[2016] UKFTT 687 (TC)

TC05416

Appeal number: TC/2014/03129

VALUE ADDED TAX – restriction of deduction of input tax under the "Kittel" principle – whether non-payment of VAT by associated company was fraudulent – whether inaccuracy in return was "deliberate" – paragraph 3 Schedule 24 Finance Act 2007 – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

VICTORIA WALK LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ASHLEY GREENBANK
SONIA GABLE

Sitting in public at Nottingham Justice Centre, Carrington Street, Nottingham on 12 and 13 April 2016

Nigel Gibbon of Nigel Gibbon & Co for the Appellant

Lucy Wilson-Barnes, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. These are appeals of the Appellant, Victoria Walk Limited ("**VWL**") against two decisions of the Respondents ("**HMRC**").

> (1) The first is a decision notified to VWL by an assessment dated 5 April 2013 and confirmed on review in a letter dated 30 April 2014 to deny the claims of VWL for input tax in the amount of £32,090 in its VAT return for the period ended 30 November 2012 (the "**11/12 period**").
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> (2) The second is the issue of a penalty assessment in the amount of £12,354 dated 24 June 2013 pursuant to schedule 24 Finance Act 2007.

2. The decision on input tax recovery and the penalty assessment relate to the same transactions. Those transactions are more particularly described at [54] to [60] below. We have referred to these transactions as the "intragroup transactions" in this decision. In summary, the intragroup transactions involve the provision of management and construction services by a connected company, Hanbeck Properties Limited ("**HPL**"), to VWL over the periods between 21 May 2008 and 20 November 2012, the charges for which are reflected in 12 invoices, all of which were dated 30 November 2012.

3. HMRC denied the input tax recovery claims in respect of those supplies in accordance with the principles set out in the decision of the Court of Justice of the European Union ("CJEU") in *Axel Kittel v. Belgium; Belgium v. Recolta Recycling SPRL* Case C-439/04 and Case C-440/04 [2006] ECR I-6161 ("***Kittel***") on the basis that VWL knew or should have known that its input tax claims were connected with a VAT loss and that that VAT loss was fraudulent.

4. HMRC also raised the penalty assessment on the basis that VWL had deliberately submitted an inaccurate return for the 11/12 period. A 90% reduction was applied to the penalty to reflect the quality of disclosure. The penalty was assessed at £12,354.65 being 38% of the potential lost revenue of £32,090.

The hearing and evidence

5. In advance of the hearing of the main issues, we heard applications from both HMRC and VWL to admit further documents in evidence. In the case of HMRC, its application related to a second witness statement from Mrs Amanda Pacey, an officer of HMRC, and an amended statement of case. In the case of VWL, its application related to documents concerning the liabilities of VWL for payments under the Construction Industry Scheme (to which we refer later in this decision) and some of the issues raised in Mrs Pacey's second witness statement.

6. There were no objections to either of the applications and we accepted the relevant documents in evidence.

7. For the main hearing, we were provided with an agreed bundle of documents. The documentary evidence included witness statements of Mrs Pacey and Mr Dean Baker, a director of, and shareholder in VWL. Mrs Pacey and Mr Baker both gave evidence and were cross-examined on their statements.

The facts

The companies

8. The appeal concerns two connected companies, HPL and VWL.

9. HPL was incorporated on 13 April 1993. At all material times, the sole shareholder in HPL was Mr Baker. Mr Baker was also the sole director of HPL.

10. VWL was incorporated on 7 August 2003. For most of the period with which we are concerned, VWL was a wholly-owned subsidiary of HPL. The shares in VWL were transferred to Mr Baker at some point in December 2012. Mr Baker was the sole director of VWL at all material times.

11. Although the two companies were connected, they were separately registered for VAT. No application was made for the two companies to be members of a VAT group.

The Millstream development

12. HPL was established by Mr Baker and carried on business as a property developer. In its early years, the company refurbished and renovated residential properties. As its business grew, HPL's business developed into that of a residential property developer buying small sites, developing them and selling the properties that it built. By 2003/4, HPL's turnover was approximately £400,000 and it employed a small permanent staff. The business was financed by funding provided in part by Barclays Bank.

13. In 2003, HPL acquired a parcel of land in Sleaford, Lincolnshire. It obtained planning permission for a mixed residential and commercial development on the site. This development is known as the "Millstream" development.

14. Financing for the project was obtained from Natwest Bank. The amount of the facility was initially £900,000. As part of the financing arrangements, HPL transferred its interest in the site to VWL, which at this time was its wholly-owned subsidiary. VWL also entered into an interest rate swap agreement with Natwest.

15. HPL and VWL entered into an agreement for HPL to provide management and construction services to VWL.

16. In May 2005, VWL made an election to waive the exemption from VAT in respect of the Millstream site.

17. The development of the Millstream site began in earnest in 2006. By mid-2007, the development was substantially complete, but the initial finance had been exhausted. Natwest agreed to make available a further £165,000 of funding to complete the work on the site, the first £100,000 of which was provided immediately. At the same time, it took a mortgage over the Millstream site for the full £1 million that it had provided by that time. The mortgage deed was signed on 8 June 2007.

18. The Millstream development was completed in October 2008. The final £65,000 of funding was drawn down on completion. VWL and Natwest entered into a second mortgage over the Millstream site for the further £65,000 on 6 November 2008.

19. At this stage VWL had tenants for most of the properties on the Millstream site. The rental income from those properties was sufficient to discharge VWL's liabilities under the mortgage from Natwest.

20. In the following paragraphs, we describe the business of HPL and the effects of the financial crisis on its business. Throughout this period, VWL continued to lease properties on the Millstream site to tenants. There were fewer upheavals in VWL's business in this period, but there were some important changes that we should record.

(1) First, as interest rates fell following the financial crisis in 2008, VWL became liable to make payments to Natwest under the interest rate swap agreement.

(2) Second, there were a number of tenant failures which affected the income from the commercial units. Mr Baker referred to a failure in 2009 and a further failure in 2010.

(3) Third, in 2010, VWL was involved in litigation concerning an allegation that part of the development on the Millstream site had encroached onto neighbouring land.

All of these events put pressure on the finances of VWL.

The business of HPL

21. The background to this appeal also requires us to focus on the business HPL and its troubles following the onset of the financial crisis in 2008.

22. We have recorded above, in 2003/2004, HPL was a small developer of residential properties. It had a turnover of approximately £400,000 and employed a small permanent staff including a bookkeeper on whom Mr Baker relied for tax and accounting compliance.

23. In 2007, HPL acquired a site known as "Timberland" for £235,000. It sought development financing from its usual bankers, Barclays.

24. For some reason, it took longer than usual to procure the development financing for the project. By this time, the prospects for the UK housing market were beginning to deteriorate. It was more difficult to obtain finance and the finance that HPL was

able to secure was subject to many more detailed conditions than had previously been the case.

