[2017] UKFTT 161 (TC)

TC05654

Appeal number:TC/2015/03746

VAT – penalties –inaccuracies in return-whether careless or deliberate-repeated errors-responsibility of taxpayer for acts of employed accountant-special reduction-whether officer's decision unreasonable-suspension of penalties-whether officer's decision unreasonable

FIRST-TIER TRIBUNAL
TAX CHAMBER

PROMO INTERNATIONAL LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MARILYN MCKEEVER
MRS HELEN MYERSCOUGH

Sitting in public at Colchester on 29-30 November 2016

Mr M Firth instructed by Tees Law for the Appellant

Mr G Thomas, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against three penalty assessments made under schedule 24 Finance Act 2007 (schedule 24) in relation to inaccuracies in the Appellant's VAT returns. References in this decision to paragraphs are to paragraphs in schedule 24 unless otherwise stated.

2. The first assessment, for the VAT period ending 09/12, was issued on 8 May 2013 and was for £27,799.37. The inaccuracies were alleged to be "careless".

3. The second and third assessments related to the VAT period 06/14 and were in the sums £17,724.00 and £27,660.50 respectively. The second assessment related to underdeclared invoices and the third to other errors. Both inaccuracies were alleged to be the result of "deliberate" behaviour.

4. As a preliminary matter, we noted that HMRC's review conclusion letter, against which the appeal was made, was dated 28 May 2015 and the Notice of Appeal was dated 9 July 2015, 12 days late. HMRC did not object to the late appeal and we allowed it to proceed.

5. The appeal raises a number of issues:

   - Whether the Appellant took "reasonable care"
   - Whether the Appellant acted "deliberately"
   - Whether HMRC have discharged the burden of proving these things
   - In relation to the second assessment, whether a supply had taken place
   - When an employer will be responsible for the malfeasance of an employee; and
   - Whether HMRC had acted "unreasonably", in the Wednesbury sense in refusing to suspend the first penalty and in refusing to make special reductions in the penalties.

The scope of the hearing

6. In the course of the hearing it became clear that the parties may be able to reach agreement on the penalty charged by the second assessment in relation to the "Talbots issue" referred to below. The judge made Directions after the hearing to enable this. We have, however, proceeded to reach a decision on the other matters in issue and have considered the facts relating to the Talbots issue in case we need to make a separate decision on this matter.

The penalty provisions

7. The penalty provisions are set out in Schedule 24 Finance Act 2007. Paragraph 1 provides:

"1—

(1) A penalty is payable by a person (P) where—

(a) P gives HMRC a document of a kind listed in the Table below, and

(b) Conditions 1 and 2 are satisfied.

(2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to—

(a) an understatement of [a][1] liability to tax,

(b) a false or inflated statement of a loss …[1], or

(c) a false or inflated claim to repayment of tax.

(3) Condition 2 is that the inaccuracy was [careless (within the meaning of paragraph 3) or deliberate on P's part][1].

(4) Where a document contains more than one inaccuracy, a penalty is payable for each inaccuracy."

8. A VAT return is one of the documents mentioned in the Table.

9. Paragraph 3 sets out the degrees of culpability:

"3—

(1) [For the purposes of a penalty under paragraph 1, inaccuracy in][1] a document given by P to HMRC is—

(a) "careless" if the inaccuracy is due to failure by P to take reasonable care,

(b) "deliberate but not concealed" if the inaccuracy is deliberate [on P's part][1] but P does not make arrangements to conceal it, and

(c) "deliberate and concealed" if the inaccuracy is deliberate [on P's part][1] and P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure)…."

10. Part 2 of the schedule sets out the amount of the penalty, which varies according to culpability and provides for a reduction in the penalty depending on the degree of co-operation provided by the taxpayer. It also gives HMRC discretion to reduce the penalty in exceptional cases where there are "special circumstances". So far as relevant Part 2 provides:

"[4

(1) This paragraph sets out the penalty payable under paragraph 1.

(2) If the inaccuracy is in category 1, the penalty is—

(a) for careless action, 30% of the potential lost revenue,

(b) for deliberate but not concealed action, 70% of the potential lost revenue, and

(c) for deliberate and concealed action, 100% of the potential lost revenue."

11. The penalties in the present case were domestic matters within category 1. The maximum penalty for the alleged "careless" errors were, accordingly, 30% and the maximum penalty for the alleged "deliberate" errors was 70%. The "potential lost revenue" is defined by paragraph 5:

"5—

(1) "The potential lost revenue" in respect of an inaccuracy in a document [(including an inaccuracy attributable to a supply of false information or withholding of information)][1] or a failure to notify an under-assessment is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment.

(2) The reference in sub-paragraph (1) to the additional amount due or payable includes a reference to—

(a) an amount payable to HMRC having been erroneously paid by way of repayment of tax, and

(b) an amount which would have been repayable by HMRC had the inaccuracy or assessment not been corrected.

(3) In sub-paragraph (1) "tax" includes national insurance contributions…."

12. Paragraphs 9 and 10 set out the reductions in the penalty which may be given for "telling", "giving" and "providing access".

9—

[(A1) Paragraph 10 provides for reductions in penalties under paragraphs 1, 1A and 2 where a person discloses an inaccuracy, a supply of false information or withholding of information, or a failure to disclose an under-assessment.][1]

(1) A person discloses an inaccuracy[, a supply of false information or withholding of information,][1] or a failure to disclose an under-assessment by—

(a) telling HMRC about it,

(b) giving HMRC reasonable help in quantifying the inaccuracy[, the inaccuracy attributable to the [supply of false information][2] or withholding of information, or the][1] under-assessment, and

(c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy[, the inaccuracy attributable to the [supply of false information][2] or withholding of information, or the][1] under-assessment is fully corrected.

(2) Disclosure—

(a) is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy[, the supply of false information or withholding of information, or the under-assessment][1], and

(b) otherwise, is "prompted".

(3) In relation to disclosure "quality" includes timing, nature and extent.

[10—

(1) If a person who would otherwise be liable to a penalty of a percentage shown in column 1 of the Table (a "standard percentage") has made a disclosure, HMRC must reduce the standard percentage to one that reflects the quality of the disclosure.

(2) But the standard percentage may not be reduced to a percentage that is below the minimum shown for it—

(a) in the case of a prompted disclosure, in column 2 of the Table, and

(b) in the case of an unprompted disclosure, in column 3 of the Table.

Standard %	*Minimum % for prompted disclosure*	*Minimum % for unprompted disclosure*
30%	*15%*	*0%*
45%	*22.5%*	*0%*
60%	*30%*	*0%*
70%	*35%*	*20%*

105%	*52.5%*	*30%*
140%	*70%*	*40%*
100%	*50%*	*30%*
150%	*75%*	*45%*
200%	*100%*	*60%.]*[1]

"

16. The disclosure of the errors was regarded as being "prompted" as they only came to light during inspection visits but as the Appellant co-operated fully with HMRC, the maximum reduction was given in each case, so reducing the "careless" penalty to 15% of the potential lost revenue and the "deliberate" penalty to 35% of the potential lost revenue.

17. Part 3 of the Schedule sets out the procedure and paragraph 14 gives HMRC a discretionary power, in the case of careless errors only, to suspend a penalty for up to two years where it considers that conditions can be imposed which will prevent a recurrence of the errors. HMRC refused to suspend the penalty for 09/12 in the present case. They did not consider suspension of the 06/14 penalties as these were alleged to be deliberate.

"14—

(1) HMRC may suspend all or part of a penalty for a careless inaccuracy under paragraph 1 by notice in writing to P.

(2) A notice must specify—

(a) what part of the penalty is to be suspended,

(b) a period of suspension not exceeding two years, and

(c) conditions of suspension to be complied with by P.

(3) HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy.

(4) A condition of suspension may specify—

(a) action to be taken, and

(b) a period within which it must be taken.

(5) On the expiry of the period of suspension—

(a) if P satisfies HMRC that the conditions of suspension have been complied with, the suspended penalty or part is cancelled, and

(b) otherwise, the suspended penalty or part becomes payable.

(6) If, during the period of suspension of all or part of a penalty under paragraph 1, P becomes liable for another penalty under that paragraph, the suspended penalty or part becomes payable."

