TC02762

Appeal number: TC/2010/09136

VAT – dishonest evasion penalty – whether Appellant dishonest within the meaning of section 61 VATA 94 – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PETER ARAKIEL BROOKES **Appellant**

-and-

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

TRIBUNAL: **JUDGE KEVIN POOLE**
WILL SILSBY CTA

Sitting in public in Priory Court, Bull Street, Birmingham on 13 December 2012

The Appellant appeared in person

David Linneker, Presenting Officer of HM Revenue and Customs, appeared for the Respondents

DECISION

Introduction

1. This appeal concerns a dishonest evasion penalty totalling £43,753 in respect of the conduct of a company which was assessed on the Appellant personally under section 61 Value Added Tax Act 1994 ("VATA94"), in his capacity as a director of that company.

2. The central issue was whether the conduct of the company giving rise to the penalty was "attributable to the dishonesty" of the Appellant within the meaning of section 61.

The facts

3. We heard evidence from the Appellant and from a Mr Christopher Griffiths (identified at [8] below) as well as from HMRC officers Clare Farrington and Philip Gittins. We were also provided with a bundle of documents. The following facts emerged from the evidence before us.

4. The Appellant was at all material times the sole director of Villagepark Homes Limited ("VPH"), which he incorporated as the vehicle for carrying out a particular residential property development in November 2003.

5. He had carried out previous residential property developments through another company, Villagepark Developments Limited ("VPD"), formed in June 2002.

6. VPH's project involved the construction of 20 new homes in Highley, Shropshire. The Appellant (on behalf of VPH) assembled the site and obtained planning permission in 2004 and appointed a company called Focus Strip Limited ("FS") as main contractor to carry out the building work, though there was no formal written contract. This was in late 2004 or early 2005. Included in the evidence before us was a copy of an invoice from FS (using the trading name "Construction & Design Services") to VPH dated 7 February 2005 for £96,000 plus VAT, which described the relevant supplies as "Excavate and pour concrete to foundations. Brickwork and Blockwork to DPC. Beam and Blockwork to floors." This copy invoice had been obtained by HMRC much later from the liquidator of FS – see below.

7. When FS started on site, it rapidly became apparent to the Appellant that they were probably not capable of running the project. Its two main people, Chris Griffiths and Bill Young, did not get on with each other and they were not running things properly, in particular they had various subcontractors on site who were not being paid on time and progress was therefore being significantly held up. There were also problems about paying suppliers of building materials.

8. Chris Griffiths ("CG") was effectively the site foreman for FS and Bill Young was the "backroom" man who dealt with the office side of things, payments to subcontractors and so on. The Appellant formed a good working relationship with CG. In order to get round the problems on site, he agreed to meet with CG and the

subcontractors on site and give CG the cash to make the necessary payments which were due to the subcontractors from FS. He also agreed to pay some of FS's building material suppliers direct on their behalf. The arrangement or understanding was that these payments would be set off against the sums due from VPH to FS under the main contract.

9. This arrangement started in March 2005. From then on, the Appellant would attend regularly on site with large amounts of cash to agree the amounts due to the subcontractors and put CG in funds to make the necessary payments (net of CIS deductions). He did not obtain any receipts for these payments. Any receipts from the subcontractors were given direct to Bill Young.

10. In about May 2005, CG had a very serious traffic accident and was in hospital for four weeks as a result. When he started back at work in July 2005, he split up with Bill Young and approached the Appellant to say he thought he could get the whole project back on track. On the Appellant's evidence, that was when CG actually took the contract over, through a different company, Design & Construction (West Midlands) Limited ("DC" – which was incorporated, according to Companies House records, on 6 October 2005).

11. Throughout this period, VPH used a self-employed book keeper to compile its VAT returns, called Marcel Kite. The Appellant did not want to deal with those matters himself, so he delegated it to her, though he signed all the returns himself.