25. It is from this point onwards that HPL began to experience significant financial difficulties. In his evidence, Mr Baker went into some detail on HPL's difficulties in selling completed developments and HPL's worsening relationship with its bankers. In late 2008, the financial pressure on HPL forced it to make redundancies. The staff made redundant included his bookkeeper.

26. We do not need to go into the detail of the difficulties experienced by HPL in this period. It is sufficient to record that it was under significant financial stress during 2009, 2010 and 2011. Barclays required HPL to renew its finances every six months and, although it did provide financial support to enable HPL to complete some of its properties, the conditions that it imposed became more and more onerous including taking security over previously completed developments. At this time, Mr Baker was doing much of the building work himself whilst also striving to keep the company afloat.

27. It is during this period that the payments made by VWL to HPL which are the subject of this appeal were made. We will come to the detail of those payments and the invoices that were issued in respect of them later in this decision. But it is useful to record that it is in this period, between 2008 and 2011, that the bulk of these payments were made.

28. In the following paragraphs, we have described certain specific issues which the business encountered in the period leading up to the submission of the VAT returns for HPL and VWL for the 11/12 period. We have dealt with them separately for ease of explanation, although the timings overlap and Mr Baker, on behalf of HPL and VWL, often had to deal with these issues concurrently.

Tax compliance issues

29. In this period, HPL and VWL's tax compliance (or lack of it) came to the attention of HMRC. We heard evidence of two particular enquiries: Mrs Pacey's enquiries into the VAT compliance of the two companies and the enquiries made by HMRC staff into the liabilities of HPL to account for PAYE income tax and national insurance contributions and its liabilities under the Construction Industry Scheme ("**CIS**").

(a) VAT enquiries

30. Mrs Pacey undertook a VAT enquiry into HPL in 2010. This enquiry was extended to VWL's position. She discovered that VWL had not submitted VAT returns since October 2008 (with the exception of one return in 2009). Mrs Pacey says that the only explanation that Mr Baker gave for VWL's failure to submit returns was that his bookmaker had been made redundant in 2008.

31. Mrs Pacey says that as part of her review of VWL's affairs she enquired about the status of the Millstream development and that she was told by Mr Baker that the company received rent from approximately ten domestic properties. Mrs Pacey says that Mr Baker deliberately misled her in this respect. She later discovered that an election to tax had been made in respect of the Millstream site in 2005 and that the development was a mixed residential and commercial development. She raised assessments on the company for unpaid VAT of £25,422. The assessment did not take into account any right of VWL to reclaim input tax on the intragroup supplies from HPL because, at the time, Mrs Pacey was not aware of the arrangements under which HPL provided services to VWL.

32. From the evidence that we have heard, we accept that Mr Baker did not disclose the existence of the commercial properties at the Millstream site when he was questioned by Mrs Pacey. Whether or not he deliberately intended to mislead Mrs Pacey is a separate question. On balance, we accept that Mr Baker was not as frank and open with Mrs Pacey as he could have been, but we doubt that he deliberately set out to mislead Mrs Pacey. It was clear from the documentation that was already in HMRC's possession including the application for VAT registration for VWL and the election to waive the exemption that there were commercial properties on the site. Mr Baker could not have hoped to gain any advantage from deceiving Mrs Pacey.

33. Notwithstanding this intervention, VWL continued not to file VAT returns until October 2012.

34. On 21 October 2012, it filed returns for the 05/12 and 08/12 periods. On 22 October 2012, it filed returns for the 05/11, 08/11, 11/11, and 02/12 periods. On 12 November 2012, it filed returns for the 11/09, 02/10, 05/10, 08/10, 11/10 and 02/11 periods. None of those returns reflected the input tax on the intragroup supplies from HPL. The return for the 11/12 period, which included the claim for the input tax on the intragroup services, was filed on 23 December 2012.

35. HPL continued to file its returns throughout. However, those returns did not reflect the output tax on the intragroup transactions. The VAT return for the 11/12 period was filed on 17 January 2013.

(b) CIS and PAYE enquiries

36. As part of Mrs Pacey's enquiry into the VAT affairs of the companies, she asked her colleagues at HMRC to review HPL's PAYE income tax and CIS compliance. Once again, Mrs Pacey says that Mr Baker deliberately misled her by saying that HPL did not engage any employees or contractors. It was subsequently discovered that HPL did have liabilities for PAYE and under the CIS scheme.

37. The enquiry into the PAYE compliance of HPL was led by Mr Mike Hale of HMRC in Lincoln. He concluded his enquiry in late 2011. The evidence suggests that HPL and Mr Baker co-operated fully with this enquiry.

38. On 9 November 2011, Mr Hale wrote to HPL to set out the conclusions of his enquiry. By an agreement dated 19 June 2012, HPL agreed to pay an aggregate amount of £9,313.53 to settle the PAYE and national insurance liabilities of HPL in seven instalments.

39. There was a separate issue in relation to penalties under the CIS. The details of the matter are not directly relevant to the matters before the Tribunal. However, it would appear that, at some point before October 2008, HPL had registered to make on-line returns under the CIS. Mr Baker was initially unaware of this, as the matter had been dealt with by the bookkeeper. However, the issue became apparent soon after his bookkeeper was made redundant, as HPL became liable to penalties under the CIS and began to receive penalty notices, even for periods in which it did not engage any sub-contractors.

40. Mr Baker raised the issue of the penalty notices with Mr Hale. Mr Hale advised Mr Baker to contact other offices within HMRC in order to prevent penalties under the CIS from continuing to accrue. Mr Baker attempted to do so on various occasions. We do not need to record the correspondence in detail. It is sufficient to say that Mr Baker was passed from one HMRC office to another as part of the correspondence. The result was that HPL was not regarded at any point as having properly appealed against the penalty notices nor as having properly applied to suspend them – notwithstanding the fact that Mr Baker had sent several letters which, although not technically worded, made it clear that HPL wished to contest the liabilities.

41. The rights and wrongs of the issues surrounding the CIS penalties are not a matter for this Tribunal. We can, however, understand Mr Baker's frustration at the manner in which he was treated by HMRC. The correspondence culminated with a letter dated 23 October 2012 from HMRC to HPL in which HMRC demanded payment of an amount of £76,212.41. This amount was made up of a mixture of PAYE and CIS penalties, an amount in respect of alleged underpayments of PAYE and some amounts of interest. However, the vast majority comprised fixed penalties under CIS regime for failure to file monthly returns for periods ending between 5 June 2009 and 5 August 2012 (which would have shown no liability). The letter stated that if no action was taken by HPL within seven days, HMRC would take steps to wind up the company.

42. Mr Baker sought to make contact with HMRC after receipt of that letter. When he did so, questions were raised about whether or not an effective appeal had already been made. In a letter dated 20 November 2012 to HPL, HMRC stated that no record of HPL's appeal against the liabilities had been received. In a letter dated 29 November 2012, HMRC demanded payment of £76,657.58 within seven days failing which HMRC would take steps to put the company into liquidation.

