TC04419

Appeal number: TC/2014/00254

VAT – Penalties – Whether director of liquidated company liable to penalties under s 61 Value Added Tax Act 1994 and schedule 24 Finance Act 2007 – Yes – Whether conduct giving rise to penalty attributable to dishonesty – Yes – Whether assessment of penalties made to "best judgment" – No – Penalties reduced accordingly – Whether omissions in VAT returns "deliberate and concealed" – Yes – Whether disclosure "prompted" – Yes – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MATTHEW HODGES **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN BROOKS
DAVID E WILLIAMS CTA (Fellow)

Sitting in public at the Royal Courts of Justice, London on 23 and 24 March 2015 with further written submissions received from the parties

Nichola Ross Martin FCA, of Ross Martin Tax Consultancy Limited, for the Appellant

Bernard Haley, of HM Revenue and Customs, for the Respondents

DECISION

1. Mr Matthew Hodges appeals against a VAT Civil Evasion Penalty Notice in the sum of £202,524 issued by HM Revenue and Customs ("HMRC"), on 20 March 2012 under s 61 of the Value Added Tax Act 1994 ("VATA"), on the basis that an under-declaration of VAT by Aqua Scaffolding Limited ("ASL"), a company of which Mr Hodges was a director, was attributable to his dishonest conduct (the "VATA Penalties").

2. He also appeals against penalty assessments in the sum of £192,170 which were also issued by HMRC on 20 March 2012, under paragraph 19 of schedule 24 to the Finance Act 2007, on the basis of a "deliberate inaccuracy" attributable to Mr Hodges in ASL's VAT returns (the "Schedule 24 Penalties").

3. In essence the grounds of appeal advanced by Mr Hodges against both the VATA Penalties and Schedule 24 Penalties are first, that he was not dishonest; and secondly that the assessments, on which these penalties are based, were not made to a HMRC officer's "best judgment", as such they are excessive and should be reduced.

4. Miss Nichola Ross Martin of Ross Martin Tax Consultancy Limited ("RMTC") appeared for Mr Hodges. HMRC was represented by its presenting officer, Mr Bernard Haley.

Evidence

5. Mr Hodges, the appellant, and Mrs Olusimbo Onojighofia, the HMRC officer who issued the VATA Penalties and Schedule 24 Penalties and made the assessments on which the penalties are based, gave sworn oral evidence before us.

6. In addition to the oral evidence we were provided with a bundle of documents. Included in the bundle, in addition to the witness statements of Mr Hodges and Mrs Onojighofia, were copies of correspondence between the parties, notes of a meeting between HMRC, Mr Hodges and his then representative held on 5 April 2011, the Notice of Appeal and HMRC's Statement of Case.

7. On the basis of this evidence we make the following findings of fact.

Facts

8. Mr Hodges was the sole director of ASL. Its business, as the name would suggest, was the erection and dismantling of scaffolding. Originally the business had been operated by Mr Hodges as a sole trader. However, even after ASL was incorporated, on 29 March 2006, it continued to be a "one man band" with no employees. Although Mr Hodges explained that it was a "myth" that more than one person was needed to erect scaffolding he said that ASL did occasionally utilise the services of subcontractors under the Construction Industry Scheme ("CIS") if help was needed.

9. In addition to providing scaffolding for private householders ASL had business customers to whom it supplied its services under the CIS scheme. Approximately 85% of the work undertaken by ASL was for its business customers with private householders accounting for the remaining 15%. Although ASL would issue invoices to its commercial clients as many private individuals wished to pay in cash, believing they would avoid paying VAT, given the competitive nature of the market in which ASL operated Mr Hodges would quote and ASL subsequently charge them a round sum eg £400. While the customer would then think that they were not being charged VAT, the amount that they paid was, in fact, a VAT inclusive amount. In such circumstances it was the practice of Mr Hodges not to issue an invoice, unless the customer specifically requested one, at the time the work was undertaken but to prepare an invoice at a later date to give to his then accountant, Gary Pennington FCCA of AFS Accountants & Taxation Advisers ("AFS"), who would reconcile the cash takings and prepare the VAT returns on the basis of these invoices.