12. It appears that Ms Kite ran some kind of purchase day book system, recording incoming invoices (including the VAT element) and the VAT element of payments made by VPH, which she compiled into spreadsheets. In early 2006, she decided she no longer wanted to continue doing VPH's books and so the Appellant took over personal preparation of the VAT returns, starting with the return to 31 May 2006 (period 05/06). His system was much less organised. He simply kept all the invoices received in a tray, when he paid them he marked them as such and moved them into a drawer. At the end of each quarter he took the invoices out of the draw and added them up to provide the purchases and input VAT figures on the VAT return. He then retained the invoices to give to his accountants at the end of the year to prepare the accounts.

13. We were not told precisely when the housing development was completed by VPH, but after the 08/06 VAT return the repayment amounts reduce sharply, so we infer that the bulk of the work was completed by then.

14. In the autumn of 2007, HMRC contacted VPH to arrange a VAT visit, which eventually took place on 15 November 2007. Clare Farrington was the HMRC officer who carried out that visit. It became apparent that the Appellant did not have the necessary records to support the repayment claims it had made for a number of periods, in addition to some other issues.

15. Ms Farrington focused initially on periods 05/05, 08/05, 11/05 and 02/06. There were various adjustments that had to be made on account of VAT incorrectly

claimed for "blocked" items, but the bulk of her concerns focused on the large discrepancies between the purchase records of VPH and (1) the amount of input tax claimed in the relevant returns and (2) the actual supporting invoices. It will be noted that the periods covered were all periods when the compilation of the VAT returns was dealt with by Ms Kite, so we accept that there were records in spreadsheet form, equivalent to a purchase day book, from which HMRC were able to list the apparently missing invoices.

16. Ms Farrington invited an explanation of the discrepancies, giving a listing of the apparently missing invoices.

17. We accept the evidence of the Appellant that he asked CG to obtain "copies" of the missing invoices from FS and DC (though we do not accept that any original invoices had been delivered by FS or DC to VPH, so we consider these "copies" to have been documents which the Appellant was in fact seeking to obtain for the first time). We accept CG's evidence that he contacted Bill Young and, after several attempts and some time, he obtained from him a set of documents that purported to be copies of the invoices in question. Apart from one apparently missing invoice (whose absence may be explained by the fact that two invoices carrying VAT of £1,489.63 had been included in HMRC's schedule, one from FS and one from DC, but only one "copy" invoice in that amount was provided), the documents provided appeared to satisfy HMRC's list exactly. CG passed the documents to the Appellant, who looked at them, on his own evidence considered them to be "useless", but then passed them on to his advisers without comment for onward transmission to HMRC.

18. This was done, under cover of a letter dated 29 February 2008, in which the advisers said "I also enclose copies of the missing purchase invoices that Peter Brookes has obtained."

19. It is immediately apparent that the "copy invoices" are very poor fabrications. They bear no resemblance to the bona fide invoices issued by FS and DC (copies of which were obtained from the liquidators' files by HMRC for comparison purposes) and they do not even attempt to fulfil the basic requirements for VAT invoices.

20. Given the Appellant's evidence that the change from FS to DC had happened on the transfer of the building contract to CG when CG and Bill Young had "fallen out" in the late summer of 2005, it appears odd that Bill Young had provided to CG not only documents purporting to be copies of FS invoices (covering the period from March to October 2005) but also copies of documents purporting to be copies of DC invoices (which covered the period from October 2005 to February 2006), DC being a company with which Bill Young, on the Appellant's evidence, was supposedly not involved.

21. We heard no evidence from Ms Kite, so we were not able to establish to our satisfaction precisely how the purchase day book records compiled by her were made up. But the Appellant gave evidence that he had simply given to her the cheque book stubs showing the payments he had made (including those in cash) and the inference is that she had regarded all such payments as being inclusive of VAT at the

appropriate rate. There were certainly no original invoices produced to HMRC at any time to justify the claiming of input VAT, nor was there any evidence in the records of FS or CD (now held by their respective liquidators) that they had ever issued VAT invoices to VPH, with the exception of one copy invoice in the records of FS which was radically different from the normal FS invoices contained in the records of that company. This copy invoice was dated 7 February 2005 and was headed "Construction and Design Services" (which, in a note at the foot of the invoice, was identified as a trading name of FS, a strange coincidence, given the name of CG's company DC which was incorporated in October 2005 – see [10] above). It carried FS's VAT number and company registration number, and the "nature of supply" details on it are mentioned at [6] above. It carried both CG's and Bill Young's names and mobile telephone numbers and carried an address in Sutton Coldfield. HMRC found this invoice in FS's records on a visit to its liquidator in July 2008.