43. On 4 December 2012, Mr Baker responded to the letter of 29 November, expressing his frustration at the process. In that letter, Mr Baker noted that he had informed HMRC that HPL had no liabilities under the CIS and had requested a suspension of returns and penalty notices. He referred to his discussions with other

departments within HMRC and to the letter of 20 November 2012 stating that there was no trace of HPL's appeal.

44. On 24 December 2012, Mr Edwards of HMRC (Debt Management) wrote to Mr Baker. He noted that HPL had been attempting to appeal against the CIS penalties but said that "I am unable to assist in this matter". The letter proceeded to suggest that if HPL could pay the non-penalty amounts comprised in the notice by 11 January 2013, Mr Edwards would consider allowing HPL further time to make its appeals to the relevant HMRC office. The letter concluded "however, if the non-penalty debts are not paid in full by 11 January 2013, then the winding up action referred to in my letter of 29 November 2012 will continue".

45. HPL did not pay the non-penalty amounts. The winding up of HPL commenced on 8 March 2013.

HPL's relationship with Barclays

46. As we have described at [24] to [26] above, the company's relationship with its main bankers, Barclays, became increasingly strained after 2008. Matters came to a head in 2012. By this stage, HPL had been able to sell one property, but Barclays were asking HPL to take steps to sell more of the properties and in particular the properties at Timberland. Mr Baker put alternative proposals to Barclays with the aim of avoiding a forced sale of the properties at low prices.

47. In summer 2012, Barclays introduced Mr Baker to Begbies Traynor ("**Begbies**"), a firm of corporate recovery and insolvency consultants.

48. Begbies produced a report in October 2012 for the benefit of HPL and Barclays, which set out various proposals for the restructuring of the business. The main findings of the report were as follows.

> (1) In balance sheet terms, HPL was insolvent. HPL held two investment properties on the Timberland site. They were valued at £325,000. The company had bank debt of £484,000 secured on the properties. In addition, HPL owned a lease of its own offices. HPL had bank debt of £168,000 in relation to the office premises. The office premises were valued at £125,000.
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> (2) HPL's projected cash flow showed that it funds available to service at least part of its debts.

49. The Begbies' report canvassed various alternative courses of action including sales of assets, a write down of existing debt and possible insolvency procedures. It concluded that the preferred approach was for HPL to sell the remaining plots on the Timberland site "without delay". The proceeds would be used to repay in part the Timberland debt. The balance of the company's debts should then be written down to an amount which could realistically be serviced by HPL from its cash flow.

50. Mr Baker says that, as part of the discussion with Begbies during the preparation of the report, Begbies advised him to address some of the compliance failures of the companies. This included the issue of the VAT invoices in respect of the intragroup transactions. Mr Baker also says that he was advised by Begbies that HPL should transfer the shares in VWL to Mr Baker. This transfer took place at some point in December 2012. We discuss these issues later in this decision.

51. Mr Baker did not immediately accept the recommendations in the report. He took advice from his accountants who were equally sceptical of Barclays' motives. Mr Baker was still considering the proposals in the report in December 2012 when he came under further pressure from Barclays to reach a decision about them. It was agreed that Mr Baker would consider the proposals over the Christmas period and let Barclays have his views on the proposals.

52. The precise timing of the next steps in this saga is not clear. Mr Baker did not respond to Barclays in the New Year regarding the proposals in the Begbies report. Mr Baker records the next event as being when he was informed that HPL's current account had gone into the red towards the end of January 2013. The deficit was caused by the debiting from the account of interest that had accrued on HPL's facilities with Barclays. This followed the refusal of Barclays to renew the company's banking facilities.

53. The withdrawal of the company's banking facilities made it impossible for HPL to continue trading. It went into liquidation on 8 March 2013.

The VAT returns for the 11/12 period

54. At this point, we will return to the issues surrounding the intragroup transactions and their VAT treatment.

55. Even though the payments were made for the intragroup transactions, no invoices were issued by HPL at the time of the payments. Furthermore, notwithstanding Mrs Pacey's intervention, VWL continued not to file VAT returns until 2012. On 21 October 2012, 22 October 2012 and 12 November 2012, VWL filed its returns for missing periods, but even at this stage, the returns did not reflect the input tax on the intragroup supplies from HPL. HPL continued to file its quarterly VAT returns, but they did not reflect output tax on the intragroup transactions.

56. On 30 November 2012, HPL issued 12 VAT invoices to VWL in respect of the intragroup transactions. These are the invoices to which this appeal relates. Mr Baker says that the reason that the invoices were issued at the same time was that, as part of the discussions with Begbies during the preparation of their report, Begbies suggested to him that it was necessary properly to document the payments that had been made and continued to be made by VWL to HPL for intragroup services. The reason for this, Mr Baker says, was that Begbies were concerned that the payments might be regarded as loans made by VWL to HPL which HPL might be required to repay.

57. Details of the invoices are set out in the table below:

Invoice no.	Details	Net	VAT	Gross
101956	Construction Work Shop 4	£54,600.00	£10,920.00	£65,520.00
101957	Management Services	£18,567.21	£3,713.44	£22,280.65
101958	Recharge items	£8,352.50	£1,670.50	£10,023.00
101959	Recharge items	£7,068.36	£1,413.67	£8,482.03
101960	Management Services	£7,220.83	£1,444.17	£8,665.00
101961	Management Services	£4,696.60	£939.32	£5,635.92
101962	Management Services	£11,724.29	£2,344.86	£14,069.15
101963	Management Services	£5,175.00	£1,035.00	£6,210.00
101964	Management Services	£8,961.15	£1,792.23	£10,753.38
101966	Management Services	£8,766.67	£1,753.33	£10,520.00
101967	Management Services	£13,379.17	£2,675.83	£16,055.00
101968	Maintenance Construction Work	£10,552.91	£2,110.58	£12,663.49
		£159,064.69	**£31,812.93**	**£190,877.62**

58. The invoices related to payments which had been made by VWL between 21 May 2008 and 20 November 2012. Details of the dates of the relevant payments are set out in the Appendix to this decision.

59. These details are drawn from the companies' records, bank statements and other evidence provided to the Tribunal. There were some gaps in that evidence, but HMRC has not sought to question whether or not the payments were made. On the balance of the evidence, we find as a fact that the payments were made in the amounts and on the dates set out in the Appendix.

60. In addition, HMRC has not sought to question, before this Tribunal, the nature of the services provided by HPL to VWL in respect of which the payments were made. On the basis of the evidence before us, we find, as a fact, that the payments were made in respect of genuine management and construction services as set out in the descriptions set out in the relevant invoices and summarized in the Appendix.

