[2021] UKFTT (TC)

TC08288

VAT – penalties – whether behaviour careless – yes – whether penalties disproportionate – no – appeal dimissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/04732

BETWEEN

IRENE AND ATTILA BALAZS **Appellant**

-and-

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

TRIBUNAL: JUDGE ANNE FAIRPO
MR RICHARD LAW

The hearing took place on 15 April 2021. The hearing was held on the Tribunal video platform. A face to face hearing was not held because of restrictions arising from the COVID-19 pandemic.

Mr Balazs for the Appellant

Ms Barnes, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

Introduction

1. The appellants appeal against HMRC's decision to issue a penalty of £11,699.00 on 29 October 2018. The penalty was in respect of inaccuracies recorded in the VAT quarterly periods 12/15, 03/16, 06/16 and 09/16 (the "relevant VAT periods").

2. The penalty was originally issued on the basis that the inaccuracies were deliberate. Due to an error on review, the penalty was recalculated on the basis that the inaccuracies were careless; HMRC have not sought to reinstate the calculation on the basis of deliberate behaviour.

3. The appellants did not appeal the underlying assessments and, as such, this decision considers only the penalties.

Background

4. The appellants are a married couple trading as a partnership. The partnership registered for VAT with effect from September 2015, stating that the intended trade was property management.

5. HMRC opened an enquiry into the relevant VAT periods on 27 July 2017 as the VAT registrations of two of the partnership's suppliers had been cancelled. The suppliers had not provided any evidence to show that they were involved in legitimate business activities.

6. As a result of the cancellation of the suppliers' registrations, HMRC denied the input tax claims made by the appellants in respect of amounts paid to the suppliers in the relevant VAT periods. The appellants were issued with assessments totalling £43,337.59 on the basis that they knew or should have known that the transactions were connected with the fraudulent evasion of VAT, applying the principle in *Axel Kittel v Belgium & Belgium v Recolta Recycling SPRL* (C-439/04 and C-440/04) ("*Kittel*").

7. The decision to issue the assessments took into account that:

   (1) All the transactions traced back to a fraudulent tax loss;

   (2) The appellants had provided no evidence of adequate due diligence in respect of their immediate suppliers;

   (3) The appellants shared a bookkeeper with one of the suppliers and the other supplier was registered for VAT at premises owned by the appellants;

   (4) No input tax for the cost of materials was claimed by the appellants. The appellants and their supplier each stated that the other was responsible for the purchase of materials.

   (5) The appellants requested a review of the decision to issue the assessments. This was undertaken and the decision upheld by the reviewing officer on 2 January 2018.

   (6) The appellants paid the assessments and did not appeal the decision to issue the assessments, nor did they appeal the review decision.

8. On 21 April 2018, HMRC issued notices of penalty assessment against the appellants for deliberate inaccuracies relating to the assessments. These were calculated at 63% of the Potential Lost Revenue.

9. The appellant requested a review of the decision to issue the penalty assessments. This was undertaken and the decision upheld by the reviewing officer on 21 June 2018.

10. The appellant appealed the decision of the reviewing officer to the Tribunal on 4 July 2018. On 29 October 2018 HMRC amended the penalty assessments following an internal

review to reflect a revised view that the appellants had been careless, rather than that their conduct had been deliberate.

HMRC submissions and evidence

Abuse of process

11. HMRC submitted that it would be an abuse of process for the appellants to argue that the penalty was inappropriate or should be reduced on the basis that they did not know that fraud had taken place.

12. The cases of *Foneshops v HMRC* [2015] UKFTT 410 ("*Foneshops*") and *Lindsay Hackett v HMRC* [2016] UKFTT 781 ("*Hackett*") had established that it is necessary to consider whether, in all the circumstances, the appellants' contentions amount to an abuse of process. HMRC submitted that, in this case, the contentions met this threshold for the following reasons.

(1) The appellants had had the opportunity to appeal the assessments and did not do so. As such, it was contended that it was not open to the appellants to now argue that they did not know, and could not have been expected to have known, that the transactions were connected with fraud.

(2) The appellants knew or should have known that the transactions were connected with fraud.

13. In the alternative, HMRC submitted that the appellants knew or should have known that the transactions were connected with fraud for the following reasons:

(1) There was no evidence of payment by the appellants to their suppliers in the appellants' bank statements.

(2) The appellants were informed by their bookkeeper that the suppliers had declared output tax on the supplies to the appellants only after HMRC had intervened.

(3) Both the appellants and their supplier deny purchasing the building materials necessary to undertake the building refurbishment described on the invoices.

(4) One of the suppliers, said by the appellants to have been recommended by a third party, was based in an apartment next door to two apartments owned by the appellants; HMRC's original understanding that he was based in an apartment owned by the appellants was accepted to have been incorrect but they contended that it was unusual that an apparently unconnected supplier should be based next door to the appellants.