22. There was also some evidence in the records of FS that it had received payments from VPH from January to July 2005, but this could not be confirmed by reference to other records, nor were there any corresponding sales invoices.

23. We note also that the services and materials provided by FS and DC as main contractors to VPH would have been zero rated under Items 2 and 4, Group 5, Schedule 8 Value Added Tax Act 1994.

24. We find that there were no original invoices provided by FS or DC to VPH and the only basis upon which VPH claimed input VAT was by allocating what it considered to be the appropriate fraction of its gross payments as being payment of input VAT. It is quite clear that VPH made the relevant payments (we accept that the development was being financed by a bank which required certificates of work done by a professional surveyor before releasing stage payments to VPH which allowed it to make its payments). However it is equally clear that those payments made by VPH would not properly have included any element of input VAT. In the absence of even incorrect invoices showing VAT purportedly charged by FS or DC, VPH should not have claimed input VAT.

25. On 8 August 2008 Ms Farrington sent a letter to VPH which enclosed a notice of assessment in respect of all the underpaid VAT that she considered was due. That assessment was for a total of £127,772 plus interest (to 8 August 2008) of £24,777.90.

26. HMRC subsequently reduced the assessment to take account of their finding that it included items which were out of time for assessment under the 3 year rule. This resulted in the issue of an amended reduced assessment on 12 May 2009, charging a total of £90,505 plus £20,542.07 of interest. This assessment excluded the figures for period 08/05.

27. HMRC then considered the question of penalties and ultimately issued letters dated 27 July 2010 addressed to VPH and the Appellant, notifying them that they considered VPH to have dishonestly evaded £90,505 of VAT for periods 11/05, 02/06, 05/06, 08/06 and 11/06, that they considered this to have occurred as a result of the Appellant's behaviour and that they therefore proposed to recover 100% of the

resulting civil evasion penalty from the Appellant under section 61 VATA94. After allowing mitigation of 40% in relation to some parts of the penalty and 80% in relation to other parts, they calculated the penalty due from the Appellant as £47,270.

28. The Appellant requested a review of this decision. On 3 November 2010 HMRC wrote to him with their formal review. They observed that the existing assessments contained a further error, in that £27,256 of VAT had been assessed in relation to period 11/05 when it was in fact proper to period 02/06. They therefore reduced the VAT assessment by that amount, as they were out of time for assessing it in relation to its proper period. However they maintained on the basis of case law (see below) that it was still permissible to assess a penalty on the Appellant in relation to the dishonest evasion of the full amount. They also decided that some of the VAT had not been dishonestly evaded and therefore cancelled the penalties which had previously been mitigated by 80%, but they maintained 40% mitigation in relation to the remainder of the amounts involved. The end result was a reduction of the overall penalty to £43,753, as follows:

VAT period	VAT evaded	Mitigation %	Penalty
11/05	£44,839	40%	£26,903
02/06	£27,256	40%	£16,353
05/06	£829	40%	£497
		Total:	**£43,753**

29. It was against this decision that the Appellant ultimately appealed. In his notice of appeal dated 26 November 2010, he essentially argued that he had not acted dishonestly. He said that if he had been acting dishonestly, he would not have submitted his books for examination "with gaping holes in them, i.e. invoices missing"; he had not prepared the "copy invoices" that he had handed over to HMRC when they asked for copies of the missing invoices (they had been given to him by the company that had done the work); his previous experience in the construction industry had not given him knowledge of the zero-rating of construction work on new dwellings (especially as the point had not come up on an earlier VAT inspection of one of his other companies); he had always employed an outside book-keeper or his accountant to do his VAT returns and they had never alerted him to a problem.

The law

30. The penalty in question is imposed under section 61 (combined with section 60) VATA94 which, at the material time, provided as follows (so far as relevant):

> "**60 VAT evasion: conduct involving dishonesty**
>
> (1) In any case where –

(a) for the purposes of evading VAT, a person does any act or omits to take any action, and

(b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability), he shall be liable, subject to subsection (6) below, to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by his conduct.