18. Paragraph 15 sets out the taxpayer's rights of appeal against the decision to impose a penalty, the amount of the penalty and the decision not to suspend a penalty and paragraph 17 sets out the Tribunal's jurisdiction in relation to each matter which may be appealed.

"15—

(1) [A person may][1] appeal against a decision of HMRC that a penalty is payable [by the person][1].

(2) [A person may][1] appeal against a decision of HMRC as to the amount of a penalty payable [by the person][1].

(3) [A person may][1] appeal against a decision of HMRC not to suspend a penalty payable [by the person][1].

(4) [A person may][1] appeal against a decision of HMRC setting conditions of suspension of a penalty payable [by the person][1].

17—

(1) On an appeal under paragraph 15(1) the …[1] tribunal may affirm or cancel HMRC's decision.

(2) On an appeal under paragraph 15(2) the …[1] tribunal may—

(a) affirm HMRC's decision, or

(b) substitute for HMRC's decision another decision that HMRC had power to make.

(3) If the …[1] tribunal substitutes its decision for HMRC's, the …[1] tribunal may rely on paragraph 11—

(a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or

(b) to a different extent, but only if the …[1] tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed.

(4) On an appeal under paragraph 15(3)—

(a) the …[1] tribunal may order HMRC to suspend the penalty only if it thinks that HMRC's decision not to suspend was flawed, and

(b) if the …[1] tribunal orders HMRC to suspend the penalty—

(i) P may appeal [1] against a provision of the notice of suspension, and

(ii) the …[1] tribunal may order HMRC to amend the notice.

(5) On an appeal under paragraph 15(4) the …[1] tribunal—

(a) may affirm the conditions of suspension, or

(b) may vary the conditions of suspension, but only if the …[1] tribunal thinks that HMRC's decision in respect of the conditions was flawed.

[(5A) In this paragraph "tribunal" means the First-tier Tribunal or Upper Tribunal (as appropriate by virtue of paragraph 16(1)).][1]

(6) In sub-paragraphs (3)(b), (4)(a) and (5)(b) "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.

19. *(7) Paragraph 14 (see in particular paragraph 14(3)) is subject to the possibility of an order under this paragraph."*

20. The Appellant appeals against the decisions to impose penalties, the amount of the penalties and the decision not to suspend the penalties

The facts

21. The Appellant's business consists in the supply of promotional products to major companies such as Proctor & Gamble and Magners and other drinks companies. Products are sourced from foreign manufacturers, usually in China, and are typically for high volume, low value items, for example 30,000 items at 80p-£1 each. The process of supply is a long one. It can take anything up to six months from the customer making an order and the Appellant paying a deposit to a manufacturer to the supply to, and payment by, the customer. This means that cash flow is critical to the company's business and this was managed by a factoring account and cash injections from a third party investor.

22. We had before us a bundle of documents and correspondence and we heard extensive oral evidence from Mr and Mrs Townsend, the directors of the Appellant, and from Mr Goodwin and Mrs Sellers, the officers of HMRC who made the visits to the Appellant and raised the assessments. We found the witnesses for both parties to be straightforward and honest, but they were, of course, viewing the facts through different lenses and in particular, had been given conflicting (or no) account of events by the company accountant, Charlotte Cudlip ("Ms Cudlip"). We have considered the correspondence in our bundles and the oral evidence presented at the hearing and have sought to reconcile the discrepancies. The account of events set out below represents our findings of fact.

23. Ms Cudlip is the key to events, though for reasons which will become apparent, she did not give evidence. Ms Cudlip was an ACCA qualified accountant who joined the company in September 2006. She was responsible for all aspects of the company's accounting function including the production of management accounts and invoices and the preparation and submission of the Appellant's VAT return. Initially, she worked alongside Mrs Lynda Townsend, who regarded her as a competent and trusted employee. Ms Cudlip was well liked and respected inside and outside the company. She worked with Mrs Townsend through three full audits and the feedback from the auditors was that her work was correct and accurate and all was as it should be.

24. In 2010, the company suffered a fall in turnover from £5m to £2m and it transpired that the manager of the Appellant's Hong Kong office had been defrauding the company of significant sums. Mr Townsend reported the manager to the Independent Commission Against Corruption (ICAC) who began an investigation which involved allowing the manager to continue with his fraudulent activity whilst monitored by the ICAC. Eventually the ICAC had sufficient evidence to arrest the manager, his wife and a third member of staff and launch a prosecution. The manager and others involved were charged in August 2011 and the case was heard in April 2012 when the participants were convicted and sentenced to prison. The fraudsters appealed which prolonged the process further although their appeals were dismissed. The managers had been embezzling money since 2007 and had stolen US$1m from the Appellant in the period. The Appellant commenced a civil case in 2012 to recover the stolen money and that case is expected to be heard some time in 2017.

25. This case had a significant financial and emotional impact on Mr and, in particular, Mrs Townsend. Mrs Townsend described herself as "traumatised" by it all. Most importantly, in the context of the present case, the criminal prosecution and civil recovery case imposed an enormous and hugely time-consuming burden on Mr and Mrs Townsend. In addition to the normal running of the company, Mr Townsend spent a lot of time in Hong Kong trying to rebuild the business there and Mrs Townsend spent several years trawling through tens of thousands of emails and other documents in order to assist the Hong Kong Authorities and then to gather evidence for the civil case.

26. As a result of this, Mrs Townsend was taken away from much of the day-to-day running of the business and spent much of her time working from home in order to avoid interruptions. By this time, Ms Cudlip had been at the company for several years. Her work had been endorsed by the auditors, she was considered professional and competent by those inside and outside the company and she was trusted completely by the directors. In these circumstances, Ms Cudlip was given increasing autonomy and responsibility for dealing with the company's financial affairs. The directors considered her more than capable of carrying out her role without constant supervision. An accounts assistant, Samantha Holmes (Samantha), was recruited in October 2010 to help Ms Cudlip. Previously, Ms Cudlip had prepared items for payment and Mrs Townsend had authorised payment. The preparation of payments was now carried out by Samantha or Marion (another member of staff) and Ms Cudlip now authorised the payments herself. In addition, the fall in turnover caused by the events in Hong Kong meant that the Appellant was now below the audit threshold and Ms Cuplip took on the preparation of the company's accounts, which also saved £10,000 in audit fees.

27. Ms Cudlip prepared a monthly "pack" of financial information which was discussed with Mr Townsend and she and Mr Townsend discussed cash flow on an almost daily basis. Cash flow was critical to the company. Mr Townsend's focus in this respect was on the factoring account with Bibby as this was the source of day-to-day funds, rather than on the bank account. He did review the bank account from time to time, but reconciliation and so on was left to Ms Cudlip.

28. One of the Appellant's major customers was Proctor & Gamble and they required goods to be delivered direct to them in Poland by road, having been shipped to Hamburg. This saved shipping and freight costs compared with import into the UK. Ms Cudlip was given the responsibility of investigating how this was to be done and implementing the new arrangements. She identified an agent in Germany, TMF, and the Appellant was registered for VAT in Germany from 1 January 2012. As most of the goods shipped to Hamburg were exported, the Appellant would have been able to reclaim the import VAT and as returns in Germany could be made monthly, this would improve cash flow.

29. The seasonal nature of the Appellant's business meant that a UK VAT repayment claim would be made for at least one quarter in the year. It is routine for HMRC to visit a business which makes a large repayment claim in order the verify the VAT position before authorising payment.

30. At this point, for reasons that are still not clear, things began to go very wrong, or at least, problems which had previously existed began to emerge.

31. Ms Cudlip submitted the 06/12 VAT return claiming a refund of VAT. Mr Goodwin, who gave evidence at the hearing made a routine visit to the company's premises in August, in order to check the VAT return which involved seeing how the company compiled its ledgers, reviewing sales invoices to see if they were correct and purchase invoices to make sure they were for business purposes and

bank statements to make sure they were consistent with the VAT return and so on. The directors were on holiday at the time and Mr Goodwin dealt only with Ms Cudlip.

32. In the course of this visit, Mr Goodwin discovered a number of basic errors in the VAT return. The accounts system would produce figures for inputs and outputs at the end of the quarter. Manual adjustments were then made in respect of late or unapproved invoices which were included in that quarter's figures and should then have been reversed out in the following quarter (when they would appear in the accounting system) in order to prevent double counting. Errors amounting to an underdeclaration of £187,584 arose as a result of incorrect figures being brought forward and/or additional invoices not being reversed out in the following quarter.