(5) The appellants stated that, as the suppliers were recommended and one had previously been used as an electrician, no due diligence checks were necessary. HMRC submitted that this was not a good reason for not conducting such checks.

(6) The email address used by one of the suppliers to register for VAT was also used on VAT applications for businesses connected with Mr Balazs.

(7) A director of one of the suppliers was also the director of a second company. He was represented by Mr Balazs during a VAT inspection of this second company.

14. HMRC also provided more detailed background evidence as to the fraudulent trading of the suppliers, as follows:

(1) Although the suppliers had made voluntary disclosures for omitted output tax to HMRC after the enquiry into the appellants' affairs began, the outstanding output tax had not been paid.

(2) One of the suppliers had no bank account.

(3) Supplier invoices for building work done included no overhead costs or purchases of materials.

(4) The suppliers provided no evidence of trading when requested by HMRC.

15. HMRC submitted that the appellants' behaviour with regard to the transactions with the suppliers should be regarded as at least careless.

Whether the penalty was disproportionate

16. It was submitted that no challenge had been made to the way in which the penalty was calculated. The calculation had been undertaken in accordance with the legislation in Schedule 24 of Finance Act 2007. The appellants had not challenged the rationality or proportionality of the statutory regime.

Appellants' submission and evidence

17. The appellants submitted that the Tribunal should consider the case on its own merits, separate from *Kittel*, and that HMRC were trying to guide the Tribunal into following an inappropriate case.

18. Mr Balazs put forward the following contentions in the hearing:

(1) He was challenging the penalty as a whole including the calculation. He believes his case is different to those of *Foneshops* and *Hackett*.

(2) He did not know anything about his suppliers' tax affairs and argued that he could not be expected to know anything.

(3) He had undertaken due diligence as he had checked that the suppliers' VAT numbers were correct. He considered that anything else would be unavailable due to data protection.

(4) The case made no sense, but he did not want to go into detail about this.

(5) The lack of evidence of payments was because he collected cash from his tenants and used this to pay his contractors.

(6) He had no time to buy building materials, as he was office-based. He gave the contractors money in advance to buy materials; the details of these were in a cash book given to HMRC. The contractor had not told HMRC that he had not purchased building materials, and Mr Balazs could provide a statement to that effect.

(7) He had represented the director at a VAT visit because he was a friend: as the director did not speak English, Mr Balazs had acted as an interpreter. He did not know anything about his friend's business.

(8) He had never refused to respond to HMRC; he had registered only because he was required to do so when he purchased a building as a going concern. Even though he had moved back to Hungary, he was still co-operating with the process.

(9) HMRC had taken time to make the repayment on his first VAT return so he did not understand why it was looked at again two years later.

(10) HMRC had advised him that there would be no penalty if he paid the VAT assessments.

(11) This was all just a mistake, and the penalty should be cancelled.

(12) He had not appealed the assessments because he did not know the law and had followed his accountants advice, which was that he should instruct a professional. He had instructed specialists VAT advisers sometime after the assessment.

19. In his skeleton argument, he also stated that:

(1) The appellants did not purchase any materials as he was paying for a full service from suppliers, including labour and materials plus warranties.

(2) The appellants had never lived nor operated next door to any of his contractors.

(3) The appellants had a right to repayment of VAT on services related to the property as they had provided evidence to show that the property was commercial and registered for VAT.

(4) HMRC's evidence was fabricated.

(5) HMRC's references were irrelevant and the CJEU had cancelled penalties in most of the cases like this.

(6) HMRC had made errors numerous times before the independent review finally took place and reduced the penalty.

20. The appellants' grounds of appeal also stated that:

(1) The penalty was disproportionate to the value of the VAT which had been assessed and repaid by the appellants.

(2) The behaviour leading to the penalty could not be deliberate as there was no evidence that the appellants were aware that the suppliers had no intention of declaring the output tax due.

(3) The appellants' only error was in recovering a small amount of input tax in relation to a VAT exempt supply.

Discussion

Abuse of process

21. We note the following helpful analysis in *Hackett* as to the principle of abuse of process and what is required when considering whether the appellants' contentions in this appeal amount to an abuse of process:

> At §33: "The principle of abuse of process is based on the underlying public interest that there should be finality in litigation, and efficiency and economy in the conduct of litigation. The bringing of a claim or the raising of a defence in later proceedings may, without more, amount to an abuse of process if the court is satisfied (the onus being on the party alleging abuse) that the claim or defence should have been raised in earlier proceedings if it was to be raised at all."
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> At §38: "What is required is a broad, merits-based judgment, taking account of all the facts and circumstances. The proper approach is to ask whether in all the circumstances a party's conduct is an abuse. Although that will often give the same result as asking whether the conduct is an abuse and then, if it is, asking whether the abuse is excused or justified by special circumstances, it will not invariably do so, and it is always necessary for the question of abuse to be considered by reference to all the circumstances of the individual case."