(2) The reference in subsection (1)(a) above to evading VAT includes a reference to obtaining any of the following sums –

……

(b) a VAT credit;

…..

In circumstances where the person concerned is not entitled to that sum.

…..

61 VAT evasion: liability of directors etc

(1) Where it appears to the Commissioners –

(a) that a body corporate is liable to a penalty under section 60, and

(b) that the conduct giving rise to that penalty is, in whole or in part, attributable to the dishonesty of a person who is, or at the material time was, a director or managing officer of the body corporate (a "named officer"),

the Commissioners may serve a notice under this section on the body corporate and on the named officer.

(2) A notice under this section shall state –

(a) the amount of the penalty referred to in subsection (1)(a) above ("the basic penalty"), and

(b) that the Commissioners propose, in accordance with this section, to recover from the named officer such portion (which may be the whole) of the basic penalty as is specified in the notice.

(3) Where a notice is served under this section, the portion of the basic penalty specified in the notice shall be recoverable from the named officer as if he were personally liable under section 60 to a penalty which corresponds to that portion; and the amount of that penalty may be assessed and notified to him accordingly under section 76.

…..

(5) No appeal shall lie against a notice under this section as such but –

…..

(b) where an assessment is made on a named officer by virtue of subsection (3) above, the named officer may appeal against the Commissioners' decision that the conduct of the body corporate referred to in subsection (1)(b) above is, in whole or part, attributable to his dishonesty and against their decision as to the portion of the penalty which the Commissioners propose to recover from him."

31. Mr Linneker submitted that behaviour can be characterised as "dishonest" for these purposes whether or not the person in question believed it to be so. As the Privy Council put it in *Barlow Clowes International Limited (in liquidation) and others v Eurotrust International Limited and others* [2006] 1 All ER 333 at [10]:

> "Although a dishonest state of mind is a subjective mental state, the standard by which the law determines whether it is dishonest is objective. If by ordinary standards a defendant's mental state would be characterised as dishonest, it is irrelevant that the defendant judges by different standards."

32. We consider the test in *R v Ghosh* [1982] 2 All ER 689 to be more helpful, providing a rather more detailed exposition of what is, essentially, the same test. In that case, the Court of Appeal explored the concept of "dishonesty" at some length (in the context of the Theft Act 1968), and it is helpful to quote at some length from the unanimous judgment of the Court:

> "…..the knowledge and belief of the accused are at the root of the problem.
>
> Take for example a man who comes from a country where public transport is free. On his first day here he travels on a bus. He gets off without paying. He never had any intention of paying. His mind is clearly honest; but his conduct, judged objectively by what he has done, is dishonest. It seems to us that, in using the word 'dishonestly' in the 1968 Act, Parliament cannot have intended to catch dishonest conduct in that sense, that is to say conduct to which no moral obloquy could possibly attach.
>
> ….
>
> If we are right that dishonesty is something in the mind of the accused (what Professor Glanville Williams calls 'a special mental state'), then if the mind of the accused is honest, it cannot be deemed dishonest merely because members of the jury would have regarded it as dishonest to embark on that course of conduct.

> So we would reject the simple uncomplicated approach that the test is purely objective, however attractive from the practical point of view that solution may be.
>
> There remains the objection that to adopt a subjective test is to abandon all standards but that of the accused himself, and to bring about a state of affairs in which 'Robin Hood would be no robber' (see R v Greenstein). This objection misunderstands the nature of the subjective test. It is no defence for a man to say, 'I knew that what I was doing is generally regarded as dishonest; but I do not regard it as dishonest myself. Therefore I am not guilty.' What he is, however, entitled to say is, 'I did not know that anybody would regard what I was doing as dishonest.' He may not be believed; just as he may not be believed if he sets up 'a claim of right' under s 2(1) of the 1968 Act, or asserts that he believed in the truth of a misrepresentation under s 15 of the 1968 Act. But if he is believed, or raises a real doubt about the matter, the jury cannot be sure that he was dishonest.
>
> In determining whether the prosecution has proved that the defendant was acting dishonestly, a jury must first of all decide whether according to the ordinary standards of reasonable and honest people what was done was dishonest. If it was not dishonest by those standards, that is the end of the matter and the prosecution fails. If it was dishonest by those standards, then the jury must consider whether the defendant himself must have realised that what he was doing was by those standards dishonest. In most cases, where the actions are obviously dishonest by ordinary standards, there will be no doubt about it. It will be obvious that the defendant himself knew that he was acting dishonestly. It is dishonest for a defendant to act in a way which he knows ordinary people consider to be dishonest, even if he asserts or genuinely believes that he is morally justified in acting as he did. For example, Robin Hood or those ardent anti-vivisectionists who remove animals from vivisection laboratories are acting dishonestly, even though they may consider themselves to be morally justified in doing what they do, because they know that ordinary people would consider these actions to be dishonest."