61. On 23 December 2012, HMRC received the VAT return of VWL for the 11/12 period. The return included a claim for repayment of input tax in the amount for £32,090. As can be seen from the table above, this amount is slightly in excess of the correct figure for the input tax incurred on the transactions, which was £31,812.93.

62. On 8 January 2013, HMRC wrote to VWL to inform VWL that its return was being reviewed.

63. On 17 January 2013, HPL submitted its return for the 11/12 period. The return showed output tax due of £35,226.30. This amount included the output tax on the intragroup transactions. HPL did not account for the VAT due.

The events of late 2012 and early 2013

64. The events of the end of 2012 and the beginning of 2013 are the crux of this case. We have described separately the various strands that comprised the chain of events that culminated in the winding up of HPL. To recap, in summary, and against the background of the continuing discussions with Barclays:

(1) on 29 November 2012, HMRC (Enforcement and Insolvency), wrote to HPL giving notice that, if payment was not made within seven days, HMRC would petition the court to wind up the company;

(2) on 30 November 2012, HPL issued the 12 invoices in relation to the intragroup transactions to VWL;

(3) on 4 December 2012, Mr Baker wrote to HMRC acknowledging receipt of the letter of 29 November 2012 and informing HMRC that HPL wished to appeal against the penalties;

(4) on 23 December 2012, VWL submitted its VAT return for the 11/12 period claiming to recover input tax of £32,090;

(5) on 24 December 2012, HMRC (Debt Management) wrote to HPL suggesting that if HPL could pay the non-penalty amounts comprised in the notice by 11 January 2013, HMRC might allow additional time for HPL to appeal against the penalties;

(6) on 8 January 2013, HMRC wrote to VWL to inform VWL that its VAT return for the 11/12 period was under review;

(7) On 17 January 2013, HPL submitted its return for the 11/12 period. It did not account for the VAT due.

65. As we have described above, at the end of January 2013, Barclays withdrew funding from HPL. At that stage, HPL could not continue trading.

66. On 1 February 2013, HMRC (Local Compliance, Lincoln) wrote to VWL to request a visit to check VWL's VAT records

67. On 6 February 2013, HMRC petitioned the court to wind-up HPL.

68. On 12 February 2013, Mr Baker met Mrs Pacey at the Lincoln tax office to review the 11/12 VAT return for VWL. At this meeting, Mr Baker produced records including the invoices for the majority of the input tax claimed in the return. Mrs Pacey was not aware of the imminent winding-up of HPL. Mr Baker did not mention the fact that HPL was in the process of going into liquidation.

69. On 14 February 2013, HMRC served the winding up petition on HPL. The notice for the creditors meeting was issued on 15 February 2013.

70. On 8 March 2013, the creditors' meeting of HPL was held. HPL was put into creditors' voluntary liquidation. The statement of liabilities, which was signed by Mr Baker, included amounts in respect of the CIS penalties and some PAYE and national insurance liabilities. It did not include any reference to the VAT in respect of the 11/12 period.

71. Mrs Pacey remained unaware of the liquidation process in relation to HPL. She continued her enquiries into the VAT return of VWL for the 11/12 period. On 5 April 2013, Mrs Pacey issued an assessment letter denying the input tax credit for the intragroup transactions on the grounds that there was insufficient evidence to support the claim for input tax. As we have mentioned above, HMRC does not rely on these grounds before the Tribunal.

72. Once she became aware of the status of HPL, Mrs Pacey issued a further letter to VWL on 17 May 2013. In that letter, she stated that the input tax recovery would be denied in accordance with the *Kittel* principle.

73. On 21 May 2013, Mrs Pacey issued a penalty explanation letter to VWL. She issued a penalty assessment on 24 June 2013. That assessment raised penalties on VWL in the amount of £12,354 on the basis that VWL had deliberately submitted an inaccurate return for the 11/12 period. The assessment allowed a 90% reduction for the quality of disclosure. The penalty was assessed at 38% of the potential lost revenue of £32,090.

74. Mr Baker subsequently engaged a VAT consultant, Mr Les Howard. Mrs Pacey met Mr Baker and Mr Howard on 5 August 2013. At that meeting, Mr Howard pointed out that the claim for input tax in the VAT return for the 11/12 period of VWL should be reduced to reflect the fact that the input tax claimed by the company was attributable to both taxable and exempt supplies.

75. On 14 October 2013, HMRC received a letter from Mr Howard including revised calculations, which reduced the input tax claim to £18,561.

76. On 11 November 2013, Mrs Pacey wrote to Mr Howard. In her letter, she accepted the reduction to the input tax claimed by VWL but refused to make any adjustment until the corresponding output tax had been brought into account by HPL.

77. Following a request for a review of the decisions, the decisions were upheld.

Issues for the Tribunal

78. There are two issues before the Tribunal.

> (1) The first is whether VWL is entitled to deduct input tax in its VAT return for the 11/12 period in respect of the relevant transactions.

(2) The second is whether VWL deliberately submitted an inaccurate return for the 11/12 period and so should be subject to the penalty imposed by HMRC.

Input tax deductibility

The law

79. The rules which govern the entitlement of a tax payer to credit for input tax are set out in sections 24, 25 and 26 VATA 1994. This appeal, however, does not turn on the wording of those sections. HMRC does not seek to rely on any question regarding the sufficiency of evidence to support the input tax claims. Instead, HMRC claims that it is entitled to refuse the claims for repayment of input tax in this case on the basis of the application of the principle in the *Kittel* case.

80. In its decision in the *Kittel* case, the CJEU said at paragraphs [55] to [61]:

> "54. As the court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see *Gemeente Leusden v Staatssecretaris van Financien* (Cases C-487/01 and C-7/02), [2004] ECR I-5337, paragraph 76). Community law cannot be relied on for abusive or fraudulent ends (see, inter alia, *Kefalas v Greece and OAE* (Case C-367/96) [1998] ECR I-2843, paragraph 20; *Diamantis v Greece* (Case C-373/97) [2000] ECR I-1705, paragraph 33; and *I/S Fini H v Skatteministeriet* (Case C-32/03), [2005] ECR I-1599, paragraph 32).
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> 55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, *Rompelman v Minister van Financiën* (Case 268/83) [1985] ECR 655, paragraph 24; *Intercommunale voor Zeewaterontzilting (in liquidation) v Belgium* (Case C-110/94), [1996] ECR I-857, paragraph 24; and *Gabalfrisa* (paragraph 46)). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see *Fini H* (paragraph 34)).
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> 56. In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
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> 57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
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> 58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.
>
> 59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.

60. It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, art 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void—by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller—causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

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."

81. The so-called *Kittel* principle is summarized in paragraph [61] of the judgment of the CJEU. The main elements of the principle are that a taxpayer's right to recover input tax can be refused where:

(1) there was a fraudulent evasion of VAT by another person;

(2) the supply in question was connected with the fraudulent evasion of VAT; and

(3) the recipient of the supply knew or should have known that, by his purchase, he was participating in the fraudulent evasion of VAT.

