



TC07849

VAT – appellant submitted VAT return including input tax relating to services said to have been supplied by charity – no such services supplied – assessment raised by HMRC – penalty on basis that director acted deliberately – assessment and penalty upheld.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2019/01853

BETWEEN

MARSH & RIDDELL LIMITED

Appellant

-and-

H M REVENUE & CUSTOMS

Respondents

TRIBUNAL: JUDGE ANNE REDSTON

The Tribunal determined the appeal on 27 and 28 August 2020 without a hearing under the provisions of Rule 29 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. Both parties consented to the appeal being determined in this way and the Tribunal decided that it was in the interests of justice to do so.

I considered written submissions from Mr Kevin Marsh, director of the Appellant, who represented the Appellant, and from Ms Nikki Griffin of HMRC's Solicitor's Office, who represented HMRC.

DECISION

INTRODUCTION

1. This was the Company's appeal against a VAT assessment of £17,533 and a penalty assessment of £7,363.86. Mr Kevin Marsh was a director of the Company and also a director of In2Mission Community Interest Company ("the CIC").
2. The assessment was issued on the basis that the Company's VAT return for the period 12/15 was incorrect, because it included credit for input tax from two invoices ("the Invoices") issued by the CIC for services which had not been supplied, and which Mr Marsh knew at the time he sent in the VAT return would never be supplied.
3. The penalty was issued by Mr Paul Gray, the HMRC Officer who had conduct of the case, on the basis that Mr Marsh, in his capacity as director of the Company, had knowingly provided HMRC with a VAT return that contained an error with the intention that HMRC should rely upon it as an accurate document. For the reasons set out in the main body of this decision, I agree with HMRC.

Evidence

4. The Tribunal was provided with a bundle of documents prepared by HMRC, which included:
 - (1) the Appellant's Notice of Appeal dated 19 March 2019, with attachments;
 - (2) HMRC's Statement of Case dated 2 August 2018, and an undated document headed "HMRC Appeal – Notes" which I have taken to be Mr Marsh's comments on the Statement of Case;
 - (3) other correspondence between the parties, and between the parties and the Tribunal;
 - (4) HMRC's visit report notes dated 29 January 2018 and 23 October 2018;
 - (5) various bank statements for an account in the name of Mr Marsh;
 - (6) a schedule relating to various payments and various invoices; these are considered further at §41ff below.
5. Mr Gray provided a detailed witness statement dated 26 May 2020 and a supplementary witness statement dated 10 July 2020. On 1 June 2020, the Appellant provided a document headed "Statement of case by K Marsh of M&R Ltd". It includes both submissions and evidence, but to the extent that it contains Mr Marsh's evidence I have treated it as a witness statement. When reference is made to that document in this decision, I have called it "Mr Marsh's SoC".
6. Where there were conflicts between the evidence given by Mr Marsh to HMRC at the meeting held on 23 October 2018, and that given for this hearing, I have preferred the former. That is because:
 - (1) the notes are a contemporaneous, or near-contemporaneous record taken during those meetings;
 - (2) Mr Marsh has not denied having made the statements which HMRC recorded in those meeting notes; and

(3) he made those statements early in the meeting, before HMRC informed him that they would be issuing an assessment and a penalty.

FINDINGS OF FACT

7. Having considered all the evidence provided, I make the findings of fact set out below. I make further a finding of fact at §89ff.

The Company and the CIC

8. Before the events with which this appeal is concerned, Mr Marsh was employed as a surveyor by Baker Mallett, a firm of quantity surveyors. At some point during 2015, Baker Mallett closed their offices in Scotland, and Mr Marsh was made redundant. He became significantly depressed as a result, and was prescribed the maximum dosage of Venlafaxine. He also began legal action in the employment tribunal against Baker Mallett.

9. On 13 November 2015, Mr Marsh and Mr Kieran Riddell formed the Company and became its shareholders and directors. With effect from the same date, the Company registered for VAT.

10. At some previous date, Mr Marsh had also become a director of the CIC, which was the trading arm of a charity which provided residential accommodation at an outdoor centre for charitable groups, schools, church groups and similar. It had no employees and was staffed entirely by volunteers. It registered for VAT with effect from 7 April 2014. Mr Marsh was solely responsible for completing the VAT returns for both the CIC and the Company.

11. Mr Marsh had anticipated that the Company would operate from the premises previously occupied by Baker Mallett, and would engage staff made redundant by Baker Mallett, but this was not possible because of employment law issues. Mr Marsh's evidence was that he and Mr Riddell then decided to run the Company from a unit in Riverside House, Selkirk, which was a shell requiring fitting out. Other contemporaneous documents cast doubt on that evidence, and I return to this at §46ff.