33. We are therefore concerned to establish first whether what the Appellant did was, according to the ordinary standards of reasonable and honest people, dishonest. If we decide that it was, then we are required to consider whether the Appellant must have realised that what he was doing was, by those standards, dishonest.

34. Finally, Mr Linneker pointed out that it was irrelevant that the full amount of VAT which had, in his submission, been dishonestly evaded, was not the subject of a valid assessment by HMRC. This was because, as had been accepted by the Court of Appeal in *Ali (trading as Vakas Balti) v HMRC* [2007] STC 618, it could be that in certain circumstances:

> "…it might be too late for them to make a new tax assessment…. But I do not see why they should not be able to raise a civil evasion penalty assessment…. in respect of tax which, on this hypothesis, will have

> been successfully evaded. That is a situation in which it seems to me to be reasonable to suppose that Parliament would have intended that the Commissioners could raise a civil evasion penalty assessment, even though they could no longer make a tax assessment for the higher amount of tax."

Discussion and conclusion

35. We apply the test of dishonesty set out in *Ghosh* and effectively summarised at [33] above. We also accept Mr Linneker's submissions, based on *Vakas Balti*, that a civil evasion penalty may be based on VAT which can no longer be assessed because an assessment would be out of time.

36. So was the Appellant's behaviour dishonest? In our view, it was. He effectively argued that his actions should be characterised as naïve incompetence rather than dishonesty, but we are not convinced by this.

37. By reference to ordinary standards of reasonable and honest people, we consider that his behaviour in passing the fabricated "copy" invoices to HMRC in spite of his own belief that they were "useless", presumably in the hope that they would satisfy HMRC, was dishonest. He could have refrained from sending the "copy" invoices to HMRC altogether, or he could have asked his advisers to submit them with a full explanation of the circumstances and of his own belief that they were "useless". He did neither. He just arranged for them to be submitted.

38. Similarly, we consider that the Appellant must have realised that what he was doing, in submitting those documents, was dishonest.

39. As summarised in the table above, the dishonest evasion penalties raised by HMRC (and which they seek to make the Appellant liable for) relate to VAT periods 11/05, 02/06 and 05/06.

40. In relation to period 11/05, they seek to impose a penalty by reference to £44,839 of under-declared VAT. Given our view that the Appellant's dishonesty only extends to the incorrectly claimed input VAT where he later submitted the fabricated "copy" invoices, we consider that only £37,661.07 of this VAT could be said to have been evaded by reason of dishonesty attributable to the Appellant (that being the total amount of the fabricated "copy" invoices included in the 11/05 return).

41. In relation to period 02/06, we accept both the amount (which equates to the total of the fabricated "copy" invoices reflected in the 02/06 VAT return) and HMRC's argument, based on the *Vakas Balti* case, that a penalty may be levied on the Appellant even though there is no assessment for 02/06 against VPH for that amount of unpaid VAT.

42. In relation to period 05/06, they seek to impose a penalty on the Appellant in relation to some other failure to produce evidence in support of an input tax claim. Again, there is in our view insufficient evidence to support a finding of dishonesty against the Appellant in relation to this claim.

43. We therefore consider that the dishonestly evaded amounts of VAT are £37,661 for period 11/05 and £27,256 for period 02/06. The total is therefore £64,917.

44. We see no reason to interfere with HMRC's percentage mitigation of 40%. This reduces the actual penalty to £38,590 and we confirm it in this reduced amount.

45. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 24 June 2013