TC03410

Appeal number: TC/2011/10186

VAT – security; Notice of Requirement; Schedule 11 para 4(2)(a) VATA; public law considerations; failure to consider relevant matters; disproportionate amount of security required; appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ARIA TECHNOLOGY LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE CHRISTOPHER HACKING
MISS SUSAN STOTT

Sitting in public at Manchester on 23 May 2013 and 21 October 2013

Ms Alison Graham-Wells, counsel, instructed by Farley Solicitors LLP,

Mr James Puzey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

Background to the appeal

1. The appellant, Aria Technology Limited (Aria), is a company engaged in the wholesale and retail sale and distribution of computer and related products from its premises at Aria House, 2, Belle View Avenue, Pottery Lane, Manchester, M12 4AS. The company is understood to have some capability for manufacture. Aria's Managing Director, Mr Taheri has spoken of his pride in showing visitors, including representatives from HMRC, around Aria's facilities. Aria was first registered for VAT with effect from 1 August 1997 under VAT registration number 693 3849 85.

2. The decision under appeal concerns the issue of a Notice of Requirement to give Security under the provisions of Schedule 11 paragraph 4(2)(a) of the Value Added Tax Act 1994 (VATA). The decision was notified in a letter from the respondents to the appellant dated 14 September 2011. The sum originally sought by that letter was £958,000.00 for quarterly VAT returns or £850,600.00 if monthly returns are submitted.

3. On 8 November 2011 the respondents wrote advising a reduction in the security required of £638,000.00 (quarterly returns) or £530,600 (monthly returns). At the time material to this proceeding Aria accounted for VAT quarterly and it is therefore the figure of £638,000 which is sought as security.

4. It is important to an understanding of this appeal to know that there are extant proceedings by HMRC against the appellant in which it is contended that the appellant knew or should have known that certain of its trading activities were related to transactions which were fraudulent by reason of a wilful failure to account for VAT at some stage in a chain of dealing with which the appellant was concerned or a related chain. This type of fraud is commonly referred to as a Multi Trader Intra Community or MTIC fraud.

5. The tribunal understands that Mr Taheri on his company's behalf denies any knowledge of such fraud or means of such knowledge and in due course that matter will come before a tribunal for decision. An application had been made by Aria to deal with the MTIC matter before the present appeal concerning security but that application was successfully resisted by the respondents. This tribunal must now consider whether the respondents' decision to require security was properly made.

The task of the tribunal

6. Paragraph (4)(a) of Schedule 11 to VATA provides:

> "If they think it necessary for the protection of the revenue, the Commissioners may require a taxable person, as a condition of his supplying or being supplied with goods or services under a taxable supply, to give security, or further security, for the payment of any VAT that is or may become due from –
>
> (a) the taxable person"

7. The jurisdiction of the tribunal in this appeal is such as to restrict the tribunal to satisfying itself that the decision made by the respondents was one at which the Commissioners could reasonably have arrived (*Mr Wishmore Limited v Customs and Excise Commissioners* [1988]STC723; *Customs and Excise Commissioners v Peachtree Enterprises Ltd* [1994] STC 747 and the Court of Appeal decision in *John Dee Limited v Custome and Excise Commissioners* [1995] STC 941.

8. The duty of the tribunal is to consider the facts known when the decision was made. Facts or matters arising after the making of the decision cannot be considered as this would amount to the exercise of a fresh discretion within the decision making process. This does not however mean that they may be ignored as they may give rise to a need to reconsider and revise the original decision.

9. What the tribunal must do therefore is to consider the decision making process and assess whether the respondents considered facts or matters which were not relevant to their decision or failed to consider facts or matters which they should have considered in arriving at their decision. In either case if such have been established the decision will be flawed and the tribunal must allow the appeal. It may also allow the appeal if it considers that the decision is one which a properly constituted set of commissioners could not have arrived at applying general principles of fairness (the so called *Wednesbury* principles).