33. In addition, Mr Goodwin found errors in relation to overclaimed import VAT. When a business imports goods from the EU, duty and VAT is paid and HMRC issue a form know as a "C79" certifying the amount of duty and VAT which may be reclaimed. Instead of using the C79, Ms Cudlip had prepared her figures from the freight forwarder invoices. These included German VAT which should have been claimed in Germany and were not eligible to be reclaimed in the UK. This resulted in an overclaim of £26,476. The total additional amount of VAT due was £279,938.63 on which interest of £5,485.99 was charged. By a letter dated 8 October 2012 Mr Goodwin raised an assessment for penalties totalling £32,109 and he also provided a number of fact sheets to assist the Appellant.

34. Mr Goodwin considered that the errors were "careless" for the purposes of schedule 24 in view of the basic nature of the errors and their size. This indicated that the person who had submitted the return had not taken "reasonable care". Mr Goodwin decided not to suspend the penalty. The purpose of the discretion to suspend the penalty is to give the taxpayer the opportunity to change the way they do things so as to ensure that the errors do not recur. Under para 14 HMRC may suspend the penalty *"only if compliance with a condition of suspension would help P* [the person completing the return] *to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy"*. Mr Goodwin agreed at the hearing that processes could have been put in place to prevent further inaccuracies, in the sense that processes could have been changed, but Ms Cudlip gave the impression that she was "not too bothered" about the errors and he formed the opinion that she would not comply with any conditions put in place and so the imposition of conditions would not help the Appellant to avoid future inaccuracies. Mr Goodwin did, however, discuss the errors and how to avoid them during the visit, in particular advising Ms Cudlip to use the forms C79 to reclaim import VAT and not the freight forwarder invoices.

35. On review in 2015, it was accepted that this penalty had been wrongly notified and assessed and as HMRC were out of time to raise it correctly, it ceased to be chargeable and does not form part of this appeal. It is, however important, in the light of the events following the submission of the following quarter's VAT return.

36. Ms Cudlip prepared and submitted the 09/12 return which included a repayment claim. Mr Goodwin again visited the Appellant's premises on 29 November 2012 for an assurance visit and further errors were discovered, mostly similar to those uncovered on the previous visit. These were summarised in Mr Goodwin's email to Ms Cudlip dated 5 December 2012:

- One error, resulting in a £125,000 overclaim, arose because the text in a box on the Excel spreadsheet had been printed in white on white and so was "hidden".
- Import duty had been wrongly posted as VAT resulting in a further overclaim (although offset against this, was underclaimed VAT which had been wrongly posted as duty).
- The carry forward figures were incorrect; and
- Ms Cudlip had continued to use the freight forwarder invoices to determine the amount of the import VAT and then made manual adjustments, instead of using the C79s. Errors in this process resulting in over £40,000 of German VAT being reclaimed in the UK return.

38. In total, the amount of repayment overclaimed was £185,329.10.

39. Mr Goodwin issued a penalty on the basis of careless behaviour for £27,799.37 on 14 March 2013. Again he did not suspend the penalty. The penalty letter of 14 March 2013 explained how the penalty was calculated. Mr Goodwin had determined that the errors were careless on the basis that they were large, basic errors, very similar to the errors found on the earlier visit, despite Mr Goodwin having given Ms Cudlip advice about the C79s on the earlier visit. Mr Goodwin concluded there was a failure to take reasonable care. Also Ms Cudlip had said that she was under a lot of pressure and could not cope.

40. Again Mr Goodwin decided that it was not appropriate to suspend the penalty. As before, he took the view that the nature and number of basic errors involved, coupled with Ms Cudlip's attitude and behaviour, which gave the impression that she was not concerned with tax compliance, meant that she did not have the ability or will to meet any conditions which might be imposed. That is to say, although there were measures which could have been introduced, Mr Goodwin was not confident that Ms Cudlip would comply with them or that they would prevent future errors.

41. At no time did Mr Goodwin contact the directors of the company or consider doing so. He did not consider it unusual to deal solely with the accounts department. And he believed that Ms Cudlip had full delegated authority in relation to VAT matters and "she dealt with everything".

42. Mr and Mrs Townsend gave evidence, which we accept, that they knew nothing about the VAT assessments and penalties. They had asked Ms Cudlip about HMRC's visits and she had assured them that all was well subject to a few inconsequential adjustments. She had taken steps to cover her tracks, deleting Mr Goodwin's email of 5 December 2012 (which was only recovered from the hard drive archive on investigation after the facts all came out). All correspondence

addressed to the company was received and dealt with in the accounts department. Ms Cudlip had destroyed all the correspondence about the penalties received from HMRC. As noted, Ms Cudlip had been given authority to make payments from the company bank account. Although payments were supposed to be prepared by one member of staff and approved by another, Ms Cudlip had used her access to the bank account to authorise herself both to prepare the payment and to authorise it. She had done this only for the penalty payments, with other disbursements being dealt with in the proper way. The payments of VAT and penalties were broken into smaller payments so as not to attract attention. Payments of PAYE of tens of thousands of pounds were regularly made to HMRC, so payments of that sort of amount to HMRC would not have aroused suspicion. In any event, as mentioned, the directors did not review the bank account regularly, but left it to Ms Cudlip to alert them to any anomalies. Nor were the penalties referred to in the accounts; Ms Cudlip took over the preparation of the accounts when the Appellant's turnover fell below the audit threshold and so she was able to conceal them.

43. All this came to light only some-time after the event.

44. In December 2013, Ms Cudlip informed Mrs Townsend that she was pregnant. She was officially due to go on maternity leave on 28 July 2014, but she had a difficult pregnancy, had time off because of ill health and worked only reduced hours in July 2014, mostly from home. It is unclear exactly when she went on maternity leave, but she was in and out of the office in July. She had been given the task of recruiting a replacement to cover her maternity leave and the company employed a lady called Claire Theobald, who proved to be an inferior candidate and was dismissed by the company after a short period.

45. The VAT return for the period 06/14 was a repayment return and Mrs Sellers, an officer of HMRC, who gave evidence at the hearing was tasked with making a "pre-credibility assurance visit" in order to verify the repayment claim. Mrs Sellers visited the Appellant's premises on 6 August 2014, shortly after Ms Cudlip had gone on maternity leave. The directors were unable to be present as they were about to fly off on holiday that day and the visit was dealt with by Samantha and Claire.

46. Mrs Sellers discovered two distinct categories of errors.

47. A manual adjustment had been made to the return reducing the total net sales by £253,203.49 which reduced the VAT due by £50,604.69. Samantha told Mrs Sellers that the adjustments had been made by Ms Cuplip and she telephoned Ms Cudlip during the visit to confirm to what they related. Ms Cudlip said that they related to invoices issued to a major customer, Talbots of Birmingham (Talbots). Ms Cudlip said that she expected the invoices to be disputed and not paid and so had removed them from the return. No credit notes had been issued. Mrs Sellers reduced the reclaim by £50,604.69 on the basis that once an invoice has been issued in respect of a supply it cannot simply be deducted because it might not be

paid. Either a credit note must be issued (and the VAT adjustment will be made in that period) or bad debt relief must be claimed in order to recover the VAT.

48. Mr and Mrs Townsend also gave evidence about the Talbots invoices. Talbots's business was to supply jewellery boxes to small jewellery retailers. Promo sourced the boxes from the manufacturers in China. Because of the significant lead times involved and Talbots' need to have a ready supply of boxes for their customers, they would place an annual order with Promo for, say, a million boxes of different shapes and sizes and would "call off" say 10,000 at a time. Until called, the boxes were stored in a warehouse and they belonged to Promo. Talbots were committed to buy the full order in the course of the year and any uncalled goods at the end of the year were deemed to be ordered and would have to be paid for. When Talbots ordered some boxes they would be delivered and an invoice would then be issued. Title did not pass until the boxes had been delivered.