The first VAT return

12. On 30 December 2015, the day before the Company's first VAT return period ended, Mr Marsh exchanged emails with the Company's accountants, Stark, Main & Co, a firm of chartered accountants and tax advisers ("the Accountants").

The communication with the Accountants

13. Mr Marsh's email to the Accountants said:

"we have not yet got the office sorted and as you are aware we have an In2mission invoice sitting for works yet to be done. We are still not sure if we will be able to get the finance to do the work and we are looking at a possible alternative! In the meantime can we include this invoice in our return or do we need to have it credited back – we don't want to end up claiming back too much VAT."

14. Mr Stark replied:

"I'd be happy for you to include at this stage as you are on the standard VAT accounting scheme which means you pay/reclaim VAT based on the date of invoice. For accounting purposes we will show this invoice as paid via Director's loan. If your new office plans do change, we will need to do an

adjustment, however based on our discussions around other set-up costs, which you are self-funding, you are unlikely to be in an overclaim situation.”

15. Despite Mr Marsh telling Mr Stark on 30 December 2015 that “we have an In2mission invoice sitting for works yet to be done”, on that date no such invoice was in existence.

The raising of the Invoices.

16. On 31 December 2015, the CIC raised two invoices to the Company, one for fitting out the office for £83,878.33 plus VAT of £16,775.67 (“the First Invoice”), and the other for rent of £3,786.67 plus VAT of £757.33 (“the Second Invoice”). Both are numbered: the First Invoice has the number T.0197 and the Second Invoice the number T.0198.

17. The wording on the First Invoice was as follows:

1. Office fit out as per quotation dated 5 November 2015 comprising the following works: cleaning out existing office space; constructing new stud partitions; lining partitions with plasterboard; new timber skirtings, suspended ceiling; plumbing installation; electrical installation; floor coverings and decoration £19,457.17
2. Cat 6 cable network installation as quote dated 17 November 2015, including 16 AU rack, patch panel and 48 way switch £10,000
3. Instructed variation: supply and fit new boiler £1,541
4. Instructed variation: install additional light fittings: £710.20
5. Instructed variation: additional dado conduit and socket outlets £230.96
6. Instructed variation: supply and fit overhead projector and [sic] £1,939.00.

18. It was common ground that none of the work described on the First Invoice was ever carried out. Moreover, the quotation to which it refers was allegedly provided on 5 November 2015, but the Company was only incorporated on 13 November 2015.

19. The wording on the Second Invoice read “share of office cost as agreed £3,786.67”. At the end of both invoices is the following (emboldening and capitals as in original):

“PAYMENT TERMS – 28 DAYS FROM DATE OF INVOICE

In2mission reserve the right to charge interest on overdue payments

Please make cheques payable to ‘In2mission CIC’

Transfer payment can be made to [bank name, sort code and the CIC’s account name and number]”

20. The Company’s first VAT return, which was filed on 12 January 2016, included credit for the input tax on the Invoices. The return stated that the Company was due a VAT repayment of £19,243, of which £17,533 related to the Invoices.

Whether the Invoices were issued on a “pro-forma” basis

21. Mr Marsh’s evidence was that the Invoices were issued on a “pro-forma” basis. HMRC do not accept this was the position. I agree. They are not marked “pro-forma”, they have the same information as would be on an actual invoice, including an invoice number, payment terms and bank account details. Furthermore, when Mr Marsh emailed the Accountants as to whether he could include the Invoices in his VAT return, he did not say they were pro-forma

invoices. I find as a fact that the Invoices were not issued on a pro-forma basis, and that Mr Marsh knew this to be the position.

Whether the CIC could have supplied those services

22. Mr Marsh's evidence was that the CIC was to carry out the work described in the First Invoice in order to fit out a shell unit at Riverside House for the Company. HMRC's position was that the CIC was a charitable body providing residential accommodation, with no employees, and could therefore never have carried out the work described in the First Invoice. In other words, the supply could never have taken place, and Mr Marsh knew this to be the position.

23. I agree with HMRC. It is simply not credible that a charity which provides residential accommodation, run entirely by volunteers, could supply the services set out in the First Invoices. Mr Marsh was a director of both the Company and the CIC, and he therefore knew this was the position when he raised the Invoices.

24. As for the Second Invoice, I find that the CIC had not made and would not make a supply of premises to the Company for which rent was payable, and Mr Marsh knew this was the case when he raised the Invoice. I come to those findings because:

- (1) the Company agreed it would rent an office unit from a third-party landlord, not from the CIC;
- (2) at a meeting with HMRC on 29 January 2018, Mr Marsh told Mr Gray that the CIC was *paying* rent to the Company of around £300pcm; and
- (3) at the same meeting, Mr Marsh said that the Company had no premises other than in Selkirk, plus a post-office box in Carlisle, so the rent could not have been for the sharing of any CIC premises sublet to the Company at any other location.