10. In January 2008 Mr Hodges, who had suffered from depression for several years and who continues to do so, separated from his wife resulting in what he describes as "difficult" divorce and custody proceedings. Since that time he has not attached ASL signs to the scaffolding and has not sought additional work but relied on the business of existing customers.

11. From early 2007 HMRC had commenced what has been described as a "builders exercise" or "builders project" in which "street sweeps" were undertaken by its officers in predominantly residential areas recording visible details of named builders, skip firms and scaffolders operating in those areas. During street sweeps carried out between 2008 and 2010, in Orpington, Bromley, Shirley and Beckenham, scaffolding with ASL sign boards attached to it was seen at ten different addresses.

12. On 22 February 2010 HMRC officers visited ASL in order to carry out compliance checks on its books and records. Part of this process was to ascertain whether sales had been recorded and included in the company's VAT returns in relation to the ten addresses where ASL scaffolding had been seen. However, only one of the ten addresses and the resulting sale was found to have been recorded by ASL and included in its VAT return. In addition, as Mr Hodges explained during the course of the hearing, ASL scaffolding that had been seen by HMRC at Mead Way in Bromley had not been erected by ASL but by a friend of Mr Hodges, in his words "using my gear".

13. As ASL had not recorded all the addresses where its scaffolding had been seen on 14 February 2011 Mrs Onojighofia of HMRC wrote to Mr Hodges:

> Dear Mr Hodges,
>
> We are enquiring into the VAT returns of Aqua Scaffolding Limited, of which you are the director.
>
> We are now making further enquiries into these returns as we have reason to believe that under-declarations of VAT have occurred and this may be as the result of dishonest conduct.
>
> I enclose Public Notice 160 for your benefit. This details the procedure we use in this type of enquiry. It also explains your rights. Please read it carefully.
>
> The enquiry will be conducted with a view to the recovery of tax arrears and interest and if there is sufficient evidence of dishonest

> conduct, the imposition of a Civil Evasion Penalty. The enquiry will not be conducted with a view to your prosecution.
>
> I would like to meet with you at our office … on Friday 18 March 20111 at 11:00 am to discuss these matters. Your adviser, if you have one, is also welcome to attend. At the meeting I will explain the procedure outline in Public Notice 160 and you will be invited to make a full disclosure of any irregularities. It is also likely that I will need to ask you some questions about your business and areas linked to our suspicions.
>
> I would be grateful if you would let me know, within 2 weeks of the date of issue of this letter, whether or not you are willing to attend such a meeting. If the suggested date or venue is inconvenient please contact me and we can arrange an alternative.
>
> Whilst attending this meeting may have benefits for you, as outlined in Public Notice 160, you should be fully aware that you are not obliged to co-operate in our enquiries. It is up to you to decide whether or not you speak to us or assist us generally in our enquiries. If you do speak to us we may use what you say, or any information you provide, in assessing your liability to tax or to a penalty in any Tribunal proceedings.
>
> If you would prefer that I deal directly with your adviser please complete the attached form 64-8 and return it to me at the top of this letter.
>
> Please let me know if there are any health, disability, or language issues that I need to take account of when making arrangements for our meeting.
>
> If you wish to discuss the contents of this letter please do not hesitate to contact me on [telephone number]
>
> Yours sincerely,
>
> Simbo Onojighofia
> Officer of HM Revenue & Customs

14. A meeting between Mr Hodges, Mr Pennington, Mrs Onojighofia and another HMRC officer was held on 5 April 2011, at the office of AFS. ASL's records including Sales and Purchase Invoices, Sales and Purchase Day Books maintained on Excel spreadsheets, Cash Book and Bank Statements were made available to the HMRC officers. Notes of that meeting prepared by HMRC were provided to Mr Pennington on 15 April 2011 and a copy of the notes annotated with his comments was returned to HMRC on 31 May 2011.

15. On 21 July 2011 an application was made by ASL to cancel its VAT registration. However, this was refused by HMRC as a result of the ongoing enquiry.

