[2015] UKFTT 0406 (TC)

TC04583

Appeal number: TC/2011/10238

Value Added Tax - Kittel challenge, assessing the Appellant to recover input tax that the Appellant had deducted between mid-2007 and 2010 (generally reducing output tax liabilities in its 3-monthly periods, but occasioning repayments in four periods) when the Appellant knew that the associated company that had made the supplies generating the input tax had neither filed any returns since July 2007, nor paid any VAT - whether the loss of the VAT by the non-payment by the associated company had been fraudulent - Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MEDALLION EUROPE LIMITED

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: JUDGE HOWARD M. NOWLAN

MICHAEL SHARP

Sitting at the Royal Courts of Justice in London on 11 to 19 May 2015

Giselle McGowan, counsel, instructed by Lawrence Sternberg, on behalf of the Appellant

Karen Robinson, counsel, instructed by HMRC, on behalf of the Respondents

DECISION

Introduction

1. This has been a difficult case. While the facts and the law have both been relatively simple, the difficult issue has been the finely balanced one of deciding whether the failure of one company to file VAT returns for 31 monthly VAT periods, and the failure to pay any VAT has occasioned a fraudulent loss of VAT, when the person in control of the company, and primarily responsible for those omissions, was a person of generally high integrity for whom we had very considerable regard.

2. The issue arose as follows. The Appeal involved two companies, effectively under common control, both of which ended up with an involvement in the printing business. For the purposes of this Appeal, the company that had initially been the only company trading as a printing company had been Medallion UK Limited ("MUK"). Between 2003 and early 2007 the associated company, the Appellant, had been involved solely in a marketing or distribution role for a totally different business that the common director of the two companies, Mr. Sheetal Ghai ("Mr. Ghai") was involved in in the USA.

3. By early 2007, losses and potential liabilities incurred by MUK led to the factoring company, Cattles Commercial Finance ("Cattles"), that was factoring MUK's receivables (with right of recourse against MUK if the factored debts were not eventually paid) indicating that it was no longer prepared to factor debts owed to MUK. Cattles suggested that if MUK undertook all of its printing for the Appellant (a company without the relevant liabilities) and it was the Appellant that made the supplies to all the customers, Cattles would then continue to factor the debts.

4. This proposal was accepted and a somewhat informal arrangement was then set up under which MUK undertook all the printing work, and then sold the printed material to its marketing affiliate, or else MUK rendered numerous services (provision of staff, machinery and rental property) to the affiliate. While we were clear that this structure was set up to accommodate Cattles, one of its consequences was that if there was no group registration including the two Medallion companies, MUK would be liable for VAT on its supplies to the Appellant (some possibly being zero-rated if the right analysis was that MUK was conducting a printing trade and some of the supplies were zero-rated), and the Appellant secured an input deduction for the invoiced amounts of VAT.

5. As a result of MUK's general problems, by 2007 it had already fallen behind with liability for PAYE and NIC, and from the monthly VAT period 07/07, Mr. Ghai ceased the earlier practice of making regular (albeit periodically late) monthly VAT returns for MUK. No returns were made for 31 VAT periods. Automatic "centralised assessments" of VAT liability were made on MUK by HMRC but the relevant assessments were for vastly lower amounts than the true liability, and MUK neither paid nor appealed the assessments or the default surcharges. Invoices in respect of the true supplies were, however, furnished to the Appellant, and the Appellant did make VAT returns (again well after the due date on several occasions), and the VAT associated with the supplies from MUK constituted about 50% of the Appellant's claim for input tax. In four (three-monthly) periods, the Appellant actually

made VAT reclaims while in other periods the claims for the input tax simply reduced the Appellant's net payment of output tax.

6. In the period prior to March 2009, HMRC had been seeking to recover PAYE and NIC non-payments from MUK, and, allegedly on the basis that these matters had to be resolved before turning to unpaid VAT, HMRC appeared not to wish to discuss unpaid VAT with Mr. Ghai, until the PAYE and NIC debts had been settled. In addition, HMRC did not include the non-paid VAT (even that based on the centralised assessments) in their claim, when they eventually obtained judgement on 12 March 2009 for virtually £87,725.76, in respect of unpaid PAYE and NIC. By the time of the court hearing, Mr. Ghai had, however, not mentioned that the real VAT debt was very considerably higher than that based on the centralised assessment, and neither was included in the claim before the court. In 2010, HMRC put MUK in liquidation and while we were not given any information about recoveries, we assumed that none, or virtually none, of the PAYE and NIC debts were recovered. Again it seems that HMRC did not prove in the liquidation for any VAT debt, and they certainly had no information about its true level.

7. Later in 2010 and 2011, HMRC discovered that the underpayment of VAT had actually been in a considerably higher amount than the largely or wholly non-paid PAYE and NIC. The under-payment by the then liquidated MUK was never calculated though it is likely to have been somewhat short of £200,000. HMRC claimed, however, that the present Appellant was denied all the input tax claims in relation to supplies from MUK because it knew that its input claims had been connected with a VAT loss, with HMRC then claiming in accordance with the decision in *Axel Kittel v. Belgium; Belgium v. Recolta Recycling SPRL* (C-439/04 and C-440/04 [2006] ECR 1-6161 ("*Kittel*") that the VAT loss had been fraudulent. The result, under the *Kittel* line of authority, was that the Appellant was denied its related input claim, the total of which had been £230,000 (following a small reduction conceded in the hearing that we will ignore) since the 06/07 period. The actual net loss at the level of MUK would have been less than that figure, by the amount of MUK's legitimate deductions for input tax. Where *Kittel* denies a trader that knew or ought to have known that its purchase was connected with a fraudulent VAT loss, the trader forfeits the whole of the input tax, regardless of whether the actual loss at the level of the supplier might have been at a lower figure.

8. While other contentions were raised in addition to the *Kittel* challenge, and very nearly the majority of the hearing was dedicated to such other contentions, they were abandoned on the last day of the hearing, very likely in response to suggestions that we made. Since the common control rendered it inevitable that the Appellant and Mr. Ghai were entirely familiar with what had happened, or rather what had not happened, at the level of MUK, the only matter that we now need to decide is whether the admitted VAT loss at the level of MUK was fraudulent or not.