82. As regards the level of knowledge required by the recipient of the supply, the *Kittel* principle has been clarified by the Court of Appeal in the case of *Mobilx Limited (in administration) v Revenue and Customs Commissioners* [2010] EWCA Civ 517. In that case, Moses LJ said at [59] and [60]:

"[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."

83. In this case, HPL has clearly made a VAT loss. VWL did not seek to argue that the intragroup transactions were not connected with that loss. Nor did VWL seek to argue that its knowledge of the loss was in any way different from that of HPL.

Given that Mr Baker was the sole director of both companies that was hardly surprising. Instead, the arguments in this case focussed on whether or not the VAT loss suffered by HPL was "fraudulent".

84. The relevant test of whether the non-payment of VAT by HPL was fraudulent and of whether Mr Baker has been dishonest, is first whether his conduct was dishonest "according to the ordinary standards of reasonable and honest people" and secondly whether "he himself must have realized what he was doing was by those standards dishonest" (see the decision of the Court of Appeal in ***R v Ghosh*** [1982] 1 QB 1053).

85. It is also clear that the burden of proof, to the civil standard of the balance of probability, falls on HMRC when it alleges fraud.

HMRC's arguments

86. Mrs Wilson-Barnes makes the following points for HMRC.

87. Mrs Wilson-Barnes says that it is not necessary for HMRC to show that there was a coherent plan that resulted in a VAT loss. She referred to the decision of the First-tier Tribunal in *Medallion Europe Limited v HMRC* [2015] UKFTT 406 (TC) in this respect and in particular to the finding of fact at [22] in that case that there was no scheme to avoid VAT.

88. There was a VAT loss. HPL failed to account for output tax. That loss was fraudulent. HPL failed to make returns and to account for VAT for over 4 years. It only decided to declare the output tax at a time when it knew or should have known that it would not be able to pay the output tax.

89. VWL's claim for repayment of input tax was connected to that loss. The position was not neutral. The input tax recovery claim would only ever have reduced VWL's own liability. It would not itself produce cash which VWL could have used to lend to HPL to allow it to pay the output tax.

90. There was no credible explanation for the failure to issue the invoices and account for the output tax in relation to the intragroup transactions over the 4 year period.

91. Equally, there was no innocent explanation for the timing of the issue of the invoices and the declaration of the output tax.

> (1) There was no independent evidence that Begbies had advised Mr Baker to tidy up the affairs of the companies by issuing the invoices and completing the VAT returns.
>
> (2) At the time of the issue of the invoices, HPL knew that it could not pay the VAT. It was clear that HPL would be forced into liquidation as a result of the CIS and PAYE penalties.

(3) HPL was on notice that it would be forced into liquidation as a result of the issue of the seven day letters by HMRC.

(4) Mr Baker was well aware of the difficulties that he was having in negotiating a package with the banks to refinance HPL. It was unsurprising therefore that its credit facilities were not extended when the accrued interest was debited from its account.

92. Mr Baker's real aim in processing the invoices at the time at which he did was to preserve VWL. The input tax claim was designed to improve the finances of VWL, whilst at the same time to allow HPL to go into liquidation.

93. The other circumstances of the case showed that the failure of the company to account for VAT over time could not be regarded simply as a result of haphazard administration. It was systematic: the companies had failed to account for CIS payments and PAYE; the companies had failed to make returns for and account for VAT; Mr Baker had deliberately misled HMRC (and in particular Mrs Pacey) when HMRC made its enquiries.

VWL's arguments

94. Mr Gibbon makes the following points for VWL.

95. HPL did make a VAT loss, but it was not fraudulent.

96. HPL should have included the output tax for the intragroup transactions in its VAT returns for the relevant periods. It should have accounted for VAT at the time. However, the other side of the transaction was that VWL did not claim the rights to deduct input tax in those periods. The position was neutral. It should be contrasted with the position of the taxpayers in the *Medallion Europe* case, on which HMRC relied.

97. There was no evidence of a contrived scheme to avoid VAT. The loss of VAT was suffered purely as a result of the liquidation of HPL.

98. Mr Baker has concentrated on what he regarded as the "real work". He did not pay sufficient attention to the administration of the business. He knew or should have known that the companies needed to file their VAT returns. However, in the past, that work had been done by his bookkeeper on whom Mr Baker relied. Mr Baker regarded the submission of VAT returns as an administrative act. It was correct that he did not have a reasonable excuse for his failure to file those returns which would provide mitigation for any penalty that was imposed. However, that did not mean that his conduct was dishonest or fraudulent.

99. As regards the meetings with Mrs Pacey, there had been a misunderstanding. It was always clear that the Millstream site was a mixed commercial and residential development. The documents were clear in this respect. There would have been no reason for VWL to elect to waive the exemption from VAT if the development did not include commercial properties.

100. As regards timing of the invoices, it was not possible to say that Mr Baker was dishonest. He had processed the invoices because it was a requirement of Begbies that the paperwork should be sorted out. Even at this late stage, there was no contrived scheme to avoid VAT. Mr Baker was still fighting to save both companies. It was only when Barclays refused to refinance the businesses that it became clear that HPL would go into liquidation.

Discussion

101. We have found this to be a difficult case.

102. There is no disagreement between the parties that HPL should have issued invoices and accounted for VAT at the time at which the supplies were made, being the time at which the services were performed or payment was made. If HPL had done so, VWL would have been entitled to recover the input tax incurred to the extent that that input tax was attributable to taxable supplies.

103. HPL did not issue invoices or account for the output tax at the time at which the supplies were made. Instead, it issued the invoices in November 2012 and went into liquidation without having accounted for the output tax. The issue before us is whether or not the failure to account for that VAT was fraudulent and whether the claim by VWL to recover the corresponding input tax on the intragroup transactions was vitiated by fraud under the *Kittel* principle.

104. There is, however, a preliminary question on the application of the *Kittel* principle which became relevant as part of the arguments of the parties on the question of whether the VAT loss was or was not fraudulent. This is the time at which the level of knowledge of the recipient should be tested.

105. In its judgment in *Kittel*, the CJEU states the principle can apply where the recipient of the supply knew or should have known "by his purchase" that his transaction was connected to a fraudulent loss of VAT (see [61] of the CJEU's judgment). In his restatement of the principle in *Mobilx*, Moses LJ refers to the knowledge of the recipient being tested by reference to "the circumstances which surround [the] transactions" (at [59] of his judgment) and "the circumstances in which his purchase took place" (at [60] of his judgment).

106. These statements suggest that the relevant time at which the knowledge of the recipient of the supply should be tested is the time at which the transaction took place, being the time at which the right to recover the input tax arose.

107. There are good reasons for this. As Moses LJ describes in his judgment in *Mobilx*, the right to deduct input tax is integral to the system of VAT "because it ensures the principle of fiscal neutrality which lies at the heart of the system of VAT" (see [26] of his judgment).

