day's contention that HMRC took no steps to pursue the £193,829.64, and are now out of time to assess. Leigh Day therefore acknowledge that they have already had the benefit of this amount, and by the appeal seek to recover the balance of VAT overpaid of £224,483.48. HMRC contend that their letter of 19 October 2007 amounts to notice of an assessment for VAT purposes, and that they are therefore entitled (subject to the outcome of this appeal) to pursue recovery of the £193,829.64.

Issues in the appeal

55. Leigh Day had accounted for VAT on the interim payments from the LSC. In fact, the services were outside the scope of VAT and should not have been subject to VAT at all (although they would still have carried a right to deduction of related input tax) (other than in respect of a *de minimis* amount relating to the one UK claimant). An

amount of £418,313.12 had been paid to HMRC as "VAT" which was not in fact due ("the liability error"). The consideration given to Leigh Day for the supply of its legal services had been reduced. That meant that, regardless of the liability error, the consideration for the supplies had subsequently changed, with the consequence that Leigh Day had accounted for VAT on the wrong amount; and the VAT required adjustment so that it was accounted for correctly, on the correct amount ("the adjustment issue").

56. Leigh Day acknowledge that if the only issue in this appeal had been the liability error, then by July 2007 they would have been out of time to correct that error (when they filed the VAT return asserting their claim). Section 80(4) VAT Act 1994 imposed a three (now four) year cap, from the end of the prescribed accounting period in which the error was made. Any claim under that section (or under regulations 34 or 35 of the VAT Regulations 1995) would be time-barred. However, Leigh Day assert that as there has been a change in the consideration given for the supply of its legal services, the required adjustment to the VAT payable could take account not only of the change in the consideration, but also the fact that VAT had previously been wrongly charged. The adjustment issue is governed by Regulation 38, and is not subject to the cap imposed by Section 80(4) VAT Act.

57. The other issue is whether HMRC's letter of 19 October 2007 is a valid notification of an assessment for VAT purposes ("the assessment issue"). If we were to dismiss the appeal, HMRC recognise that they are now out of time to issue a notification of an assessment to pursue recovery of £193,829.64.

Submissions of the parties

58. Leigh Day submit that as a result of the settlement terms of the Cape litigation, the consideration for the supplies of legal services made by Leigh Day had changed. The consequence was that Leigh Day had accounted for VAT on the wrong amount, and the VAT required adjustment so that it was accounted for correctly on the finally agreed amount – irrespective of the mistake made by charging VAT on supplies made to non-EU clients. This adjustment was made in 2006 when the LSC recouped its payments on account and then paid Leigh Day £1,875,000. In making the adjustment, they repaid the totality of payments previously received from the LSC, thus reducing the consideration to nil, and then accepting £3,937,500 as payment in respect of their services (of which £1,875,000 was paid by the LSC).

59. Leigh Day contend that Regulation 38 applies in these circumstances. It is not in dispute that if Regulation 38 does apply, the three year limitation period that used to apply by virtue of regulation 38(1A) does not apply in the light of the decision in *General Motors Acceptance Corporation (UK) plc*.

60. Leigh Day submit that all of the requirements imposed by Regulation 38 have been met.

61. First, there has been a decrease in the consideration paid to Leigh Day to nil by a recoupment of all amounts previously paid by the LSC. That decrease was then followed by an increase in the consideration to the agreed sum.

62. Second Leigh Day submit that the decrease "includes an amount of VAT", as there were some clients (admittedly few in number) to whom VAT was properly chargeable – namely the one UK resident client and the Italian clients. In any event, they submit, the reference to VAT in Regulation 38 includes amounts purporting to be VAT, and is not limited to amounts which are "VAT" properly due under the legislation.

63. Finally, Leigh Day submit that the adjustment to the consideration and VAT payable were made in their accounts in November 2006, when they recorded the payments made to and by the LSC, and those adjustments were reflected in their VAT return for the period 07/07.