The evidence

9. Evidence had been given by two HMRC officers, by Mr. Ghai's accountant, by Mr. Ghai's cousin who held 40% of the shares in MUK and worked actively in the business when it commenced trading though for only a few months, and by Mr. and Mrs. Ghai. We will in due course shortly describe the further one or two non-*Kittel* challenges that HMRC had made in relation to the deductibility of the Appellant's input tax, which were abandoned on

the last day of the hearing. Much of the evidence related to them. So far as the only remaining issue is concerned, virtually everything now revolves around the general integrity of Mr. Ghai, along with the business pressures that he was obviously suffering; the circumstances relating to the failure to make returns or to pay VAT for the 31 periods; the whole arrangement in relation to the supply of services between the two companies, and the discussions between Mr. Ghai and HMRC in relation to the various defaults and requests for time to pay negotiations. Evidence and documentary evidence was furnished by HMRC in relation to various fairly limited discussions between Mr. Ghai and HMRC in relation to clearing the defaults (principally those in relation to PAYE and NIC) and we will mention the relevant points in expanding on the facts. That aside, everything in this Appeal now revolves around our judgment of the integrity and evidence of Mr. Ghai.

10. We will in due course comment generally on Mr. Ghai's evidence and the fact that we did regard him to be a highly competent and knowledgeable businessman. The comments will make more sense, however, if we describe the relevant facts in more detail first.

The facts in more detail

11. Mr. and Mrs. Ghai had been involved prior to 2003 in at least two businesses. One was Mr. Ghai's role in relation to the Appellant, which since the 1990s had been undertaking a limited role in relation to invoicing, and delivering goods sourced by the American company with which Mr. Ghai was involved. More relevantly, both Mr. and Mrs. Ghai had had some role in a printing company called Fairprint Limited. It seemed that either one of their fathers or uncles had been involved in the printing business and that it was something of a family tradition.

12. When Fairprint Limited was placed in administration, Mr. Ghai said that as he and his wife had been called upon to honour personal guarantees, they found that they had effectively ended up owning most of the equipment required to run a printing company. At the same time, their cousin or one of their cousins, Mr. Handa, was made redundant and because he had also been influenced by the family's printing tradition, he decided to join with Mr. and Mrs. Ghai in forming MUK. Mr. Handa owned 40% of the shares and Mr. and Mrs. Ghai the balance between them. MUK then commenced its printing trade. We were told that the printing business was very competitive and that the great majority of new companies failed. Mr. Handa certainly realised that the business was going, at the least, to be difficult, and he therefore obtained re-employment elsewhere and ceased to play any active role in MUK's business before the end of 2003.

13. At some time well before 2006, MUK had acquired two printing presses, one called a B1 press, and the other a B2 press, the latter apparently printing up to half the capacity or size of the former. They had been supplied by Kenmark Print Machinery Limited, then the largest supplier in Europe of second-hand printing equipment, and they had been financed on hire purchase by a finance company called Surrey Asset Finance. We were not given the size and weight of the machines, nor the figures of monthly or yearly hire purchase payments but on the assumption that the B1 machine at least was of roughly the size of a later press that Mr. Ghai described to us, the B1 machine must have been a vast machine. The one that Mr. Ghai described was said to be longer than the very large court in which the hearing was taking place, and the weight of the machine would have been very considerable.

14. The B1 machine was apparently always troublesome; the B2 machine was less troublesome but it had not been serviced and maintained and notwithstanding that both had been purchased from an apparently reputable supplier, they proved extremely unsatisfactory. They occasioned losses in the business, leading to Mr. Ghai ceasing to make the regular payments to Surrey Asset Finance. Surrey Asset Finance sued for the payments and obtained judgment apparently in August 2005. MUK would have made claims against the supplier but it had gone into liquidation. Mr. Ghai also wished to bring counter-claims against Surrey Asset Finance for up to £1million for the losses that the defective machines had occasioned, the hire purchase company bearing a statutory liability for the condition of the machines under hire purchase law, but inability to fund lawyers to present the counter-claim precluded MUK from pursuing it. We understand, however, that the dispute with Surrey Asset Finance was eventually settled on the basis that the judgment in their favour was effectively ignored; no material payment had to be made to Surrey Asset Finance, but nevertheless MUK did not manage to negotiate any further payments in its favour to compensate for the losses.

15. MUK had suffered another problem in relation to water damage resulting from a leaking roof in its leased premises. It appears that MUK must have been responsible for such repairs because it also had to meet claims from the landlord, or building costs to remedy the defects.

16. The MUK business had apparently always operated on the basis that it factored its receivables to the finance company Cattles that we have already mentioned, MUK being responsible to bear the cost of bad debts if any of the debtors ultimately failed to pay their debts. Once MUK was involved in litigation with Surrey Asset Finance, and disputes with its landlord, Cattles apparently indicated that the reduced credit standing of MUK meant that Cattles were no longer prepared to rely on ultimate rights of recovery against MUK, though if sales could be routed through another company, without the complication of the litigation, disputes and losses, they would continue to factor the debts owed to that other company.

17. A scheme was therefore devised under which there would be some form of arrangement with the Appellant, a “clean” company, so to speak, that conveniently already existed, under which either the Appellant would become the marketing arm of MUK’s business, or else the Appellant would rank as the printer, with MUK rendering numerous services, i.e. provision of staff, machinery and premises, to enable the Appellant to operate. It seems from information given to HMRC in a routine VAT visit made in July 2006 that this arrangement had probably commenced in April 2006.

18. There was considerable, now irrelevant, dispute in the hearing as to whether Mr. Ghai had or had not said that there was a written contract in relation to the supplies rendered by MUK to the Appellant. There was clearly no written contract, and this is not surprising when we observe that the arrangement was rather vague, and that it inherently had to be flexible. Initially the deal was that whilst the Appellant would be the party to all contracts with customers, with the result that the Appellant would invoice customers and factor the relevant receivables with Cattles, the Appellant would pay MUK 80% of its receivables to MUK for MUK’s services, so that MUK could meet its various expenses.

19. We should mention one or two minor points in relation to the arrangement between the two companies, before turning to the principal feature of relevance in this Appeal. One

minor question was whether the right analysis at the outset was that MUK was still conducting a full printing trade, albeit always printing for the one customer, or whether the printing trade was fundamentally conducted by the Appellant, with MUK thus providing the various services of provision of staff, machinery and premises. It seems that the only relevance of this issue is that if MUK was still printing for the one customer, it would follow that some of its supplies would be standard-rated while others might be zero-rated. This was apparently the approach adopted by MUK in preparing its monthly invoices to the Appellant. In other words, supplies that would later rank as zero-rated supplies when made to end customers by the Appellant were treated in the same manner when MUK invoiced the Appellant. HMRC apparently suggested that this was wrong at some point, and that all MUK's supplies should be treated as standard-rated. While no attention was given to this issue in the hearing, it certainly seems that MUK always continued to treat some supplies as standard-rated and others as zero-rated. Moreover this analysis would sound to have been justified at least in the early period of the operation of the arrangement. Over time, functions were however passed over to the Appellant, and the picture appears to have somewhat changed. When the lease came up for renewal, the lease was taken out by the Appellant. When different second-hand machinery was acquired, it was acquired by the Appellant, and it may eventually have been the case that apart from staff secondment, little was being done by MUK. Reflecting this, the percentage of the Appellant's receivables payable to MUK was reduced, first to 60% for two months and then to 40%. As functions were progressively passed over to the Appellant, we accept that it became more realistic to treat the remaining supplies as constituting simply standard-rated support services in the Appellant's expanding printing activity.