49. Mr Townsend told us, and we accept, in relation to the disputed invoices, that he received information from Bibbys and the bank that Talbots was in financial difficulties. He immediately telephoned the warehouse and instructed them not to allow the Talbots' lorry to load a consignment of boxes which had been ordered by Talbots and were already waiting on pallets in the warehouse. That order was never delivered. Title to the boxes remained with Promo. Invoices were generated by the accounting system but they were never issued. Mr Townsend acknowledged in correspondence that credit notes should have been issued, but he meant that they should have been issued for accounting purposes to make the books balance. The Appellant's position was that there had not been a supply for VAT purposes, and so no VAT could be due and the adjustment was properly made.

50. It was agreed at the hearing that the parties would seek to agree the position in relation to the Talbots invoices and the Judge made Directions to that effect. Accordingly, we will not at this stage make any decision concerning the appeal against the penalty issued in relation to the underdeclared output tax on the 06/14 return, but the above findings of fact will be relevant if the parties are unable to reach agreement and we need to make a decision on that issue.

51. The second category of error was the same as had been found in the two 2012 visits: the import VAT had been claimed by reference to the freight forwarder invoices and not the C79s. Samantha explained that the import VAT is initially entered against the freight forwarders' invoices which are subsequently cross-checked with the C79 and items not shown on the C79 are removed via a manual adjustment. Although some adjustment had been made, input tax of £79,030.45 had been overclaimed. Essentially, this was German VAT which should have been reclaimed in Germany and was not eligible to be reclaimed in the UK. Ms Cudlip's time sheet showed that she was in the office on the day the VAT return was submitted which was consistent with Samantha's statement to Mrs Sellers that Ms Cudlip had submitted the return.

52. Mrs Sellers wrote to the company on 11 August 2014 setting out the errors and stating that HMRC were considering imposing a penalty. The letter was addressed to Promo International Limited, as HMRC's other letters had been, but now that Ms Cudlip was on maternity leave, the letter was not intercepted and reached Mr Townsend.

53. The letter came as a "bolt from the blue" and Mr Townsend wrote to Mrs Sellers on 9 September acknowledging that there had been errors but asserting, on the basis of what he had been told by Ms Cudlip, that previous repayment claims had been agreed without adjustment following visits. On the basis of further information from Ms Cudlip he explained that the errors had arisen because Ms Cudlip had been unable to complete the return owing to the complications of her pregnancy and this had also meant that they were short staffed and the planned training and handover had been curtailed. He stated that, as a result, the return was completed by "a more inexperienced member of staff" and this led to the errors.The letter also indicates that Mr Townsend was not, at this point, aware of the previous VAT assessments and penalties. He concluded by setting out how errors would be avoided in the future and requesting that any penalties be suspended.

54. There was some confusion about who was responsible for the 06/14 VAT return. At the visit, Samantha informed Mrs Sellers that the return had been completed by Ms Cudlip. In subsequent correspondence with HMRC, Mr Townsend stated that the return had been prepared by "the other girls" (ie Samantha and Claire). This was based on what Ms Cudlip told him before he had reason to doubt her statements. He also spoke to Samantha who was rather evasive and said that she had done some of the work and Ms Cudlip had done some. Mrs Townsend had also been told by Ms Cudlip that a "junior member of staff" had prepared the return. Mrs Townsend had established that Ms Cudlip was in the office on the day the return was submitted online, from a review of her time sheets. Samantha also told her that she, Samantha, had prepared the figures on an Excel spreadsheet which had excluded the German VAT. Ms Cudlip had made a manual adjustment to include a reclaim in respect of the German VAT before submitting the return. It may be that Samantha's evasiveness arose from a misguided loyalty to Ms Cudlip. In any event, we find as a fact that the 06/14 VAT return was submitted by Ms Cudlip and that she made the manual adjustment to the figures which resulted in the errors.

55. Mrs Sellers replied to Mr Townsend on 24 September 2014 informing him that this was not the first time errors had been discovered and referring to the previous visits and the adjustments which had been made. Mrs Sellers also disputed Mr Townsend's reasons for the errors as it had been apparent from her visit and the telephone call to Ms Cudlip during her visit that Ms Cudlip had prepared the return. The letter contained penalty assessments in relation to the Talbots invoices and the underdeclaration of import VAT. Both penalties were assessed as "deliberate" We do not consider the Talbots penalty further for the reasons mentioned above. The penalty in relation to the import VAT was £27,660.50 based on potential lost revenue of £79,030. The penalty was at the rate of 35% as

the maximum reduction for a prompted disclosure was given for "telling, helping and giving". Mrs Sellers considered that the Appellant's behaviour was "deliberate" because "you have continued to make errors relating to the recovery of import VAT despite being notified of these mistakes on previous returns. You have failed to put procedures in place to prevent similar mistakes occurring and have therefore allowed these errors to continue. This has resulted in the net tax liability being significantly reduced and you should have been aware this was not in line with your previous returns".

56. Mr Townsend replied acknowledging the errors and their obvious and basic nature and pointing out that the return had omitted some legitimate claims which he considered showed that the return had been completed by inexperienced staff.

57. Mr Townsend subsequently spoke to Mrs Sellers on the telephone and on 17 November 2014 wrote to her saying he was unaware of "any fine" relating to previous VAT inspections and asking for details as a matter of urgency.

58. There was further correspondence in which Mr Townsend made it clear that the directors were unaware of the previous claims and penalties which had been paid without their knowledge or consent and indicating they were conducting a full investigation. HMRC provided copies of the correspondence and assessments. Mr Townsend asked for a review of all the decisions. On 29 April 2015, Mr Townsend sent Mrs Sellers a letter signed by Ms Cudlip before she "resigned" in which Ms Cudlip confirmed that she had been the person solely responsible for submitting the VAT returns, that all the post was received in the accounts department and not forwarded to the directors, that she had authorised and paid the previous penalties herself and that the directors of the Appellant were completely unaware of all this until contacted by HMRC in the latter part of 2014.

59. Mr Townsend asked for a review of all the penalty decisions. There was an unsuccessful attempt at ADR, followed by the review conclusion letter of 28 May 2015 which cancelled the 06/12 penalty because of procedural errors and confirmed the 09/12 and 06/14 penalties.

60. We were also taken to the minutes of an interview with Ms Cudlip conducted by the directors on 1 December 2014 at which they confronted Ms Cudlip about the previous inspections. Ms Cudlip was evasive and unhelpful and purported to be unable to recall anything about a discrepancy in the figures of £280,000 although she could remember the name of the officer, where the meeting took place and the fact they talked about the Olympics!

61. In the course of their investigation, the directors reviewed other aspects of Ms Cudlip's work and discovered widespread systematic defaults which had cost the company hundreds of thousands of pounds without there being any apparent benefit to Ms Cudlip herself.

62. As noted, a substantial amount of the penalties arose from erroneous claims for refunds of German VAT on the UK VAT returns. Mrs Townsend gave evidence,

which we accept that she reviewed all the intervening returns and the only returns on which such claims were made were those which had given rise to the penalties. This is consistent with the other facts as the inclusion of German VAT gave rise to large reclaim returns which were the trigger for the compliance visits. However, Mrs Townsend also discovered that Ms Cudlip had not made the legitimate claims to recover German VAT through TMF, the agents which she had appointed. We were taken to correspondence with TMF which showed that TMF had repeatedly chased Ms Cudlip for the information for the returns and had been forced to submit nil returns in order to avoid penalties in Germany. In Germany, returns are submitted monthly and had claims been submitted timeously, the VAT would have been reclaimable every month with significant cash flow benefits to the company. When Mr Townsend had asked about the German VAT, Ms Cudlip had assured him that the payments would be made shortly.

63. We heard further from Mrs Townsend that when she provided TMF with the information required to complete the returns properly, the Appellant received a refund of £480,000 of German VAT for the period from mid-2012 to December 2014.

64. There was nothing in the evidence to suggest that if the German VAT had been reclaimed there would have been a double claim in the UK also. Had things been done properly, UK VAT would have been reclaimed in the UK and German VAT would have been reclaimed in Germany. There is nothing to indicate there would have been any double counting.

65. Further, Mrs Townsend also found that there had been under-invoicing of approximately Euro 1m and that "there are missing funds to the tune of £1m". Charlotte had produced financial information which was patently untrue. Sales were shown as having been invoiced when they had not been, even when customers chased for an invoice, some sales invoices were written off and payments were allocated against invoices when no funds had been received.