16. Following a subsequent exchange of correspondence, in which it maintained that ASL had made under-declarations of VAT in its 12/06 accounting period which continued until and including its 03/11 accounting period, on 20 December 2011 HMRC issued ASL with VAT assessments totalling £529,536 in respect of these VAT accounting periods. These assessments were made, in accordance with s 73 VATA to the best of Mrs Onojighofia's judgment on the basis of the ratio of declared/undeclared sightings of ASL's scaffolding. The basis of her calculation was explained in an "Assessment Calculation" attached to Mrs Onojighofia's letter to ASL of 10 October 2011 as follows:

> A test sample found only one out of ten sightings declared = $^{1}/_{10}$ x 100 = 10%.
>
> Therefore suppression rate = 100% - 10% = 90%.
>
> Since 10% of the takings have been declared I have uplifted sales by an additional 90% for each quarter to represent the correct level to October 2006. This is the point of Company formation. The conduct is one involving dishonesty.

17. As is apparent from the "Assessment Calculation" HMRC were of the view that the under-declaration of VAT was deliberate and arose as the result of dishonest conduct attributable to Mr Hodges a s 60 VATA Civil Evasion Penalty Notice was issued to ASL, on 20 March 2012, in the sum of £202,524. This was in respect of its VAT accounting periods from 12/06 to 12/08 (inclusive). At the same time the VATA Penalties were issued on Mr Hodges personally, as a director of ASL. Although s 60 VATA provides that a person may be liable to a penalty equal to the "amount of VAT evaded", in this case HMRC have mitigated the penalty in accordance with their power under s 70 VATA by 30% because of the co-operation of Mr Hodges.

18. In addition to the VATA Penalties, on 20 January 2012 HMRC issued ASL with a notice of penalty assessments under paragraph 1 of schedule 24 to the Finance Act 2007. At the same time HMRC issued the Schedule 24 Penalties to Mr Hodges. These penalties were imposed on ASL and Mr Hodges for a "deliberate inaccuracy" in ASL's VAT returns filed respect of its VAT accounting periods from 03/09 to 03/11 (inclusive). The total sum of the penalties assessed was £192,170. Although, as with the VATA Penalties there could be a liability to 100% of the "potential lost revenue" it would appear from the size of the penalties that HMRC have reduced these by 20% as a result of the quality of the disclosure by Mr Hodges.

19. On 8 May 2012 RMTC wrote to HMRC on behalf of ASL and Mr Hodges to appeal against the assessments, the VATA Penalties and Schedule 24 Penalties. The letter appreciated that the appeals were out of time but explained that:

> The director of the company, Mr Hodges did not appreciate the full significance and ramifications of the allegations made against him. He considered that the assessments were overstated but assumed that if HMRC was winding up the company that would be the end of the matter. It seems he either misunderstood, or was not made fully aware of the full implications of s 60 VATA (and Schedule 24 FA 2007) and so had ended up being entrapped by s 60.

20. This letter was treated as a request for a review by HMRC which, on 22 August 2012, responded with a "review conclusion letter". Although this upheld the assessments on ASL, VATA Penalties and Schedule 24 Penalties it was acknowledged that although Mrs Onojighofia's assessment seemed "unrefined" in the absence of assistance from ASL it was the best judgment HMRC could make.

21. Both ASL and Mr Hodges then appealed to the Tribunal but on 21 January 2013, having gone into liquidation, ASL was wound up and its appeal was subsequently struck out leaving the appeal of Mr Hodges against the VATA Penalties and Schedule 24 Penalties before the Tribunal.

Law

22. We first set out the legislative provisions that we have referred to above in respect of the VATA Penalties, the Schedule 24 Penalties and the "best of judgment" assessments together with the relevant authorities before considering the burden and standard of proof applicable in relation to these matters.

VATA Penalties

23. Section 60 VATA provides:

> (1) In any case where–
>
> (a) for the purpose 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…

24. Insofar is it applies to the present case s 61VATA provides:

> (1) where is appears to the Commissioners
>
> (a) that a body corporate is liable to a penalty under section 60 [VATA], 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 named officer
>
> (2) …
>
> (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.