20. It does of course follow that insofar as MUK treated some of its supplies to the Appellant as being zero-rated and chose not to follow HMRC's suggestion of treating them all as standard-rated services, this approach has actually marginally diminished the present problem of no tax having been paid by MUK on the services supplied, with the Appellant then claiming a matching input deduction in respect of standard-rated services.

21. Another point to mention, and we do not over-stress it because the Respondents said that they had no record of it, but nevertheless Mr. Ghai said that he had asked HMRC whether supplies from MUK to the Appellant could just be disregarded. Since in fact this would have been the effect of a group registration, had one been made, it seems somewhat regrettable that according to Mr. Ghai, this suggestion had been turned down by HMRC and they had simply said that MUK should issue the invoices for the supplies and duly make its VAT returns. A group registration could of course have been made, and this would have altogether eliminated the whole of the problem so that it seems to be a shame that it was not considered more carefully.

22. The final point that we should make before turning to what actually happened in relation to invoicing and VAT returns is that, as a formal finding of fact, we are quite clear that the service role between the two companies, MUK and the Appellant, all commenced because of Cattles requirements before it would continue to factor the receivables, and we are clear that there was no intention on the part of Mr. Ghai, or anyone, to set up a scheme, plainly fraudulently, so that one party would render services to the other, the first would fail to make returns and to pay any VAT, and the other would make input claims for VAT that had never been paid. Beyond our having no hesitation in making that clear finding of fact, it

also seems fairly obvious that no deliberate fraudster could possibly have initiated a scheme based on an expectation that it would take from mid-2006 to 2010 and 2011 before HMRC tumbled to what was happening, when MUK would have failed to make any VAT returns, or to pay any VAT, for 31 periods. In particular when the HMRC officer's meeting note for the meeting referred to in paragraph 17 above, held in July 2007, concluded by saying:

> *"4. Matters for consideration: Invoicing arrangements twixt Medallion UK Plc and Medallion Europe Ltd should be considered and checked,"*

the intending fraudster might have thought it improbable that a plan for failing to pay the VAT in one company and recovering it, or obtaining credit, in the other would have been very likely to succeed So we certainly conclude that there was no deliberate plan to achieve the results that in fact materialised.

23. Having now aired those relatively minor points, what actually happened is that MUK did regularly invoice the Appellant on a monthly basis, largely in accordance with the 80%, and later 60% and 40% proportions of the Appellant's receivables. The Appellant had three-month VAT periods, so that it was clear that the monthly invoicing would have been based on calculating the monthly receivables of the Appellant for the purpose of calculating the monthly amounts to be invoiced. We will turn below to certain minor defects in relation to the actual invoicing.

24. The serious point to record, however, is that, while MUK's monthly VAT returns had been made up until mid-2007, with the June return being dealt with, out of time, in August 2007, Mr. Ghai, who accepted that he was principally responsible for the returns, refrained from making any returns for MUK for the 07/07 period and for the following 30 monthly periods. As we have also said, however, the Appellant, armed with the invoices from MUK, did make its three-monthly VAT returns (some out of time), claiming input deductions for the VAT referred to as chargeable in respect of all MUK's invoices.

25. When asked why he had ceased to make the VAT returns for MUK, Mr. Ghai's answer was that he decided not to make the returns once he was clear that MUK did not have the funds with which to pay the VAT. There was some slightly inconclusive cross-examination as to whether Mr. Ghai knew that there was a legal requirement to make VAT returns within the appropriate period after the end of each VAT period. Mr. Ghai said that he certainly now knew that that was the case. We did not understand him to assert that he thought back in 2007 that it was unnecessary to make the returns in a timely fashion. Had he asserted that he thought that this was unnecessary, we would not have accepted that evidence, firstly because as an experienced accountant and businessman it would have been inconceivable that Mr. Ghai could truly have believed such an assertion, and secondly because anyone could have reasoned that the absence of such an obligation would have undermined any tax collection system. Furthermore when he received monthly default surcharges in respect of each failure to make a return, and the failure even to pay the VAT assessed (i.e. the very modest amount charged under the automatic "centralised assessment" procedure), he said that he sometimes opened the envelopes and sometimes he chose not to open them. When he opened the envelopes, in view of the standard wording that would have been bound to accompany default surcharge notices, it seems extraordinarily improbable that he would never have read the text that made the reporting and payment obligations obvious.

26. From some date prior to July 2007, Mr. Ghai knew that MUK had also failed to keep up to date with its PAYE and NIC payments. In the light of this, and when anyway MUK had other pressing creditors, we think it realistic to suppose that Mr. Ghai's slightly more realistic reason for having ceased to file VAT returns would have been that when he had pressing claims from general creditors and when he was already in arrears with PAYE and NIC payments, he found it preferable to try to deal with and satisfy MUK's various creditors and problems one at a time, rather than to accelerate a material increase in those problems. Inevitably he had to deal with demands from suppliers first, along with the payment of net wages to the staff or else the business would inevitably cease. Whilst HMRC would object to being placed last in the queue of creditors, in order to keep the business operating, he will almost certainly have felt that he had no alternative but to choose this order for dealing with his numerous problems. We are not remotely saying that this was right or justified. We are merely speculating that this would have been the true explanation for why Mr. Ghai would have failed to make VAT returns, so refraining from drawing HMRC's attention to the unfortunate fact that the VAT actually owed was considerably greater than that in the centralised assessments.

27. In terms of our having to assess whether Mr. Ghai acted fraudulently or dishonestly, it is worth just recording that there are several respects in which his actions support his claim that he was not being dishonest. Beyond the really material fact, all related to whether he hoped and intended to discharge the VAT debt in full eventually, it is certainly worth noting that:

- Mr. Ghai never dreamt of paying the VAT assessed under the centralised assessments, without drawing HMRC's attention to the fact that those assessments were materially too low;
- he did not seek to maximise the element of non-payment, coupled with recovery, by treating all the supplies as being standard-rated, as he was invited and instructed to do by HMRC; and
- he appeared (at least according to his evidence) almost to have requested the substance of a group registration between the two companies, which HMRC seemed to tell him to ignore, when such a registration would have been both entirely feasible, and bound to eliminate the present problem or opportunity of non-payment coupled with credit.