The appeal

10. This appeal is very different from the more usual appeals concerning security issues. It is different both in scale and substance. The amount at issue was significant so that a requirement to provide the security could reasonably be expected to give rise to serious financial consequences for the appellant which would need to be weighed in the balance.

11. Beyond merely the size of the notified requirement the appeal differs from the more usual appeals of this type by not having been preceded by a long and unhappy history of delays or defaults in accounting for VAT as a result of adverse trading conditions. The appellant says that prior to the series of quarterly accounting periods with which the appeal is concerned and for which it says there are clear reasons for the defaults, it has had a very good record of VAT compliance. This has not been challenged by the respondents. Indeed it could not be because the respondents accept that the decision maker did not look at the

appellant's compliance history prior to the VAT periods with which this appeal is concerned.

12. The third respect in which this appeal differs from other similar appeals is that the appellant is, as mentioned above, concerned with an ongoing appeal in which it has been refused a substantial VAT repayment. It is, in part, the appellant's case that it was, for reasons which will be explained, entitled to expect forbearance by HMRC pending the outcome of the MTIC appeal hearing. In this regard the appellant says it had been reassured that HMRC would not take steps to recover outstanding VAT pending determination of the MTIC appeal. The difference between recovery action and the issue of a Notice of Requirement (a distinction on which the respondents rely) is a subtlety which clearly escaped Mr Taheri.

13. By reason of these matters the hearing occupied two very full days. The tribunal has had the benefit of a transcription of the proceedings and helpful argument from experienced counsel for each of the parties both orally and in the form of skeleton arguments and written closing submissions.

The issues

14. The Notice of Requirement was communicated in the two letters of 14 September 2011 and 8 November 2011 to which reference is made above. In reply to the first of these letters Mr Taheri wrote on 3 October 2011 to the officer dealing with the matter. His letter outlines the stance taken throughout this matter by the appellant thus:

> "Dear Mr Reeves,
>
> We acknowledge your letter of 14/09/2011.
>
> We would like to appeal against the security claim of £850,600, based on the following reasons.
>
> Underpayment of VAT
>
> The initial underpayment of VAT is the result of monies withheld from Aria Technology by HM Revenue & Customs (HMRC). As a small owner managed business it is unreasonable to expect us to carry on trading in a normal manner while HMRC unjustifiably, for an indeterminate period of time withhold substantial amounts of working capital in the amount of £445,156.98.
>
> All transactions relating to the July 2006 claim were carried out in good faith, with long standing suppliers.

To minimize the effect of this we had to reduce the payments to HMRC for VAT liabilities over 5 quarterly periods (which by itself caused significant trading issues and put the business at severe risk). Schedule of reductions in VAT payments per the attached.

We received no correspondence from HMRC for over two years indicating that the above reduction in VAT payments was not acceptable to HMRC. Further, on 10 June 2010, in a letter from HMRC Officer David O'Leary, we received confirmation that there would be no action in relation to the outstanding debt while an ongoing appeal to the tribunal in relation to withheld VAT is ongoing.

From the date of the final deduction we have traded as a 'normal' business, and indeed paid VAT liabilities in a timely manner and all our transactions have been carried out with absolute integrity. Even though we are only a small business with limited working capital we are a substantial contributor [*(to?)*] *sic* the UK economy.

To claim security against the £445,156.98 is unjust and relates to a completely separate transaction that is going through the appeals process and is not 'normal' trading practice.

For the quarter ended October 2010, Aria Technology accidentally paid twice, £139,541.59. This was unexpectedly withheld by HMRC, saying it was to be used again[*(st*)] *sic* the 'old outstanding balance'. This came without warning, and once again had a significant impact on our ability to trade. We wrote to you at the time indicating we would be deducting the amount from our next VAT payment. At no time did we receive any correspondence from you.