64. Leigh Day further submit that if the Tribunal should find against them on the adjustment issue, then the letter to Baker Tilly from HMRC dated 19 October 2007 is not a valid notification of an assessment for the purposes of section 73, VAT Act 1994. This is because the letter does not meet the legal requirements for an assessment – it was merely correspondence between HMRC and Leigh Day's advisors indicating that HMRC intended to issue an assessment. And in any event, Leigh Day submit that the letter was addressed and sent to Baker Tilly, and was not therefore notified to them.

65. HMRC submit that Regulation 38 is not in point. They submit that the reference in paragraph (1) to "an amount of VAT" is to "actual" VAT, and does not refer to amounts wrongly charged as VAT. They also submit that Leigh Day had not complied with the requirement that any adjustment be reflected in Leigh Day's accounts in the relevant accounting period.

66. HMRC also submit that to the extent that there was a decrease in the consideration for the supplies made by Leigh Day, that

consideration was not reduced to zero (and then increased to £3,937.000) The consideration was reduced to £3,937,500 (of which £1,875,000 was paid by the LSC).

67. As regards their letter of 19 October 2007, HMRC submit that this complies with all the requirements applicable to VAT assessments, and that as it was sent to Leigh Day's advisors and subsequently came to the attention of Leigh Day, it had been properly notified to them.

Analysis

Regulation 38

68. The first question for consideration is whether Regulation 38 applies only to "actual" VAT, or can apply to amounts which purport to be VAT.

69. To the extent that it may be relevant, we find that the consideration paid to Leigh Day was not reduced to zero and then increased from zero to £3,937,500 (of which £1,875,000 was paid by the LSC). We can find nothing in the Community Legal Service (Costs) Regulations 2000 which would support such a contention. The consideration was reduced to £3,937,500 (of which £1,875,000 was paid by the LSC). This is exactly analogous to the common situation where one party to a transaction reimburses the legal costs incurred by another. The consideration for the supply of legal services in these circumstances is not reduced to zero and then lifted back up to the full amount merely because the client is reimbursed for the costs he has incurred.

70. Leigh Day acknowledge that they are out of time to make any adjustment under Regulations 34 and 35. Their only basis for a claim is under Regulation 38. They note that even if they had been in time to make a claim under Regulations 34 and 35, this would not have obviated the need for a Regulation 38 adjustment, at least so far as the UK and Italian clients were concerned.

71. We were referred to *CCE v McMaster Stores (Scotland) Ltd* [1995] STC 846, in which the Court of Session held that Regulation 38 could not be used to correct an error which was also within the scope of Section 80, VAT Act 1994. The Court of Session emphasized that the purpose of Regulation 38 was to enable adjustments to the VAT account to reflect increases or decreases in the consideration, and that purpose must be respected, whether or not there has been (coincidentally) a liability error. Lord Hope said:

> In my opinion [*Regulation 38*] is concerned only with the making of adjustments to the VAT account to reflect an increase or a decrease in consideration which includes an amount of tax chargeable on the supply. It does not deal with the problem which has arisen in this case, where the supply was an exempt supply and no VAT was due to be paid on it to the commissioners. A claim for the recovery of overpaid tax which arises in these circumstances should be made under [*s80 VAT Act 1994*] [legislative references have been updated].

72. The decision of the Court of Session in *McMaster Stores*was considered and followed by the VAT and Duties Tribunal in the *Robinson Group of Companies Ltd* case ((1998) decision 16081). Leigh Day submit that on the facts in *McMaster* and *Robinson* there had been no adjustment to the consideration, only a liability error, and in consequence *McMaster* and *Robinson* can be distinguished from the facts in this case, and *McMaster* does not prevent Regulation 38 from being used where there is both an adjustment issue and a liability error.

73. However, on a closer examination of the *McMaster* case, it would appear that there had been an adjustment to the consideration. *McMaster* dealt with circumstances where a landlord had thought it had elected to waive exemption on lettings of shops, but had failed to notify Customs (as was) of its election. The election was therefore invalid, and VAT was not properly chargeable on rents. The landlord had then refunded the VAT incorrectly charged to its tenants, and then sought to reclaim this amount from Customs. The VAT and Duties Tribunal found that there had been a decrease in the consideration paid by the tenants (as "consideration" for VAT purposes is the "VAT inclusive" amount). This finding by the Tribunal was not challenged in the appeal to the Court of Session. Therefore the decision in *McMaster* does cover circumstances where a taxpayer is seeking to apply Regulation 38 to a case where there is both a liability error and an adjustment issue.

