[2016] UKFTT 524 (TC)

TC05273

Appeal number: TC/2015/02393

Excise duty and customs duty – civil evasion penalties – section 8 of the Finance Act 1994 and section 25 of the Finance Act 2003 – whether conduct involving dishonesty – appeal dismissed – penalties upheld

FIRST-TIER TRIBUNAL
TAX CHAMBER

ZUNED OSMAN **Appellant**

- and -

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

TRIBUNAL: JUDGE THOMAS SCOTT

Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 16 June 2016

The Appellant participated by conference call

Sadiya Choudhury of Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This was an appeal against two penalties, one of £500 for evasion of customs duty and one of £1595 for evasion of excise duty.

2. The principal issue in the appeal was whether the burden of proof had been discharged by HMRC in imposing the penalties for **dishonest** evasion of customs duty and excise duty.

3. The secondary issue was whether the mitigation against the full chargeable penalties applied at the discretion of HMRC was sufficient.

Telephone Hearing

4. Since the Appellant Mr Osman now resides in Saudi Arabia, with the agreement of the Tribunal and HMRC Mr Osman participated and gave oral evidence by telephone conference call.

5. Ms Choudhury of Counsel appeared for HMRC in person, as did Officer Scheepers, a witness for HMRC.

The Facts

6. HMRC led evidence of Officer Scheepers. From that evidence and the documents made available to the Tribunal for the hearing, I find the following facts.

7. On 11 April 2014 Mr Osman and his wife arrived at Heathrow Airport, having flown from Saudi Arabia. They proceeded with their luggage through the green "nothing to declare" channel.

8. In the green channel, Border Force Officer Scheepers asked Mr Osman to stop. He then asked him various questions including whether the bags with him were all his, whether he had packed them himself, and whether he was aware of the contents.

9. Mr Osman confirmed that he was carrying in his luggage some cigarettes. On examining the baggage, Officer Scheepers discovered 1200 Benson and Hedges special filter cigarettes and 37 kilograms of Al Fakher flavoured water-pipe or "shisha" tobacco in 1 kilogram packets.

10. Officer Scheepers seized the shisha tobacco and cigarettes. He issued Mr Osman with a seizure information notice and a warning letter about seized goods, both of which Mr Osman signed. He also gave him copies of HMRC Notice 1 (which deals with UK duty free allowances) and Notice 12A (titled "what you can do if things are seized by HMRC").

11. Border Force referred the matter to HMRC. On 29 October 2014 Officer Dawson of HMRC wrote to Mr Osman to inform him that an enquiry had been opened into the attempted smuggling of tobacco products into the UK. The letter referred to non-payment of duty and the possible imposition of penalties if there was sufficient evidence of dishonest conduct.

12. No reply was received to this letter and on 12 November 2014 HMRC wrote to Mr Osman again seeking a response. Following further correspondence, Mr Osman provided his response on 16 December 2014.

13. Officer Dawson issued the civil evasion penalty notice on 13 January 2015. The total amount of duty evaded was £5238 and HMRC discounted this amount by 30% for disclosure and 30% for co-operation, giving a total reduction of 60%. The discounted custom penalty was £500, and the discounted excise penalty was £1595, giving a total penalty of £2095.

14. On 28 January 2015 Mr Osman asked for a review of the decision. The decision was upheld on review and notified in a letter to Mr Osman dated 25 February 2015.

15. Mr Osman filed a notice of appeal on 23 March 2015. In summary, his grounds of appeal were as follows:

    (a) He was not acting dishonestly in bringing into the UK the cigarettes and shisha molasses. His actions were the result of ignorance and oversight. Although he was a regular traveller he misunderstood the rules and was ignorant of his personal allowances.

    (b) This was the first time he had brought back cigarettes and shisha. It was all for personal use by him and his wife.

    (c) He had wrongly assumed that if he was flying in from a non-EU country the relevant allowances would be high.