In the present case it is not disputed that Mr Hodges was a named officer of ASL and that notice of a penalty imposed under s 61 has been served on him.

25. Under s 70 VATA HMRC may reduce a penalty imposed under s 60 VATA to such amount (including nil) as they think proper.

Schedule 24 Penalties

26. Under s 97 of the Finance Act 2007 provisions imposing penalties on taxpayers who make errors in certain documents, including VAT Returns, are contained in schedule 24 of that Act. Therefore, all subsequent references to paragraphs, unless otherwise stated, are to the paragraphs of that schedule.

27. Paragraph 1 provides:

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

> (a) P gives HMRC a document of a kind listed in the Table below [which includes a VAT Return] 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 liability to tax,
>
> (b) a false or inflated statement of a loss, 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.

As with the VATA Penalties, where a company is liable to pay a penalty under paragraph 1 for a deliberate inaccuracy that was attributable to an officer of the company, under paragraph 19, that officer is "liable to pay such portion of the penalty (which may be 100%) as HMRC may specify by written notice to the officer."

28. Insofar as it applies to the present case paragraph 3 provides:

> (1) 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 and 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 inaccurate figures.

29. The amount of a penalty, payable under paragraph 1 is set out in paragraph 4. Insofar as it applies to the present case paragraph 4(2) provides that the penalty for careless action is 30% of the potential lost revenue; for deliberate but not concealed action, 70% of the potential lost revenue; and for deliberate and concealed action 100% of the "potential lost revenue" which, for present purposes, is defined by paragraph 5(1) as "the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment."

30. Paragraph 9 provides:

> (1) A person discloses an inaccuracy, a supply of information or withholding of information, 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 or withholding of information, or the under-assessment, and
>
> (c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy attributable to the supply of false information or withholding of information, or the 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, and
>
> (b) otherwise is "prompted".
>
> (3) In relation to disclosure "quality" includes timing, nature and extent.

31. Under paragraph 10(1) HMRC "must" reduce the standard percentage of a person who would otherwise be liable to a penalty as shown in column 1 of the table below, to one that reflects the quality of the disclosure. However, paragraph 10(2) precludes a reduction in the standard percentage below the minimum shown for it.

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%

32. HMRC may also reduce a penalty because of "special circumstances" under paragraph 11 although the ability to pay or the fact that a potential loss from one taxpayer is balanced by a potential payment from another are precluded from being special circumstances by paragraph 11(2).

33. On an appeal against a decision that a penalty is payable the Tribunal may, under paragraph 17(1), affirm or cancel HMRC's decision. However, if the appeal is against the amount of a penalty paragraph 17(2) allows the Tribunal to substitute HMRC's decision for another decision provided that it was within HMRC's power to make the substituted decision.

34. With regard to a reduction of a penalty under paragraph 11 in relation to special circumstances, under paragraph 17(3), the Tribunal may only substitute its decision for that of HMRC if it "thinks that HMRC's decision in respect of the application of paragraph 11 was flawed." If so, paragraph 17(6) provides that:

> "Flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.

Assessments

35. Under s 73(1) VATA where it appears to HMRC that a person's VAT returns are "incomplete or incorrect":

> … they may assess the amount of VAT due from him to the best of their judgment and notify it to him.

36. We were referred to the observations of Woolf J (as he then was) in *Van Boekel v Customs and Excise Commissioners* [1981] STC 290 in relation to a "best of Judgment" assessment. These were referred to in some detail by Carnwath J (as he then was) in the Court of Appeal in *Rahman (Trading as Khayam Restaurant) v Customs and Excise Commissioners* [1998] STC 826:

> "… because there are dangers in taking Woolf J's analysis of the concept of 'best judgment' out of context. The passages I have italicised show that the tribunal should not treat an assessment as invalid merely because it disagrees as to how the judgment should have been exercised. A much stronger finding is required; for example, that the assessment has been reached 'dishonestly or vindictively or capriciously'; or is a 'spurious estimate or guess in which all elements of judgment are missing'; or is 'wholly unreasonable'. In substance those tests are indistinguishable from the familiar *Wednesbury* principles (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223). Short of such a finding, there is no justification for setting aside the assessment."