74. We therefore conclude that we are bound by the decision of the Court of Session in *McMaster*, and that Regulation 38 can only be utilized to address adjustments to VAT payable in consequence of a change in the consideration. It cannot be used to address circumstances where VAT had been incorrectly charged in the first place.

75. But even if we are wrong on this point, we find that Leigh Day did not satisfy the burden of proof that it had met all the requirements of Regulation 38.

76. Regulation 38(5) requires:

(5) Every entry required by this regulation shall, except where paragraph (6) below applies, be made in that part of the VAT account which relates to the prescribed accounting period in which the increase or decrease is given effect in the business accounts of the taxable person.

77. That adjustment is itself subject to a limitation period which was formerly three years, now four years, under regulation 34(1A) and section 80, VAT Act 1994. This is confirmed by HMRC's internal guidance (VR7120) which at the material time stated that adjustment must be made "within three years of that tax period".

78. The decrease in the consideration for Leigh Day's services occurred at the latest on 22 November 2006 when the LSC paid to Leigh Day the amount that they determined was owed. For Regulation 38 to apply, the relevant entries in Leigh Day's VAT account and business accounts must have been made within three years of this date.

79. The term "business accounts" is not defined in the legislation, and the term must therefore have its ordinary meaning. We hold that, adopting that ordinary meaning, the term "business accounts" means the formal record maintained by a taxpayer of the debits and credits relating to its assets, liabilities or capital; in other words, it means the financial books and records maintained by the taxpayer. In the context of a firm of solicitors we find that this includes the accounting records it maintains under the SRA Accounts Rules relating both to "client" and "office" entries.

80. The evidence before us is that the contribution made by Cape's insurers was paid into Leigh Day's client bank account, and amounts were repaid to the LSC out of the client bank account. The only entries made in Leigh Day's business accounts at that time were in the client and client bank account ledgers. No entries were made in Leigh Day's office ledgers

"because we had already recorded income in excess of this amount in the office account and in the P&L for earlier years." (*per* Mr Cole – see paragraph 48 above)

81. The point is that the entries made in Leigh Day's business accounts only reflected cash flow: the movements in cash, in and out of Leigh Day's client bank account when amounts were received from Cape's insurers and paid to the LSC. The accounting entries did not reflect the reduction in consideration for the supplies of legal services made by Leigh Day to its clients.

82. We find that the reduction in the consideration for the supply of legal services was only given effect in Leigh Day's business accounts on 18 February 2013, when the various adjustments to counsels' fees and to the LSC had been worked out, and the amounts refunded to the LSC had been written off. It was only at this point that the reduction in the consideration was reflected as a reduction in the turnover of Leigh Day as recorded in its business accounts.

83. As reduction in the consideration was reflected in the business accounts of Leigh Day more than three years after the date on which the consideration was actually reduced, Leigh Day have not complied with the time limits imposed by section 80 and regulation 34(1).

84. For completeness we record that Leigh Day provided no evidence as to the entries made in their VAT Account. We therefore had no evidence to be able to make findings as to whether the relevant accounting entries had been in that part of Leigh Day's VAT account for the prescribed accounting period relating to 22 November 2006.

85. We therefore find that Leigh Day have not satisfied the burden of proof that is upon them to show that all the requirements of Regulation 38 have been met.

86. We therefore hold that Leigh Day's claim for relief under Regulation 38 fails.

87. The consequence is that Leigh Day would need to rely on Regulation 35 in order to correct its error, and make a claim under s80, VAT Act 1994. However, it did not seek to use that regulation nor did it make a s80 claim, and it is now out of time to do so.