66. The directors were at a loss to explain Ms Cudlip's behaviour. It does not seem she benefitted personally from it. Nor do we have any explanation. However, we accept that it was Ms Cudlip personally who made the errors in the VAT returns in dispute and that she took deliberate steps to conceal her actions from the directors including the fact of the penalties and the payment of them. We have found that the directors were unaware of the situation until Mrs Sellers' letter following the August 2014 visit.

67. The company has now put procedures in place to prevent a recurrence of these errors and in particular:

- German sales and import VAT are posted to a separate nominal ledger so that it is no longer necessary to extract the figures from the total VAT information and make manual adjustments
- UK import VAT is also posted in a separate ledger to facilitate reconciliation with the C79 each quarter

- The submission of the German and UK VAT returns are co-ordinated

68. In future, the VAT liability will also be reconciled with the ledgers quarterly.

69. Mrs Townsend stated that since 2014 they had had compliance visits which had found the VAT claims completely accurate.

The Appellant's submissions

70. The burden in on HMRC to prove that the errors were made and the nature of the errors i.e. whether careless or deliberate.

71. There was no potential lost revenue attributable to any error relating to the claiming of German VAT in the UK.

72. The Appellant took reasonable care to comply with its VAT obligations by appointing a qualified accountant to deal with them.

73. None of the errors was deliberate.

74. HMRC should have informed the directors directly.

75. The Appellant has a reasonable excuse for any errors.

76. HMRC should have reduced the penalty by virtue of special circumstances.

77. HMRC's decision not to suspend the penalties was flawed and should be remade.

The Respondent's submissions

78. The person who is obliged to submit accurate VAT returns is the Appellant.

79. For this purpose, Ms Cudlip *was* the company and her actions are to be attributed to the company.

80. Ms Cudlip (and therefore the company) acted carelessly in 2012 and deliberately in 2014 and therefore the penalties should stand.

81. In the alternative, the company had acted carelessly in 2014.

82. It was not credible that the directors were unaware of the earlier assessments and penalties and in any event they had failed to exercise proper oversight of the company's business in accordance with their Companies Act 2006 obligations so they had failed to take reasonable care.

Discussion

Burden of proof

83. HMRC accept that the burden of proof lies on them. That burden is to the normal civil standard of the balance of probabilities. The state of affairs asserted must be more likely than not on the basis of the evidence.

84. Mr Firth submits that in considering what is likely, the Tribunal is entitled to take account of inherent probabilities with serious matters such as fraud or deliberate behaviour being less likely than careless behaviour. He argues that more cogent evidence is needed to prove deliberate behaviour.

The Potential Lost Revenue issue

85. Penalties under schedule 24 are tax geared and depend on the amount of the potential lost revenue which is defined in para. 5 as *"the additional amount due or payable in respect of tax as a result of correcting the inaccuracy…"* . Mr Firth argues that for this purpose, the EU VAT system must be looked at as a whole as it would be discriminatory to treat traders differently depending on the place of claim. Mr Firth points out that to the extent that the Appellant had overclaimed the import tax in the UK, they had underclaimed the same amount of import tax in Germany, so that the Company's net position is the same, and when viewed in an EU context, there had been no overall loss of tax. Therefore there was nothing on which a tax-geared penalty could bite.

86. In support of this contention, Mr Firth relied on the reference to the European Court (Case C-309/06) of issues arising in *Marks & Spencer plc v the Commissioners of Customs and Excise*. In that case, HMRC wrongly categorised chocolate covered teacakes as biscuits, which were standard rated for VAT. It was subsequently agreed that they were cakes, which were zero-rated. Marks & Spencer plc reclaimed the overpaid VAT. HMRC refused the repayment on the basis that Section 80 of the VAT Act 1990 enabled them to refuse a reclaim if the claimant would be "unjustly enriched" which HMRC said would be the case as the company had passed on 90% of the amount of the VAT to its customers. The European Court stated that *"…the general principle of equal treatment requires that similar situations are not treated differently unless differentiation is objectively justified…"*. So taxable persons marketing similar goods must be treated in the same way irrespective of whether they usually paid VAT or reclaimed it. The Court held that the question of unjust enrichment was unrelated to the status of the trader as debtor or creditor of HMRC and the provision of domestic law that repayment would be refused where the trader would be unjustly enriched did not infringe the principles of equal treatment and fiscal neutrality.

87. In the domestic context, Mr Firth also referred to the First Tier Tribunal case of *Christopher Horne v HMRC* [2013] UKFTT 177(TC) which involved "special reduction " of a penalty and to which we will return. At the time the penalty was assessed on an underpayment of tax, the taxpayer was owed an amount in respect of an excessive payment of PAYE tax for a later year. In the specific circumstances of that case, the Tribunal effectively determined that the excess tax paid should be set against the underpaid tax and if the excess cancelled out the underpaid tax the penalty should be reduced to 0%.

88. Mr Thomas acknowledged that HMRC had not considered the German VAT position in calculating the potential lost revenue. He considered that German VAT could only be recovered in Germany and were it otherwise, there would be a risk of double claiming as the UK authorities could not check what was happening in Germany. He also submitted that there was no breach of the principles of fiscal neutrality and equality as taxable persons in different countries would be treated in the same way in the UK and Germany respectively.

89. We do not find the *Marks & Spencer* case of assistance here. That case was concerned with the extent to which domestic legislation could override the EU principles of fiscal neutrality and equality which is different from the issue here. Nor does *Horne* establish any general principle that a taxpayer can set off an overpayment of one tax against an underpayment of another, even within the UK, let alone across borders.

90. The potential lost revenue is *"the additional amount due or payable in respect of tax as a result of correcting the inaccuracy…"* . Schedule 24 as a whole, including the definition of potential lost revenue does not just apply for VAT purposes. It applies to most UK direct and indirect taxes and duties from income tax and inheritance tax to Aggregates Levy and Air Passenger Duty. Construing para 5 of schedule 24 according to normal principles of construction and in the context of the schedule as a whole, it is quite clear that the reference to "tax" in the definition of potential lost revenue is a reference to UK tax only. HMRC cannot be expected to charge tax by reference to what may or may not have been paid in other countries. A taxpayer would be able to claim relief under double tax treaties or by way of unilateral relief where tax is payable in more than one country and that is the proper way of dealing with such matters.

91. Nor do we consider that there is any breach of EU principles provided HMRC treats taxable persons from all countries in the same way where they are in similar circumstances. This is the case here.

92. In summary, potential lost revenue can only refer to UK tax. In the present case, the inaccuracies did lead to an underdeclaration of UK tax liabilities so that there was potential lost revenue by reference to which penalties could be calculated. The fact that the amounts wrongly claimed in the UK could have been properly claimed in Germany does not affect this.

The attribution issue

93. The taxpayer in the present case is Promo International Limited, the company. The VAT returns, including the inaccuracies in it, were completed by Ms Cudlip. Can Ms Cudlip's actions be regarded as those of the company?

94. Mr Firth submitted that they could not. He referred to the case of Mahendran v HMRC [2015] UKFTT 278 (TC) where the Tribunal said:

" HMRC has fairly pointed out the decision of the Special Commissioners in the case of Rowland which the Tribunal found of great assistance. In particular Judge Shipwright considered at 20 b of that decision

95. *"b. It was sensible and reasonable for Mrs Rowland to employ and rely upon persons whom she reasonably believed to have the relevant specialist knowledge and expertise that she did not possess personally."*

96. *This Tribunal considers it was similarly sensible and reasonable for the appellant in this case to employ and rely upon persons whom she reasonably believed to have the relevant specialist knowledge and expertise that she did not possess personally."*

97. Mr Firth argued that the Appellant, by hiring an ACCA qualified accountant to deal with VAT matters well within her capability, acted in a reasonable and sensible way and the fact that they were let down by Ms Cudlip did not mean that the Appellant did not take reasonable care. Mr Firth further submitted that it would be contrary to the EU principle of equal treatment to discriminate between taxpayers who relied on a professional adviser who was an employee rather than a third party adviser, in the application of penalties.

98. With respect, the question is not whether the company acted reasonably in relying on Ms Cudlip, but whether Ms Cudlip *was* the company for this purpose.

99. Although he did not refer to this in detail at the hearing, Mr Firth submitted authorities from which we infer that he was also seeking to rely on the "Hampshire Land principle" which we discuss below.

100. There have been a number of cases on the responsibility of a company for the acts of fraudulent employees and agents.