22. In this case, there has been no previous determination as to the facts by a tribunal because the assessment was not appealed. That is not a decisive factor, but it is also not irrelevant. The appellants have stated that they did not appeal the assessments because they did not know the law and had trusted their advisers to deal with the dispute. Mr Balazs stated that specialist advisers were instructed "some time after the assessment" although we note from correspondence that they appear to have been instructed before the first review request. We

consider that the fact that the appellants did not appeal the assessment does not, in this case, equate to accepting that the contentions on which that assessment are based are correct.

23. As noted in *Hackett* at §45, the abuse of process principle is a

> "procedural rule based on the need to protect the process of the court from abuse and the defendant from oppression. [Where] there has been no determination of the facts and issues by the tribunal, it would in my judgment not be an abuse of the processes of the tribunal for those facts and issues to fall to be determined by the tribunal on this appeal … requiring HMRC, on whom the burden of proof is accepted to fall in this appeal, to prove relevant facts which have so far not been substantively determined could be regarded in any sense as oppressive".

24. We have noted and considered the decision in *Foneshops*. Neither the decision in *Foneshops* nor the decision in *Hackett* are binding on us, both being decisions of the First-tier Tribunal. On balance, we agree with the approach in *Hackett* and note further that the decision in *Foneshops* related to a matter which had been the subject of a previous appeal, albeit that the previous appeal had been struck out by the tribunal. The strike out of an appeal is, substantively, a tribunal decision in relation to that appeal and the tribunal considered that the penalty appeal was effectively attempting to re-run an appeal which had been decided by the tribunal. No such earlier appeal or decision exists in respect of the assessment in this case.

25. Accordingly, we have considered the contentions made by the appellants, and those made by HMRC in their alternative argument, with regard to the behaviour which led to the assessment.

Appellants' behaviour

26. The penalties under appeal have been calculated on the basis that the appellants' behaviour which led to the penalties had been careless.

27. We have considered the submissions and evidence put forward by the parties and conclude that the appellants' behaviour should be regarded as at least careless, such that the penalty is appropriate, for the following reasons.

28. The appellants did not undertake any reasonable due diligence on the suppliers; their contention that data protection prevents checks other than that on the VAT number was not supported by any evidence. No explanation was given as to why, for example, standard financial checks were not undertaken. There was no evidence that any references had been obtained, other than the initial introduction to the supplier.

29. No input tax was claimed by either the appellants or their suppliers in relation to building materials and we have had contradictory evidence from the appellants as to who was responsible for the supply of building materials. They have stated that they paid for a "full service from suppliers" and that the price "included all labour and materials", but in the hearing Mr Balazs stated that they provided cash to their suppliers to purchase materials. Whilst we note that English is not apparently Mr Balazs' first language, we consider that there is a clear inconsistency in the statements.

30. No clear explanation was given as to why an email address belonging to another business of Mr Balazs' was used by one of the suppliers in their VAT registration. Mr Balazs suggested that it might have been done by the accountants, but we consider that this seems rather unlikely.

31. The appellants' contention that the lack of evidence of payment was due to the use of cash is not credible when considering that the supplies in question amounted to over £43,000. We note Mr Balazs contention that he had provided HMRC with his cash book but further note

that HMRC state that no such evidence was provided, and no copies of a cash book were provided by either party in the Tribunal bundle.

Proportionality

32. Although the grounds of appeal included a statement that the penalty was disproportionate to the amount of VAT involved, no further submissions as to proportionality were made by the appellants.

33. We consider that it is clear that HMRC had correctly calculated the amount of the assessment. In calculating the penalty, HMRC took into account the following:

(1) The disclosure was prompted.

(2) A reduction of 20% (out of a possible 30%) was given for providing information about the error.

(3) No reduction was given for assisting HMRC in quantifying the error.

(4) No reduction was given for telling HMRC about the error.

34. We consider that these reductions were appropriate given our conclusions above. We see no reason to disturb HMRC's conclusion as to the appropriate reduction. For a prompted disclosure in relation to careless behaviour, the maximum penalty is 30% of the potential lost revenue and the minimum penalty is 15% (paragraphs 4 and 10, Schedule 24, Finance Act 2007). Applying the reduction of 20% to the minimum penalty and deducting the result from the maximum penalty gives a penalty percentage of 27%, which is that used by HMRC in the revised penalty.

35. Given our conclusions as to the appellants' behaviour and the overall circumstances of the case, we consider that the penalty is proportionate and that there are no grounds for reducing the penalty below that established by HMRC.

Conclusion

36. To summarise, we consider that the behaviour which led to the penalty was at least careless, that the penalty was correctly raised and appropriately calculated in line with statutory requirements and is not disproportionate.

37. The appeal is therefore dismissed.

Right to apply for permission to appeal

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.

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ANNE FAIRPO
TRIBUNAL JUDGE

RELEASE DATE: 1 OCTOBER 2021