Burden and Standard of Proof

37. In *Khan v HMRC* [2006] EWCA Civ 89, Carnwath LJ (as he had then become) said, at [69]

> "The position on an appeal against a "best of judgment" assessment is well-established. The burden lies on the taxpayer to establish the correct amount of tax due:
>
> > "The element of guess-work and the almost unavoidable inaccuracy in a properly made best of judgment assessment, as the cases have established, do not serve to displace the validity of the assessments, which are *prima facie* right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessments right or more nearly right." (*Bi-Flex Caribbean Ltd v Board of Inland Revenue* (1990) 63 TC 515, 522-3 PC per Lord Lowry).
>
> That was confirmed by this court, after a detailed review of the authorities, in *Customs and Excise Commissioners v Pegasus Birds Ltd* [2004] STC 1509; [2004] EWCA Civ 1015. We also cautioned against allowing such an appeal routinely to become an investigation of the *bona fides* or rationality of the "best of judgment" assessment made by Customs:
>
> > "The tribunal should remember that its primary task is to find the correct amount of tax, so far as possible on the material properly available to it, the burden resting on the taxpayer. In all but very exceptional cases, that should be the focus of the hearing, and the Tribunal should not allow it to be diverted into an attack on the Commissioners' exercise of judgment at the time of the assessment." (para 38(i))

> It should be noted that this burden of proof does not change merely because allegations of fraud may be involved (see e.g. *Brady v Group Lotus Car Companies plc* [1987] STC 635, 642 per Mustill LJ)."

38. With regard to the VATA Penalties s 60(7) VATA provides that:

> … the burden of proof as to the matters specified in subsection (1) (a) and (b) above shall lie upon the Commissioners.

39. Although there is no specific statutory provision comparable with s 60(7) in relation to penalties under schedule 24 it is well established that in penalty cases, such as the present (where the penalty is criminal for European Convention on Human Rights purposes), the burden of proof that the determination of the penalty was correct is on HMRC. However, notwithstanding the allegation of dishonesty against Mr Hodges in the present case the standard of proof is the civil standard (see *Re B* [2009] 1 AC 1).

40. As Lady Hale, giving the judgment of the Supreme Court in *Re S-B (Children)* [2010] 1 AC 678 said, at [34]:

> "… there is no necessary connection between the seriousness of an allegation and the improbability that it has taken place. The test is the balance of probabilities, nothing more and nothing less."

Summary of Submissions

41. For HMRC, Mr Haley contends, that as a result of the failure to include details of the scaffolding seen on the street sweep in its VAT returns, not only was there an under-declaration of VAT by ASL, and therefore inaccuracies in its VAT returns, but that this was attributable to the dishonest and deliberate conduct of Mr Hodges who concealed it from HMRC and as such should be liable to the VATA and Schedule 24 Penalties.

42. However, Mr Haley, who did not quite concede that the quantum of the penalties should be reduced or that suppression only occurred in relation to residential customers, accepted that the "best of judgment" assessments of the under-declaration of VAT, on which the penalties are based, were "unrefined" and were we to find that there were undeclared sales, but not to the extent assessed, the amount can be varied. On the basis of the evidence that 85% of ASL's customers were other businesses and one of the nine apparently "undeclared" sightings of ASL scaffolding was when it had been used by a friend of Mr Hodges, Mr Haley suggests that the under-declaration could be recalculated by application of the following formula:

> Declared Gross Sales (VAT Inclusive) x 15% (declared residential sales) x 8 (sales uplift) x VAT fraction.
>
> eg £401,915.42 x 15% = £60,287.31 x 8 = £482,298.5 x VAT fraction[1]

This produces a reduction from the assessed VAT under-declaration of £529,536 to £70,250. Although Mr Hodges could be liable to penalties equal to the amount under-declared Mr Haley accepted that a 30% reduction for mitigation/disclosure was appropriate for both the VATA Penalties and Schedule 24 Penalties in view of Mr Hodges' attendance at meetings and production of records, albeit after requests and, if applied, the penalties would be reduced from £394,694 to £49,175