101. In the case of *McNicholas Construction Co Ltd. v HMRC* [2000] STC 553, the company had claimed VAT input tax in respect of invoices submitted by sub-contractors who purported to have carried out work for the company. In fact, no work had been carried out and the input VAT was not properly claimable as a result of the fraud of the company's site manager and the sub-contractors. The question was whether the company was responsible for the fraudulent activities of its employees.

102. Dyson J said:

" It is common ground that the knowledge and dishonest acts of the site managers could not be attributed to MC by virtue of the primary rules of attribution, the general rules of agency or the ordinary rules of vicarious liability of an employer for the acts of or defaults of his employee. As was made clear by Lord Hoffmann in Meridian , the question whether the acts or defaults of an employee of a company may nevertheless be attributed to the company is a matter of interpretation of the relevant substantive rule. In some cases, the acts or defaults of the "directing mind and will" of the company, or at least those of the directing mind and will of its relevant functions, will

be attributed to the company. In others, the acts or defaults of other employees who cannot be said to be the "directing mind and will" are to be attributed. The question in each case is whether attribution is required to promote the policy of the substantive rule, or (to put it negatively) whether, if attribution is denied, that policy will be frustrated.

*45. Thus in Tesco Supermarkets Ltd v Nattrass [1972] AC 153 , it was held that the acts and defaults of the manager should not be attributed to the company, since otherwise the statutory defence of due diligence would be rendered nugatory, and the clear intention of Parliament would be thwarted. In the Pioneer Concrete case, the employees made a restrictive agreement in breach of an order of the court, and in defiance of a clear express prohibition by the board of directors. The Court of Appeal had accepted Pioneer's argument that it was not liable because of the prohibition by the directors. The House of Lords took a different view. They held that to accept that argument would allow a company to enjoy the benefit of restrictions outlawed by Parliament and the benefit of arrangements outlawed by the courts. Recourse to the "guiding will" rule for attribution would lead to this unacceptable result. As Lord Nolan put it (475A–D): *22*

"The Act is not concerned with what the employer says but with what the employee does in entering into business transactions in the course of his employment. The plain purpose of section 35(3) is to deter the implementation of agreements or arrangements by which the public interest is harmed, and the subsection can only achieve that purpose if it is applied to the actions of the individuals within the business organisation who make and give effect to the relevant agreement or arrangement on its behalf".

46. In Meridian itself, investment officers of a company used funds managed by the company to acquire shares in a public issuer. The company thereupon was required by statute to give notice that it had become a substantial security holder. It did not do so, and proceedings were instituted against the company for breach of statute. The Court of Appeal in New Zealand held that the knowledge of the officers should be attributed to the company on the basis that one of them was its "directing mind and will". The Privy Council dismissed the appeal. It did not decide whether the officer was in fact the company's directing mind and will. Lord Hoffmann considered the question of attribution by examining the policy of the substantive rule. At page 511C, he said:

"… The policy of section 20 of the Securities Amendment Act 1988 is to compel, in fast moving markets, the immediate disclosure of the identity of persons who become substantial security holders in public issuers. Notice must be given as soon as that person knows that he has become a substantial security holder. In the case of a corporate security holder, what rule should be implied as to the person whose knowledge for this purpose is to count as the knowledge of the company? Surely the person who, with the authority of the company, acquired the relevant interest. Otherwise the policy of the Act would be defeated. Companies would be able to allow employees to acquire interests on their behalf which made them substantial security holders but would not have to report them until the board or someone else in senior

management got to know about it. This would put a premium on the board paying as little attention as possible to what its investment managers were doing. Their Lordships would therefore hold that upon the true construction of section 20(4)(e) , the company knows that it has become a substantial security holder when that is known to the person who had authority to do the deal. It is then obliged to give notice under section 20(3) ."

103. Mr Thomas submitted that this showed that the actions of employees, even fraudulent actions contrary to the interests of the company, and even where, as in *Pioneer Concrete*, the company had forbidden the actions carried out, could be attributed to the company and that attribution depended on the purpose of the relevant legislation.

104. In the present case, schedule 24 was designed to discourage errors from being made on tax returns, including VAT returns, by imposing penalties which escalated according to culpability. Mr Thomas submitted that the penalty regime would be rendered toothless if the company was not liable for the actions of its employees, since it could only submit returns through its employees, and as suggested in *Meridian*, it would encourage the directors to pay as little attention as possible to what the employees were doing.

105. In reply, Mr Firth contended that the directors of a company must still comply with their Companies Act obligations to manage the company with due diligence and they must still act reasonably in relying on someone else, whether an employee or outside advisor.

106. McNicholas also referred to the Hampshire Land principle which was interpreted to mean that the act of an employee would not be attributed to the employer where the act was directed at and harmful to the interests of the employer. Dyson J said:

107. *"it was:*

"a well-recognised exception from the general rule that a principal is affected by notice received by his agent that, if the agent is acting in fraud of his principal and the matter of which he has notice is relevant to the fraud, that knowledge is not to be imputed to the principal."

…The circumstances in which the exception to the general rule of attribution will apply are where the person whose acts it is sought to impute to the company knows or believes that his acts are detrimental to the interests of the company in a material respect. This explains, for example, the reference by Buckmaster LJ to making "a clean breast of their delinquency". It follows that, in judging whether a company is to be regarded as the victim of the acts of a person, one should consider the effect of the acts themselves, and not what the position would be if those acts eventually prove to be ineffective. As the Tribunal pointed out, in Pioneer Concrete the company suffered a large fine for contempt of court on account of the wrongful acts of its managers. The fact that their wrongful acts caused the company to suffer a financial penalty in

this way did not prevent the acts and knowledge of the managers from being attributed to it.

56. The Hampshire Land principle or exception is founded in common sense and justice. It is obvious good sense and justice that the act of an employee should not be attributed to the employer company if, in truth, the act is directed at, and harmful to, the interests of the company. In the present case, the fraud was not aimed at MC. It was not intended by the participants in the fraud that the interests of MC should be harmed by their conduct."

108. *McNicholas* was considered in the Upper Tribunal case of *Mobile Sourcing Limited v HMRC* [2016] UKUT 274 (TCC). Where the Tribunal said:

"The question arose as to whether the dishonest acts and intentions of the site managers should be attributed to the company. The judge (Dyson J) held that those acts and intentions should be attributed to the company. Even though such attribution did not result from the primary rules of attribution or the general rules of agency or the ordinary rules as to vicarious liability, it was appropriate in the relevant statutory context to attribute to the company the acts and knowledge of the persons who had a part to play in the making and receiving of the supplies involved in the VAT arrangements. This was appropriate in order to advance the policy of the statutory provisions which was to discourage the dishonest evasion of VAT."

109. The Tribunal went on to consider the Supreme Court case of *Bilta (UK) Ltd v Nazir (No. 2)* [2016[AC] 1which reviewed the authorities in some detail and in particular reinterpreted the application of the Hampshire Land principle or breach of duty exception. The Tribunal quoted Lord Walker of Gestingthorpe's summary of the law as to the breach of duty exception and went on to apply *Bilta* and to consider its impact on *McNicholas*.

"Lord Walker summarised the law as to the breach of duty exception in a number of propositions which included the following:

(1) the underlying rationale of the breach of duty exception is to avoid the injustice and absurdity of directors or employees relying on their own awareness of their own wrongdoing as a defence to a claim against them by their own corporate employer;

(2) the exception does not apply to protect a company where the issue is whether the company is liable to a third party for the dishonest conduct of a director or employee;(3) the supposed distinction between primary and secondary victims, although sometimes a useful analytical tool, is ultimately much less important than the distinction between third party claims against a company for loss to the third party caused by the misconduct of a director or employee, and claims by a company against its director or employee (or an accomplice) for loss to the company caused by the misconduct of that director or employee

The application of Bilta to the facts of this case.