VAT Assessment

88. Assessments for VAT are governed by section 73(1), VAT Act 1994. This provides that HMRC

> may assess the amount of VAT due from [the taxpayer] to the best of their judgment and notify it to him.

89. There is a distinction to be drawn between (a) the act of making an assessment by HMRC and (b) the notification of "it" (the assessment) to the taxpayer.

90. The legislation does not prescribe the form a notice of assessment must take.

91. The leading case on the form of notices of assessment is *House t/a P and J Autos v CCE* [1994] STC 211 (upheld by the Court of Appeal [1996] STC 154). This was considered by the Upper Tribunal in *Queenspice Limited v HMRC* [2010] UKUT 111 (TCC), when Lord Pentland usefully summarized the requirements for a valid notice of assessment as follows (at paragraph 25):

> In my opinion the following points may be taken from the judgment of May J in *House*:
>
> (i) Like its predecessor, section 73(1) of the 1994 Act lays down no particular formalities in relation to the form or timing of the notification of the assessment.
>
> (ii) A notification pursuant to section 73(1) can legitimately be given in more than one document.
>
> (iii) In judging the validity of notification, the test is whether the relevant documents contain between them, in unambiguous and reasonably clear terms, a notification to the taxpayer containing (a) the taxpayer's name, (b) the amount of tax due, (c) the reason for the assessment, and (d) the period of time to which it relates.

92. Leigh Day submit that the letter of 19 October 2007 does not meet the requirements of a valid assessment. In particular:

(1) Leigh Day was not aware that this letter was regarded by HMRC as an assessment until it received HMRC's skeleton argument a few days before the hearing of the appeal;

(2) Baker Tilly (to whom the letter was addressed) at no point considered that the letter was an assessment

(3) The letter was sent to Baker Tilly and not to Leigh Day (the taxpayer)

(4) The letter does not use the term "assess" or "assessment".

(5) It is informal and in the nature of correspondence between the parties, and both Leigh Day and Baker Tilly expected that it would be followed up with a formal assessment (but which in the event never came).

93. Leigh Day submit that the letter would not be enforceable by HMRC, and that a formal assessment or demand setting out the amount of tax and interest due would be required.

94. HMRC submit that the letter meets all the requirements for an assessment as set out in the *House* judgement. It contains, in reasonably clear and unambiguous terms (a) the taxpayer's name, (b) the amount of tax due, (c) the reason for the assessment, and (d) the period of time to which it relates. Although it was sent to Baker Tilly,

they were Leigh Day's advisors, and it is not disputed that the letter came to the attention of Leigh Day subsequently. Mr Cole in giving evidence confirmed that Baker Tilly had sent a copy of the letter to him, but could not remember when he had received it. HMRC further submit that a further formal demand or assessment would not be required for enforcement purposes. VAT assessed and notified to a taxpayer is deemed to be an amount of VAT due (subject to any appeal) and is recoverable as such pursuant to s73(9).

95. We find that the letter is clear and unambiguous notification of an assessment. We note that it follows on from HMRC's letter of 18 September 2007, in which they state that they will proceed to issue "the appropriate letter adjusting the VAT repayment". It sets out Leigh Day's name, the amount of tax due, the reason for the assessment and the period to which it relates. The letter sets out in terms how the tax assessed should be paid, and it is clear on its face that the taxpayer should not wait for a further document before making payment.

96. The fact that it does not include the word "assess" or "assessment", or that neither Leigh Day nor Baker Tilly appreciated that it was an assessment are relevant factors. We agree with HMRC's submission that an amount assessed and notified to a taxpayer is VAT due and recoverable (subject to any appeal), without the need for any formal demand or assessment.

97. We find that the letter of 19 October 2007 meets all the requirements for a valid notice of assessment.

98. However the letter was addressed to Baker Tilly, and sent to them and not to Leigh Day. Unlike HMRC's letter of 18 September, a copy was not sent to Leigh Day. The requirement of section 73(1) is that the assessment must be notified to the taxpayer.

99. Section 98, VAT Act provides as follows:

> Any notice, notification, requirement or demand to be served on, given to or made of any person for the purposes of this Act may be served, given or made by sending it by post in a letter addressed to that person or his VAT representative at the last or usual residence or place of business of that person or representative.