[1] $^{1}/_{6}$ for VAT period 03/11 and $^{7}/_{47}$ for VAT periods 12/01 to 12/06

43. Miss Ross Martin's primary case, on behalf of Mr Hodges, is that HMRC have, on the evidence, failed to establish that he was dishonest or that any inaccuracy in ASL's VAT returns was deliberate and concealed; at worst she submits that Mr Hodges was careless. Although she did not suggest a reduction in excess of 30% for mitigation/disclosure Miss Ross Martin did submit that the health and marital issues faced by Mr Hodges amount to special circumstances under which the Schedule 24 Penalties should be reduced.

44. She also questions the sampling technique of HMRC and the way in which the sample was extrapolated to produce sales figures of over £4 million for ASL over the period in which the street sweeps were undertaken which she submits is wholly unrealistic for such a one man operation as there would not be sufficient days in the year to erect and dismantle enough scaffolding to achieve such a return.

45. Although Miss Ross Martin, in our view quite correctly, accepted that "best of judgment" assessments were not reached "dishonestly or vindictively or capriciously" nor were they a "spurious estimate or guess in which all elements of judgment are missing" or "wholly unreasonable"- she described them as "naïve"- she did propose alternative methods of calculation.

46. The first, based on the number of "undeclared" ASL sign boards identified in HMRC's street sweep (nine) compared with the assumed number of residential jobs undertaken (15% of the total) with the ratio applied over the VAT periods concerned arrives at a figure for of £1,801 in respect of the under-declared VAT.

47. The alternative method estimates the number of jobs that would be possible to erect and dismantle scaffolding based on the working days each year. This assumes that the average gross value of a job (calculated on the basis of the total value of the work declared by Mr Hodges divided by the jobs undertaken) is £797, that for an average job it takes two days to load, erect and dismantle scaffolding and therefore the average sales per man per day is £399. It also assumes that there are 20 working days per month. On this basis, after taking account of the days actually worked, Miss Ross Martin calculates that the maximum sales potential on "free days" amounts to £77,440 which, applying the appropriate VAT fraction amounts to a VAT under-declaration of £11,153.

Discussion

48. In the present case as ASL's scaffolding was seen at ten addresses during HMRC's street sweep and only one of these included by Mr Hodges in its business records from which its VAT returns were prepared we have no hesitation in finding that there was an under-declaration of VAT by ASL which, given it supplied its services to other businesses under the CIS scheme and supplied invoices as a matter of course to its commercial clients, was in relation to services provided to its residential customers and resulted in the submission of inaccurate VAT returns to HMRC. The question therefore that arises is whether such an inaccuracy in its VAT returns was, in relation to the VATA Penalties, attributable to the dishonest conduct of Mr Hodges and, in respect of the Schedule 24 Penalties, whether the inaccuracy was deliberate and concealed, deliberate but not concealed, careless or innocent.

49. Although Miss Ross Martin referred us to *Stuttart and another (trading as de Wynns Coffee House v Customs and Excise Commissioners* [2000] STC 342 and *R v*

Ghosh [1982] 2 All ER 689 with regard to dishonesty, we gratefully adopt the following approach of the Tribunal (Judge Cannan and Mr Davison) at [8] of *Hussein v HMRC* [2014] UKFTT 307 (TC) in relation to s 60 VATA:

> "The test in relation to dishonesty is objective. Did the appellant have knowledge sufficient to render his conduct dishonest according to normally acceptable standards of honest behaviour? On the facts of this case the question is simply whether the appellant deliberately understated his takings in order to evade VAT."

50. Other than the instance where ASL's scaffolding had been used by his friend, which we accept, Mr Hodges was unable to provide any satisfactory explanation for it being seen at the other locations which were not reflected in the sales records. In the absence of any such explanation we do not accept that the failure to record and account for VAT at the addresses where ASL's scaffolding was seen can be due to his failure to take reasonable care or as the result of an innocent mistake, rather we find that omission to be deliberate and the consequent under-declaration of VAT to be attributable to the dishonest conduct of Mr Hodges. We also find the inaccuracy in the VAT returns of ASL not only to be deliberate but deliberate and concealed by virtue of it not having been recorded in the documents provided to HMRC by Mr Hodges and ASL.