47 It is clear from the decision of the Supreme Court in Bilta that it is important to have regard to the context in which the question of attribution arises and the persons who are relevant to the application or non-application of the breach of duty exception. If the question of attribution arose as between MSL and Wigig, for example in a claim by MSL against Wigig for damages for fraud, it is clear from Bilta that Wigig could not argue that its knowledge of the fraud should be attributed to MSL so as to give Wigig a defence. It would make no difference whether MSL was the primary victim of the fraud or only a secondary victim. When considering whether MSL had suffered loss, it would be irrelevant to consider whether MSL would have suffered loss if the fraud on HMRC had succeeded. In assessing whether the actions of Wigig were harmful to MSL, there would be no question of the court being slow to find such harm; the court would make the findings which were appropriate on the evidence before it. In other words, the distinctions which were drawn in McNicholas and applied in Greener Solutions as to when to apply the breach of duty exception would have no part to play in the context of a claim by MSL against Wigig.

48 If the facts of McNicholas were to recur and the matter were to be analysed after Bilta, we do not consider that a court or tribunal would adopt the original reasoning in McNicholas. That reasoning was resorted to when it was not appreciated, as it is now appreciated, that one could hold that the knowledge of a relevant person could be attributed to the company in a claim by a third party against the company and, at the same time, could hold that there was no such attribution in a claim by the company against the person who was in breach of duty. After Bilta, the reasoning in a McNicholas case would simply be that as between the company and HMRC, the company was responsible for the wrongdoing committed for it by the wrongdoer, even though that involved a breach of duty owed by the wrongdoer to the company.

110. So the position after *Bilta*, as set out in *Mobile Solutions*, is that as between a company and third party such as HMRC, the wrongful acts of an employee can be attributed to the company. The fraud exception is of limited application and prevents the employee from relying on their own wrongful acts as a defence to an action by the company against him.

111. Applying these principles to the present case, the policy of the statutory provisions in schedule 24 is to encourage the careful and accurate completion of tax returns This is achieved by imposing penalties on those taxpayers who fail to take reasonable care or who deliberately include inaccuracies. With this context in mind, we find that Ms Cudlip's actions can, and are to be, attributed to the Appellant in determining the Appellant's liability to HMRC for VAT penalties in relation to the returns completed by Ms Cudlip.

Were the inaccuracies careless or deliberate?

112. It is important to focus on the actions which are relevant in considering whether the behaviour was careless or deliberate within schedule 24. Considerations such as those in *Mahendran*, discussed above or the comments in *Auxilium Project Management Ltd v HMRC* [2016] UKFTT 249 (TC) to the effect that that there are circumstances in which a taxpayer may be regarded as having exercised

reasonable care by relying on the advice of a competent professional advisor, on which Mr Firth also relied, are not in point. The question is not whether the Appellant, in the person of the directors, took reasonable care by employing and relying on an accountant whom they reasonably believed to be competent. The question is whether the Appellant, which means Ms Cudlip in this context, took reasonable care in completing the company's VAT returns.

113. Mr Thomas drew our attention to the explanation of the meaning of taking reasonable care *in Collis v Revenue and Customs Commissioners* [2011] UKFTT 588 (TC). The Tribunal said, in the context of para 3 of schedule 24:

"That penalty applies if the inaccuracy in the relevant document is due to a failure on the part of the taxpayer… to take reasonable care. We consider that the standard by which this falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question."

114. In relation to the 2012 errors, HMRC considered them to be careless for several reasons. First, the basic nature of the errors-one resulting from a formatting error, the mixing up of the postings of items as duty or VAT and the use of the figures for import VAT in the freight forwarding invoices instead of the C79s. Secondly, some of the errors had been repeated even though Mr Goodwin had explained the correct treatment only a few months earlier. Thirdly, comments made by Ms Cudlip during the visit indicated that the discovery of the errors was "a wake-up call" and that she was distracted and under pressure from over-work. Finally, Mr Goodwin felt that Ms Cudlip's attitude showed a lack of concern about the inaccuracies.

115. A reasonably competent accountant exercising reasonable care would not have made the basic errors which were in fact made in the 09/12 VAT return and certainly would not have repeated errors which had recently been pointed out to her.

116. We agree that the errors in the 09/12 return were careless and that a penalty was due accordingly.

117. The inaccuracies in the 06/14 return are alleged to be "deliberate". This was defined in the *Auxilium* case as follows:

" In our view, a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test. The question is not whether a reasonable taxpayer might have made the same error or even whether this taxpayer failed to take all reasonable steps to ensure that the return was accurate. It is a question of the knowledge and intention of the particular taxpayer at the time"

118. HMRC sought to extend that definition to the situation where the taxpayer "buries its head in the sand" and deliberately refrains from finding out the true position. This is derived from the case of *Anthony Clynes v HMRC* [2016] UKFTT 369 (TC) where the Tribunal said:

"The fact that the deliberate conduct is tied to the inaccuracy, indicates that for this penalty to apply the person must have, in a subjective sense, acted with some level of knowledge or consciousness as regards the inaccuracy. In the case of a Company we take the relevant awareness or knowledge to be that of the relevant officers, such as the appellant acting as director, acting on its behalf….

86 However, we consider that the term "deliberate inaccuracy on a person's part" can extend beyond this. Our view is that, depending on the precise circumstances, an inaccuracy may also be held to be deliberate where it is found that the person consciously or intentionally chose not to find out the correct position, in particular, where the circumstances are such that the person knew that he should do so. A person cannot simply escape liability by claiming complete ignorance where the person clearly knew that he should have taken steps to ascertain the position. We view the case where a person makes such a conscious choice not to take such steps with the result that an inaccuracy occurs, as no less of a "deliberate inaccuracy" on that person's part than making the inaccuracy with full knowledge of the inaccuracy."

119. Mrs Sellers had originally treated the errors relating to the import VAT as deliberate because they were repeated errors, they significantly reduced the Appellant's liability to tax and the Appellant had failed to put in place procedures which would prevent the errors recurring, indicating there was no interest in preventing recurrence.

120. Mr Thomas also submitted that the directors must have been aware of what was going on or were deliberately "burying their heads in the sand" and failing to exercise proper oversight.

121. We have found as a fact that the directors did not know about the previous penalties or Ms Cudlip's other defaults until Autumn 2014. In any event, it is not the directors' intention which is relevant here .

122. In the circumstances of this case, it must be established that Ms Cudlip reclaimed the German VAT in the 06/14 return, knowing that the Appellant was not entitled to do so and intending that the amount reclaimed would be more than it should be.

123. The burden is on HMRC to prove this on the balance of probabilities.

124. Mr Firth pointed out that the return contained errors in HMRC's favour as well as errors in the company's favour. It is difficult to find a motive for Ms Cudlip knowingly submitting an incorrect return. There was no personal benefit to Ms Cudlip, nor was there any overall benefit to the company. Had matters been dealt with correctly, the reclaim would not have been made in the UK, but the same amount could have been reclaimed in Germany, and repaid sooner because of the monthly accounting.

125. We have also taken into account the circumstances in which the return was submitted and the fact that it was two years since the previous, similar, errors. Ms Cudlip was clearly under pressure. She was heavily pregnant and unwell. She had

been unable to attend the office regularly and had been attempting to deal with her work from home. She was about to go on maternity leave and the VAT return had to be submitted. She made the same mistaken manual adjustments to the return which she had made two years previously.

126. We do not consider that HMRC have provided sufficient evidence that Ms Cudlip intended the return to be incorrect for the inaccuracies to be considered deliberate.

127. There is evidence that they arose from lack of reasonable care and we find that the errors in relation to the import VAT in the 06/14 return were careless for the purposes of schedule 24.

Special Reduction

128. Para 11 of schedule 24 permits HMRC to make a special reduction in the amount of a penalty if "they think it right because of special circumstances".

129. Mr Firth submitted that the fact that the overclaim in the UK was matched by an underclaim in Germany, so that there was no net benefit to the company, amounted to special circumstances which merited a special reduction in the penalty to nil, by analogy with the *Horne* case, discussed above.

130. Mr Thomas sought to distinguish *Horne* on the basis that that case indicated HMRC should consider a taxpayer's situation in the round, but here that would require HMRC to do the work of the German tax authorities and/or the company. Mr Firth denied this and argued that the point of the case was that it showed such circumstances *could* be special circumstances.

131. Where there is an appeal against the amount of a penalty, as here, the Tribunal may, by virtue of para 17(3) rely on para 11 to the same extent as HMRC, but only if HMRC's decision in relation to para 11 was flawed in the judicial review sense. Mr Firth submitted that neither Mr Goodwin nor Mrs Sellers took into account the fact that the overclaim in the UK was matched by the underclaim in Germany and there was no benefit to the company. This, he argued, was a relevant consideration which the officers had failed to take into account and so their decisions were flawed.

