Neutral Citation: [2024] UKFTT 00347 (TC)

Case Number: TC09147

FIRST-TIER TRIBUNAL
TAX CHAMBER

Sitting at Taylor House, London EC1

Appeal reference: TC/2018/06906

VALUE ADDED TAX – inaccuracy penalties of £1.44m under Schedule 24 FA 2007 – prior litigation established that VAT returns contained deliberate inaccuracies (mostly related to the Kittel *principle) – did the reduction from the standard penalty percentages reflect quality of disclosure? – Held: quality of disclosure was 'so-so' and the reduction reflected this quality – were the penalties disproportionate? Held: no – were there special circumstances making it right to reduce penalties? – Held: no – appeal dismissed and penalties affirmed*

Heard on: 18 and 19 December 2023
(with further submissions and evidence in writing on 12 January, 31 January and 12 February 2024)
Judgment date: 19 April 2024

Before

TRIBUNAL JUDGE ZACHARY CITRON
MS CATHERINE FARQUHARSON

Between

C F BOOTH LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: James Pickup KC and Conrad McDonnell of counsel, instructed by EY

For the Respondents: Howard Watkinson and Joshua Carey of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

THE PENALTIES APPEALED AGAINST

1. This was an appeal against HMRC's decision to raise penalties (the "**penalties**") in the sum of £1,444,813.71 on the appellant ("**CFB**") under Schedule 24 (*Penalties for Errors*) to Finance Act 2007.

2. The penalties were raised in respect of two types of inaccuracies in CFB's VAT returns in 2012, 2013 and 2014:

(1) inaccuracies (the "***Kittel* inaccuracies**") in respect of input tax treated as allowable in the VAT returns – whereas, under the principle in *Axel Kittel v Belgium* [2008] STC 1537 ("***Kittel***"), the input tax was not allowable, as it was incurred in transactions that CFB knew were connected with the fraudulent evasion of VAT; this was the basis for the lion's share (about 95%) of the penalties; and

(2) inaccuracies (the "**zero rating inaccuracies**") in respect of output tax on supplies treated as zero-rated – whereas, because inter alia CFB also knew that they were connected with the fraudulent evasion of VAT, they were standard rated.

3. The *Kittel* inaccuracies were in CFB's VAT returns for the 03, 04, 05, 06, 07, 08 and 09 periods of 2013, and for the 02 period of 2014; those inaccuracies were, in effect, 'corrected' by HMRC's decision of 17 March 2015 (the "**the *Kittel* assessment**") to disallow the input tax in question.

4. The zero rating inaccuracies were in CFB's VAT returns for the 10, 11 and 12 periods of 2012 and the 01, 02 and 03 periods of 2013; those inaccuracies were 'corrected' by HMRC's decision of 8 July 2014 (the "**zero rating assessment**") to standard rate the supplies in question.

5. The penalties were on the basis that the inaccuracies were deliberate on CFB's part, but not concealed i.e. CFB did not make arrangements to conceal the inaccuracies.

6. The penalty percentage in respect of the *Kittel* inaccuracies was 52.5%. This represented a reduction (to reflect the quality of CFB's disclosure of the inaccuracies) to the mid way point between the "standard" (70%) and the minimum (35%) percentages where the inaccuracy is deliberate and not concealed, and the disclosure is prompted.

7. The penalty percentage in respect of the zero rating inaccuracies was 47.25%. This represented a reduction from the "standard" (70%) percentage of 65% of the difference between the standard and the minimum percentages, as in the paragraph immediately above.

8. The penalties were assessed by notice dated 4 May 2018.

BACKGROUND – CFB'S UNSUCCESSFUL APPEAL AGAINST THE *KITTEL* AND ZERO RATING ASSESSMENTS

9. CFB had appealed against the *Kittel* and zero rating assessments. As the Upper Tribunal in *CF Booth v HMRC* [2022] UKUT 00217 (TCC) (a decision whose context we will explain shortly) said:

> 10. ... The hearing before the FTT lasted 13 days, in which the FTT [First-tier Tribunal] heard evidence from 12 HMRC witnesses and 7 witnesses for [CFB]. The documentary evidence comprised 23 lever arch files.
>
> 11. The [FTT's decision], released on 8 November 2017, was lengthy and detailed, running to 90 pages and comprising over 300 paragraphs. The FTT concluded that:

> (1) it was more likely than not that [CFB] knew that the eight sales of metal, treated as being zero-rated, were connected with the fraudulent evasion of VAT,
>
> (2) In relation to the 655 transactions in which [CFB] purchased scrap metal, transactions in the supply chains leading up to them were part of an orchestrated scheme to defraud the HMRC, and [CFB] knew that its transactions were connected with the fraudulent evasion of VAT.