51. We also find the disclosure of inaccuracy in the VAT returns to have been prompted, as defined by paragraph 9(2) of schedule 24, in that it was discovered by HMRC on an examination of ASL's records. It therefore follows that we find Mr Hodges to be liable to the VATA Penalties and Schedule 24 Penalties.

52. Given that the quantum of the penalties is dependent on the amount of VAT evaded (VATA Penalties) and potential lost revenue (Schedule 24 Penalties) it is necessary to consider the "best of judgment" assessments. As is clear from *Pegasus Birds* and *Khan* our primary task is "to find the correct amount of tax, so far as possible on the material properly available" with the burden resting on the taxpayer.

53. Having considered the calculations submitted by the parties, both original and revised in the light of the evidence of Mr Hodges at the hearing, if HMRC's revised "sales uplift" of £482,298.50 (as suggested by Mr Haley) is applied to Miss Ross Martin's average sales per man per day of £399 (from her alternative "free days" calculation) the total number of working days at 1,209 is more than the 1,152 actual working days during the period under review. For Mr Hodges to have generated such additional turnover he would either have had double the amount charged to his customers or increase his work force. Given our finding of fact that Mr Hodges operated as a one man band in a competitive market, we do not consider that the correct amount of tax can be found by the application of the revised calculation suggested by Mr Haley as this, like the "unrefined" original assessment, relies on an uplift based on the very small street sweep sample.

54. However, we have found that there was an under-declaration of VAT by Mr Hodges as a result of his failure to account for work undertaken for all residential customers and consider Mr Hodges assertion that any cash received from ASL's private customers would be banked and not retained by him to meet business or personal expenses unrealistic notwithstanding the production of several bank statements showing that ASL had an overdraft and regular small cash withdrawals being made. In the circumstances we consider that Miss Ross Martin's alternative

"free days" calculation (which we have appended to the decision) provides the corrections to the original assessment on which the penalties were based to make it, as Carnwath LJ said in *Khan v HMRC*, referring to Lord Lowry in *Bi-Flex Caribbean Ltd v Board of Inland Revenue*, "more nearly right".

55. We therefore find that there was an under-declaration of VAT of £11,153 being £2,718 for the VAT periods 12/06 to 12/08 and £8,435 for the 03/09 to 03/11 VAT periods.

56. Although the total amount of the penalties could be equal to the "VAT evaded" (the VATA Penalties) or 100% of the "potential lost revenue" (Schedule 24 Penalties) HMRC accept that these should be reduced by 30% as a result of the co-operation of Mr Hodges with HMRC. As we did not hear any specific argument on mitigation or reductions for disclosure we also accept that a 30% reduction is appropriate in the circumstances.

57. As it was raised by Miss Ross Martin, we also consider whether there should be any further reduction in the Schedule 24 Penalties for "special circumstances" under paragraph 11 of the schedule. It is clear from paragraph 17(3) of the schedule that we may only substitute our decision for that of HMRC if we think HMRC's decision was "flawed" in a judicial review sense.

58. In the present case Mr Haley confirmed that HMRC had not considered whether a reduction should be made for "special circumstances". A failure of HMRC to consider whether a reduction for special circumstances, albeit under the similarly worded paragraph 9 to schedule 56 of the Finance Act 2009 in relation to PAYE penalties, was considered by the Tribunal (Judge Redston and Mr Speller FCA) in *Bluu Solutions Ltd v HMRC* [2015] UKFTT 95 (TC), at [145]:

> "We considered a number of other cases which considered these special circumstances provisions, or the similar paragraphs in other penalty statutes. In *Hardy v HMRC* [2011] UKFTT 592 (TC) and *Rodney Warren & Co v HMRC* [2012] UKFTT 57 (TC) HMRC never considered the special circumstances provisions, so the tribunals found that the decision was "flawed." We agree with that approach."