    (d) The shisha smoking molasses contained minute traces of tobacco, and was labelled as herbal. Due to his ignorance, oversight and wrong assumptions he had brought in this large quantity thinking that it would be exempt from tax and duties and would not be a tobacco product.

    (e) He had co-operated fully with HMRC and all relevant authorities from the moment he was asked by Officer Sheepers whether he had any tobacco products on him. He had answered that question honestly and told him the quantities even before he and his wife were asked to proceed to the search area.

The Relevant Law

Duties

16. Both the cigarettes and water-pipe or shisha tobacco were liable to excise duty and customs duty. Under the relevant Combined Nomenclature which determines the classification of goods entering the European Union for customs duty purposes, shisha tobacco falls within the heading "other manufactured tobacco and manufactured tobacco substitutes" : CN code 2403 11 00.

17. Under the Traveller's Allowance Order 1994, the relevant personal allowance for tobacco products was, broadly, 200 cigarettes or 250 grams of smoking tobacco.

Excise Duty Penalty

18. The excise duty penalty was imposed under Section 8 Finance Act 1994 ("FA 1994"). Section 8(1) states as follows:

> *"(1) Subject to the following provision of this section, in any case where -*
>
> *a) any person engages in any conduct for the purpose of evading any duty of excise, and*
>
> *b) his conduct involves dishonesty (whether or not such as to give rise to any criminal liability)*
>
> *c) that person shall be liable to a penalty of an amount equal to the amount of duty evaded or, as the case may be, sought to be evaded."*

19. Section 8 was repealed by paragraph 21(d)(i) of Schedule 40 to the Finance Act 2008. However, the Finance Act 2008, Schedule 41 (Appointed Day and Transitional Provisions) Order 2009 (S1 2009/511) provides at Article 4 that paragraph 21, Schedule 40 repeals Section 8 FA 1994 only in so far as it relates to conduct involving dishonesty which gives rise to a penalty under Schedule 41 to the Finance Act 2008.

20. Article 6 of S1 2009/511 further provides that paragraph 21 of Schedule 40 only repeals Section 8 FA 1994 in relation to conduct involving dishonesty which relates to inaccuracy in a document or a failure to notify HMRC of an under-assessment by HMRC.

21. Notwithstanding the valiant attempts of the Parliamentary draftsman to obscure the issue, the upshot of this is that Section 8 remains in force in relation to any other conduct involving dishonesty entered into for the purpose of evading excise and duty. HMRC were therefore entitled to issue a penalty to Mr Osman under Section 8, subject of course to this appeal.

22. Under Section 16(1B) FA 1994, there is a right of appeal to the Tribunal against a "relevant decision", which is defined to include a decision that a person is liable to penalty under Section 8: Section 13A(2)(h) FA 1994.

23. Under Section 8(4) FA 1994, on an appeal the Tribunal has power to reduce the penalty (including to nil), but not on the grounds of inability to pay, and to reduce or cancel any reduction to a penalty made by HMRC.

Customs Duty and import VAT penalties

24. These penalties were imposed under Section 25 of the Finance Act 2003 ("FA 2003"), the provisions of which are, in all material respects relevant to this appeal, identical to those set out in Section 8 FA 1994.

Burden of Proof

25. Section 16(6) FA 1994 (for excise duty) and Section 33(7)(a) FA 2003 (for customs duty and import VAT) provide that the burden of proof is on HMRC to establish that the Appellant has engaged in conduct for the purpose of evading the duty or VAT and that his conduct involved dishonesty. Otherwise the burden of proof is on the Appellant.

26. The standard of proof is the ordinary civil standard, namely proof on a balance of probabilities.

The Test of Dishonesty

27. So, the burden of proof is on HMRC to establish on a balance of probabilities that Mr Osman's conduct involved dishonesty. In establishing the appropriate test to apply in assessing dishonesty in the context of civil penalties, I have reviewed a number of cases. It appears from that review that in relation to questions such as the applicability in civil cases of the dishonesty test in criminal proceedings, the extent to which the civil test is objective, and what is meant by any subjective element to the test, there have been some inconsistencies between certain of the decided cases. HMRC's own suggested formulation of the appropriate test has also developed over time. It may therefore be of assistance if I set out five propositions which seem to me to derive from the authorities in assessing dishonesty in this civil context.