CFB'S APPEAL AGAINST THE PENALTIES

10. HMRC "reconsidered" their decision to raise the penalties but, by a letter dated 13 September 2018 from HMRC Officer Jayne Woods, found there were no grounds to amend the type of penalty (deliberate) or to adjust the reductions given for disclosure.

11. The decision to raise the penalties was then upheld on statutory review (letter from HMRC Officer Stacey Watts dated 4 October 2018).

12. On 2 November 2018 CFB appealed against the penalties.

13. CFB's notice of appeal accepted that its VAT returns contained the *Kittel* and zero rating inaccuracies. It disputed, amongst other things, that the inaccuracies were deliberate on CFB's part.

14. By a decision dated 17 January 2020 (*CF Booth v HMRC* [2020] UKFTT 0035 (TC)) the FTT struck out most of CFB's grounds of appeal. The remaining ground was that the quantum of the penalties should be reduced for the quality of disclosure; plus, so far as relevant to the narrower scope of the appeal as it now stood, arguments put forward in correspondence by EY seeking a reduction in respect of special circumstances and also in relation to the proportionality of the penalties.

15. That decision was upheld on appeal by the Upper Tribunal (in the decision cited in [9] above, dated 9 August 2022). The Upper Tribunal held that CFB's appeal could only proceed on the footing that deliberate inaccuracy was the basis for the penalties. As regards proportionality, the fourth ground of appeal before the Upper Tribunal was that "the arguments on proportionality and special circumstances should be permitted to proceed, and should be taken into account, either to re-characterise the penalty as a penalty for "careless conduct" or otherwise to mitigate the amount of it". The Upper Tribunal's decision on that ground read as follows:

> 77. Mr McDonnell argued that the penalty assessment was disproportionate and excessive, offending against the principle of proportionality. The penalty assessment should be reduced either to comply with proportionality requirements of EU VAT law or, alternatively, the FTT should provide that no penalty was payable or that only the penalty rates for "careless conduct" should apply with mitigation. Mr McDonnell submitted that the 2020 Decision [the 17 January 2020 FTT decision] precluded the second path.
>
> 78. In support of that submission, Mr McDonnell argued that the Appellant was in fact the victim of the fraud, having paid VAT to its suppliers but having had its input tax disallowed. Moreover, in most cases HMRC had collected VAT twice by disallowing input tax from other suppliers in the chain of transactions, and now sought in addition a substantial penalty. Mr McDonnell submitted that the FTT had not taken these issues properly into account.
>
> 79. We reject these arguments. Whilst it is true that proportionality is a fundamental principle of EU VAT law, the FTT in the 2020 Decision at §91 noted that the Ground of Appeal relating to the two letters from Ernst &

> Young upon which the Appellant sought to rely was not struck out, but that the matters raised in those letters (regarding proportionality and/or special circumstances) were instead relevant to the extent that they dealt with the narrower scope of the appeal as it stood after the 2020 Decision.
>
> 80. It follows that to the extent that the Appellant's arguments in relation to proportionality and/or special circumstances go to the quantum of liability rather than the incidence of liability concerning the penalty assessment, the Appellant's appeal has not been struck out; but the appeal can only proceed on the footing that deliberate inaccuracy was the basis for the penalty.