132. As we have found above, HMRC was entitled to consider only the UK tax position in applying schedule 24. They were not obliged to consider the position in Germany. They did not therefore fail to take account of a relevant matter. "Special circumstances" must be just that; something out of the ordinary which justifies a departure from the normal treatment.

133. In applying para 17(3) is not relevant that a different officer or the Tribunal might have taken a different view. We consider that HMRC's decisions that there were no special circumstances in this case to be well within the range of reasonable decisions open to the officers so that their decisions were not flawed in the Judicial Review sense and we cannot remake those decisions.

Suspension of the 2012 penalties

134. Under para 14 of schedule 24 HMRC have power to suspend all or part of a penalty for a careless inaccuracy but may only do so where compliance with a condition of suspension would help the taxpayer to avoid becoming liable for further penalties for careless inaccuracy.

135. Mr Goodwin refused to suspend the penalty imposed in respect of the 09/12 VAT return. Suspension was not considered in relation to the 2014 penalty as this was alleged to be in respect of deliberate inaccuracies and so para 14 did not apply.

136. Mr Goodwin did not deny that there were suitable conditions which could have been set. He did not suspend the penalty because he considered that Ms Cudlip, who would have been responsible for implementing them, had a lax attitude to compliance and would not have complied with any such conditions. Accordingly, he took the view that the imposition of conditions would not have the effect of helping the taxpayer to avoid becoming liable for further careless inaccuracy penalties.

137. On an appeal against a refusal to suspend a penalty, the Tribunal can order HMRC to suspend the penalty only if it thinks that HMRC's decision not to suspend is flawed. Again, "flawed" is defined by para 17(3) to mean "flawed when considered in the light of the principles applicable in proceedings for judicial review.". That is, the decision must be "unreasonable" in the sense of the well-known Wednesbury principles: the decision maker must have taken account of some irrelevant matter, or not taken account of a relevant matter or his decision must be one which no reasonable decision maker could have taken.

138. Mr Thomas submitted that this test sets a high bar and as requested by Mr Firth provided authorities for this statement after the hearing.

139. He submitted that "unreasonable" in this context does not mean unreasonable in the dictionary or colloquial sense of "not guided by or based on good sense" (or something similar). It *means 'Wednesbury unreasonableness', i.e. "something so absurd that no sensible person could ever dream that it lay within the powers of the authority"*: *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223, 229.

140. The test has often been stated by the courts in very strong terms. So, for example, in *Council of Civil Service Unions v Minister for the Civil Service* [1985] AC 374 at 410G-H, Lord Diplock wrote: *"By 'irrationality' I mean what can by now be succinctly referred to as 'Wednesbury unreasonableness'… It applies to a decision which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it."* Lord Diplock's decision in this case was applied in *AA (Uganda) v Secretary of State for the Home Department* [2008] EWCA Civ 579 at [41] and by Lord Mance in *AXA General Insurance Ltd v HM*

Advocate [2011] UKSC 46 at [97], who illustrates the standard with the *"familiar extreme example" of unreasonableness, namely "a blatantly discriminatory decision directed at red-headed people."*

141. It is important that the Tribunal does not substitute its own decision for the original decision simply because it believes that the original decision was wrong. It has to conclude that the decision was wrongly made. Hence, for example, Lord Ackner's comment in *R v Secretary of State for the Home Department ex p Brind* [1991] 1 AC 696, at 757-G – the *"standard of unreasonableness … has to be expressed in terms that confine the jurisdiction exercised by the judiciary to a supervisory, as opposed to an appellate, jurisdiction."*

142. Unreasonableness goes beyond a difference of opinion, or even a passionate disagreement: per Lord Russell in *Secretary of State for Education and Science v Tameside Metropolitan Borough Council* [1977] AC 1014 at 1074H-1075C, *"it is quite unacceptable… to proceed from 'wrong' to 'unreasonable'… History is replete with genuine accusations of unreasonableness when all that is involved is disagreement, perhaps passionate, between reasonable people… 'Unreasonable' is a very strong word indeed, the strength of which may easily fail to be recognised."* Similarly, Lord Hailsham concluded, in *In re W (an Infant)* [1971] AC 682 at 700E that *"not every reasonable exercise of judgment is right, and not every mistaken exercise of judgment is unreasonable."*

143. Mr Firth sought to argue that Mr Goodwin's decision was flawed on all three grounds:

- The decision was based on Mr Goodwin's subjective opinion as to whether the taxpayer would comply with conditions which was not based on any particular conduct and was an irrelevant consideration
- He had failed to take account of a relevant consideration in that he had not taken account of the directors' attitude to tax compliance
- It was irrational of Mr Goodwin reach a subjective view on such a serious matter without any substantial basis.

152. Mr Thomas argued that Mr Goodwin's decision was not so unreasonable as to be "absurd" or "outrageous in its defiance of logic". He contended that the decision was reasonable, as it was based on the whole context of information available to Mr Goodwin at the time, including the inaction of the company in response to his previous visit and the impression he formed of the company during that visit.

153. We agree with Mr Thomas that the Appellant has a high hurdle to clear to show that Mr Goodwin's decision was Wednesbury unreasonable so as to allow the Tribunal to interfere with it.

154. We do not consider that the opinion of an experienced officer like Mr Goodwin as to the likelihood of a taxpayer complying with any conditions imposed is an irrelevant consideration. Indeed, it goes to the heart of the requirement in para 14 that the conditions must help the taxpayer to avoid further careless inaccuracies which requirement must be satisfied before HMRC can suspend the penalty.

155. We agree with Mr Firth that it would have been desirable for Mr Goodwin to speak to the directors and it would certainly have been good practice for him to have done so. On the other hand, he was, and believed himself to be, dealing with the person who had authority to deal with these matters and who would be responsible for implementing any conditions which were imposed. He also reasonably assumed that any correspondence addressed to the company would be seen by the directors and that they would be aware of the assessments and penalties. He could not have known that Ms Cudlip had intercepted HMRC's letters and taken active steps to conceal the penalties from the directors. In the circumstances, Mr Goodwin's failure to consider the directors' attitude to tax compliance cannot be taken to vitiate his decision.

156. Finally, looking at all the circumstances and Mr Goodwin's knowledge at the time, his decision cannot be said to have crossed the boundary into irrationality. His decision was one which a reasonable officer was entitled to make.

157. Accordingly, we consider that the decision not to suspend was not flawed and there is no basis for the Tribunal to interfere with the decision.

Decision

158. For the reasons set out above, we have decided that the penalty for careless inaccuracy imposed in respect of the 09/12 VAT return was properly imposed and that the decisions that there were no special circumstances and that the penalty should not be suspended were not flawed. Accordingly, we affirm that penalty.

159. In relation to the penalty imposed in respect of the overclaim for import VAT in the 06/14 VAT return, we have decided that the inaccuracies were not deliberate but were careless.

160. We have therefore considered the amount of the penalty and under para 17(2) of schedule 24, we are empowered to substitute our own decision for HMRC's. We agree that the disclosure of the inaccuracy was "prompted" and note that the range of penalties for careless inaccuracy in the case of a prompted disclosure is between 15% and 30% of the potential lost revenue. HMRC gave the maximum reduction to the deliberate penalty for the taxpayer's co-operation in giving, telling and helping. We therefore propose to reduce the penalty for careless inaccuracy by the maximum amount so that the penalty for the import VAT errors in the 06/14 return will be 15% of the potential lost revenue.

161. We do not consider that the decision that there were no special circumstances was flawed.

162. HMRC did not consider suspending this penalty as they took the view the inaccuracies were deliberate and suspension is not available in deliberate cases. We note that the directors have now put in place effective procedures to ensure that the mistakes which were made cannot happen again and that recent compliance visits have not discovered any inaccuracies. We suggest that HMRC may wish to consider suspending the penalties in full now that they are able to do so.

163. This decision is a final decision in relation to the issues within its scope. If the parties are unable to reach agreement in relation to the Talbots invoices in accordance with the directions issues after the hearing, the Tribunal will proceed to make a separate decision in respect of that issue.

164. 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.

MARILYN MCKEEVER

TRIBUNAL JUDGE
RELEASE DATE: 10 FEBRUARY 2017