TC04208

Appeal number: TC/2013/04253

VAT – misdeclaration penalty – s 63 VATA – disallowance of input tax on Kittell basis – penalty not assessed and notified until nearly two years after Tribunal appeal against disallowance withdrawn – whether penalty assessed out of time – s 77(2) VATA allowing assessment up to two years after amount of VAT due for relevant period has been "finally determined" – whether this took place on withdrawal of appeal or at earlier time – further mitigation of penalty also sought – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

R S GARMENTS (a firm comprising Ragveer Singh and Balbir Kaur) **Appellants**

-and-

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

TRIBUNAL: **JUDGE KEVIN POOLE**
MRS SHAMEEM AKHTAR

Sitting in public in Priory Court, Birmingham on 17 September 2014

Robert Holland of Dass Solicitors for the Appellant

Simon Charles of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal concerns a misdeclaration penalty assessed under s 63 Value Added Tax Act 1994 ("VATA"). It is concerned in particular with the time limit applicable to the assessment of such a penalty in the particular circumstances of the case and whether, if the penalty was assessed in time, it ought to be mitigated by more than the 5% mitigation allowed by HMRC.

The facts

2. We received a small bundle of documents and heard oral evidence from Ragveer Singh, a partner in the appellant firm, and from Officer Piers Ginn, the HMRC officer who checked and agreed to the issue of the penalty the subject of this appeal. We find the following facts.

3. The appellant firm (comprising Ragveer Singh and his mother Balbir Kaur) commenced to trade on 6 April 2007, in succession to a sole trader business previously carried on by Balbir Kaur since at least 31 May 2006. The VAT registration number of the original business was transferred to the firm.

4. The appellants claimed a net repayment of £197,901.34 of VAT in respect of their VAT period ended 30 April 2007 (compared to the previous three returns submitted by Mrs Kaur which had reflected payment liabilities of approximately £11,500 in total). HMRC undertook an exercise to verify the claimed repayment and decided to refuse it, on the basis that it arose out of transactions which the appellants knew, or ought to have known, were connected with VAT fraud. The appellants co-operated with the verification exercise, providing copies of relevant documents and attending meetings. HMRC's decision to disallow £204,092.22 of input tax (which related to purchases of fabric) and accordingly to refuse the repayment was issued on 16 October 2008 by Officer Peter Knapp.

5. The appellants appealed against the decision to the VAT and Duties Tribunal on 13 November 2008.

6. The appeal continued until 1 June 2011, when Dass Solicitors gave formal notice of withdrawal of the appeal to the Tribunal. The hearing of the appeal had been fixed for 20 June 2011.

7. In January 2013, Officer Ginn became involved in a project at HMRC whose purpose was to consider the feasibility of issuing misdeclaration penalty notices to traders who had been subjected to disallowance of input tax on MTIC grounds. As part of the project, traders were prioritised by reference to what HMRC considered to be the relevant two year limitation period provided for in section 77(2) VATA. As HMRC considered that two year period to have started to run on 1 June 2011 in relation to the appellants, the process of considering this particular case for penalty purposes was commenced on 8 May 2013.

8. The views of Officer Knapp (the Officer who had originally made the decision to disallow the input tax) as to the mitigation of any penalty were sought by means of a written "mitigation framework" document, no copy of which was unfortunately included in the evidence before us. On the basis of that document and an assessment of HMRC's files and records, Officer Neil Mackay produced a proposed penalty and the role of Officer Ginn was to check and agree with it before it could be issued. No copy of Officer Mackay's proposal was included in the evidence before us, and Officer Ginn could not recall whether he had agreed with or modified Officer Mackay's original proposal, but in any event Officer Mackay sent a letter dated 23 May 2013 to the appellants (which Officer Ginn said he would have checked and agreed) notifying the assessment of a misdeclaration penalty of £29,083, calculated as 15% of the amount of disallowed input tax (£204,092.22), resulting in a penalty before mitigation of £30,613.83, with mitigation (at 5%) of £1,530.69, thus arriving at a final penalty of £29,083 after rounding down to the nearest pound.

9. In the letter notifying the penalty, Officer Mackay explained the factors which had been taken into account in arriving at the 5% mitigation as follows:

> "* How the infringement occurred
>
> * Degree of cooperation in identifying and quantifying the error
>
> * Evidence of efforts made to seek advice
>
> * Evidence of steps taken to correct systems in order to prevent similar errors in future
>
> * Compliance history"

10. In cross-examination, Officer Ginn said 2.5% mitigation was allocated in respect of the compliance history of the appellants (where he was not aware of any "significant issues") and 2.5% mitigation in respect of the assistance that had been provided in quantifying the error once HMRC had questioned it (by providing the necessary records and attending meetings), though in his witness statement he had said that the whole 5% "relates to the fact that the Appellant supplied HMRC with the information requested and attended meetings, but at no point did the Appellant actively quantify the misdeclaration to HMRC."

