TC04122

Appeal number: TC/2014/00919

VAT – appeal against denial of input tax claim – HMRC application for strike out of proceedings – appellant convicted of recklessly submitting a false VAT return – s 72(3)(b) VATA 1994 – whether abuse of process - doctrine of issue estoppel – whether no reasonable prospect of success – Kittel principle - proceedings struck out

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR LESTER STACEY (t/a LAZYDAYS MOTORHOMES) **Appellant**

- and -

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

TRIBUNAL: JUDGE PETER KEMPSTER

Sitting in public at Priory Courts, Birmingham on 27 October 2014

The Appellant in person, assisted by his colleague Mr Neil Taylor

Ms Kathryn Whelan (HMRC Solicitor's Office) for the Respondents

DECISION

1. By a notice of appeal dated 12 February 2014 the Appellant ("Mr Stacey") appealed against a refusal by the Respondents ("HMRC") to make a repayment of VAT of over £250,000 shown on his VAT return for the period 03/10. By an application dated 12 June 2014 HMRC applied for the proceedings to be struck out, on the grounds set out below.

Background

2. Mr Stacey is a sole trader selling caravans and motor homes, trading as Lazydays Motorhomes. He first met Mr Michael Davies over 30 years ago, when Mr Davies was 19 years old. Mr Stacey employed Mr Davies as a salesman for nine years and always found him to be honest and straightforward. Mr Davies left but later reapplied and Mr Davies again employed him as a salesman from 2008. During 2009-10 Mr Stacey took a sabbatical from the business because of a heart problem, and he left the business in the control of Mr Davies; he trusted Mr Davies to run matters responsibly. Mr Stacey signed the VAT returns as the proprietor. In 2010 Mr Stacey was arrested and accused of tax fraud. As the prosecution moved towards trial it became apparent to him that his business had been used as a vehicle for a tax fraud by Mr Davies; it later transpired that when Mr Davies reapplied for a job he was already on bail relating to other VAT fraud charges; there had been a calculated plan to exploit the business as part of other frauds, and the fact that the business dealt in high value items (motor homes worth over £30,000 each) suited Mr Davies and the other fraudsters.

3. Mr Stacey was prosecuted under two counts on one indictment:

(1) (Along with eight other individuals, including Mr Davies) conspiracy to cheat the public revenue – Mr Stacey pleaded not guilty and the count was ordered to lie on file in respect of him. Mr Davies was convicted on this count (and received a custodial sentence).

(2) (Alone) recklessly making a statement by furnishing a VAT return that was false in a material particular, contrary to s 72(3)(b) VAT Act 1994 – Mr Stacey pleaded guilty to this count. His formal basis of plea, dated 11 June 2013, was as follows:

> "**R v Lester John Stacey**
>
> **Basis of Plea**
>
> 1. I plead guilty to a charge contrary to s 72(3)(b) of the Value Added Tax Act 1994 on the following basis.
> 2. I was reckless in not ensuring that the information contained in the VAT return which I signed on 19/4/10 was correct (so far as the £256,744.78 is concerned).
> 3. The VAT return was compiled by Neil Taylor from information and documents supplied to him by Michael

Davies, whom I had left in charge of my business during 2009 and early 2010.

4. I was aware that Davies had "diversified" into the business which, it transpires, was fraudulent, having been informed of the diversification by Tracey Henney. I had asked Davies about the trade and had accepted his assurances that it would make some, though limited, profit, and I trusted that he was undertaking legitimate business.

5. I had no reason to suspect that the 10 deals were fraudulent, since I had employed Davies for about 9 years in the past without any problems, and at that time (April 2010) I was entirely unaware of his involvement in the conspiracy to cheat to which he pleaded guilty in January 2012.

6. I had no knowledge of any of the co-defendants and to this day have never met or spoken with any of them save at court in these proceedings.

7. I admit that in failing to make further enquiry before signing the VAT return in relation to the £256,744.78 I acted recklessly.