VAT transaction on Sale of Property

On the 30th June 2011 Aria Technology sold its freehold property to Aria Land. This was done for commercial reasons, as it is intended to sublet unused space within the property, as well as streamline the group structure.

The property was sold and bought on an 'arm's length transaction' - £1.8m plus VAT £0.32m. The sale was within a group structure and is a normal transaction in the commercial environment.

This generated £320,000 of input tax for Aria Land, for quarter end 06/11 and an output tax for quartered *(sic)* ended 07/11 for Aria Technology.

It was pre-agreed with HMRC via both conversation with Steve Jones, that it would be acceptable for you to withhold refunding us £320k, then Aria Land holding the refund for a month, and then Aria Technology paying it over £320k at the due date. This is clearly in HMRC's favour, and was deemed a fair and reasonable action by both parties.

However if it is decided retrospectively that this is not agreed then please refund the £320,000 to Aria Land, we will then repay this back.

Either way it should not be included as part of the security deposit.

Conclusion

Aria Technology has always acted with integrity and in good faith, welcomed any visits from HMRC, and always informed HMRC by telecommunications and written letter or email of our actions. In summary, I believe that we could not be more open and honest in all our dealings.

We are a substantial contributor to the UK economy employing 48 people whose livelihood depends on us. As a result of HMRC's position, the continuing function of Aria Technology as a going concern is being placed in jeopardy

In relation to HMRC's revised position, it is both unreasonable, and inequitable for HMRC to change its stance in relation to the action against Aria Technology as outlined in David O'Leary's letter above. We are more than willing to reach agreement with HMRC as to Aria's VAT position but would ask that HMRC honour its original stance as per David O'Learys letter.

Further we also consider that HMRC's change of position and the timetable provided to Aria Technology to comply with the revised position is unrealistic and implausible. Any trading body would take some time to create new working capital models and adjust its business generally to take account a material change in VAT treatment by HMRC and this process can take a considerable amount of time.

On the basis of the above, I respectfully request that you reconsider your claim for security.

Kind regards

Aria Taheri

Managing Director"

15. This letter sets out the core argument from the appellant company's point of view. It was following this letter that the respondents reduced the requirement for security to £638,000. Mr Reeves who replied to that letter on behalf of the respondents on 8 November 2011, stated that the letter from David O'Leary to which Mr Taheri had referred and on which he apparently placed reliance as to the continuation of a status quo pending the outcome of the MTIC appeal had been misconstrued. The inference that debt recovery would not be pursued was, Mr Reeves wrote, "an incorrect inference on your part".

16. Mr Taheri considered Mr O'Leary's letter of 10 June 2010 to be an undertaking not to take any debt recovery or management action in relation to Aria Technology's VAT balance as at that date. It was as a direct consequence of this belief that Mr Taheri pursued his ongoing policy of retaining VAT in such sums as would, as closely as possible, equate to the VAT repayment to which he contends his company is entitled as a result of its wrongful denial by the respondents, the subject of the MTIC proceedings.

16. The tribunal does not doubt that as a result of both correspondence and discussions between himself and HMRC personnel Mr Taheri believed that an arrangement had been agreed or at least tacitly accepted, whereby Aria Technology might retain as working capital a sum of VAT which would otherwise be payable in a sum approximately equal to the VAT which Aria says should be returned to it in respect of the quarter 07/06.

17. It is equally clear that any such undertaking or tacit acceptance is disputed by the respondents.

18. The relevant issue in this context however is the extent of the tribunal's jurisdiction to deal with the question of the appellant's "reasonable expectation". The tribunal cannot exercise jurisdiction other than the appellate jurisdiction conferred on it by statute. It has no power to adjudicate the merits of the contending parties' arguments as to whether the respondents acted reasonably or otherwise in light of its correspondence and other communications which Mr Taheri says amounts to an undertaking to refrain from the sort of action the

respondents have now taken. That seems quite clear following *Reed Employment plc and others v Revenue and Customs Commissioners* [2010] UKFTT 596 (TC) and *HMRC v Abdul Noor* (2013) UKUT 71, cases referred to by counsel in their submissions. That does not mean however that these matters are wholly otiose. On the contrary they are matters which the respondents' decision maker should, in our view, have taken into consideration as being relevant to a proper understanding of the matter as a whole and, more particularly, the matters of the need to issue and the quantum of, a Notice of Requirement.