100. So notifications under the Act may be served by posting them to the taxpayer at his last or usual place of business. The section refers to "VAT Representatives", but this has a special meaning (see section 48) and relates to taxpayers (for example) who do business in the UK but have no establishment in the UK. Such persons may be required to

appoint a VAT Representative. Baker Tilly was not a VAT Representative for these purposes. Indeed, it is clear from subsequent correspondence that HMRC were unsure whether Leigh Day had ever formally authorised HMRC to correspond with Baker Tilly in the first place.

101. The use of "may" in the section indicates that this is not the only way in which notices may be served. So we would consider (without deciding the point) that personal service on a taxpayer, or service at a registered office of a company incorporated under the Companies Act 2006 would be good service.

102. However, we consider that notification to an advisor (who is not a VAT Representative for the purposes of section 48) is not sufficient for the purposes of section 7391). The notification of an assessment is a critical document, and a taxpayer cannot be put at risk that his advisor might delay in sending the notice to him (or indeed fail to do so altogether). We therefore find that the letter of 19 October 2007 had not been notified to Leigh Day in accordance with the requirement of section 73(1).

103. HMRC submit that any failure to serve the notice of assessment on Leigh Day was "cured" by subsequent correspondence, and that their letter of 31 January 2008 setting out the results of a reconsideration is sufficient to constitute a valid notification for the purposes of s73(1).

104. Irregularities in the notification process can be cured by HMRC making a further proper notification. In the case of *Grunwick Processing Laboratories Limited v CCE* [1986] STC 441 (affirmed by the Court of Appeal [1987] STC 357), Customs had failed properly to notify the taxpayer of an assessment. It was held that the result was that the assessment was unenforceable unless and until it was notified properly. As HMRC subsequently properly notified the taxpayer of the assessment, they could proceed to enforce it.

105. We find that HMRC's letter of 31 January 2008 was not a valid notification for the purposes of s73(1). The letter of 31 January 2008 is clearly a response to Baker Tilly's request (contained in their letter of 3 October 2007) for a formal reconsideration of the decisions made in HMRC's letter of 18 September 2008. It is true that the 31 January letter was sent to Leigh Day, contains Leigh Day's name, the amount of tax due, and the reason why HMRC consider that VAT is due and the period of time to which the VAT relates. But it does so in the context of the reconsideration. The references to the amount of tax, the period to which it relates and the reasons why HMRC consider that the tax is due

are necessarily included as they are an essential part of the reasons given by the review officer for upholding the original decision. To describe this letter as a further notification of the assessment is a step too far. Unlike the letter of 19 October 2007, we find that this letter is in the nature of correspondence between the parties and is not notification of an assessment expressed in reasonably clear and unambiguous terms.

Costs

106. This appeal relates to a decision dated 31 January 2008, and the Notice of Appeal is dated 21 February 2008. The appeal was made to the VAT and Duties Tribunal, but transferred to the First Tier Tribunal (Tax Chamber) on 1 April 2009.

107. Rule 29, Value Added Tax Tribunals Rules 1986 (SI 1986/509) provided for a general costs-shifting power enabling the VAT and Duties Tribunal to direct that a party pay for the costs of the other party consequent on the appeal. In practice, HMRC's policy was not to seek costs against unsuccessful appellants, save in "*exceptional tribunal hearings of substantial and complex cases where large sums are involved and which are comparable with High Court cases, unless the appeal involves an important general point of law, requiring clarification*".

108. On 1 April 2009, the functions of the VAT and Duties Tribunal were transferred to this Tribunal pursuant to the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 (SI 2009/56). Leigh Day's appeal is "current proceedings" under the transitional provisions contained in that Order, and continued as proceedings before this Tribunal. Under Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273) , this Tribunal does not have a general power to award costs other than in cases categorised as "Complex", and even that is subject to an election out of the general costs-shifting regime by the taxpayer.