8. Although not strictly relevant to the charge to which I have pleaded guilty, I would add that I did not sign the Transatlantic Bank Corp application, and assume Davies forged my signature from the copy of my driving licence which he obtained from Henney.

9. I had no involvement save for signing the VAT return."

4. At the hearing Mr Stacey handed up an extract from the judge's sentencing remarks at his criminal trial. The copy available had certain parts redacted and Mr Stacey could not explain the reason for the editing. I am reluctant to make too much of the contents of an incomplete document but it is apparent that the trial judge accepted that Mr Stacey had turned over the running of his business to Mr Davies.

Respondents' case

5. Ms Whelan for HMRC submitted as follows.

6. The proceedings should be struck out on one or both of two bases:

(1) They constituted an abuse of process by virtue of involving an attempted retrial of matters already determined, contrary to the principle of issue estoppel.

(2) They had no reasonable prospect of success, given the admissions made by Mr Stacey in the criminal proceedings.

Abuse of process

7. It was not open to the Tribunal to revisit what amounted to a finding by another court, albeit on the basis of a guilty plea before the trial took place. To do so would

offend the principle of issue estoppel. Alternatively, continuing the appeal would be an abuse of process.

8. In *MJ Feehan* [1993] VATTR 266 the taxpayer had sought to appeal against assessments in circumstances where he had been prosecuted in relation to the operation of gaming machines. The VAT Tribunal had stated

> "I have to ask the question whether, taking all the circumstances, and having regard to public policy and the desirability of limiting litigation and avoiding costs, the issue now before me has been effectively covered by the criminal proceedings. Mr Mathew suggested that the Appellant might have been a mere agent (guilty of conspiracy to defraud but not himself the principal tax payer); or that he might be in partnership with others. I intend no disrespect to the forceful argument that he put forward in concluding that it would be an abuse of the process of this tribunal to allow the Appellant to pursue the grounds of appeal now in dispute."

9. In fairness to the Appellant, the VAT Tribunal had reached a different conclusion in *Citrone* (2000) 16662. However, *Citrone* was distinguishable as there it had been held that notwithstanding an earlier criminal conviction, there was still scope to discuss the precise details of the assessment which had been the subject of a compromise agreement. In the current appeal, by contrast, there was no scope to discuss the claim to input tax, given the relevant law as stated in *Mobilx Ltd & others v HMRC* [2010] STC 1436 - summarised below.

10. Several ECJ cases culminating in *Kittel v Belgium* [2008] STC 1537 had established that:

> "51. … traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT …
>
> 61. By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct."

11. The Court of Appeal in *Mobilx* stated:

> "[59] The test in *Kittel* is simple and should not be over-refined. It embraces not only those who know of the connection but those who 'should have known'. Thus it includes those who should have known from the circumstances which surround their transactions that they were connected to fraudulent evasion. If a trader should have known that the only reasonable explanation for the transaction in which he was involved was that it was connected with fraud and if it turns out that the transaction was connected with fraudulent evasion of VAT

then he should have known of that fact. He may properly be regarded as a participant for the reasons explained in *Kittel*.

[60] The true principle to be derived from *Kittel* does not extend to circumstances in which a taxable person should have known that by his purchase it was more likely than not that his transaction was connected with fraudulent evasion. But a trader may be regarded as a participant where he should have known that the only reasonable explanation for the circumstances in which his purchase took place was that it was a transaction connected with such fraudulent evasion.

[61] Such an approach does not infringe the principle of legal certainty. It is difficult to see how an argument to the contrary can be mounted in the light of the decision of the court in *Kittel*. The route it adopted was designed to avoid any such infringement. A trader who decides to participate in a transaction connected to fraudulent evasion, despite knowledge of that connection, is making an informed choice; he knows where he stands and knows before he enters into the transaction that if found out, he will not be entitled to deduct input tax. The extension of that principle to a taxable person who has the means of knowledge but chooses not to deploy it, similarly, does not infringe that principle. If he has the means of knowledge available and chooses not to deploy it he knows that, if found out, he will not be entitled to deduct. If he chooses to ignore obvious inferences from the facts and circumstances in which he has been trading, he will not be entitled to deduct."