The HMRC check

25. On 9 February 2016, HMRC wrote to the Company saying that they were checking its VAT return for the period ending 31 December 2015. HMRC's letter set out a number of requirements, including that the Company send "a VAT audit trail detailing sales and purchases that make up the figures on the return" and "the reason for the repayment".

26. In his reply dated 17 February 2016, Mr Marsh sent HMRC the Invoices along with invoices for other supplies received. His letter said (my emphasis):

"the reason for the repayment claim being down to the refurbishment and fit out of our new offices undertaken in November/December 2015 prior to us starting to trade in January 2016."

27. When he wrote this letter to HMRC, Mr Marsh plainly knew that the work had never been "undertaken".

28. On 18 February 2016, Mr Hugh McCauley of HMRC emailed Mr Marsh to ask when the Company had paid the Invoices. Having noted that Mr Marsh was also a director of the CIC, Mr McCauley also asked what tax point the CIC was using to account for VAT and whether it was using cash accounting.

29. On 21 February 2016, Mr Marsh replied, saying "I confirm that the invoices have been paid" and that as the CIC used cash accounting, "the VAT would be included in the VAT

return for the CIC for the period ending 31 March 2016". Having received that confirmation, HMRC released the VAT repayment to the Company.

The position of the CIC

30. Mr Marsh's SoC says that the Invoices were paid using the directors' loan account, as advised by the Accountants in the email of 30 December 2015. I have inferred from this that the Company "paid" the liability by transferring it to Mr Marsh, so that it became his liability, with the result that the Company no longer showed the Invoices in its books as being owed due to the CIC.

31. However, a transfer of this nature within the books and records of the Company does not put any money into the hands of the CIC. For that to happen, value has to pass to the CIC, and neither the Company nor Mr Marsh paid the value of the Invoices to the CIC.

32. On 7 May 2016, the CIC submitted its VAT return for the quarter ending 31 March 2016. This showed:

- (1) sales (excluding VAT) of £104,639 and purchases of £112,422;
- (2) total VAT due on sales of £15,998.12;
- (3) total VAT reclaimed on purchases of £18,740; and
- (4) net VAT reclaimed from HMRC of £2,752.21.

33. I find that the CIC did not pay HMRC the VAT shown on the Invoices, because:

- (1) the total VAT on the sales shown on the return of £15,998.12 is less than the VAT shown on the Invoices of £17,533; and
- (2) HMRC also made separate enquiries into the CIC's VAT returns. On 31 July 2017, Mr Marsh provided an analysis of the return for 31 March 2016, and this showed the turnover figure as having been amended from the £104,639 shown on the submitted return to a single receipt of £15,216.54, which was identified as a donation.

The funding

34. Mr Marsh told HMRC that the Company had expected that the costs of the supplies set out in the Invoices would be covered by funding provided by Scottish Enterprise under the "Business Gateway" scheme and by the directors, Mr Marsh and by Mr Riddell. It is common ground that no funding was received, but there is a dispute between the parties as to when Mr Marsh knew that this would be the case.

35. HMRC's case is based on what Mr Marsh said at the meeting on 23 October 2018, namely that he had known that this was the position "sometime in January", and that he also knew the VAT return "was not correct when he submitted it" on 12 January 2016. HMRC have inferred that Mr Marsh therefore knew by that date that no funding would be provided.

36. Mr Marsh's evidence in his SoC is that:

- (1) "the exact timescale as to when it was known this was a no go is not entirely clear and I do not recall the exact dates given the lack of correspondence on this matter...I am guessing that it must have been late February 2016";
- (2) no formal application was made to Scottish Enterprise, the discussions were carried out via meetings, and there is no written correspondence between that organisation and the Company about the loan application or its refusal; and

(3) the Company “sought loan funding from Barclays as a back-up option to Scottish Enterprise Funding” and Mr Marsh also provided a letter from Barclays dated 4 April 2016 declining the Company’s application for funding. However, he has not attached the Company’s letter to Barclays applying for funding, and the Barclays letter does not state the purpose of the loan.

37. I find that when Mr Marsh submitted the return on 12 January 2016, there was no prospect of funding being provided for the supplies set out in the Invoices for the following reasons:

(1) the CIC could not have provided the supplies in the First Invoice (see the finding of fact at §23), and it is therefore not credible that either the CIC would have applied for funding to do the work, or that the Company would have applied for funding so that it could be carried out by the CIC.

(2) Mr Marsh does not dispute that on 23 October 2018 he told HMRC that he knew the VAT return “was not correct when he submitted it”.