28. First, the test is not the same as that applying in cases of criminal dishonesty. This means in particular that the appropriate test is not the "two step" approach set out in *R v Ghosh* [1982] QB 1053. As explained with helpful clarity in *Kiamarz Bahrami Birgani v HMRC* [2016] UK FTT 213 (TC), at [27]:

> "The two-step approach set out in **R v Gosh** [1982]1 QB 1053 involves
>
> > *(1) an objective test: that the action must be dishonest "according to the ordinary standards of reasonable and honest people," and (2) a subjective test: "whether the defendant himself must have realized that what he was*

> *doing was by those standards dishonest". This contrasts with the test for dishonesty set out in* ***Barlow Clowes****, which is primarily an objective test."*

29. There are two important differences between the *Ghosh* approach and the civil test as described further below. First, the *Ghosh* test allows for greater weight to be attached to the subjective element of the test. Secondly, that subjective element is framed and assessed in a different way.

30. The fact that the *Ghosh* and *Barlow Clowes* tests differ significantly has recently been confirmed by the Upper Tribunal in *Peter Brookes v HMRC* [2016] UKUT 0214 (TCC), at [13]. The proper approach of applying the *Barlow Clowes* test in civil penalty cases is demonstrated in the subsequent decision of this Tribunal in *Jabbar Rabbani v HMRC* [2016] UKFTT 341 (TC), at [53] to [54].

31. In a number of reported cases, HMRC have previously argued that the appropriate test in civil cases was *Ghosh*. In some cases the tribunal has not demurred on the basis that the *Ghosh* test would favour the appellant. In view of more recent decisions, it is to be hoped that HMRC will no longer adopt the *Ghosh* formulation in attempting to prove dishonesty is civil penalty cases. Whether or not it favours the taxpayer, it is the wrong test.

32. Secondly, the test is not wholly objective. HMRC have on occasion, though not in this appeal, sought to argue that it is. For a recent example, see *Ganjo Rasull v HMRC* [2015] UKFTT 193, at [45], where the argument was rejected. The case cited by HMRC in *Ganjo Rasull* was, interestingly, also cited by Ms Choudhury in this appeal, namely the High Court decision in *Sahib Restaurant Ltd v HMRC*, (Case M7X 090, 9 April 2008, unreported). As I will explain below, *Sahib Restaurant* is not authority that the test is wholly objective.

33. Thirdly, the test is primarily objective, by reference to normally accepted standards of behaviour. That is clear from the three decisions which are most relevant and helpful in understanding the test, namely *Royal Brunei Airlines v Tan* [1995] 2 AC 378, *Twinsectra v Yardley and others* [2002] UK HL 12, and *Barlow Clowes International Ltd v Eurotrust International Ltd* [2006] 1WLR 1476.

34. A useful analysis of how to apply these three decisions in practice is contained in *Binto Binette Krubally N' Diaye v HMRC* [2015] UKFTT 0380 (TC), at [42] to [50]. That decision derives considerable guidance from the judgment of Arden LJ in the Court of Appeal decision of *Abou-Ramah v Abacha* [2006] EWCA Civ 1492. See, most helpfully, [473] in *N'Diaye*:

> *"However, the objective is not entirely banished. In* ***Abou-Ramah*** *at [66] Arden LJ first summarizes* ***Barlow Clowes*** *and then says:*
>
> > *"On the basis of this interpretation, the test of dishonesty is predominately objective: did the conduct of the defendant fall below the normally acceptable standard? But there are also subjective aspects of dishonesty. As Lord Nicholls said in the* ***Royal Brunei*** *case, honesty has "a strong subjective element in that it is a description of a*

type of conduct assessed in the light of what a person actually knew at the time as distinct from what a reasonable person would have known or appreciated.""