19. The issue of a Notice of Requirement is a serious step which can have profound consequences for the taxpayer. Such a notice may be required to be issued where the Commissioners

> "think it necessary for the protection of the revenue" (Schedule 11, paragraph 4 (2) VATA above).

It follows that the proper focus of those charged with responsibility of making a decision about security is the risk posed by the taxpayer of default in its VAT obligations. A secondary but equally important focus is the question of the quantum of any such requirement.

20. This is not an academic exercise – it is, or at least ought to be, a 'real world' evaluation of the risk of loss to the revenue balanced against the effect of such a requirement on the tax payer. This can in some circumstances be a difficult matter. It requires a structured decision making approach which looks carefully at all relevant matters and discards the irrelevant. There needs to be a 'balancing' of the advantage to the revenue of issuing such a notice against the consequences this may have for the taxpayer.

21. The function of the tribunal on appeal is not to supplant its judgment as to whether the notice should be issued or to evaluate the amount of the security which it thinks is appropriate but rather to look at the decision making process to ensure that it was carried out properly in accordance with public law principles.

22. We heard sworn evidence from Mr Reeves, a Higher Officer of the respondents whose decision it was to issue the Notice of Requirement and from Mr Taheri, Managing Director of the appellant on its behalf.

23. Both witnesses were considered by the tribunal to have been good historians who gave their evidence carefully. Mr Reeves was perhaps a little defensive at times but this is perhaps understandable as his cross examination by Ms Graham-Wells was determined and detailed. Mr Taheri struck the tribunal as a reliable witness who, when occasion demanded, conceded matters which were clearly contrary to interest. Both were witnesses of truth on whose testimony the tribunal was able to rely although some of Mr Reeves' responses suggested some "after-the-event" reconstruction. This was, however, an appeal in which the decision turns not on the tribunal's preference of one party's account of factual

events but on the application of the law to substantially agreed facts. In this the tribunal has been much assisted by the written submissions of counsel for each party following the close of the hearing.

The tribunal's consideration of the facts and its conclusions.

24. The facts can be quite simply stated.

25. The appellant has withheld payment of VAT properly due to the respondents over the quarterly VAT accounting periods: 01/07; 04/07; 07/07; 04/10; 07/10 and 07/11. The accrued unpaid VAT for these periods totalled £949,407.27 of which a sum of £313,613.71 related to the balance of the appellant's VAT account for the period 07/06 which is under separate appeal in the MTIC proceedings. The remaining balance of unpaid VAT was thus £635,793.56 The retentions made by the appellant from the later VAT periods arose as a result of overpayments of VAT made by the appellant which were promptly set off by HMRC against the outstanding balance due. The appellant considered these set offs as unreasonable in the light of what it understood to be Mr O'Leary's assurance.

26. It is not disputed by the respondents that the amounts withheld have throughout this matter been generally such as to amount to around £445,156.98 being the sum withheld by HMRC for the quarter 07/06 to which sum the appellant states it is entitled but which is the subject of the MTIC proceedings referred to above.

27. The appellant has, to the knowledge (and possibly also to the irritation) of the Revenue, pursued a policy of responding to set-offs by HMRC of VAT subsequently overpaid by the appellant on at least two occasions, by withholding such overpaid amounts from a subsequent payment of VAT so as to bring the outstanding balance due to HMRC back to approximately the sum £445,156.98. Significantly it also continued to pay VAT on its ongoing trading account. Although this may not be a matter which could have been taken into account by Mr Reeves the VAT paid subsequently to the retentions of which complaint is made has, we were told, amounted to over £1.2M.