108. Furthermore, the right to deduct input tax arises as soon as the taxpayer pays the input tax to the supplier. As Moses LJ explains at [28] in *Mobilx*:

> "[28] Since the right to deduct is fundamental to the system of VAT because it ensures that the charge is limited to the value added at each stage of the supply and because it ensures fiscal neutrality, it may not, in principle, be limited; any derogation from the principle of the right to deduct tax must be interpreted strictly (see *Magoora sp zoo v Dyrektor Izby Skarbowej w Krakowie* (Case C-414/07) [2008] ECR I-10921). Moreover, the right must be exercisable immediately in respect of all taxes charged on input transactions. Since the right arises immediately the taxable person pays tax (input tax) to his supplier, the principle of legal certainty demands that he knows when he enters into the transaction that it is within the scope of the tax and that his liability will be limited to the amount by which any output tax he may be liable to pay, on making a supply, exceeds the input tax he has paid. The objective criteria determine both the scope of the tax and the circumstances in which the right to deduct arises."

109. It follows that the right of an innocent third party to deduct input tax cannot be vitiated by fraud of the supplier or another person in the supply chain where he or she is not aware and could not have been aware of any connection to the fraud at the time of the transaction, even if he or she subsequently becomes aware of the connection to fraud.

110. The *Kittel* case and the *Mobilx* case are examples of what is known as missing trader intra-community ("**MTIC**") fraud. In these cases, there is typically no connection between the supplier and the recipient of the supply other than the series of transactions in which they are involved. It is therefore entirely consistent with the principle of fiscal neutrality and legal certainty that the question of whether a recipient of the supply should be regarded as a participant in the fraud (and so not entitled to deduct input tax) should be determined at the time of the transaction when the right to deduct input tax arose.

111. It was accepted by the parties that the *Kittel* principle is capable of being applied outside the context of an MTIC fraud case and the argument proceeded on that basis. But, there is, of course, a material difference between this case and the MTIC fraud cases in that, in this case, the two parties are connected and are controlled by the same person.

112. Does the same reasoning apply where there is a connection between the parties other than the transactions in which they are involved? In our view it does not. As Moses LJ explains in his judgment in *Mobilx* (see [30] et seq), the *Kittel* principle is an extension of the basic principle that a person who is engaged in fraud cannot establish that the objective criteria which determine the scope of VAT and the right to deduct input tax have been met. The CJEU in *Kittel* simply extended the basic principle, beyond the person engaged in the evasion of VAT, to persons who knew or should have known that they were taking part in a transaction connected with the fraudulent evasion of VAT (see *Mobilx* at [41] and *Kittel* at [56] to [59]).

113. The statements of that principle (in *Mobilx* and *Kittel*) are referring to persons who, absent the extension of the basic principle, would otherwise be entitled to claim to recover the input tax. Where the two parties to the transaction in question are intimately connected – as in this case, where HPL and VWL are both ultimately owned by the same person and have the same director – the knowledge and motives

of one cannot sensibly be distinguished from the other. If at any stage in the transactions or their reporting, one of them is engaged in conduct which would be regarded as the fraudulent evasion of VAT (which might vitiate its rights under the VAT system), the other must equally be regarded as being so engaged. That is not so much an application of the *Kittel* extension to the basic principle, but of the basic principle itself.

114. The arguments have been put to us in stark terms.

115. Although in making her submissions Mrs Wilson-Barnes argued that HMRC was not required to show that there was from the outset a coordinated plan on the part of HPL and VWL to defraud HMRC of the output tax on the intragroup transactions, HMRC's position was that VWL and HPL, in the form of Mr Baker, have not been honest and open with HMRC throughout. HMRC points to the discussions with Mrs Pacey in this respect. The inference that we were invited to draw appeared to be that HPL and VWL were indeed, from the outset, engaged in a plan to defraud HMRC of the output tax on the intragroup transactions.

116. On the other hand, VWL's position has been that, throughout the process, Mr Baker (and so VWL and HPL) have acted with integrity. Its position is that the claims for input tax by VWL were honestly and validly made and that the fact that HPL did not account for the corresponding output tax was an unfortunate consequence of the liquidation of HPL, which was caused by Barclays' refusal to renew the bank facilities for HPL in January 2013.

117. In our view, it is instructive to consider the facts at various stages in the timeline.

118. We start with the time at which the payments were made.

119. As we have noted above, we have found as a fact that the payments were made on the dates set out in the Appendix and that those payments were made in respect of supplies of services made by HPL to VWL. The payments for the intragroup transactions were made in a period between May 2008 and November 2012. Those payments included amounts in respect of VAT.

120. It is clear to us, and we find as a fact, that at the time at which the payments were first made, there was no coordinated plan to avoid VAT.

121. The first point that we take into account in this respect is that, as we have found, the payments (including the VAT) were made by VWL to HPL. If there had been a fraudulent plan throughout to arrange affairs such that VWL would be preserved but HPL would be allowed to go into liquidation owing amounts to its creditors (including HMRC), there would have been little incentive for VWL to continue to make payments to HPL, a company which it knew was in financial difficulty.

122. Secondly, the payments were made over a period of more than four years. It is not realistic to think that a coordinated plan could have been conceived under which the claims for input tax were deferred over such a period on the assumption that a

benefit would be obtained by putting HPL into liquidation having failed to pay the corresponding output tax at the end of that period. This is particularly the case given that the payments were subject to enquiries by HMRC part of the way through this period.

123. Finally, this is not a case in which the taxpayer (VWL) claimed the benefit of the recovery of input tax whilst the supplier (HPL) did not account for the corresponding output tax. Throughout the period of four or more years prior to that date HPL did not account for the output tax but VWL did not seek to reclaim the input tax. The facts in this case are, in this respect, materially different from those in the *Medallion Europe* case, on which HMRC relied.

124. That having been said, we do not agree with Mr Gibbon's submission that at this stage the position was neutral. VWL would not have been entitled to recover all of the input tax even if it had made the claim at the time at which the supplies were made. This is because part of the input tax was attributable to exempt supplies made by VWL as later pointed out by Mr Howard and accepted by HMRC. In the circumstances, however, we accept that Mr Baker did not at the time appreciate this particular aspect of the VAT regime.

125. There follows a lengthy period during which VWL failed to make returns for VAT except when prompted by Mrs Pacey's enquiries and HPL's returns did not reflect the VAT on the payments received from VWL. HMRC seeks to characterize these failings as further evidence of dishonest behaviour on the part of Mr Baker whereas the Appellant describes these lapses as a failure on the part of Mr Baker – perhaps careless, but not dishonest – to pay appropriate attention to the administration of the businesses.