16. The Upper Tribunal also said this as regards the penalties being for *deliberate* inaccuracies:

> 42. Mr McDonnell also submitted that prior to the release of the 2017 Decision [the FTT decision of 8 November 2017] the required mental or conscious element in relation to deliberate inaccuracy had not been established. Prior to the 2017 Decision, he said that the position was uncertain or "inchoate" as regards the Appellant's entitlement to claim input tax. Mr McDonnell also argued that HMRC would need to prove that the Appellant's employee who completed and filed the VAT returns knew that they were inaccurate.
>
> 43. We have no hesitation in rejecting those submissions. In the present case, the FTT in the 2017 Decision held that Appellant knew that its transactions, for which it was claiming input tax and zero-rating, were connected with fraud. Those findings have not been appealed. As the FTT correctly held at §40 of the 2020 Decision, this meant that the Appellant never had any entitlement to an input tax deduction as a result the application of the *Kittel* principle. The same must apply in relation to the Appellant's claims for zero-rating of the MGB transactions. Because it knew, before submitting its returns, that its transactions were connected with fraud, the Appellant also knew that it had no entitlement to an input tax deduction or, in relation to the MGB transactions, an entitlement to zero rating. The FTT's 2017 Decision therefore simply identified and confirmed the Appellant's existing state of knowledge – a state of knowledge which disqualified it from any entitlement to an input tax deduction (and to zero rating in respect of the MGB transactions) in the first place. The FTT's decision on this point is, in our view, unimpeachable.
>
> 44. The relevant knowledge is, moreover, that of the Appellant as a corporate entity, not that of the individual within the Appellant who completed the VAT returns. As the FTT noted in the 2017 Decision at §315 in relation to the *Kittel* principle, it is not necessary for HMRC to identify an individual whose knowledge can be vicariously attributed to the Appellant. Similarly, in relation to the penalty assessment for deliberate inaccuracy, it is not necessary for HMRC to prove or plead that the individual who completed the VAT returns was aware of the deliberate inaccuracy. If it were otherwise, a penalty could simply be avoided by keeping the person completing the returns in the dark as to the Appellant's knowledge that its transactions were connected with the fraudulent evasion of VAT.

17. At [84], the Upper Tribunal reiterated that the effect of the FTT's 2017 decision was that CFB knew that it was not entitled to claim an input tax deduction on its VAT returns but did so nonetheless. That, said the Upper Tribunal, is not "a filing position" but a deliberate inaccuracy.

MATTERS BEFORE THIS TRIBUNAL

18. The effect of the above is that for the purposes of this appeal

(1) the relevant VAT returns contained the *Kittel* and zero rating inaccuracies;

(2) those inaccuracies were deliberate; and

(3) the issues in this appeal are whether the quantum of the penalties should have been reduced for

(a) the quality of CFB's disclosure of the inaccuracies,

(b) based on proportionality, or

(c) based on special circumstances.

EVIDENCE AT THE HEARING AND POST-HEARING EVIDENCE AND SUBMISSIONS

19. We had a hearing bundle of 5,682 pages. This included witness statements of:

(1) Howard Ratcliffe, an employee of CFB and responsible for CFB's accounts and tax compliance at relevant times;

(2) Jason Booth, a director of CFB since August 2012; in 2012 and 2013 Mr Booth was primarily focused on trading, with responsibility for supervising some of the buying team; and

(3) HMRC Officer David Lewis, who was not involved in the raising of the penalties but who was "adopting" an earlier witness statement of HMRC Officer Jayne Wood (who wrote the "reconsideration" letter of 13 September 2018), who had retired from HMRC by the time of the hearing.

20. Shortly before the hearing, CFB applied to the Tribunal to admit a second witness statement of Mr Ratcliffe. This was essentially a response to HMRC's case, made out in their skeleton argument of 7 December 2023, that in "several important instances" CFB was "reticent" to provide information and documents, delayed doing so, and in some instances "sought to mislead" HMRC. At paragraph 25 of their skeleton argument, HMRC pointed to contemporaneous documents which, they said, supported this contention. Mr Ratcliffe's second witness statement was, in effect, CFB's counter arguments, again based on pointing to contemporaneous documentation. It was not, therefore, witness evidence in the sense of things that Mr Ratcliffe had himself said, seen or experienced. In the circumstances, we consider it fair and just that we have regard to the arguments made in Mr Ratcliffe's second witness statement.

21. Mr Ratcliffe, Mr Booth and Officer Lewis all attended the hearing and were cross examined.

22. We received post-hearing evidence and submissions as follows:

(1) on 12 January 2024 (per permission given by the Tribunal at the hearing for evidence to be adduced of a "further consideration" by HMRC's final-responsibility team on special reductions, as foreshadowed in HMRC's "reconsideration" letter of 13 September 2018), an email chain including:

(a) 19 July 2018 internal HMRC email from Ian Maitland-Round of HMRC's "Fraud Investigation Service" unit to Paula Bold of HMRC's "Tax Administration Litigation and Advice" unit; the email starts by saying: "In accordance with CH175000 I am referring this case to you because our refusal of Special Reduction (SR) has been challenged"

(b) 24 July 2018 email from Denise Hart of TALA to Ian Maitland-Round

(c) 30 July 2018 email from Denise Hart of TALA starting "Hi Iain"