(3) His more recent evidence is extremely vague and entirely unreliable. He says “the exact timescale...is not entirely clear”; he does “not recall the exact dates” and he is “guessing” that it was late February 2016”.

(4) I also reject his evidence that he was having discussions with Scottish Enterprise in relation to the funding of the fitting out of the Company’s offices. A public body such as Scottish Enterprise has formalities which must be followed in order to obtain funding, and there would at the very minimum have been an exchange of emails setting out the criteria and the nature of the funding request. In other words, if there were discussions, there would be at least some written evidence.

(5) I disregard the Barclays letter as there is no indication as to what the loan application related.

The advice from the Accountants

38. Mr Marsh also submitted that he sought advice from the Accountants “on the matter of crediting the In2mission invoices” and was told by email that the Company’s VAT position had been corrected by subsequent adjustments. He stated in his SoC:

“As I had used my own funds to buy office furniture and other equipment and this had not yet been accounted for in any VAT return our accountants prepared an adjustment to our records to remove the in2mission invoices and process the business purchases [I] had made through our accounts as a late return.”

The emails

39. Mr Marsh emailed the Accountants on 24 February 2016. This was three days after he had told HMRC that the invoices had been paid by the Company and that the related VAT would be included as output tax in the CIC’s return for the quarter ended 31 March 2016. His email to the Accountants said:

“Are you free sometime in the next few days to discuss how to handle the adjustments needed to our first VAT return. I’ll bring along the invoices if that is of assistance.”

40. On 14 March 2016, Ms Rogerson of the Accountants emailed Mr Marsh and said:

“further to our recent meeting, please see the attached documents which detail the adjustments to your first VAT return, together with a directors’ loan schedule. As discussed, following the adjustment there was a slight underclaim of VAT for the period amounting to £1.24 which you said you were not bothered about reclaiming. I have therefore made an adjustment so that the VAT amount for the period ties in with the £19,242.75 actually reclaimed. As your VAT account balances, there will be no need to take any further action in your end of March year end return.”

The schedule and the invoices

41. Mr Marsh produced a schedule (“the Schedule”) which he said had been supplied to him by the Accountants. For the reason set out at §93, I have not needed to make a finding of fact as to the source of the Schedule.

42. The first part of the schedule repeated the invoices which formed the basis for the submitted VAT return, and the second part set out what Mr Marsh said were the adjustments. In the extract from the Schedule below, the first line sets out the total of those invoices, and all the adjustments are then itemised. .

	Date		Excl VAT	VAT	Incl VAT
		Supplies from VAT return	102,191.12	19,242.76	121,433.87
1	31/12/15	The Invoices	(87,665.00)	(17,533.00)	(105,198.00)
2	31/12/15	Rent	(2,500.00)	(500.00)	(3,000)
3	31/12/15	Purchases by Director’s loan	80,143.33	16,028.67	96,172
4	17/12/15	RIBA-NBS licence	10,000.00	2,000.00	12,000.00
5	11/12/15	Camerons prints	21.59	4.33	25.92
6	31/12/15	Deposit for office	1,000.00	nil	1,000.00
			93,191.04	19,242.76	122,433.79

43. Mr Marsh submitted that the effect of the Schedule was that

the input VAT of £19,242.76 claimed on the VAT return was the same as the input VAT which would have been claimed if the costs the directors had born personally but which related to the Company had instead been included on that return.

44. Of the figures set out in the Schedule, an invoice in the name of Mr Riddell was provided to support the Camerons prints figure. No explanation was provided for the negative rent figure of £2,500 + VAT, and from my review of the file I was unable to locate any invoices to support the RIBA figure of £10,000 + VAT. The “purchases by directors loans” was further itemised in a second schedule (“the Second Schedule”). This listed 22 items, and attached some supporting invoices. These were not supplied in any sort of organised way, and in particular were not cross referenced to the Second Schedule. From my review, there were no invoices for four items totalling £6,024 (including VAT). Two of the invoices, totalling £8,352, were addressed to the CIC, and one to the Company, c/o the CIC. A number were addressed to “Mr Marsh Riddell, In2mission CIC” and others to Mr Marsh.

A minority were issued to the Company, with no reference to the CIC, including one for a printer costing £22,934.

Fitting out 7A Riverside House

45. On 1 March 2016, the Company began operating from 7A Riverside House. Mr Marsh's evidence was that this office was adjacent to the shell unit which the Company had previously been planning to occupy, but unlike that other shell unit, number 7A simply required certain furniture and office equipment and did not need fitting out.