The negotiations with HMRC officers in relation to underpaid PAYE and NIC

28. There had been occasional contacts and discussions between HMRC and Mr. Ghai in relation to the discharge, and a possible "time to pay" agreement for the unpaid PAYE and NIC debts. Mr. Ghai said that he had been told that he could not negotiate in relation to historic PAYE and NIC outstanding debts until the current payments were being made correctly, and also that he could not enter into negotiations in relation to VAT until the PAYE and NIC arrears had been settled or discharged. The reason for this, confirmed by the witness for HMRC responsible for collection matters, was that interest accumulated in respect of PAYE and NIC debts, but did not run in respect of many VAT liabilities, so that in the interests of taxpayers HMRC conceded a policy of seeking to clear first the debts that were accumulating interest, only thereafter turning to the VAT debt. Whilst this was the prime reason for dealing with PAYE and NIC first, we do note that there were two references

in the letters and documents to why the PAYE and NIC were being dealt with first that made the point that these debts were thought to be larger than the VAT liability. That was certainly so as regards the accumulating VAT debts resulting from the centralised assessments, but had HMRC known that the real VAT debts were considerably higher than their centralised assessments, they would almost certainly have had to conclude that the outstanding VAT debt exceeded the PAYE and NIC debts. In any event it remains the case that in the run-up to the March 2009 County Court hearing in relation to the PAYE and NIC debts that we deal with in the next paragraph and indeed even before and indeed after the actual liquidation of MUK in 2010, HMRC had still not been told either that the true VAT debt owing was considerably higher than the amounts in the centralised assessments, nor indeed had there been any mention of the outstanding VAT.

29. Contacts between Mr. Ghai and HMRC in relation to the outstanding PAYE and VAT debts (particularly in 2008) were fairly sporadic because on at least two occasions Mr. Ghai had to defer any discussions because of his need to go to America for the purpose of his US business. The Appellant's counsel suggested that there were regular attempts by Mr. Ghai to discuss the defaults, particularly those in relation to PAYE and NIC that had to be dealt with first. We consider this to be an exaggeration. If we ignore records of phone calls that were largely administrative in the sense of trying to arrange for future discussions, and reference to promised calls that were not made, the actual contacts were relatively few, and virtually none involved either a serious disclosure or a serious negotiation. Mr. Ghai also accepted that he had a bit of a habit of putting matters off until the last minute, and he did not put any payment plan to HMRC in relation to the unpaid PAYE and NIC debts until March 2009, immediately before there was to be a County Court hearing in which HMRC sought judgment for £87,725.76 in respect of the PAYE and NIC debts.

30. The very rough payment plan that was sent to HMRC's Debt Management centre on 6 March 2009 (received on the 9 March) in anticipation of the County Court hearing on 12 March, was sent with a letter that explained all the troubles that MUK had had in relation to the defective printers, and it explained that other creditors had by March 2009 been dealt with. The one page handwritten monthly "income and expenditure" budget that accompanied the letter suggested that the average monthly income was £48,000, and the projected expenses £41,635, such that there was a projected monthly surplus of £6,365. Points to mention in relation to the relevant "Business Budget" were that:

- to Mr. Ghai's credit, the statement did indicate that the monthly liability for VAT was put at £5,600, which nobody from HMRC noticed (during 2009 and much of 2010) considerably exceeded the figure in the centralised assessments;
- while there was at least a figure of £2,000 for "sundry expenses", some of the figures looked to be relatively low and none were explained and justified. Doubtless this might have been done, had the projection been treated as a starting point for negotiations; and
- one of the deductions, as an expense, was a monthly "loan repayment" figure of £1,130.

The proposition then advanced was that MUK could easily pay £2,500 a month in reducing the outstanding PAYE and NIC liabilities. There was also a proposal that the Directors would make an immediate payment of £10,000 out of their personal funds. This potentially

meant that the £90,000 debt would be reduced to £80,000, and that it would take 32 months in which to pay off the deficit.

31. We were told that HMRC indicated during the court hearing that they rejected this settlement approach. We were not told why that was. One further respect in which the udget plan may have been seen to be deficient was that at this stage HMRC had not fully (or possibly "remotely") understood the nature of the arrangements between the two companies. On the knowledge that we now have, it is worth observing that the relevant Budget did not really create a remotely clear picture of realistic profit, since the entirety of the income of £48,000 consisted of the payment from the Appellant (representing 40% of the Appellant's monthly sales). Since that 40% figure was relatively arbitrary, there was no way of knowing, from the Budget figures alone, how confident Mr. Ghai might have been that the Appellant would have no difficulty in paying roughly the £48,000 a month. When the percentage figure had started at 80%, then been reduced to 60% for two months and then reduced to 40%, it was obvious that it was just an arbitrary figure. It may have been perfectly sensible, in the sense of being a figure that the Appellant could afford, and a figure that would clear all the expenses at the level of MUK and leave a surplus, but unless a consolidated picture of reliable figures for the two business had been produced it would have been difficult to be confident that the Budget report was definitely reliable.

32. Whatever the position, HMRC rejected the proposal. According to Mr. Ghai, the judge then had no option but to declare the £87,725.76 to be immediately owing, because MUK accepted the figure and could offer no defence. According to Mr. Ghai, though this was neither confirmed nor denied by HMRC who produced no witness to the court hearing, the judge had then said that he hoped that HMRC would revert to Mr. Ghai with a counter-proposal. Mr. Ghai said that the HMRC representatives had said that they would but in the event nothing was done.

33. By 4 August 2009, the unpaid sum in respect of PAYE and NIC had risen to £149,682.01. While the following figure was notified, we believe, only in a letter dealing perhaps with the default surcharge in respect of the September 2009 VAT period (and certainly not in any meeting at which there was a discussion about the outstanding VAT), we understand that the cumulative centralised assessments for VAT (for 18 periods and not it seems to the then date!) had reached £23,510.17.

34. During the latter part of 2009, HMRC were threatening to petition for the winding-up of MUK. On 13 August, MUK's accountant wrote to HMRC, saying that MUK could not pay either the debt confirmed by the County Court judgment, or doubtless the then increased PAYE and NIC debt just mentioned, asking HMRC not to proceed with the liquidation, and promising to revert within 14 days. HMRC did not apparently respond to this letter.