The above were attached to a short witness statement of HMRC Officer Nick Mosley, in which he said (inter alia) that there was a subsequent draft email dated 30 July 2018, which appears not to have been sent;

(2) on 31 January 2024 (and as directed by the Tribunal at the hearing):

(a) a 110 page bundle of correspondence comprising 38 communications (in writing) between CFB and HMRC between 18 September 2012 and 9 December 2014; and

(b) an 80 page bundle of meeting notes of 12 meetings between CFB and HMRC between 27 September 2012 and 23 May 2014;

(3) on 12 February 2024, an application by CFB to make further written submissions in the light of the post-hearing evidence received from HMRC in January 2024 (with a copy of those submissions). In the circumstances, we consider it fair and just that we have regard to the arguments made in those submissions.

LAW

Legislative Framework

23. There follow relevant extracts from paragraphs 1, 4, 4A, 9, 10 and 11 of Schedule 24:

> 1. (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.
>
> (4) Where a document contains more than one inaccuracy, a penalty is payable
>
> for each inaccuracy.

Tax	Document
…	…
VAT	VAT return under regulations made under paragraph 2 of Schedule 11 to VATA 1994
VAT	Return, statement or declaration in connection with a claim
…	…

> 4. (1) This paragraph sets out the penalty payable under paragraph 1.

(2) If the inaccuracy is in category 1, the penalty is—

(a) …

(b) for deliberate but not concealed action, 70% of the potential lost revenue, and

(c) …

(5) Paragraph 4A explains the 3 categories of inaccuracy.

4A. (1) An inaccuracy is in category 1 if— (a) it involves a domestic matter…

9. (A1) Paragraph 10 provides for reductions in penalties—

(a) under paragraph 1 where a person discloses an inaccuracy that involves a domestic matter,

…

(A3) Sub-paragraph (1) applies where a person discloses—

(a) an inaccuracy that involves a domestic matter,

…

(1) A person discloses the matter by—

(a) telling HMRC about it,

(b) giving HMRC reasonable help in quantifying the inaccuracy …, and

(c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy … is fully corrected.

(2) Disclosure—

(a) is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy …, and

(b) otherwise, is "prompted".

(3) In relation to disclosure "quality" includes timing, nature and extent.

10. (1)If a person who would otherwise be liable to a penalty of a percentage shown in column 1 of the Table (a "standard percentage") has made a disclosure, HMRC must reduce the standard percentage to one that reflects the quality of the disclosure.

(2) But the standard percentage may not be reduced to a percentage that is below the minimum shown for it—

(a) in the case of a prompted disclosure, in column 2 of the Table, and

(b) ...

Standard %	Minimum % for prompted disclosure	….
…	…	…
70%	35%	…
…	…	…

> 11.(1) If they think it right because of special circumstances, HMRC may reduce a penalty under paragraph 1 ...
>
> (2) In sub-paragraph (1) “special circumstances” does not include—
>
> (a) ability to pay, or
>
> (b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.
>
> (3) ...

24. The penalties amount to a criminal penalty and therefore engage the protection of Article 6 of the European Convention on Human Rights.

25. The burden of proof accordingly fell on HMRC.

Authority on when it is right to reduce penalties because of “special circumstances”

26. *Barry Edwards v HMRC* [2019] UKUT 131 (TCC) concerned late filing penalties under Schedule 55 to Finance Act 2009, which, at paragraph 16, contains provisions on special circumstances that are very similar to paragraph 11 of Schedule 24. Concerning these, the Upper Tribunal cited and agreed with the statement made by Judge Vos in *Advanced Scaffolding (Bristol) Limited v HMRC* [2018] UK FTT 744 (TC):

> “[101] I appreciate that care must be taken in deriving principles based on cases dealing with different legislation. However I can see nothing in schedule 55 which evidences any intention that the phrase “special circumstances” should be given a narrow meaning.
>
> [102] It is clear that, in enacting paragraph 16 of Schedule 55, Parliament intended to give HMRC and, if HMRC's decision is flawed, the Tribunal a wide discretion to reduce a penalty where there are circumstances which, in their view, make it right to do so. The only restriction is that the circumstances must be “special”. Whether this is interpreted as being out of the ordinary, uncommon, exceptional, abnormal, unusual, peculiar or distinctive does not really take the debate any further. What matters is whether HMRC (or, where appropriate the Tribunal) consider that the circumstances are sufficiently special that it is right to reduce the amount of the penalty.”