46. However, the invoices provided to support the Schedules provided evidence about when the Company had decided to operate from 7A Riverside House. One was dated 22 December 2015, was addressed to the Company at 7A Riverside House and was for the supply of "installation of units and worktops...including agreed installation charge for providing generator – no power to office; supply and install additional wall units to existing kitchen; replace network cables". Another invoice, dated 30 December 2015, gave the delivery address as Mr Marsh Riddell at 7A Riverside House; this was for a "reception/meeting furniture pack" costing £10,000 plus VAT.

47. From these documents it is clear that in December 2015 the Company was *already* arranging for the fitting out and furnishing of 7A Riverside House. It is difficult to reconcile that fact with Mr Marsh's evidence that in December 2015, the Company was expecting to fit out a different office unit in the same block. I also note the £22,934 invoice for the printer had no customer address or delivery address.

48. However, this point was not raised by HMRC and it is not necessary for the purposes of this decision for me to make a finding as to whether the Company always intended to operate from 7A Riverside House and never had any intention of working out of a nearby shell unit..

What happened to the VAT on the invoices listed on the Schedules?

49. Mr Marsh's SoC says that the invoices listed on the Schedules were "processed through our accounts as a late return" and the Invoices were removed from their records at the same time. In other words, his evidence was that the VAT which could have been claimed against these invoices was offset against (and/or cancelled out) the VAT which had actually been claimed on the Invoices.

50. However, the position was more complicated. When Mr Marsh met HMRC on 23 October 2018, he said that these invoices had been included in the CIC's VAT return for the quarter ended 31 March 2016, and that a further sales invoice was then raised by the CIC for services to the Company, which allowed the Company to a credit for the related input tax. It therefore appears that the VAT on the invoices may have been claimed *by the CIC*.

51. However, I make no finding of fact as to what happened to the VAT on these invoices, as my decision in relation to this appeal would be unchanged whether or not some or all of the VAT was claimed in the CIC's VAT return.

The VAT assurance visit on 18 January 2018

52. On 21 December 2015, Mr Marsh was notified of an HMRC VAT assurance visit to take place on 18 January 2018. Its purpose was to check "the company's VAT returns and records" and "the systems the company has in place to accurately record all VAT transactions". Mr Gray attended with a Ms McBride; Mr Marsh attended for the Company.

53. Mr Marsh answered routine questions about the Company's business, and the HMRC officers checked the Company's purchase invoices for periods 03/17 through to 12/17. The period ending 12/15 was not reviewed. Although HMRC and Mr Marsh discussed certain transactions between the Company and the CIC, none related to the Invoices. The only outstanding points following this meeting were resolved by email correspondence.

54. Mr Marsh confirmed in his SoC that HMRC only considered the periods subsequent to 12/15 and "no information was provided to Officer Gray which dated further back than the March 2017 return" and that it was therefore "not possible" that anything at this meeting could have given HMRC grounds for concern about the Invoices.

The visit on 23 October 2018

55. Mr Gray and a colleague attended the Company's offices for a further visit on 23 October 2018. The focus of this visit was the Invoices. It is not in dispute that, during the meeting, Mr Marsh said:

- (1) the services described in the Invoices had never been supplied;
- (2) he knew the VAT return was "not accurate and not correct at the time it was submitted";
- (3) his statement to HMRC in his email of 21 February 2016 that the Invoices had been paid was not accurate;
- (4) he could not explain why he had not previously disclosed this information, including at the VAT assurance visit; but
- (5) stated he had been suffering from anxiety and depression at the time.

56. Mr Grey told Mr Marsh that he would be raising an assessment "on these false invoices". Mr Marsh responded by saying that he "had paid for some expenses and no input tax had been claimed". He then produced the Schedule and the Second Schedule together with his explanation of the processing of the invoices involving the CIC as described at §50 above. Mr Gray confirmed his decision to issue an assessment, and said he would also be issuing a penalty on the basis that the behaviour was deliberate.

The assessments and the appeal

57. On 1 November 2018, HMRC issued the assessment which is under appeal for £17,533. On 22 November 2018, HMRC issued a penalty for £7,363.86. The Company asked for a statutory review of both the assessment and the penalty; Mr Ian Hartley, the review officer, upheld both decisions and the Company made an in-time appeal to the Tribunal.

58. The case was listed for a hearing on 1 April 2020. The Company had instructed Bannerman, Burke & Co ("BBC"), a firm of solicitors, to represent it at the hearing. However the hearing was cancelled on 24 March 2020 because of the coronavirus pandemic.

59. On 30 March 2019 the Tribunal asked the parties for their views as to how to proceed with the appeal. On 9 April 2019, BBC responded, saying that they had taken their client's instructions and the client "has no particular reason for any oral evidence" and had consented to the case being decided on the papers. HMRC also consented to the case being decided in that way.