12. Mr Stacey's conviction demonstrated that he had the "means of knowledge" required by *Kittel*. By his guilty plea he could no longer place himself in the position of an unwitting taxpayer; he was a taxpayer who should have known that the transactions were connected to the fraudulent evasion of VAT.

No reasonable prospect of success

13. For the same reasons as stated above, even if the continuation of the proceedings would not amount to an abuse of process, they had no reasonable prospect of success and thus should be struck out.

Appellant's case

14. Mr Stacey submitted as follows.

15. Mr Stacey was shocked when he was arrested and accused of tax fraud – he had always considered himself a diligent taxpayer.

16. He had been duped by Mr Davies, whom he had trusted. At the criminal trial the judge had described Mr Davies as the ringleader of the fraud. The prosecution had effectively accepted that Mr Stacey knew nothing of the fraud by not pursuing the conspiracy charge against him. While he was not attempting now to deny the fact of his conviction on the lesser charge, he had pleaded guilty under duress in order to speed as far as possible the conclusion of the criminal proceedings, particularly in view of his health. He accepted that as he had signed the incorrect VAT return he was

legally responsible; that was the basis of the "recklessness" but it went no wider and certainly not to any admission of knowing about the fraud. He did not know of the fraud when he signed the return. Also, he had no means of knowing about the fraud at that time; he had not even been present on the business premises.

17. The VAT dispute had had a serious effect on the business because HMRC had refused to reply to communications and had held up other VAT payments due. The business was currently owed around £600,000 by HMRC, including the amounts claimed in the disputed return. The business had been close to bankruptcy. He was a legitimate businessman who had been duped by fraudsters – he was the victim, not the perpetrator.

18. In *Bond House Systems* [2006] STC 419 it had been held that transactions not themselves vitiated by VAT fraud could constitute proper supplies for VAT purposes. In *Armitage v Nurse & others* [1998] Ch 241 it had been held that an allegation of dishonesty must be made expressly, which HMRC had failed to do in the current proceedings because they cited only that Mr Stacey "knew or ought to have known".

Consideration and Conclusions

19. I consider HMRC have raised three contentions in support of their strike out application, which I deal with in turn:

(1) Continuation of the proceedings would be contrary to the doctrine of issue estoppel.

(2) Continuation of the proceedings would be an abuse of process.

(3) The proceedings have no reasonable prospect of success.

HMRC contention that continuation of the proceedings would be contrary to the doctrine of issue estoppel

20. I take the following two authorities to be a fair statement of the legal position.

21. In *Carl-Zeiss-Stiftung v Rayner & Keeler Ltd (No 2)* [1966] 2 All ER 536 Lord Guest stated (at 564–565):

> "The doctrine of estoppel per rem judicatam is reflected in two Latin maxims, (i) interest rei publicae ut sit finis litium and (ii) nemo debet bis vexare pro una et eadem causa. The former is public policy and the latter is private justice. The rule of estoppel by res judicata, which is a rule of evidence, is that where a final decision has been pronounced by a judicial tribunal of competent jurisdiction over the parties to and the subject-matter of the litigation, any party or privy to such litigation as against any other party or privy is estopped in any subsequent litigation from disputing or questioning such decision on the merits. As originally categorised, res judicata was known as "estoppel by record". But as it is now quite immaterial whether the judicial decision is pronounced by a tribunal which is required to keep a written record of its decisions, this nomenclature has disappeared and it may be

> convenient to describe res judicata in its true and original form as "cause of action estoppel". This has long been recognised as operating as a complete bar if the necessary conditions are present. Within recent years the principle has developed so as to extend to what is now described as "issue estoppel", that is to say where in a judicial decision between the same parties some issue which was in controversy between the parties and was incidental to the main decision has been decided, then that may create an estoppel per rem judicatam."