27. The Upper Tribunal also noted that the FTT there went on to say that special circumstances may or may not operate on the person involved but what is key is whether the circumstance is relevant to the issue under consideration.

28. The Upper Tribunal said in *Marano v HMRC* [2023] UKUT 113 (TCC) (at [138]) that “proportionality might, where a tax-geared penalty is levied, be a special circumstance depending on the particular facts of that case.”

HMRC’S CASE IN OVERVIEW

29. HMRC submitted that the reductions to reflect the quality of CFB’s disclosure of the inaccuracies were “ample”, given that CFB knew its transactions were connected with the fraudulent evasion of VAT – so rendering its VAT returns inaccurate – yet CFB did not tell HMRC about this.

30. HMRC accepted that CFB “generally co-operated” (and that this was reflected in the reductions provided). But in “several important instances” CFB was “reticent” to provide information and documents, delayed doing so, and in some instances “sought to mislead” HMRC.

31. HMRC submitted that the penalties were not disproportionate:

(1) [77]-[80] of the Upper Tribunal's decision (see [15] above) "determined" that the penalties were "not disproportionate in principle"

(2) Schedule 24 was a "proportionate" penalty scheme; and for such a scheme to produce a disproportionate penalty in an individual case is only likely in a wholly exceptional case, dependent upon its own particular circumstances: see *HMRC v Trinity Mirror* [2015] UKUT 421 (TCC) at [66]; and there is nothing exceptional about CFB's case.

32. HMRC submitted that there was no judicial review type flaw in HMRC's decision-making.

CFB'S ARGUMENTS IN OVERVIEW

Submissions on whether to further reduce the penalties to reflect quality of CFB's disclosure

33. CFB submitted that HMRC received "full and exemplary cooperation" from CFB: reference was made to Mr Ratcliffe saying at paragraph 46 of his first witness statement that if HMRC requested records or information by email, he generally sent it straight away; and at paragraph 52, to his saying that CFB aimed to respond in a timely manner to all requests for information during HMRC's verification process.

34. CFB cited the following as showing the degree of cooperation with HMRC:

(1) an HMRC email thanking CFB for forwarding some invoices "so promptly" (5 December 2013)

(2) HMRC saying at a meeting that they appreciated CFB's cooperation (18 February 2014 meeting) and that they greatly appreciated a list sent to them.

35. CFB submitted that it could not be criticised for not holding stock records, as this was commercially driven. As Mr Ratcliffe said, CFB have never kept detailed stock records and/or product trail, and it is not realistically sensible in CFB's business to do that (paragraph 59).

36. CFB submitted that there was no suggestion that CFB had incomplete or inaccurate records of its transactions; or that relevant information was withheld from HMRC.

37. CFB submitted that it told HMRC the identity of all its suppliers and nature of its trading with them.

38. CFB submitted that the maximum reduction for prompted disclosure should have been applied, under paragraph 10 of Schedule 24, because CFB was "open" with HMRC through out: it told HMRC about the transactions, helped HMRC to quantify the sums in issue, and made its records and documents fully accessible to HMRC.

Submissions on proportionality and whether right to reduce penalties because of special circumstances

39. CFB submitted that the penalties were raised at a time when VAT law in the UK was fully subject to European VAT law, and on an appeal the lawfulness and amount of the penalty should be determined by reference to the law applicable at that time. It submitted that s6 of the European Union (Withdrawal) Act 2018 provides that judgments of the Court of Justice of the EU ("**CJEU**") made before 1 January 2021 are binding on UK courts.

40. CFB submitted that European VAT law carries an inherent requirement of proportionality. CFB cited Lord Hoffmann in *C R Smith Glaziers (Dunfermline) Limited v C&E Comrs* [2003] UKHL 7 at [25] (in the context of discussing what conditions would be

appropriate in domestic legislation (enacting a EU directive) as being justifiable to prevent evasion, avoidance or abuse), as follows:

> "25. ... But in general European law would require them to satisfy the principle of proportionality in its broad sense, which, following German law, is divided into three sub-principles: first, a measure must be suitable for the purpose for which the power has been conferred; secondly, it must be necessary in the sense that the purpose could not have been achieved by some other means less burdensome to the persons affected and thirdly, it must be proportionate in the narrower sense, that is, the burdens imposed by the exercise of the power must not be disproportionate to the object to be achieved. In the particular instance of conditions for allowing a VAT exemption, the Court of Justice has recently said that such conditions must be "necessary for the attainment of the specific objective which [the legislation] pursues and have the least possible effect on the objectives and principles of the Sixth Directive": *Ampafrance SA v Directeur des Services Fiscaux de Maine-et-Loire (Joined cases C-177 and 181/99*) [2000] ECR I-7013, 7074, para 60."