THE VAT ASSESSMENT

60. The Company did not seek to argue it had received a supply of services from the CIC. Instead, the issue between the parties was whether the assessment should be cancelled because of the Schedules.

The Company's position

61. The Company's case was that the VAT assessment should be cancelled because the VAT on the items listed on the Schedules had not been claimed, and that VAT should be regarded as offsetting the input VAT claimed on the Invoices. In other words, the Company's position was that the Schedules show HMRC have not suffered any loss of tax revenue. Mr Marsh also submitted that he was acting on the basis of advice provided by the Accountants.

HMRC's position

62. HMRC say that the Company's position is simply wrong as a matter of law. VATA s 24(6)(a) provides as follows (emphases added):

“for VAT on the supply of goods or services to a taxable person...to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents or other information as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases.”

63. VATA s 26(1) reads:

“The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period...as is allowable by or under regulations as being attributable to supplies within subsection (2) below.”

64. VATA s 25(2) provides that a trader is “entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him”.

65. The relevant regulations include in particular Reg 29, which is headed “claims for input tax”. Paragraph 1 provides (emphasis added) that “a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable”.

66. On the facts of this case, and as accepted by Mr Marsh, the services set out on the Invoices had never been supplied, so the Company was not entitled to deduct the input tax there set out, and HMRC was therefore correct to issue a further assessment under VATA s 73. In HMRC's submission, the Company could not simply decide that this incorrect return was validated on the basis that other allowable inputs had been overlooked and not claimed, because

- (1) the amounts shown on the Schedules are not in any event equal to the values on the Invoices, but even if they had been, this does not invalidate the assessment;
- (2) the correct course of action for the Company was to correct the error on the 12/15 VAT return by removing the Invoices, and then to make a claim for any input VAT relating to other supplies it had received; and

(3) there was no legal basis on which the Company could simply assume that the VAT on the Schedules stood in place of the VAT which it had claimed from HMRC on the Invoices.

The Tribunal's decision on this issue

67. The assessment under appeal was made under VATA s 73(1), which reads:

“Where...it appears to the Commissioners that such returns are...incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.”

68. It is not in dispute that the CIC did not provide the supplies set out on the Invoices. I have also found as facts that (a) the CIC could never have made those supplies, and (b) Mr Marsh knew that the return was wrong when he submitted it. The Company's return for period 12/15 was therefore clearly incorrect, and HMRC are thus empowered by VATA s 73(1) to raise an assessment to collect the VAT.

69. As to Mr Marsh's submission that the assessment should be cancelled because of the items on the Schedule, HMRC are right for the reasons they have given. If the Company wanted to claim input tax, it should have included the relevant figures on a VAT return. It cannot simply offset the VAT on the incorrectly claimed Invoices against a miscellany of other amounts, by way of the Schedules.

70. It is academic whether the VAT could have been claimed on those items, had the proper route been followed, and the following points are therefore observations only:

(1) One of the invoices was addressed to Mr Riddell, two were addressed to the CIC, and a significant number were addressed to Mr Marsh. Although Mr Marsh *may* have been able to demonstrate that, as a matter of economic reality, the Company was the recipient of these supplies, the onus would have been on the Company, see *Praesto v HMRC* [2019] EWCA (Civ) 353.

(2) Moreover, Mr Marsh's evidence as given to Mr Gray on 23 October 2018 was that the VAT on these items had been included in *the CIC's* VAT return for the quarter ended 31 March 2017, with a further sales invoice then being raised to the Company. If so, the input tax has already been claimed in a VAT return.

71. Mr Marsh has also submitted that he was following the advice of the Accountants. Even if this was the case (as to which, see below), it would make no difference to the validity of the assessment which is under appeal. As a matter of law, HMRC had the power to issue that assessment because the conditions in VATA s 73(1) had been met.

72. I therefore refuse the Company's appeal against the VAT assessment, which is upheld.

THE PENALTY

73. The issue here was whether the Company should be charged a penalty on the basis that Mr Marsh, the Company's director, had acted deliberately

The legislation.

74. FA 2007, Sch 24, is headed “Penalties for errors”. Para 1 states that a penalty is payable if a person gives HMRC a VAT return which “contains an inaccuracy which amounts to, or leads to...a false or inflated claim to repayment of tax”, and that inaccuracy was careless or deliberate.

75. Para 3 reads (where “P” is “the person”):

“For the purposes of a penalty under paragraph 1, inaccuracy in 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 but P does not make arrangements to conceal it, and
- (c) ‘deliberate and concealed’ if the inaccuracy is deliberate on P’s part and P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure).”