22. In *Crown Estate Commissioners v Dorset County Council* [1990] 1 All ER 19, Millett J (as he then was) stated (at 23):

> "Res judicata is a special form of estoppel. It gives effect to the policy of the law that the parties to a judicial decision should not afterwards be allowed to relitigate the same question, even though the decision may be wrong. If it is wrong, it must be challenged by way of appeal or not at all. As between themselves, the parties are bound by the decision, and may neither relitigate the same cause of action nor reopen any issue which was an essential part of the decision. These two types of res judicata are nowadays distinguished by calling them "cause of action estoppel" and "issue estoppel" respectively."

23. Mr Stacey is clear that he does not seek to resile from his previous admission that he recklessly submitted a false VAT return. What he intends to argue in these proceedings is, *inter alia*, that he was not responsible for or aware of the falsity of that return. His admitted reckless behaviour is doubtless a matter which HMRC would emphasise in the tax appeal, and the Tribunal may consider it an important factor in determining whether the *Kittel* test is satisfied. However, I am not satisfied that Mr Stacey is by his tax appeal seeking to "reopen any issue which was an essential part of the decision" in the criminal proceedings. Accordingly I do not accept that the tax appeal is barred by the doctrine of issue estoppel.

HMRC contention that continuation of the proceedings would be an abuse of process

24. HMRC cite the VAT Tribunal case of *Feehan*. However, in that case the taxpayer had, according to the case report, been convicted of "conspiracy to cheat the Public Revenue contrary to section 1(1) of the Criminal Law Act 1977." That is very similar to the charge against Mr Stacey (and others) which (in his case) was ordered to lie on file. My understanding of that situation is that the judge at Leeds Crown Court (I do not have his/her name) determined that there was sufficient evidence for a case to be made but that it would not be in the public interest to proceed with the prosecution – probably because Mr Stacey had admitted the other charge (that under s 72(3)(b) VAT Act 1994) – and thus no verdict was recorded; although the charge could be reinstated subsequently, that would require exceptional circumstances and the permission of the trail judge. So, in my opinion, the current appeal is distinguishable from *Feehan* (which in any event is not binding on this Tribunal): there has been no finding (in respect of Mr Stacey) on the conspiracy to cheat charge.

25. For the same reasons as I set out at paragraph [23] above in relation to the issue estoppel ground, I am not satisfied that Mr Stacey's pursuit of his tax appeal before

this Tribunal is an action that would (to use the words of Lord Diplock in the leading case of *Hunter v West Midlands Police* [1982] AC 529) "bring the administration of justice into disrepute among right-thinking people". Accordingly I do not accept that the tax appeal constitutes an abuse of process.

HMRC contention that the proceedings have no reasonable prospect of success

26. I first set out my understanding of the stance of both parties in the current appeal, if those proceedings were to continue.

(1) *HMRC's stance*: HMRC have not yet produced their statement of case in relation to the appeal but their basic stance is clear. They consider the *Kittel* test is met in relation to the disputed denied VAT repayment, in that Mr Stacey knew or should have known that the relevant transactions were connected with fraudulent evasion of VAT. They accept that, if the appeal proceeds, they bear the burden of proof (on the balance of probabilities) that the *Kittel* test is satisfied.

(2) *Mr Stacey's stance*: Mr Stacey's basic stance is as follows:

- He was an innocent dupe.
- He trusted his long-time employee Mr Davies to run his business in his absence.
- Mr Davies betrayed that trust by using the business to participate in organised VAT fraud.
- Mr Stacey was unaware of the fraud.
- Both he and his business have suffered as a result of the fraud and the denial of the VAT repayment would be further punishment for something where he was the victim, not the perpetrator.

27. I can at this point dispose of two of Mr Stacey's objections to HMRC's application (see paragraph [18] above). First, Mr Stacey cites the *Bond House* authority but that is only one case in the line of authorities on what is now usually referred to as the *Kittel* principle. The current state of the law on that principle is as summarised by the Court of Appeal in *Mobilx*. Secondly, Mr Stacey is incorrect to suggest that HMRC must prove that he was himself dishonest. It would be sufficient for HMRC to succeed in this appeal (if it continues) for them to prove (on the balance of probabilities) that Mr Stacey *should have known* that the relevant transactions were connected with fraudulent evasion of VAT. It is open to them to further allege that he had actual knowledge thereof, but not essential to their case.