28. The appellant's stated justification for its actions is that it had understood from the letter written by Officer David O'Leary to the appellant on 10 June 2010 that, pending the outcome of the MTIC appeal, HMRC would not press for the payment of VAT withheld equal to the amount of the VAT reclaim for the 07/06 period which had been denied. Specifically Mr Taheri said that he relied on the following words in that letter:

> "whilst the appeal is ongoing there will be no debt management action on the outstanding VAT balance"

29. The tribunal notes the respondents' contention that this line of argument amounts to a question of the appellant's reasonable expectation. Such an argument is outside of the tribunal's jurisdiction to entertain following, in

particular, the decision in *HMRC v Abdul Noor* referred to above. It does not however seem to have precluded the respondents contending that on a proper construction of these words Mr Taheri could not have understood them to extend to a Notice of Requirement which cannot be considered to be a debt management process.

30. The tribunal is inclined to accept that Mr Taheri was reasonably entitled to think that, as long as no more than the amount of the denied input VAT for period 07/06 was owing to HMRC, he would not be subject either to recovery proceedings or a Notice of Requirement which, in practical terms, would have a very similar effect.

31. However it really matters rather little what view the tribunal takes of this matter as the issue of the appellant's "reasonable expectation" is one which the tribunal accepts is outside its proper jurisdiction and as to which it does not seek to make a determination. That does not mean that this matter is of no significance to the question of the respondents' decision making process. Whatever Mr Taheri's understanding of David O'Leary's letter may have been, the fact that that letter was sent on HMRC's behalf to the appellant and its content are matters relevant to the consideration which Mr Reeves needed to give to the decision making process.

32. They were relevant because they explained why the retentions were being made and should have alerted Mr Reeves to the fact that it was only the denied input tax which was ever really likely to be at risk. Knowing this he might have reconsidered the need to issue the notice or the amount of security it was proper to seek. It cannot be said that these matters could not have made any difference to his decision.

33. There were in our finding other facts which would have been relevant and which Mr Reeves should have taken into account.

34. It does seem to the tribunal to be extraordinary that Mr Reeves did not feel it to be important to look at the history of the appellant's compliance record. Certainly by the time the amended Notice of Requirement was issued Mr Reeves knew very well why Mr Taheri was withholding VAT payments. He may not have agreed with this procedure but it must have been clear to him that the policy Mr Taheri was pursuing was not one which was likely to put at risk more than the amount of the denied input tax. This is therefore a matter which ought to have featured in both his decision to issue a Notice of Requirement (or to withdraw or amend the Notice already issued) and his decision as to the amount of security reasonably to be required.

35 In the event the only concession made was to reduce the amount of the requirement by £320,000, being VAT in respect of a land transaction between the appellant and a related property company within the appellant's group. Why this sum ever featured as part of HMRC's assessment of the amount of the requirement in the first place was far from clear and Mr Reeves' explanation for

this was most unconvincing. He told the tribunal that he thought it might have foreshadowed a series of such transactions but was obliged on being pressed about this to accept that he had no evidence at all to suggest that this was the case.

36. Had Mr Reeves looked at the appellant's history of compliance it seems probable that he would have formed a different and more realistic view as to the risk to the revenue posed by the appellant.

37. An understanding of what Mr Taheri was doing would, it seems to the tribunal, have led Mr Reeves to the almost inevitable conclusion that there was either little risk to the revenue or that any risk which did exist was limited to the amount of the denied input tax for the period 07/06.

38. No proper consideration appears to have been given to the very serious consequences for the appellant's business of issuing the notice. Mr Reeves whilst having agreed that he was aware of the importance of working capital to a business appears to the tribunal to have followed a somewhat mechanistic approach in the assessment of the sum required by HMRC as security. In particular he followed what is understood by the tribunal to be a fairly standard calculation for the amount of the security with little or no regard to the particular circumstances of this matter.