35. On 19 January 2010, Mr. Ghai contacted HMRC, indicating again that he wished to enter into a payment plan. We are not absolutely clear as to what was discussed but we believe that Mr. Ghai made the point that if a liquidator was appointed, the liquidator's charges would exhaust most of the assets, and he also said during cross-examination at times that when HMRC came to deal with the administrators or the liquidator, they would often accept 25% of a tax debt in full settlement. Mr. Ghai's proposal, therefore, on 19 January 2010 appears to have been along the lines that he would pay £20,000 immediately (though in cross-examination he said that the figure that he had probably proposed had been £10,000),

and he would give certain personal guarantees for MUK's debts. We imagine that the guarantees might have been intended to guarantee the 25% proportion of the debts that Mr. Ghai understood that HMRC would customarily expect to receive from liquidators. Accordingly Mr. Ghai's suggestion was that if the up-front payment, coupled with the guarantee, could be supplemented by a payment plan for the balance from MUK, this would be a "win/win" situation for everyone. HMRC would receive everything that they might receive from the liquidator; Mr. Ghai would save the costs of liquidation, in which he assumed that he (and possibly HMRC) would receive nothing because of the liquidator's charges, and Mr. Ghai would be able to save MUK.

36. In the event, HMRC rejected this approach; MUK was placed in liquidation on the following day, 20 January 2010, and the PAYE and NIC debts at that time were £177,620.66. We were never told whether HMRC received any payment in the liquidation, but we imagine (from Mr. Ghai's summary at one point of the few remaining assets of MUK) that HMRC was unlikely to have received any significant amount, if indeed anything at all, in discharge of the PAYE and NIC debts. We are mystified by the amount of HMRC'S claim in the liquidation because it rather appears that they proved for the PAYE and NIC debts, and may have altogether ignored MUK's VAT debt, even the low element based on the centralised assessments.

37. As we indicated above, in the period between 2007 and late 2009, assets and activity had progressively been passed over to the Appellant, or (where for instance, replacement second-hand machinery was acquired) simply purchased by the Appellant, rather than by MUK. The lease had certainly been taken, on the renewal date, by the Appellant, such that there was no entry for rent in MUK's Budget for monthly expenditure that we referred to in paragraph 30 above, and while MUK was shown in that Budget to be incurring expenditure of £9,400 on stock purchases, there was certainly no rental or hire purchase cost shown for any machinery. We had also been told that the electricity consumption in using the printing press had been roughly £5,000 a month, so that when the Budget plan contained a blank against the entry for electricity, it rather emerges that by March 2009, let alone we imagine by January 2010, the vast majority of the trade had, in a rather vague sense, been passed over to the Appellant.

38. We were given no evidence in relation to whether and when remaining assets had been passed over to the Appellant, but it was nevertheless obvious that after the liquidation of MUK, the Appellant was able to conduct the printing trade on its own. We were told that at the date of the hearing the trade was currently viable, though reference was made to two serious problems that the Appellant had incurred between early 2010 and the date of the hearing. One was that, having initially been informed by the landlord that the lease (then held by the Appellant) would be renewed, at the last minute the landlord changed its mind and the Appellant had to find new premises very quickly. When the machinery was installed in the new premises the weight of it caused some problem with the seams in the solid floor, so that (presumably at great cost) the machinery had to be removed and stored, while building works were undertaken to strengthen the floor. Without telling customers (in order not to lose them) printing work had to be sub-contracted during this operation, and one can only imagine that the overall costs of the move, plus the removal of the machine into storage, and then the building works and the sub-contracting would have been extremely costly.

39. We were also told that the Appellant's main customer removed the Appellant from its list of approved printers, either when it was taken over or for some other reason. It may be that the position was later reversed.

40. None of the points that we have mentioned in paragraphs 37 to 39 have much bearing on the point that we must address in this Appeal, but we have recorded them to complete the picture that the Appellant, and in particular Mr. Ghai, had been beset by numerous problems, and therefore struggled to a praise-worthy level to preserve the business.

The "Kittel" challenge

41. The point that is presently material, however, is that, when HMRC had at long last investigated matters, they concluded by 2011 that although they had failed to recover the VAT owed by MUK, following its liquidation, there did appear to be a good case for saying that they could instead assess the Appellant to VAT, so as to reverse the input deductions that the Appellant had obtained in respect of supplies made by MUK ever since July 2007. Under the *Kittel* principles, laid down by the ECJ, if a trader claims a deduction for input tax, and the input tax was attributable to, and traced to, a transaction in which there had been a fraudulent loss of VAT on the part of some other party, and the claimant knew or ought to have known of those facts then, as a participant in the fraud, the claimant of the input tax, i.e. the Appellant in this case, forfeits its right to deduct the input tax.

42. The Respondents accordingly assessed the Appellant to VAT in order to recover the whole of the input VAT attributable to the supplies to the Appellant by MUK since July 2007. In due course it was conceded by the Appellant that Mr. Ghai, being responsible for the VAT filings by both MUK and the Appellant, had obviously known that the VAT chargeable on MUK had not been paid. It was also accepted that the effect of the *Kittel* principle was to deny to the present Appellant the whole of its relevant claimed input deduction, regardless of whether MUK itself would have been entitled to set some genuine input deductions against its own liability in respect of the supplies made to the Appellant. Accordingly it was eventually conceded that the disputed amount of input tax (following a small adjustment that the Respondents conceded during the hearing) was £230,086. The remaining issue is whether Mr. Ghai had been dishonest in relation to the non-payment of MUK's VAT, i.e. whether the acknowledged VAT loss had in fact been a fraudulent loss.

The other contentions that were abandoned on the last day of the hearing

43. Having reviewed matters, HMRC concluded that, whilst its assessment had initially been based entirely on *Kittel* principles, there was another ground, or possibly two other grounds, on which the Appellant might forfeit the ability to deduct input tax. We will only mention them briefly, since they were abandoned on the final day of the hearing, but we mention them in part because much of the time spent during the hearing was dedicated to these points.

44. The first additional ground was geared to whether there had in fact been supplies of services or goods to the Appellant by MUK. We accept that there was some considerable vagueness to the arrangements between MUK and the Appellant that were initially designed to accommodate Cattles' request in relation to factoring. It was not clear whether MUK was simply providing various services, such as the provision of staff, accommodation and machinery, with the Appellant undertaking the printing, or whether MUK was printing and

selling all the printed material to its marketing affiliate. Certainly the roles and activities changed over time, the Appellant progressively building up its activities, to the extent that when MUK was liquidated, nobody troubled to tell us whether any remaining assets needed to be transferred to the Appellant to enable the Appellant to do what it was certainly doing very shortly after MUK's liquidation, namely conducting the entire trade.

45. The Respondents' claims in relation to the whole issue as to whether there were services, involved arguments concerning whether there was a written contract for the arrangements; whether Mr. Ghai had said that there was or not; whether the Appellant had made full payment for the services, and certain alleged defects in the various monthly invoices. The point about the monthly invoices almost ranked as a distinct, and thus a third, point because it was suggested that some of the invoices failed to include the required details, such that they did not constitute valid VAT invoices.