126. On balance, during this period, we accept Mr Baker's explanation that during this period he simply got on with what he regarded as "the real work" and did not prioritize dealing with the tax compliance issues. That may be understandable given the pressures that Mr Baker was under at the time. However, his almost complete disregard of the tax compliance aspects cannot but reflect badly on Mr Baker. He is an experienced businessman. He was well aware of the compliance obligations of VWL and HPL.

127. The next important milestone in the facts of this case is 30 November 2012. On this date, HPL issued the invoices for the intragroup transactions. At this stage, there was a clearly a risk that HPL may default in accounting for any output tax due in respect of the transactions. HPL's financial position was perilous: its bankers, Barclays, had been pressing Mr Baker to take steps to realize its assets and pay off some of the company's debts; Barclays had asked Begbies to work with Mr Baker to put together a plan for restructuring HPL's business; HPL's financing arrangements were due for renewal in January 2013 and without the approval of Barclays to reschedule its debts the company would be insolvent; and, even if HPL had not yet received the seven day notice that was issued on 29 November 2012, Mr Baker was well aware that HMRC was demanding payment of the CIS penalties.

128. Mr Baker says that, at this time, he believed that HPL would be able to meet its debts and pay the VAT.

(1) He believed that Barclays would reschedule HPL's debts in January 2013. It had done so before and there was no reason to believe that it would not do so again. Although Barclays had appointed Begbies to consider the options for restructuring the business of HPL, which included a liquidation of HPL, the Begbies' report had recommended a series of steps to preserve the business and put the finances of HPL on a more sustainable basis. He had no reason at that time to believe that Barclays would not follow the recommendation of Begbies.

(2) The company had received demands from HMRC for CIS and PAYE liabilities, but he believed that he had reached agreement with Mr Hale and that the liability was much lower than that specified in the notice.

(3) The issue of the invoices and the making of the VAT returns in respect of the intragroup transactions were simply part of a process of putting the affairs of the companies in order as recommended by Begbies. The repayment of the VAT to VWL would indirectly finance the payment of VAT by HPL.

129. As regards the financial position of HPL, the Begbies' report showed that HPL was unable to meet its debts without a significant restructuring. There was no assurance that Barclays would accept the report and continue to finance the company. On the other hand, Begbies had recommended an approach which could have resulted in Barclays continuing to support HPL. On this point, Mr Baker's belief that Barclays might extend its financing for the company might have been optimistic, but it was not entirely fanciful.

130. The position in relation to the CIS and PAYE liabilities appears at this point to be more critical. Mrs Wilson-Barnes submitted that the statement of affairs which was signed by Mr Baker on 8 March 2013 in connection with the winding-up of HPL is evidence that HPL acknowledged all along that the vast majority of the CIS penalties were properly payable. That statement shows liabilities for CIS penalties to be taken into account in the liquidation of HPL in the amount of £55,818. In his evidence, Mr Baker contested that assertion. He pointed out that, at this stage, the company was in insolvent liquidation and under the control of the liquidator. In short, he had lost his battle to preserve HPL and there was nothing to be gained in contesting the amount of the CIS liabilities. On this point, we accept Mr Baker's evidence. Although he may have failed to respond to certain letters and notices from HMRC, it is clear that throughout Mr Baker consistently contested the vast majority of the CIS penalties.

131. Even so, and even before the receipt of the letter of 29 November 2012, HPL must have been aware that there was a serious risk that HMRC would take action to wind-up the company in order to pursue the CIS penalties. Mr Baker says that he assumed that the agreement between HPL and HMRC in relation to the PAYE and national insurance liabilities of HPL was sufficient to deal with the company's liabilities under the CIS. As a result, HPL did not respond to the penalty notices

which continued to be issued by HMRC because he understood that all such matters had been agreed following the enquiry by Mr Hale. Even if that was Mr Baker's honest belief at the time, on the evidence, in our view, it was not a reasonable one for him to hold. Mr Hale always made it clear that the remission of the penalties under the CIS was not within his remit. Mr Hale did, however, agree to contact other members of HMRC, which he did. He also advised Mr Baker on where to address his concerns. We have some sympathy for Mr Baker in this respect. He was passed from "pillar to post" within HMRC, but it must have been clear to him that this issue was far from being resolved by 30 November 2012.

132. HMRC also points to the fact that all of the invoices were processed at the same time and questions the reasons for the issue of the invoices at this particular time. It says there is no independent evidence of the request by Begbies for the VAT affairs of the companies to put into better order. That is true, but, on balance, we accept Mr Baker's explanation that he had been told by Begbies to put the affairs of the businesses in order. The completion of the VAT returns of VWL in October 2012 at the time of the preparation of the Begbies report and the issue of the invoices are consistent with that explanation. However, we do not accept that Begbies specifically told Mr Baker to issue the invoices.

133. This brings us to final part of this saga namely when VWL submits its return to recover the input tax on 23 December 2012.

134. At this stage, which is less than a month after the issue of the invoices, there remains a real and material risk that HPL will default in the payment of the output tax. We infer from the facts that Mr Baker must have known that at this stage. By this time, Mr Baker had received the letter of 29 November 2012 in which HMRC threatened to commence action to wind-up HPL within days. He had responded to that letter, but had not received any indication that an appeal would be accepted. In addition, Mr Baker had not received any response from Barclays to confirm that HPL's debts would be rescheduled or that the Begbies' recommendation would be accepted. We accept that he was still working to preserve both of the businesses. But, in our view, the steps that he then took are consistent with an approach that was designed to hedge his bets and ensure that, if HPL did go into liquidation, there was a reasonable prospect that VWL would survive.

135. Mr Baker submitted the VAT return for VWL for the 11/12 period on 23 December 2012 in advance of the date required for submission. He did not submit the return for HPL for the same period until 17 January, after the due date and after he knew that VWL's return was under enquiry. In the circumstances, Mr Baker does what any businessman would do in relation to his commercial debts. He seeks to collect in the debts due to him before then dealing with his creditors. The question is whether that approach, while understandable, is one that can be legitimately applied in relation to receivables and payables for VAT where the debtor and creditor is the same person (HMRC).

136. We have found this a difficult case, however, on balance, and it is only marginally so, we have come to the conclusion that Mr Baker does act dishonestly

when he submits the VAT return for VWL for the 11/12 period. It is true that, having issued the invoices, it was incumbent upon VWL to include the input tax in its return. But it was equally incumbent upon HPL to include the output tax in its return and to account for it. To our mind, if Mr Baker was being open and honest with HMRC and simply seeking to correct the errors of the previous four years, he would have submitted the VAT returns for both companies at the same time and would have drawn HMRC's attention to the fact that the entries were required to correct inaccuracies that had built up over the four year period in both companies.

137. Even if it is correct that, at the time, it could not be said for certain that HPL would be put into liquidation owing the output tax, it was clear that it was extremely likely that that would happen. Mr Baker was aware of the risks that Barclays might not reschedule the debts of HPL and was well aware that HMRC was likely to take enforcement action in relation to the CIS penalties. Against that background, it was extremely unlikely that HPL would be able to meet its liabilities.