We also agree that such an approach must be correct. As the Tribunal observed in *Bluu*, at [126]:

> "If HMRC have failed to consider para 9 at all, so that they make no decision on special circumstances, they have failed to exercise their discretion. Although para 6(3)(b) gives the tribunal the jurisdiction to make a new decision on special circumstances only if "HMRC's decision in respect of the application of paragraph 9" was flawed, it seems to us that the tribunal must also have jurisdiction to make a decision where HMRC have failed to exercise their discretion, so that they have made no decision about the application of para 9."

59. Although it would seem from *Bluu* that Mr Haley could himself have considered whether a special circumstances reduction was appropriate, he did not do so and, as such, it is open to us to consider this issue. However, given that despite his health and matrimonial difficulties Mr Hodges remained actively involved in his business, we are unable to find that there should be any further reduction in the Schedule 24 Penalties because of special circumstances.

Decision

60. For the above reasons although we dismiss the appeal on the basis of the evidence before us we find that the under-declaration of VAT in the best of judgment assessment should be reduced to the sums stated in paragraph 56 above and penalties reduced accordingly.

61. We therefore confirm the penalties in the following amounts:

(1) the VATA Penalties in the sum of £1,902; and

(2) the Schedule 24 Penalties in the sum of £5,905.

Right to apply for Permission to Appeal

62. 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.

JOHN BROOKS
TRIBUNAL JUDGE

RELEASE DATE: 28 May 2015

Appendix
"Free Days" calculation of penalties

Aqua Scaffolding Ltd

Estimate of the value of the number of jobs that would be possible to erect and Strike down based on working days per year.

Assumptions:

Average gross job value - £797

Days to load, erect and strike an average job – 2

Therefore average sales per man per day - £399

Number of working days per month22, less holidays 2 – 20*

Days off ill – unknown

A	B	C	D	E	F	G	H	I	J	K
12/06	17239.73	22	784	44	60	16	5,120	7/47	762.55	
03/07	20943.69	26	806	52	60	8	2,560	7/47	381.28	
06/07	26845	34	790	68	60	-8	(2,560)	7/47	(381.28)	
09/07	24432.96	31	788	62	60	-2	(640)	7/47	(95.32)	
12/07	26482.26	33	802	66	60	-6	(1,920)	7/47	(285.96)	
03/08	29741.17	37	804	74	60	-14	(4,480)	7/47	(667.23)	1
06/08	24892.25	31	803	62	60	-2	(640)	7/47	(95.32)	3
09/08	19493.97	24	812	48	60	12	3,840	7/47	571.91	1
12/08	16797	21	800	42	60	18	5,760	7/47	857.87	
12/08	8398.57	10	840	20	60	40	12,800	3/23	1,669.57	
03/09	11678.35	15	779	30	60	30	9,600	3/23	1,252.17	
06/09	11376.95	14	813	28	60	32	10,240	3/23	1,335.65	1
09/09	20815	26	801	52	60	8	2,560	3/23	333.91	1
12/09	39646.25	50	793	100	60	-40	(12,800)	3/23	(1,669.57)	1
03/10	8401.25	11	764	22	60	38	12,160	7/47	1,811.06	
06/10	29714.64	37	803	74	60	-14	(4,480)	7/47	(667.23)	
9/10	31754.38	40	794	80	126	46	14,720	7/47	2,192.34	1 + 1 friend
12/10	11691.25	15	779	30	104	74	23,680	7/47	3,526.81	
03/11	21570.75	27	799	54	60	6	1,920	1/6	320.00	
	401915.42	504	15152	1008	1152	242	77,440		11,153.23	
					**		*			

Average value per job 797.4512

A – VAT period

B – Value declared (including VAT)

C – Number of jobs

D – Value per job

E – Estimated number days worked

F – Working days per VAT quarter

G – Free days

H – Max sales potential on free days

I – VAT fraction

J – Total possible VAT underdeclaration*

K – Street Sweep sightings

* Assumes that taxpayer did work every working day and no days lost for sickness, childminding or bad weather etc
** Had subcontractor working with him in the quarters 9/10 and 12/10

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