46. It had seemed to us that there had plainly been some services rendered by MUK to the Appellant. There was some doubt as to whether the full amount of the invoiced consideration had been duly paid, though that point was only advanced in the context of whether there had genuinely been a provision of services, and our conclusion was that there plainly had been such supplies. Since any defects in the invoices also appeared to be relatively trivial, we suggested to the Respondents that we were not inclined to decide this case in favour of the Respondents on any of these "service" or "invoice" bases. As we have said, the points were abandoned, and we will make no further reference to them.

47. We might add, however, that, as we recorded in paragraph 22 above, the Respondents never suggested, and there was no evidence to suggest, that Mr. Ghai had initially set up the services arrangement for what would have plainly been the fraudulent motive of failing to pay the VAT in the one company, and claiming input deductions in the other. More relevantly we make the new point that there was no contention or suggestion that as the printing business was progressively passed over, bit by bit it seems, from MUK to the Appellant, this was part of a plan on the part of Mr. Ghai to insulate the ongoing business from the liabilities by putting it into the clean company and to allow the former printer, MUK, to go into liquidation, defaulting both on its PAYE and NIC debts and its VAT liability. We can well imagine that Mr. Ghai might have been entirely ignorant of the *Kittel* doctrine and of the manner in which this principle has effectively given HMRC a second opportunity to recover at least the VAT that they failed to recover from MUK. Any intending fraudster, understandably ignorant of the *Kittel* principle, might have planned to protect the business in the way that we have just postulated, and planned to default on all the MUK liabilities. We do note, however, that albeit at the last minute, Mr. Ghai seemed to be endeavouring to ensure that MUK would remain in existence, and that a plan could be arranged to meet its liabilities. We are going to have to consider this aspect below, but we say now that we consider that Mr. Ghai's apparent efforts, albeit last minute efforts in both March 2009 and January 2010, to see that MUK could remain in business seemed to be genuine efforts to preserve MUK, and to set up some deferred payment plans to discharge at least some of the debts. We do not believe that Mr. Ghai's last minute efforts in both March 2009 and January 2010 were a fabricated way of feigning honesty, all in the interest of expecting the last minute approaches to be rejected so that the business could continue in the hands of the Appellant, while MUK was liquidated with all the bad debts going unsatisfied.

The law

48. Both of us on the Tribunal were entirely familiar with the *Kittel* principle, and we need add nothing to the points mentioned in paragraphs 41 and 42 above to that principle. The only legal point that we now need to address is how we should assess the issue of whether the VAT loss at the level of MUK was fraudulent.

49. The relevant test of whether the non-payment of the VAT by MUK was fraudulent, and of whether Mr. Ghai has been dishonest, was whether first his conduct fell below that generally regarded as honest by reasonable and honest people, and whether secondly *"he himself must have realised that what he was doing was by those standards dishonest"*.

50. It is also clear that the burden of proof, to the civil standard of the balance of probability, falls on the Respondents when they allege fraud.

The respective contentions of the parties in relation to dishonesty

51. The Respondents contended that the indications of dishonesty were that:

- MUK had deliberately failed to render VAT returns;
- it had deliberately failed to pay any sums due;
- Mr. Ghai had deliberately failed to draw to the Commissioners' attention the very considerable under-estimation of MUK's real VAT liability; and
- MUK had deliberately decided to delay the payment of tax.

52. It was contended for the Appellant that while there had plainly been a VAT loss, this resulted from credit problems, and not from fraud or any dishonesty on the part of Mr. Ghai. Mr. Ghai had been heavily influenced by statements from HMRC officers that he could only negotiate in relation to historic deficits in relation to PAYE and NIC when the current payments were all being made on time and in full, and he could not negotiate anything in relation to VAT until the PAYE and NIC matters had been dealt with. Furthermore his dealings all appeared to be with people with the narrow focus of just considering "their" taxes, namely PAYE and NIC, and nobody seemed to be interested in VAT. It was also suggested that whenever Mr. Ghai sought to have any discussion with anybody about time to pay arrangements or the VAT situation, he never managed to speak to the same person twice and there was never an occasion when anybody at HMRC sought actually to engage with Mr. Ghai in relation to a discussion about some form of payment plan. Mr. Ghai himself admitted that he had something of a tendency to leave matters until the last minute, so that he may not have wholly helped himself. However it was always his intention to pay the outstanding debts, and he had sought to prevent the liquidation of MUK so that he might have managed to discharge the liabilities over a period of time, under some "time to pay" arrangement.

Our decision

53. As we said in the first paragraph of this Decision, we have found this Appeal to be a difficult one. That may seem surprising in view of the fact that Mr. Ghai failed to make any VAT returns for MUK and failed to make any VAT payments for MUK for 31 monthly periods; he went to court on two occasions (in March 2009 and January 2010) and neither then nor at any other stage voluntarily revealed to HMRC that the VAT debts (that HMRC

appeared to have neglected and ignored in both hearings themselves) seriously exceeded the anyway unpaid amount assessed by the centralised assessments, and in MUK's liquidation not only was nothing or very little paid in respect of the unpaid PAYE and NIC liabilities, but certainly nothing was paid by MUK in respect of its VAT liabilities. Astonishingly, at that stage nothing was known by HMRC about the true amount of the VAT liability. While that also represents a failing on the part of HMRC, to which we refer below, it is quite clear that MUK had statutory obligations to make VAT returns, of which Mr. Ghai must have been aware, and the fact that he never sought to remedy the astonishing failure to make the 31 returns or to disabuse HMRC of the figures in their assessments, was a serious and deliberate omission.

54. The above facts may seem consistent only with a deliberate attempt to conceal for as long as possible the fact that if anything the outstanding VAT liabilities were a more serious, and of course ever escalating, liability than the PAYE and NIC liabilities, with HMRC being placed deliberately, and ignorantly, at the back of the queue of creditors, and possibly in the expectation that if the debts were settled at all, it might be on the basis of some small percentage payment in discharge of the totality.

55. The difficult that we face, however, is that we concluded that Mr. Ghai was not only a relatively distinguished accountant and businessman, and fundamentally an honest and commanding witness, but that he had fought against numerous problems (none of his making) in his effort to keep the business alive, and we were inclined to think that both Mr. and Mrs. Ghai should simultaneously be applauded for having struggled against the odds to achieve this. Mr. Ghai had worked extremely hard and had drawn no salary whatsoever. Since we were told that the Appellant now had a viable business, albeit apparently having been re-capitalised by Mr. and Mrs. Ghai borrowing £250,000 against the security of their house, and naturally (we accept so far greatly assisted by the fact that virtually £370,000 owing to HMRC by MUK had not been paid), but we still recognise and record that Mr. Ghai appeared to have had very much more than his fair share of problems.