35. The passage in *Sahib Restaurant* favoured by HMRC is doing no more than enunciating this proposition. Judge Pelling QC (sitting as a judge of the High Court) stated, at [40]:

*"…In my view in the context of the civil penalty regime at least the test for dishonesty is that identified by Lord Nicholls in **Tan** as reconsidered in **Barlow Clowes**. The knowledge of the person alleged to be dishonest that has to be established if such an allegation is to be proved is knowledge of the transaction sufficient to render his participation dishonest according to normally acceptable standards of honest conduct. In essence the test is objective – it does not require the person who is alleged to have been dishonest to have known what normally accepted standards of honest conduct were."*

36. Fourthly, the objective element is not determined by reference to a reasonable person, but by reference to the actual knowledge of the particular person who HMRC must prove has acted dishonestly.

37. Fifthly, the relevant knowledge is that person's actual knowledge regarding the facts which (objectively) point to dishonesty in the case in question. Whether that person regards their behaviour as dishonest by their own moral code is not the test. Nor is that person's knowledge of the relevant "normally accepted standards" the test.

38. In reaching a judgment as to alleged dishonesty in civil penalty cases the tribunal must have regard to the fact that while the test is primarily objective, the tribunal's fact-finding responsibilities in relation to the taxpayer's knowledge are critical. For example, by normally accepted standards proceeding through the green channel while in possession of goods on which duty is clearly due might well be indicative of dishonesty by those objective standards. But what if the person did not understand the difference between the green and red channels, and could not read the relevant customs warnings at the airport?

39. In establishing and weighing up the relevant facts, the tribunal will also have regard to the standard of the burden of proof on HMRC, namely a balance of probabilities.

Discussion

40. HMRC submitted in their Skeleton Argument that Mr Osman did engage in dishonest conduct for the following reasons:

"[25] The number of cigarettes and amount of shisha tobacco the Appellant had in his possession when he was intercepted by Officer Scheepers was 154 times his personal allowance for tobacco products. Nevertheless, he entered the green channel thus showing that he had "nothing to declare." HMRC submit that, despite the Appellant's assertions to the contrary, he would have been aware of his personal allowances from the signs posted around Heathrow Airport, including at the entrance to the channels.

HMRC further submit that he was also aware that he was carrying tobacco products considerably in excess of his allowance. His actions in entering the green channel with excessive quantities of cigarettes and shisha tobacco were therefore dishonest.

[26] The fact that the cigarettes and tobacco may have been for the personal use of the Appellant and his wife is not relevant to the question of whether a penalty arises. Both section 8 FA 1994 and section 25 FA 2003 are concerned with whether the individual has engaged in dishonest conduct for the purpose of evading the relevant duty. If the Appellant had passed through the green channel without being intercepted HMRC submit that the duties on the goods which exceeded his personal allowance would have been evaded.

[27] The only explanation provided by the Appellant as to why he was carrying excess cigarettes is the statement in the grounds of appeal that he believed that allowance when flying in from non-EU countries would be higher. HMRC submit that this explanation is not credible, given the fact that the Appellant was a regular traveller and would have been aware of the allowances from the signs displayed in the airport.

[28] The Appellant has made contradictory statements in relation to the shisha tobacco. For example, he states that he was not aware that shisha molasses was tobacco. However, he admits to smoking one to two kilograms a day with his wife. He also states in his grounds of appeal that when asked whether he had any tobacco products by the Border Force officer he had informed him of the amounts before being led to the search area. It is not clear whether this means he informed the officer of the amount of shisha tobacco he was carrying at that time but if it does, HMRC submit that he would not have needed to inform the office of the quantity of shisha tobacco he was carrying if he did not consider it to be tobacco.