The issues, the submissions of the parties and the related law

11. On behalf of the appellants, Mr Holland accepted that, in the light of their withdrawal of the appeal in June 2011, it could not be argued that they had a reasonable excuse for the error in the return: by withdrawing from the appeal they had implicitly accepted that they knew or should have known of the connection to fraud and therefore that the input tax was not properly claimable. In this regard, Mr Holland accepted that the decision in *Meridian Defence & Security Limited v HMRC* [2014] UKFTT 300 (TC) was correct.

12. There was no disagreement between the parties that the requirements of section 63(2) VATA (which requires the potential VAT loss to exceed a certain size before a penalty can be imposed under s 63 VATA) were satisfied.

13. The only disputes were therefore:

(1) whether the penalty assessment had been made within the time required by section 77(2) VATA; and

(2) whether the amount of mitigation applied by HMRC was appropriate.

14. We consider these two points in turn.

Time limit

15. Section 77(2) VATA provides as follows:

> "Subject to subsection (5) below, an assessment under section 76 of an amount due by way of any penalty, interest or surcharge referred to in subsection (3) of that section may be made at any time before the expiry of the period of 2 years beginning with the time when the amount of VAT due for the prescribed accounting period concerned has been finally determined."

16. It was common ground that the decision under appeal concerned "an assessment under section 76 of an amount due by way of any penalty, interest or surcharge referred to in subsection (3) of that section". The only question therefore was whether the time when the assessment was "made" was before the expiry of two years "beginning with the time when the amount of the VAT due for the prescribed accounting period concerned has been finally determined".

17. Whilst the letter dated 23 May 2013 notifying the assessment to the appellants did not give the date on which the assessment had been made, it must have been on that date or earlier, otherwise it could not have been notified on that date.

18. The key dispute between the parties was when "the amount of the VAT due for the prescribed accounting period concerned has been finally determined".

19. Mr Charles submitted, based on statements of the Court of Appeal in *Liaquat Ali (trading as Vakas Balti) v HMRC* [2006] EWCA Civ 1572, that the amount of the appellants' VAT due for period 04/07 was "finally determined" on 1 June 2011, when the appellants' appeal against the original decision to disallow the input tax was withdrawn. It followed that the assessment which was notified to the appellants on 23 May 2013 was made within the relevant two year period.

20. *Liaquat Ali* was concerned with a dishonest evasion penalty under section 60 VATA (not, as in the present appeal, a misdeclaration penalty under section 63 VATA). The taxpayer had failed to register for VAT and he was assessed for an amount of unpaid VAT which, it turned out, was too low. The Commissioners purported to amend the assessment and then notified a dishonest evasion penalty

based on the amount of unpaid tax comprised in the amended assessment. At the hearing, the Commissioners accepted that the purported amended assessment was invalid, and withdrew it (there being no power to amend an assessment – they should have notified a supplemental or amended assessment, but it was too late to take either step by the time of the hearing). However, they sought to maintain the dishonest evasion penalty based on the amount of unpaid VAT comprised in the invalidly amended assessment, and the issue before the Court of Appeal was whether they could do so; in other words, could a penalty be calculated by reference to an amount of VAT that was not legally due?

21. Whilst there was no suggestion in that case that the penalty assessment was out of time, the Court of Appeal considered the time limit provisions for the purpose of deciding the question that was actually before them. Section 77(2) VATA applied to penalties under section 60 VATA (as it does to the penalty in this appeal) and the Court of Appeal therefore felt the need to make some comment about the meaning of the phrase "finally determined" as it appears in that subsection, for the purpose of addressing the taxpayer's submissions about the effect of the subsection in deciding the issue under appeal.

22. In particular, they said this (per Lloyd LJ) at [40] and [47]:

> "Suppose the Commissioners have issued a tax assessment which has been successfully appealed, against their opposition, so that, on the facts known, the tax has been finally determined, but not as contended for by the Commissioners. It matters not what sort of tax assessment led to the successful appeal. Under section 77(2) the Commissioners then have a further period of 2 years in which to make an assessment to a civil evasion penalty (if they have not already done so).
>
> … After the determination of an appeal against a tax assessment, the Commissioners have two years under section 77(2) to make a penalty assessment on the basis of dishonesty in any event, and they may have a longer period by virtue of section 77(4)"

and (per Arden LJ) at [55]:

> "I agree with the rejection by Lloyd LJ of the appellants' arguments as to the meaning of "finally determined" for the reasons he gives. I agree with him that it refers to the final determination of the VAT due whether by assessment and the expiration of the time for appeal against that assessment or by appeal so far as an appeal lies."

23. On the basis of these comments, Mr Charles submitted that the VAT due for accounting period 04/07 only became "finally determined" on 1 June 2011 when the appellants withdrew their appeal against the decision to refuse the relevant input tax claimed for that period.

24. Mr Holland submitted that the comments in *Liaquat Ali* should be read alongside the general comments made by the Court of Appeal in the subsequent case

of *HMRC v BUPA Purchasing Limited and others* [2007] EWCA Civ 542, in particular as to the importance of time limits for raising assessments.