56. There are the following other factors that we should list and mention in favour of the proposition that Mr. Ghai's conduct cannot properly be ranked as dishonest or fraudulent:

- Although by August 2007 he may well have decided that since he was unable to fund the payment of any more VAT he would make no return for the period 07/07 and for later periods, he did in August provide the correct figure for the June 07 return in an amount in excess of £7,000 in place of the earlier lesser figure. This hardly suggested that he was trying to conceal the quite considerable amount of VAT payable, and we are unable to understand how when the centralised assessments were later made they were for approximately 10% of that amount. Mr. Ghai can hardly have anticipated that.
- Mr. Ghai cannot be challenged for paying the centrally assessed debts, as if they represented the correct liability. That would have been fraudulent and there was never any suggestion that he thought of doing that.
- Although Mr. Ghai cannot have been oblivious to the fact that the inter-company service role between MUK and the Appellant enabled the Appellant to seek to use the credit for input tax in respect of the supplies, when MUK had neither declared nor paid the VAT owed by MUK in respect of the supplies, the points that we mentioned

in paragraphs 20 and 21 above (in relation to some of the supplies always being treated as zero-rated supplies and the possibility of ignoring the supplies altogether under a group registration) do not suggest that Mr. Ghai was seeking to maximise the benefit of a deliberate plan. They fortify the conclusion that the mismatch arose by accident, and certainly not as part of a fraudulent plan.

- When Mr. Ghai provided in March 2009 the monthly Budget for MUK's income and expenditure, the revealed figure for the average of the monthly VAT liability was put at £5,600, rather than the vastly lower figure in the centralised assessments. Nobody at HMRC seemed to spot this.
- There is not the slightest doubt that even if we must conclude that in technical terms Mr. Ghai's conduct was dishonest and fraudulent, we must make it absolutely clear that this is only in the sense that he was pressured by circumstances to put the payment of employees and suppliers first before HMRC or else the business would have ground to a halt. This is very much to be contrasted with the planned frauds in MTIC cases and in all other situations where a trader simply sets out to defraud HMRC of VAT possibly for personal gain or as part of an orchestrated fraud. In this case, by contrast, Mr. Ghai worked for no payment.
- Mr. Ghai had been told that he could not negotiate time to pay arrangements in relation to PAYE and NIC back liabilities until the payments were being made currently, and that he had to deal with PAYE and NIC first, before dealing with any time to pay arrangement for VAT purposes. He also said that while he was himself at least partly to blame for the lack of constructive discussions with HMRC as he always put off approaching HMRC until the last minute, he also said that he never managed to speak to the same person twice in relation to VAT, and never had a meaningful meeting with HMRC in relation to any payment plan. We will deal below with HMRC's own failings in this matter, but just note at this point that it is fairly extraordinary that HMRC allowed 31 monthly periods to pass, with no VAT return or payment, without visiting the taxpayer to enquire fully into the circumstances.
- Although Mr. Ghai's approaches to HMRC, with some offer of a payment from Mr. and Mrs. Ghai's personal funds on the occasions of the March 2009 court hearing and the January 2010 liquidation were always very much last minute approaches, and advanced only on a very outline basis, it does not appear that Mr. Ghai was content to let MUK go into insolvent liquidation, even when by 2009 and 2010, much of and on the latter occasion, virtually the totality of the business and its assets had been passed over to the Appellant. Both approaches were at least ostensibly based on his desire to keep MUK in existence and seek to ensure that it met its liabilities.
- One might consider a businessman foolhardy if he makes efforts to preserve an under-capitalised business that is only going to make losses, and either foolhardy or worse if this is done at the expense of preferring other creditors and putting HMRC at the back of the queue, and in ignorance of what is owed to them. So much time was taken up during the hearing in relation to the points that were eventually abandoned that we never managed to see full accounting information and clear indications of the viability of the business. We must record however that many of the problems suffered by Mr. Ghai, the faulty machinery, the liquidation of the machinery supplier, the leaking roof, the shift of premises, the need to strengthen the new building's floor and the need to

remove and store the machinery and the loss of the major customer, seemed to be unfortunate "one-off" problems, albeit that there were many of them, that did not suggest that the business was fundamentally flawed, or inevitably loss-making. We also concluded that nobody appeared to have better judgment in relation to the issue of the viability of the business than Mr. Ghai and we certainly did not conclude that he was just struggling on in a foolhardy manner, and whilst not paying the tax debts, to sustain a business that would never be viable.

57. These various factors have weighed heavily in our consideration in relation to the balanced question of whether Mr. Ghai was or was not dishonest. Our conclusion ultimately has to be that he was dishonest for the following reasons.

58. We consider it highly significant that when Mr. Ghai decided that MUK would neither declare nor pay its VAT liabilities, the Appellant ended up making the matching input claims for VAT that it knew that MUK had not paid. We have already said that our conclusion was that the inter-company service arrangements commenced at the suggestion of Cattles in order to enable Cattles to continue its factoring role with a company that had no liabilities, but it is inconceivable that Mr. Ghai could not have observed the feature that the Appellant would actually be reclaiming VAT had MUK had not paid. Beyond the fact that this would have been obvious to somebody of Mr. Ghai's ability, it is also clear that monthly calculations were made of the Appellant's turnover so that MUK could efficiently invoice the Appellant for monthly services, and whilst occasionally the Appellant's returns may have been late, the Appellant did always make its three-monthly VAT returns, and pay the net amount shown to be owing.

59. We accept that in a sense, the Appellant's claims do not greatly aggravate the non-payment of the VAT by MUK, because but for that non-payment the claims would have been entirely proper. Nevertheless when MUK's liabilities were consistently not being returned, and Mr. Ghai must have known that a serious escalating debt was being matched by claims that reduced the Appellant's net VAT liability and on four occasions led to actual recoveries of non-paid VAT, we must and do treat this as dishonest.

60. Another factor that very strongly influences our decision is that in March 2009, the Budget settlement proposal was put to HMRC on the basis that all the current liabilities were being met and that the profit in MUK of in excess of £6,000 a month could easily enable £2,500 a month to be paid in reduction of the historic PAYE and NIC debts. In the light of this, how is it explained that less than five months later (by August 2009, as mentioned in paragraph 33 above) the PAYE and NIC debts had risen to £149,692? The debts appeared to be escalating by £12,500 a month. By the date of the liquidation, when some staff may or may not have been re-engaged by the Appellant, the same debts had escalated by roughly a further £28,000, i.e. by roughly £7,000 a month.

61. These facts leave us having to question whether the Budget statement of monthly income and expenditure was good enough merely to launch a last minute effort to stall the County Court appearance, or else that having failed in that objective, Mr. Ghai was prepared to let the HMRC debts just go on rising, while preferring others.