109. The default position, in a case that was not categorised as Complex or where a taxpayer's election out of the general costs-shifting regime in a Complex case had been made, is that this Tribunal's power to award costs is limited to the making of a wasted costs order or where a party or its representative had acted unreasonably. However, under paragraph 7(3) of Schedule 3, Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009, this Tribunal has the power, in respect of "current proceedings", to give any direction to ensure that proceedings are dealt with fairly and justly and in particular

can apply any provision in procedural rules that had applied before the transfer of functions to it (including the power to award costs under rule 29 of the 1986 Rules).

110. Application was made by Leigh Day that we make an order that Rule 29, Value Added Tax Tribunals Rules 1986 should apply to this appeal. The application of paragraph 7(3) was considered by the Upper Tribunal in *Atlantic Electronics v HMRC* [2012] STC 931 in which it gave guidance as to how the First Tier Tribunal should exercise its discretion.

111. The Upper Tribunal considered a number of examples:

> [31] The first example, at one end of the spectrum, is a case where the appeal was commenced in the VAT Tribunal just a day or two before 1 April 2009 and would have been allocated as a Complex case had the 2009 Rules applied. It is to be assumed for the purpose of the example that the vast majority of the work and expense will be done and be incurred after that date. It would be an oddity if there were radically different costs consequences in such a case as compared with an appeal started a day or two after 1 April 2009. In such a case, the policy of the 2009 Rules ought to be the starting point. I consider this further at para [37] below.
>
> [32] The alternative approach in this first example is that, since the proceedings started in the VAT Tribunal, its rules should govern the entire proceedings. That is a possible, but in my judgment an incorrect, approach. It fails to reflect the clear policy which can be detected in the 2009 Rules themselves that a taxpayer is to have a choice of costs regime.
>
> [33] The second example is at the other end of the spectrum. It is a case where the hearing of an appeal has been held by the VAT Tribunal and completed before or very shortly after 1 April 2009 with the decision outstanding at that date. It is to be assumed that the virtually all of the work had been done and virtually all of the costs had been incurred before that date. There would be a different, but equally great, oddity if there were radically different costs consequences in such a case as compared with an appeal where the decision has been released a day or two before 1 April 2009. Unless there is some policy which drives the tribunal in such a case to apply the new approach to costs to proceedings which were almost entirely conducted in the VAT Tribunal, then that oddity can easily be avoided by an exercise of the para 7(3) power and, in the absence of such policy, it would, I consider, be obviously fair and just (in the absence of some special circumstances) to apply the costs regime previously applicable, that is to say to apply r 29. I see no reason at all to think that there was such a policy. In other words, the policy of taxpayer choice is not determinative of the costs regime which should apply although the taxpayer's actual preference is one factor which needs to be taken into account.

[34] This leads to a third example where the proceedings were commenced in the VAT Tribunal and straddle 1 April 2009 in a substantial way, as in the case of Atlantic's appeal. It is to be assumed for the purposes of this example that substantial work has been carried out and considerable expense incurred over a significant period before that date and that substantial work will be carried out and considerable expense will be incurred over a significant period after 1 April 2009. The issue then is how costs are to be dealt with. A number of questions arise including these: If a party seeks a prospective direction, how should that be resolved? Does it make any difference when the application for such a direction is made? How is the relative amount of work and expense in the first period as compared with the second period to be taken into account, if at all? If neither party makes an application to the tribunal for some sort of prospective direction, how should the tribunal deal with costs at the end of the day?

112. It considering these examples to the context of this appeal, we consider that it is closest to the first example. Roughly five years and a half years elapsed between the filing of the notice of appeal and the appeal hearing. Although one year and one month elapsed before the transfer to this Tribunal on 1 April 2009, it appears that relatively little work would have been done on the appeal in that time. We note in particular that HMRC's Statement of Case is dated 29 April 2009 – after the transfer. Neither party have submitted to us that they incurred substantial costs prior to 1 April 2009.