76. Para 4(2) provides that the penalty for careless action is 30% of the potential lost revenue (“PLR”); for deliberate but not concealed action it is 70% of the PLR, and the penalty for deliberate and concealed action is 100% of the PLR. Those maximum penalties can be reduced for the “quality of disclosure”. Para 5(1) defines the PLR as “the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment”. Para 9(2) says that a disclosure is “unprompted” if it is “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”, and that otherwise it is “prompted”,

77. The other provisions in para 9, together with para 10, provide for the penalty to be reduced for telling HMRC about the inaccuracy, giving HMRC reasonable help in quantifying it, and allowing HMRC access to records for the purpose of ensuring that the under-assessment is fully corrected.

78. Where a disclosure is “prompted”, the maximum reduction for “deliberate but not concealed” behaviour is 35% of the penalty, in other words, the statute does not permit the penalty to be reduced below 35%. The maximum reduction for “deliberate and concealed” behaviour is 50% of the penalty.

79. Para 11 allows HMRC to reduce the penalty for “special circumstances”. These are undefined. In the recent Upper Tribunal (“UT”) case of *Barry Edwards v HMRC* [2019] UKUT 131 (Nuje J and Judge Herrington), the UT warned against putting any “judicial gloss” on the words “special circumstances” – in other words, trying to define the term. They also approved the following statement made by Judge Vos in *Advanced Scaffolding v HMRC* [2018] UKFTT 0744 (TC) at [102]:

“It is clear that, in enacting paragraph 16 of schedule 55, Parliament intended to give HMRC and, if HMRC’s decision is flawed, the Tribunal a wide discretion to reduce a penalty where there are circumstances which, in their view, make it right to do so. The only restriction is that the circumstances must be ‘special’. Whether this is interpreted as being out of the ordinary, uncommon, exceptional, abnormal, unusual, peculiar or distinctive does not really take the debate any further. What matters is whether HMRC (or where appropriate, the Tribunal) consider that the circumstances are sufficiently special that it is right to reduce the amount of the penalty.”

80. Para 14 allows HMRC to suspend a penalty, but not where it has been imposed for deliberate behaviour.

81. Para 15 allows a person to appeal a penalty to the Tribunal; the Tribunal then has the power to affirm HMRC's decision, cancel the decision, or substitute another decision which HMRC had the power to make. However, if HMRC had decided that there were no special circumstances, the Tribunal can only consider that issue if they decide HMRC's decision in relation to special circumstances was flawed in a judicial review sense.

The penalty assessment

82. This penalty was raised on the basis that the disclosure was prompted and the behaviour was deliberate but not concealed. The penalty range was therefore between 35% and 70%. HMRC reduced the maximum penalty by 40% for "helping us understand it" and 30% for "giving us access to records", and 10% (out of a maximum of 40%) for "telling us about it" because the Company had had "numerous opportunities to advise HMRC about this error but chose not to do so", but instead had made false statements confirming that the Invoices had been paid.

83. The review officer, Mr Hartley, considered whether there were any special circumstances, but said:

"I have not found any evidence of uncommon or exceptional circumstances in this case. Simply, you have claimed input tax to which you knew you were not entitled. Therefore, it seems to me that the circumstances of this case are precisely those for which the penalty regime was designed."

HMRC's case

84. HMRC submit that the Company, acting through its director Mr Marsh, had deliberately submitted a VAT return which contained "an inaccuracy which amounts to, or leads to...a false or inflated claim to repayment of tax", because:

- (1) the supplies in the Invoices were never received, and Mr Marsh knew that they would not be received when he submitted the return;
- (2) when the return was selected for challenge before the repayment was made, Mr Marsh confirmed to HMRC that the supplies had been delivered and that payment had been made for the supplies shown on the Invoices, when he knew neither of those statements were true; and
- (3) Mr Marsh accepted during the meeting on 23 October 2018, that he knew the VAT return was "not accurate and not correct at the time it was submitted" and that his statement in the email of 21 February 2016 that the Invoices had been paid was also not accurate.

85. HMRC relied on *Auxilium Project Management v HMRC* [2016] UKFTT 249 (TC), where the Tribunal (Judge Greenbank and Mr Bell) considered the Sch 24 penalty provisions, and said at [63] that "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". In their submission, that was the position here.

Mr Marsh's submissions on behalf of the Company

86. Mr Marsh put forward the following submissions:

- (1) he had acted in reliance on advice given by the Accountants on 30 December 2015 that he could include the Invoices in the VAT return;

(2) he understood from that email of 30 December 2015 that the Invoices would be paid through the directors' loan account, and his statements to HMRC on 21 February 2016 that the Invoices had been paid were therefore not dishonest;

(3) he had acted on the Accountants' advice in relation to the adjustments shown on the Schedules; the Accountants' email ends by saying "as your VAT account balances, there will be no need to take any further action in your end of March year end return". Mr Marsh therefore had no reason to think he had to disclose anything to HMRC; and

(4) at the relevant time he had a diagnosed mental health condition as he was suffering from serious depression and anxiety; he was also engaged in an employment law dispute with his former employer.