28. Mr Stacey accepts (or at least, he is in no position to deny) that the relevant transactions were connected with fraudulent evasion of VAT. He disputes that he knew or should have known of that connection. He considers that he was the victim of the fraud and thus should not be denied the VAT repayment. An important point is that the *Kittel* test is not one of culpability, or even negligence, but instead relates to

the objective conditions necessary for a valid input tax deduction. As stated by Moses LJ in *Mobilx* (at [52]):

> "If a taxpayer has the means at his disposal of knowing that by his purchase he is participating in a transaction connected with fraudulent evasion of VAT he loses his right to deduct, not as a penalty for negligence, but because the objective criteria for the scope of that right are not met. It profits nothing to contend that, in domestic law, complicity in fraud denotes a more culpable state of mind than carelessness, in the light of the principle in *Kittel*. A trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises."

29. Mr Stacey denies any prior knowledge of the frauds perpetrated by Mr Davies. Whose knowledge is relevant here? The point was considered by the Upper Tribunal in *Greener Solutions Ltd V HMRC* [2012] STC 1056. I gratefully adopt the concise summary of that case provided by Sir Andrew Morritt C in *Bilta UK Ltd (in liqn) v Nazir & othrs* [2012] STC 2424 (at [26]):

> "*Greener Solutions Ltd* … also concerned a "missing trader" fraud. In that case Greener Solutions ("GSL") sought repayment of the input tax incurred in respect of mobile telephones it had bought and then exported. The individual who had effected all the relevant transactions on behalf of GSL was Oliver Murray. Murray knew of the fraud committed by Jag-Tec, the missing trader. The question was whether his knowledge should be imputed to GSL. Warren J concluded at para 43 that it should be because Murray had effectively implemented the fraud on behalf of GSL but the fraud was not aimed at GSL."

30. The role of Mr Murray in relation to the company in *Greener Solutions* was explained by Warren J:

> "[6] Mr Wells, appearing behalf of GSL, says this: Mr Murray was instructed by GSL as a "deal consultant" to introduce a legitimate new mobile telephone deal to GSL. He was not employed as a company official, nor was he a director or employee or agent. He was not a controlling mind of GSL. There was no contract of employment. GSL had no employer control or sanction over Mr Murray. GSL itself kept overall control of the Transaction.
>
> [7] HMRC ascribe a rather fuller role to Mr Murray. Mr Foulkes appearing for HMRC says that there was no issue but that Mr Murray had been engaged by GSL to source and conduct the Transaction on its behalf. Although he provided the directors of GSL with some of the relevant documentation in respect of the Transaction, which had to be formally "signed off" by a director, the evidence demonstrated that the real responsibility for the deal lay with Mr Murray. The Tribunal would appear to have accepted that. This follows from the way in which they addressed the law. In considering the attribution of knowledge to a company, we find this at [20] of the Decision:
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> > "The context in which attribution is relevant is the application of *Kittel* where knowledge is critical to the VAT result. For

> this reason one would in principle attribute the knowledge of someone, whether an employee or not, dealing with a transaction in which *Kittel* is relevant, to the company engaged in the transaction. If such knowledge were not attributed to the company the directors could close their eyes to the fraud by leaving the transactions to employees."
>
> [8] Mr Murray was clearly seen by the Tribunal as "dealing with the transaction": see paragraphs 5(c) and (d) above. That the Tribunal then went on to consider the *Hampshire Land* exception for fraud (which I come to later) indicates that, but for that exception, they would have attributed the knowledge of Mr Murray to GSL. Thus at paragraph 34 of the Decision, the Tribunal identified the issue as being whether the *Hampshire Land* exception applied stating also that Mr Murray "was engaged by GSL to do all acts relating to the transaction short of signing the contracts"."