113. The Upper Tribunal's guidance in such cases is as follows:

[39] Consider, then, an application (whether to fix a costs-shifting regime or a no costs-shifting regime) made by the taxpayer in the first example within a reasonable time after 1 April 2009. The two policies of the 2009 Rules which I have identified would be properly reflected by the making of the direction sought by the taxpayer. Save in the most exceptional circumstances (which it is not easy to envisage), I would expect the tribunal to make a prospective direction reflecting the taxpayer's choice.

[40] Suppose, however, that the taxpayer does not make an application within a reasonable time and thereby fails to make an election within a reasonable time. What, then, is the position if either party thereafter seeks a prospective determination or, if no application is made, what is the position at the end of the appeal? The question, in essence, is whether the policy of the 2009 Rules is best reflected by (i) applying the actual default position under r 10 as applied to current proceedings or (ii) applying the default position applicable to a Complex case, on the footing that the case is one which is complex in nature or (iii) adopting some other position.

[41] In my view, the tribunal in the first example ought, in the absence of exceptional circumstances, to reflect the two policies which I have identified. Once a reasonable time has passed, there is no longer a policy

> imperative to give the taxpayer a choice; on the contrary, the second policy, to achieve certainty, suggests strongly that he should no longer have a choice. If he is to have no choice, it is in my judgment, the default regime under r 10 which should apply. He could not, seeing the wind blowing strongly in his favour, after the passage of time, successfully seek a prospective costs order applying r 29 or seek an order for costs when he actually wins his appeal.
>
> […]
>
> **[50]** Ideally, any application to depart from the default regime ought to be done within a reasonable time of 1 April 2009. If an application were made shortly after 1 April 2009, and if the tribunal were to reject the idea of a direction applying different regimes, then it would have to attempt to resolve the tension as best it can. But if the application were delayed for some time, the passage of time will make it more difficult, I consider, to obtain a prospective direction disapplying r 10 and applying r 29. This is not, in my view, because of any reasonable expectation on the part of the taxpayer that the default regime will apply, but rather because this is what the second policy, the policy of certainty which lies behind the 2009 Rules, requires. If neither party makes an application for a prospective direction, that certainty is to be found in the default regime and the passage of time renders a departure from that regime more difficult to justify.

114. On balance, taking into account the guidance given by the Upper Tribunal, we consider that it is inappropriate for the Tribunal to exercise its discretion under Paragraph 7(3), and we decline to make an order that "old" Rule 29 should apply. As this appeal has not been categorised as "Complex", no order as to costs will be made.

115. In reaching our decision as to whether to order that "old" Rule 29 should apply, we have taken into account the fact that the Appellant did not pursue any application for the Tribunal to exercise its discretion under paragraph 7(3) until the substantive hearing of the appeal. We consider that limited costs would have been incurred by the parties between 21 February 2008 when the Notice of Appeal was filed, and 1 April 2009 when the appeal was transferred to this Tribunal; we note in particular that HMRC's Statement of Case is dated 29 April 2009 – after the transfer. We also note that this case would not meet the requirements for classification as a "Complex" case under this Tribunal's rules.

116. For completeness, we note that even if we had exercised our discretion to order that Rule 29 should apply, it is likely that we would not have made any order as to costs in any event given the split outcome of the appeal.

Conclusions

117. We find that Leigh Day's error in incorrectly charging VAT on its supplies is not capable of correction under Regulation 38, notwithstanding that there was also a reduction in the amount of consideration for the supplies that it made.

118. In any event, we find that Leigh Day have not satisfied the burden of proof that is upon them to show that all the requirements of Regulation 38 have been met.

119. Finally, we find that although the letter from HMRC dated 19 October 2007 satisfied the requirements for a notice of assessment, it had not been notified to Leigh Day in accordance with the requirements of section 73(1) VAT Act 1994. We further find that HMRC's review letter of 31 January 2008 did not constitute a further notification of the assessment.

120. 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.

NICHOLAS ALEKSANDER
TRIBUNAL JUDGE

RELEASE DATE: 9 May 2014

Cases referred to in argument but not mentioned in this decision:

Cumbria County Council v HMRC [2011] UKFTT 621 (TC)
Burford v Durkin [1991] STC 7