25. *BUPA* was concerned with an entirely different question from that involved in this appeal; essentially it was being argued that HMRC's interpretation of the various provisions limiting the time for making assessments was effectively driving a coach and horses through the time limits that were imposed by Parliament. The Court of Appeal disagreed, though in doing so it made some general comments about time limits to which Mr Holland referred us (per Arden LJ at [59] and [60]):

> "I accept that time limits are an important driver of good governance in tax matters. They are imposed by Parliament on the Commissioners, and by their very nature in any context they often give uncovenanted (but important) benefits to a party.
>
> … Nonetheless, the purpose of time bars is primarily to protect the taxpayer from being faced with a stale claim for the first time after the limitation period has expired."

26. Mr Holland submitted that in this case, Parliament would have wished to confer the benefit of a time bar defence to protect the taxpayer from being faced with a stale claim relating to events which occurred over six years before the penalty was raised and well over seven years before the appeal against the penalty is being heard. He pointed out that this was not a dishonest evasion case like *Liaquat Ali*, in which the passage of time would make it harder for HMRC to discharge the burden of proof; in the present case, he said, the burden of proof lay on the appellants and in those circumstances it was not only contrary to the intentions of Parliament but also in breach of the European law requirements of legal certainty and proportionality to interpret the phrase "finally determined" as referring to anything later (in this case) than the decision by HMRC to disallow the claimed input tax (which was communicated to the appellants on 16 October 2008). He appeared to accept that if the appeal against the assessment had run its course and been determined by the Tribunal, the date of that determination would "in effect" amount to a "new final determination".

Mitigation

27. Section 70(1) VATA contains a general power for HMRC or, on appeal, the Tribunal, to "reduce the penalty to such amount (including nil) as they think proper". It is made clear by s 70(2) VATA that the Tribunal has power to cancel any mitigation applied by HMRC. There are also certain matters listed in s 70(4) which must not be taken into account when considering mitigation:

> "(a) the insufficiency of the funds available to any person for paying the VAT due or for paying the amount of the penalty;
>
> (b) the fact that there has, in the case in question or in that case taken together with any other cases, been no or no significant loss of VAT;

(c) the fact that the person liable to the penalty or a person acting on his behalf has acted in good faith."

28. Mr Holland argued that there were some "flaws and weaknesses" in HMRC's approach to assessing the penalty and applying mitigation to it, though he was not specific about the detail. Whilst accepting that the withdrawal of the appellants' appeal precluded them from arguing they had acted innocently when submitting the return, he argued that some credit should be given for the fact that the appellants had withdrawn the appeal, thereby accepting that they had made an incorrect return and admitting the amount involved. However, there was no evidence of any wider factors that might have had a bearing on mitigation.

29. Mr Charles submitted there was no material evidence before the Tribunal which could justify any further mitigation beyond the 5% already given. The appellants had made an admittedly incorrect return and by withdrawing from the appeal they had effectively admitted that they knew or should have known that the relevant transactions were connected to fraud and therefore could not give rise to recoverable input VAT. Any wider suggestion that they had acted in good faith could not be taken into account under s 70(4)(c) VATA (above). Their co-operation was no more than delivering the records which were properly required by HMRC and attendance at meetings – they had done nothing to identify or quantify the error until pressed to do so by HMRC. Any suggestion that credit should be given for the fact that they had withdrawn from the appeal was negated by the express basis on which they had done so – i.e. that they did not have the funds to fight the appeal, rather than specifically accepting that their appeal had no merit. There was no evidence of them having sought any advice before making the return. There had been no correction to their systems in order to prevent a similar error in the future – what had actually happened was that they had not made any further attempts at MTIC trading once HMRC had pulled them up on this attempt. Finally, the compliance history of Mrs Kaur, whilst not known to contain any other problems, was short.

Discussion and conclusion

Time limit

30. We essentially agree with the submissions of Mr Charles. It seems clear, on the basis of the comments of the Court of Appeal in *Liaquat Ali*, that if the appeal against the original assessment had been continued to a conclusion and decided by the Tribunal, the liability to VAT for the relevant period would have been "finally determined" by that decision (subject to any appeal). We consider that the appellants' withdrawal from the appeal (as a result of which HMRC's decision to deny the input tax became final) should be regarded in exactly the same way. We see nothing in Mr Holland's arguments about the intentions of Parliament (which seem to us to have been expressed in terms which are perfectly sufficient to undermine his argument) or about the European law principles he referred to (which he did not develop in any detailed way, but which seem to us to be of equally little assistance to the appellants).

31. We find that the penalty assessment was made before the expiry of two years beginning with the time when the amount of VAT due for period 04/07 was finally determined by virtue of the appellants withdrawing from the appeal on 1 June 2011.

Mitigation

32. On the question of mitigation, we do not consider that the appellants' withdrawal of the substantive appeal shortly before the hearing merits any greater mitigation than the 5% already given by HMRC for the general co-operation of the appellants. There was nothing in the evidence before us that persuaded us the mitigation applied by HMRC was inadequate.

Conclusion

33. It follows that we consider the penalty assessment to have been made within the time limit prescribed in s 77(2) VATA and that we see no reason to interfere with the 5% mitigation applied by HMRC.

34. The appeal is therefore dismissed.

35. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 30 December 2014