138. We are reinforced in our conclusion by the transfer of shares in VWL to Mr Baker, which occurred at about the same time. Mr Baker said that the reason for the transfer was that Begbies had advised him that the transfer should take place in order to ensure that the financial position of HPL was not adversely affected by the worsening position of VWL. On the evidence, we do not accept that explanation. VWL was in a materially better financial position that HPL. It seems to us more likely that the transfer of the shares in VWL was designed to ensure that, if HPL were to go into liquidation, the shares in VWL would not be part of its assets at the time. This step, therefore, seems consistent with an approach that is designed to improve the prospects that VWL would survive any winding up of HPL.

139. We also take into account the fact that Mr Baker was less than transparent in his subsequent meeting with Mrs Pacey. We do not draw the inferences from that meeting that Mrs Pacey seems to draw. It was not unreasonable for Mr Baker to assume that different parts of HMRC would communicate with each other and so that Mrs Pacey might be aware that HMRC had issued a petition for the winding up of HPL. However, the fact that Mr Baker does not mention the potential winding up of HPL to Mrs Pacey at their meeting is also an indication of the approach that he is seeking to take.

140. We do not reach our conclusion without material reservations. It is clear to us that Mr Baker worked extremely hard over many years to preserve the businesses of both HPL and VWL. At the end of 2012, the strain that he was under was considerable. That strain pushed Mr Baker into taking actions which we believe must be regarded as dishonest in terms of the VAT legislation by seeking to recover input tax knowing that the corresponding output tax would not be paid.

141. It is equally clear to us that HMRC played a not insubstantial part in the collapse of HPL. It is difficult to understand how, after Mrs Pacey's own investigations in 2010, HMRC did not pay closer attention to the VAT compliance of HPL and VWL. That may or may not have caused the discrepancies relating to the treatment of the intragroup transactions to come to light at an earlier stage. What is

clear to us, however, is that the lack of assistance provided to Mr Baker to resolve the issues surrounding the accruing CIS penalties compounded the company's difficulties and pushed the company into insolvent liquidation in 2013.

Penalty for deliberate inaccuracy

142. The second issue before the Tribunal is the imposition of a penalty in the amount of £12,354 by HMRC on the grounds that VWL deliberately submitted an inaccurate return.

The law

143. The provisions which govern the imposition of the penalty are found in Schedule 24 Finance Act 2007. The relevant provisions are set out below. 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, 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."

144. The list of documents to which these provisions apply includes a VAT return.

145. Paragraph 3 provides in so far as relevant:

> "(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 but P does not make arrangements to conceal it…."

Discussion

146. VWL has accepted that if the Tribunal finds that VWL acted dishonestly in relation to the submission of the return for the 11/12 period, it must follow that the inaccuracy in the return was deliberate for the purpose of Schedule 24.

147. No further arguments have been raised before us in relation to the level of the penalty. On that basis, we confirm the penalty.

Decision

148. For the reasons that we have given above:

(1) we disallow the claim of VWL to recover the input tax relating to the intragroup transactions in its return for the 11/12 period;

(2) we confirm the penalty in the amount £12,354 in respect of the inaccurate return for the 11/12 period.

149. We dismiss the appeals.

Right to appeal

150. 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.

ASHLEY GREENBANK
TRIBUNAL JUDGE

RELEASE DATE: 17 OCTOBER 2016

APPENDIX

Invoice no.	Details	Payment dates	Amount of payment	Total
101956	Construction Work Shop 4	19 December 2008	£20,000	£65,520.00
		22 December 2008	£20,000	
		15 January 2009	£880	
		16 January 2009	£4,140	
		19 January 2009	£5,000	
		30 January 2009	£4,000	
		23 February 2009	£4,000	
		02 March 2009	£2,500	
		23 March 2009	£2,500	
		30 March 2009	£2,500	
101957	Management Services	14 September 2010	£1,000	£22,280.65
		27 September 2010	£1,292.50	
		30 September 2010	£2,788.15	
		25 October 2010	£1,200	
		28 October 2010	£5,000	
		1 November 2010	£2,500	
		18 November 2010	£2,500	
		26 November 2010	£3,500	
		30 November 2010	£2,500	
101958	Recharge items	21 May 2008	£1,000	£10,023.00
		24 September 2008	£3,523	
		6 October 2008	£4,000	
		7 October 2008	£1,500	
101959	Recharge items	24 June 2009	£1,206.60	£8,482.03
		27 July 2009	£1,682.80	
		28 July 2009	£767.63	
		29 July 2009	£825	
		03 August 2009	£1,000	

		30 November 2009	£3,000	
101960	Management Services	14 December 2009	£1,000	£8,665.00
		29 January 2010	£1,500	
		01 February 2010	£3,000	
		03 February 2010	£1,165	
		10 February 2010	£1,000	
		31 August 2010	£1,000	
101961	Management Services	13 December 2010	£2,500	£5,635.92
		10 January 2011	£1,635.92	
		10 January 2011	£500	
		26 January 2011	£1,000	
101962	Management Services	14 March 2011	£2,500	£14,069.15
		21 March 2011	£3,000	
		26 April 2011	£864.60	
		19 May 2011	£1,413.47	
		27 May 2011	£1,200	
		29 July 2011	£3,481.08	
		26 August 2011	£1,610	
101963	Management Services	09 February 2011	£1,610	£6,210.00
		30 September 2011	£1,000	
		18 November 2011	£1,200	
		25 November 2011	£2,400	
101964	Management Services	12 September 2011	£1,445	£10,753.38
		12 December 2011	£308.38	
		19 December 2011	£1,000	
		23 December 2011	£1,500	
		18 January 2012	£1,750	
		08 February 2012	£400	
		09 February 2012	£2,150	
		24 February 2012	£1,200	

		28 February 2012	£1,000	
101966	Management Services	12 March 2012	£120	£10,520.00
		12 March 2012	£1,500	
		22 May 2012	£3,600	
		25 May 2012	£400	
		30 May 2012	£4,800	
		31 May 2012	£100	
101967	Management Services	11 June 2012	£2,000	£16,055.00
		28 June 2012	£1,800	
		12 July 2012	£1,000	
		18 July 2012	£1,500	
		19 July 212	£1,200	
		27 July 2012	£1,155	
		31 July 2012	£1,800	
		09 August 2012	£1,000	
		17 August 2012	£1,500	
		24 August 2012	£500	
		31 August 2012	£2,600	
101968	Maintenance Construction Work	10 September 2012	£1,000	£12,663.49
		14 September 2012	£2,750	
		18 September 2012	£360	
		09 October 2012	£650	
		10 October 2012	£1,800	
		10 October 2012	£100	
		18 October 2012	£2,550	
		26 October 2012	£1,000	
		09 November 2012	£1,453.49	
		20 November 2012	£1,000	