39. Mr Reeves told the tribunal that he had taken "Policy" advice about this matter but had apparently neglected to point out to the relevant department dealing with "policy" the letter from David O'Leary, a letter which the tribunal finds to be sensitive to this very issue of balancing the risk to the Revenue with the likely effect on the appellant's business.

40. Nor does Mr Reeves appear to have considered the particular effect of the requirement on the position of the appellant in the ongoing appeal proceedings in the MTIC case. The requirement could well have presaged an end to any chance on the part of the appellant of having the matters concerned in those proceedings fairly dealt with. A suspicious mind might conclude that that was indeed the respondents' intention. The tribunal would naturally be reluctant to draw any such conclusion. It must be said however that Mr Reeves stated in his evidence to the tribunal that the matter of the MTIC proceedings and the Notice of Requirement were to his mind quite separate matters.

41. It is, however, less than clear to the Tribunal what precise role was played by Mr Alan Vaggers in all of this. Mr Vaggers was, we were told, working in the respondents MTIC team in the Kings Dock in Liverpool. Mr Reeves' attention was first drawn to Aria Technology by Mr Vaggers who visited him

> "at my desk and went through a brief background as to the history of Aria Tech from the October 06 period and laid out the fact that they had taken the decision whereby they had wilfully refused to then pay any subsequent tax on returns submitted, and he then asked me whether or not that being the case (the question of security) might be looked at 'going forward'"

This was over two years after the first retentions.

42. What is clear is that following this meeting, Mr Reeves apparently decided in short order to proceed with the issue of the Notice of Requirement. Clearly he was entitled to consider the matter of the deliberate withholding of VAT as a serious matter. It was quite right that he should. What he does not appear to have done, however, is to make any relevant enquiries into the substance of the appellant and its creditworthiness so as to enable him to form a view as to the risk, if any, it might pose to the revenue. There is absolutely no mention anywhere in this security proceeding of the financial accounts of the appellant, published or otherwise or any other credit information concerning the appellant having been obtained and considered by the respondents. This does seem to the tribunal to be extraordinary in the particular circumstances of this appellant who had gone to some trouble to explain what it was doing and why.

43. The manner in which Mr Reeves undertook the assessment of the amount of security required seems also to have the hallmarks of one which was not greatly concerned with the balancing of risk with the potential for damage to the appellant's business. The initial calculation included not only 6 months estimate of future liability for VAT but also the VAT arrears. Significantly the amount in dispute in the MTIC proceedings was not included in the calculation which has been suggested as an indication that this was not considered to be money which was at risk to the Revenue.

44. Mr Reeves omitted to take account of a significant repayment claim made by the appellant for the period 04/11 in its business. Again the explanation for this by Mr Reeves was less than convincing. He said that this repayment claim might not form part of the regular pattern of the appellant's business but it was pointed out to him that repayments had previously been made and that it was unreasonable not to take account therefore of this element in coming to a decision as to the amount of security required. The tribunal agrees.

45. The conclusion which the tribunal has drawn from these proceedings is that the process of deciding to issue the Notice of Requirement and the assessment of the sum in which the notice was issued was flawed. The process involved a failure to take account of relevant matters and the assessment of a sum for the security which was in excess of that reasonably required to secure the risk to the revenue. On both accounts the decision needs to be revisited. As a result of these shortcomings HMRC has come to a decision at which no reasonable panel of commissioners properly constituted could have arrived. It is for the respondents to decide whether to issue a new Notice of Requirement and if so in what sum.

46. In order that there should be no doubt about this matter the tribunal makes it quite clear that it does not accept that the appellant was in fact entitled to withhold VAT in the manner in which it has chosen to do. It understands why the appellant has done this but that does not mean that it approves of this course of action.

47. For the reasons stated above the Tribunal allows this appeal

48. 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.

CHRISTOPHER HACKING

TRIBUNAL JUDGE

RELEASE DATE: 17 March 2014