31. In the current appeal the taxpayer is not a company but a sole trader (Mr Stacey). That situation has been examined by this Tribunal in *Darren Leitch (trading as London Mobile Communications) v HMRC* [2012] UKFTT 229 (TC) where Judge Berner stated:

> "[11] … we are only concerned with the question of what Mr Leitch knew or should have known.
>
> [12] For a number of reasons it is important to note that in respect of the transactions that are the subject of this appeal Mr Leitch is a sole trader; the supplies giving rise to the claim for repayment of input tax were not made by a limited company. It is true, as we shall describe, that Mr Leitch also carried on business through a limited company, London Mobile Communications Limited ("LMC Ltd"), and that company was involved, as supplier of the relevant goods to LMC, in the deal chains, but it is his role as a sole trader that forms the context of these appeals.
>
> [13] This is, in our view, significant in determining the person or persons whose knowledge or means of knowledge must be determined. Were these appeals to have been made by a limited company, which cannot have any knowledge or means of knowledge in its own right, the question would arise as to what extent the knowledge of directors or employees of the company could be imputed to the company itself: see, for a recent example, *Revenue and Customs Commissioners v Greener Solutions Limited* [2012] UKUT 18 (TCC). Where the appellant is a sole trader, the ordinary rules of agency apply. In this case, as we shall describe, Matthew Sheridan, who worked for LMC on a self-employed basis, had authority to conclude, and did conclude, transactions on behalf of Mr Leitch. Only in certain cases, those involving traders with whom LMC had not previously dealt, particularly large deals or if credit was sought, did Mr Sheridan refer the transaction to Mr Leitch for approval. We are satisfied, therefore, that Mr Sheridan's knowledge and actions in relation to LMC may be attributed to Mr Leitch. That was the submission put for HMRC, and it was not disputed."

32. In both *Greener Solutions* and *Leitch* the person whose knowledge was attributed to the taxpayer was not an employee of the taxpayer, but instead a self-employed "consultant". I consider that where the person with knowledge of the connection to fraud is an employee of the taxpayer – here, Mr Davies – then the same result should follow *a fortiori*: in fact and by the ordinary rules of agency Mr Davies had authority to conclude the relevant transactions on behalf of Mr Stacey, and Mr Davies' knowledge about the fraudulent nature of those transactions must be attributed to Mr Stacey for the purposes of the *Kittel* test.

33. Mr Stacey does not contest that Mr Davies had actual knowledge that the relevant transactions were connected with VAT fraud. Accordingly, I do not consider that Mr Stacey would have any reasonable prospect of defeating HMRC's contention that the *Kittel* test is satisfied, with the result that his appeal would have no reasonable prospect of succeeding.

34. Tribunal Procedure Rule 8(3)(c) provides:

> "The Tribunal may strike out the whole or a part of the proceedings if … the Tribunal considers there is no reasonable prospect of the appellant's case, or part of it, succeeding."

35. A strike out on those grounds is not mandatory. The use of the word "may" in Rule 8(3)(c) confers a discretion on the Tribunal. Such discretion must be exercised in accordance with the overriding objective: "to deal with cases fairly and justly" (Rule 2(1)). On balance I consider that the proceedings should be struck out. I have taken into account that the sum in dispute is large, and that its non-recovery by Mr Stacey may prejudice the continuation of his business. Also, that Mr Stacey has maintained consistently both in these proceedings and his criminal trial that he was an innocent dupe in relation to the VAT fraud. However, I am satisfied that the particular circumstances of this case mean that it would not be in the interests of justice to require HMRC to defend an appeal that Mr Stacey has no reasonable prospect of successfully pursuing.

36. Accordingly, I conclude that the proceedings should be struck out under Tribunal Procedure Rule 8(3)(c).

Decision

37. The application is GRANTED and the proceedings are now STRUCK OUT.

38. 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.

PETER KEMPSTER

TRIBUNAL JUDGE

RELEASE DATE: 11 November 2014