[29] The Appellant also states that he understood at the time that the duties only applied to the actual tobacco content of the shisha molasses but this was less than 5% of each package. As can be seen from both Section 1 of the Tobacco Products Duty Act 1979 and heading 2403 of the CN, that is not correct because the tobacco content, even if small and mixed with other ingredients, makes the product liable to the relevant duty. However, even if the Appellant genuinely believed that duty was chargeable only on the tobacco content, he was carrying 37 kilograms at the time of interception. Thus, even if the tobacco content was less than 5%, he was still carrying tobacco in excess of his allowance (and even the allowance of both him and his wife combined)."

41. Mr Osman's grounds of appeal are summarised at [15] above.

42. In his oral evidence, Officer Scheepers stated as follows:

    a) When he had stopped Mr Osman in the green channel and asked him various preliminary questions, in response to being asked whether he was carrying any cigarettes or tobacco products, he had replied "some cigarettes". He did not declare the shisha.

    b) During the questioning and the seizure of the goods, he would describe Mr Osman's manner as "calm, and not argumentative or shocked".

    c) At the airport terminal, there were signs describing goods on which duty would be due, and the relevant personal allowances, at the baggage

carousels; shortly before the green, red and blue channels, and again in the green channel itself.

43. In his oral evidence, provided by telephone, Mr Osman stated as follows:

a) He was a regular air traveller, making "at least two trips a year", usually between the UAE and the UK, but also from Malaysia.

b) He was aware that there were signs at the airport regarding allowances, but he had "not paid them attention".

c) He was aware that duty free allowances applied to cigarettes, but did not know the number, and he was unclear whether shisha was dutiable.

d) He had thought that higher allowances applied when bringing in goods from outside the EU.

e) Although he was not certain about the duty position, he had not contemplated proceeding through the red channel and seeking clarification.

f) He agreed that Officer Scheepers' testimony was accurate.

44. Applying the *Barlow Clowes* test as described above, and taking account of the principles to be derived from the relevant cases, I have considered whether Mr Osman engaged in conduct for the purpose of evading excise and customs duty and whether his conduct was dishonest.

45. I have concluded that HMRC were correct in finding that on the balance of probabilities Mr Osman did engage in such conduct, and was dishonest. In reaching this conclusion I have relied in particular on the following facts:

a) Mr Osman's written and oral command of English is very good.

b) Mr Osman fully understood the difference between the green and red channels, and made a conscious decision to enter the green channel. He did so even though he was not certain whether in fact he had "nothing to declare".

c) At the material time, Mr Osman was a seasoned traveller. He had travelled to and from third countries (including Saudi Arabia) on 15 occasions between 2009 and the date of seizure. Warnings about the relevant restrictions would not have escaped his notice on all of those trips.

d) Choosing not to pay attention, or sufficient attention, to those warnings does not negate dishonesty. As Lord Nicholls stated in *Royal Brunei* (at [106]):

> *"Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless."*

e) Mr Osman stated that he and his wife smoked around 1kg of shisha every two days. The habitual consumption of such a substantial amount makes it less likely that Mr Osman would be unaware of the potential duty on such goods or the import restrictions.

f) The quantity of seized goods was 154 times Mr Osman's personal allowance for tobacco products. That excess is so significant that, even if Mr Osman was not aware of the precise allowances, it is more likely than not that he was aware that he must have exceeded them.

g) Given the frequency of his air travel, and the other facts noted above, I am not persuaded by Mr Osman's assertion that he believed allowances to be "high" when arriving from non-EU countries.

h) Mr Osman understood that the shisha contained tobacco, but said that he believed the tobacco content to be so small that no duty would arise. However, given that he was carrying 37kg of shisha, he would be more likely than not to have been aware that such a significant amount might attract duty.

46. It remains for me to decide whether the reduction to the penalty amount made by HMRC is appropriate.

47. HMRC reduced the aggregate penalty by 30% for disclosure, and 30% for co-operation, resulting in a total discount of 60%. I am satisfied in all the circumstances that this mitigation was both properly considered and reasonable.

48. For the reasons stated above, the appeal is dismissed, and the total amount charged of £2095 is confirmed.

49. 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.

THOMAS SCOTT
TRIBUNAL JUDGE

RELEASE DATE: 29 JULY 2016