The Tribunal's conclusion

87. I agree with HMRC that (a) the relevant test is that set out in *Auxilium*, and (b) Mr Marsh knowingly provided HMRC with a document that contained an error with the intention that HMRC should rely upon it as an accurate document, and he thus acted "deliberately". I have come to that conclusion because I have already found as facts that:

(1) The CIC could never have supplied the services set out in the Invoices, and Mr Marsh knew that was the case, see §23-24.

(2) The Invoices were not issued on a pro-forma basis, and Mr Marsh knew that was the case, see §21.

(3) When the VAT return was submitted on 12 January 2015, there was no prospect of funding being provided for the supplies set out in the Invoices, see §37.

(4) On 23 October 2018, Mr Marsh told HMRC that he knew the VAT return "was not correct when he submitted it", see §55.

(5) Neither the Company nor Mr Marsh paid the value of the Invoices to the CIC, and Mr Marsh knew that was the position, see §33. However, on 21 February 2016, Mr Marsh emailed HMRC, saying "I confirm that the invoices have been paid", see §29.

Mr Marsh's mental health

88. I have not overlooked the fact that Mr Marsh was suffering from depression and anxiety, and was on a high dose of medication for that condition. That is not in dispute. I also recognise that a person cannot be found liable to a penalty for acting "deliberately" if he did not have the necessary mental capacity.

89. However, Mr Marsh was able to set up his new business, arrange the lease of premises, exchange emails with the Accountants, contract with numerous suppliers, and act as director for the CIC. From these wider activities I find as a further fact that Mr Marsh's mental health did not prevent him from knowing and understanding, before 12 January 2016 when he submitted the VAT return, that:

(1) the CIC could not provide the services set out in the Invoices;

(2) these services would not be funded; and

(3) they would never take place.

90. Mr Marsh thus deliberately claimed the input tax on the Invoices when he knew that the relevant conditions for making that claim were not present.

91. Mr Marsh also prays in aid his dispute with his former employer. That too does not change my conclusion: whatever the level of stress and anxiety Mr Marsh was under, he remained aware of what he was doing so as to be liable for the penalty.

The role of the Accountants

92. Mr Marsh has also sought to rely on the advice given by the Accountants on 30 December 2015. However, this does not change the position because:

(1) The advice given was correct: traders operating on the normal non-cash basis include invoices in their returns on receipt, but if the work is not carried out, an adjustment is made in a later return.

(2) Mr Marsh did not tell the Accountants the CIC would never be in a position to carry out that work.

(3) Mr Marsh told the Accountants that “we are still not sure if we will be able to get the finance to do the work and we are looking at a possible alternative”. He did not tell the Accountants that he knew *before he sent the VAT return to HMRC* that no funding would be received and the work would never be carried out. .

93. I decline to make a finding of fact as to whether the Accountants advised that the VAT position could be corrected by using the adjustments shown on the Schedule. That is because emails about the adjustments are dated February and March 2016 and so were exchanged *after* Mr Marsh deliberately sent an incorrect return to HMRC.

94. I also note that the emails between Mr Marsh and the Accountants set out at §39-40 lack relevant details. Mr Marsh’s email refers only to “the adjustments needed to our first VAT return” without saying what they were, and the email from the Accountants refers to “the attached documents which detail the adjustments to your first VAT return, together with a directors’ loan schedule”, but there is nothing on the Schedule or the Second Schedule to show that these documents were attached to that email, such as a footer with the Accountants’ name..

Mitigation and special circumstances

95. I agree with HMRC that a 10% reduction (out of a maximum of 40%) is an appropriate mitigation for “telling”, for the reasons given they give.

96. Mr Hartley considered whether there were special circumstances when he carried out the statutory review of the penalty, and found that there were none. The Tribunal only has the power to interfere with that conclusion if his decision was flawed in a judicial review sense. I find that Mr Hartley’s decision was not only entirely reasonable, but agree with him that “the circumstances of this case are precisely those for which the penalty regime was designed”.

DECISION AND APPEAL RIGHTS

97. For the reasons set out above, the Company’s appeal is dismissed and HMRC’s VAT assessment and the penalty assessment are both confirmed.

98. 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.

99. 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.

**ANNE REDSTON
TRIBUNAL JUDGE**

RELEASE DATE: 17 SEPTEMBER 2020