62. The third factor that influences us in our decision that Mr. Ghai was dishonest is the feature that by the time MUK was liquidated in January 2010, it very much seems that the

great majority, if not the totality, of the trading assets and business had been assumed by the Appellant. Mr. Ghai said that MUK merely had a few computers at the point of its liquidation.

63. We certainly stop short of saying that there was a deliberate plan for progressively transferring the business to the Appellant, so that MUK, with little left in it, could safely be liquidated, with most or all of its debts to HMRC remaining unpaid. We do not assert that this was the plan because we believe that the landlord wished the company with better credit standing to take the lease; it made sense to acquire replacement second-hand machinery in the company with the better credit standing, and when the Cattles arrangement had already placed all the customers in the hands of the Appellant, there were these various other factors that resulted in the progressive transfer of the business.

64. We also accept that Mr. Ghai made the last minute effect to initiate a negotiation for a time to pay arrangement for MUK in January 2010 and he said that he and his wife would immediately pay £10,000 or £20,000 immediately from their personal resources in the interests of agreeing some form of payment plan. So, Mr. Ghai seems to have been seeking to keep MUK in business, and it is not evident that he was planning to see it pass into insolvent liquidation.

65. While we stop short of saying that there was therefore anything approaching a deliberate plan to shift the business to the clean company, and allow MUK to be placed in insolvent liquidation, we cannot believe that Mr. Ghai was wholly ignorant of this possibility. We consider it feasible and likely that, just as he had earlier mentioned the way in which he expected HMRC to settle for 25% of the debts with an administrator, and that he and HMRC could negotiate something similar without the costs of a liquidator, it is distinctly possible that Mr. Ghai hoped and expected to be able to agree some partial payment settlement with HMRC. This was certainly rendered feasible by the time the business was largely in the hands of the Appellant, and MUK was left with relatively little other than the liabilities to HMRC.

66. For these three reasons, namely the matched non-payment by MUK and the input claim by the Appellant, the disconnect between the claims made in the March 2009 business plan and the feature that the liabilities thereafter continued to escalate by 6 or 3 times the amount by which it had been suggested that they could easily be diminished, while the VAT debt also continued to escalate in a wholly undisclosed manner, and the feature that the business had largely been transferred to the Appellant by January 2010, such that Mr. Ghai could more easily have negotiated a partial payment for the full discharge of MUK's liabilities, do lead us to conclude that Mr. Ghai had been dishonest. In shades of dishonesty, however, his was clearly at the very low end of the scale.

67. In considering the requirement in relation to demonstrating fraud that the test is in part subjective and that we must be satisfied that Mr. Ghai would himself have realised that his conduct was dishonest, we make the following observations. We are certainly prepared to accept that Mr. Ghai's dominant frame of mind is likely to have been that in order to preserve the business, he had virtually no alternative but to act as he did. We cannot, however, believe that he would not have acknowledged that his conduct was dishonest when he deliberately refrained from making VAT returns for more than two and a half years, and never divulged the real figures to HMRC. He must have realised that this conduct was

fraudulent, particularly when he knew that MUK was meticulously issuing invoices to the Appellant, and the Appellant regularly filing returns and claiming credit for the non-returned, and non-paid VAT liabilities of MUK. We also have to question how Mr. Ghai would have thought his March 2009 submission of a payment plan to be wholly honest when in fact in the immediately following period the failures to pay PAYE and NIC escalated, making any proposition that MUK would eventually pay off all its debts to HMRC, particularly the undisclosed ones, decidedly suspect. We accordingly conclude that while we appreciate that Mr. Ghai would see himself as essentially having been forced to do as he did, we cannot believe that he would have disputed that his conduct was fraudulent.

68. The result is therefore that this Appeal is dismissed and HMRC's assessment in the sum of £230,086 is confirmed.

Two additional points

69. We will now add two additional points. Neither has any bearing on our decision, but we consider them both to be worth making.

HMRC's conduct

70. Whilst the extraordinary way in which HMRC handled the situation that we have had to consider has no bearing on the crucial issue in this Appeal, we do say that HMRC has been somewhat remiss in their handling of this case.

71. A statement was made in July 2007 that HMRC needed to get to grips with the inter-company service arrangements. HMRC never achieved this (or, it seems, sought to achieve this) until well after the liquidation of MUK in 2010.

72. Suggestions made by HMRC in relation to the requirement (in fact ignored) that all the services rendered by MUK should be treated as standard-rated services were probably wrong when MUK was undertaking all the printing, and they would have maximised the present problem. The suggestion that no thought should be given to a group registration undermined the very feature that would have eliminated the whole problem.

73. HMRC failed to spot indications, in August 2007 and in the March 2009 Budget of income and expenditure that made it clear that the true VAT liabilities were vastly in excess of those in the centralised assessments.

74. HMRC inexplicably did nothing for 31 periods when MUK failed to file returns or to pay anything at all in respect of VAT.

75. Finally it seems that HMRC managed to institute formal court proceedings in March 2009 and liquidation proceedings in January 2010, still concentrating only on the PAYE and NIC debts, and seemingly not claiming or proving for any debt in respect of VAT.

Possibly a just outcome

76. Our final observation is that the outcome of this Decision may require Mr. Ghai to prove what he consistently protested. In other words, he consistently said that he did not wish to be involved with a company that had defaulted on its liabilities and that as late as the date 19 January 2010, he was seeking to preserve MUK in existence and arrange for some time to pay plan to enable MUK to discharge its historic debts.

77. The effect of the *Kittel* doctrine, and the fact that this Decision does confirm HMRC's denial of input tax to the Appellant, such that the assessment for VAT in the amount of £230,086 is confirmed is that the Appellant becomes liable for somewhat more in VAT than the debt would have been in the hands of MUK. This is because the Appellant forfeits its entire claim for input tax, regardless of the fact that, by claiming input deductions, MUK's net VAT liability would have been of a somewhat lower amount. It is, however, inconceivable that MUK's liability would have been diminished by the amount of the unpaid PAYE and NIC that HMRC can plainly not recover from the Appellant. Accordingly the confirmed assessment is now for considerably less than MUK's total debt that was not discharged.

78. We hope, therefore, that in the light of the fact that any element of dishonesty by Mr. Ghai has been so marginal, and that much of his work when foregoing all salary himself and while seeking to preserve the business has been so praise-worthy, and in the light of the failings by HMRC that we have just mentioned in relation to this case that HMRC will negotiate a time to pay arrangement with Mr. Ghai, that will enable Mr. Ghai to establish the point that he consistently pleaded before us. In other words, that over time and in a sensibly negotiated settlement, he will be able to ensure both that the business continues and that these remaining (somewhat diminished) liabilities to HMRC are discharged.

Right of Appeal

79. 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.

HOWARD M. NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 14 AUGUST 2015