41. CFB cited Case C-712/17 *EN.SA Srl v Agenzia delle Entrate*, where the CJEU considered the question of whether a fine in an amount equal to the amount of the improperly deducted VAT was compatible with the VAT principles of proportionality, and held:

> "40. In the first place, in order to assess whether a penalty is consistent with the principle of proportionality, account must be taken of, inter alia, the nature and the degree of seriousness of the infringement which that penalty seeks to sanction, and of the means of establishing the amount of that penalty (judgment of 26 April 2017, *Farkas*, C-564/15, EU:C:2017:302, paragraph 60 and the case-law cited).
>
> 41. In that regard it should be noted that, in the present case, for the purpose of ensuring the correct collection of VAT and preventing evasion, national law provides for the imposition of a fine, the amount of which, rather than being calculated according to the taxable person's tax liability, is equal to the amount of tax which he has improperly deducted. Since the tax liability of a person subject to VAT is equal to the difference between the output tax payable on the goods and services supplied and the deductible input tax relating to the goods and services received, the amount of tax improperly deducted does not necessarily correspond to that liability.
>
> 42. That is particularly the case in the dispute in the main proceedings. As the Advocate General noted in point 63 of her Opinion, since EN.SA. bought and sold, fictitiously, the same quantities of electricity at the same price, its VAT liability for those transactions was zero. In that situation, a fine equal to the full amount of the input tax improperly deducted, imposed without taking account of the fact that the same amount of output VAT had been duly paid and that the Treasury had not, as a result, lost any tax revenue, constitutes a penalty that is disproportionate to the objective which it pursues."

42. CFB noted that in *Farkas*, the CJEU found (at paragraph 65) that

> "the infringement consists of an error relating to the application of the VAT mechanism, which is an infringement of an administrative nature and which, in view of the information in the case file sent to the Court, first, did not cause the tax authority any loss of revenue, and secondly, shows no evidence of fraud"

and accordingly the CJEU indicated that a penalty of 50% of the VAT in question "appears to be disproportionate".

43. CFB submitted that there is no express mechanism in Schedule 24 for the requirement for proportionality to be taken into account; but, in relation to a VAT penalty, it must be taken into account.

44. CFB submitted that, as was the position in *Farkas*, there has been no net loss of revenue to HMRC, and no fraud committed by CFB, so that a 50% penalty (as against the penalty percentage of 52.5% for the penalties in respect of the *Kittel* inaccuracies) would be disproportionate and harsh.

45. CFB stressed the following:

(1) although CFB was found to have had *knowledge* of the connection to fraudulent VAT evasion, CFB was not itself the fraudulent party; CFB noted that HMRC had neither pleaded nor proved that CFB was fraudulent;

(2) CFB bore the cost of the frauds by others: it has been denied recovery of input tax which it incurred; HMRC never repaid that input tax to CFB;

(3) HMRC have the ability under *Kittel* to withhold and/or recover input tax from every trader in the relevant 'supply chains'; publicly available documents, namely the First-tier and Upper Tribunal decisions in *Sandham (t/a Premier Metals Leeds) v HMRC* [2019] UKFTT 218 (TC) and [2020] UKUT 193 (TCC), show that HMRC have done that in relation to at least one of CFB's direct suppliers, Premier Metals Leeds;

(4) it follows that where HMRC have pursued that right, HMRC have made not a VAT loss, but in fact a net gain out of the circumstances in question: i.e. in the case of Premier Metals Leeds and its relevant transactions with CFB, HMRC have made a double recovery;

(5) it is inherently disproportionate and contrary to the VAT principle of neutrality that HMRC should both deny input tax to a trader (such as Premier Metals Leeds) and at the same time treat its corresponding supplies (such as supplies to CFB) as subject to output tax, and then in turn deny input tax to CFB on those same transactions, while collecting output tax from CFB on its corresponding outputs.

46. CFB argued that it was significant that HMRC had not made payments to CFB on the basis of the *Kittel* inaccuracies contained in CFB's VAT returns (due to their concerns about those inaccuracies); in other words, the "PLR" in respect of the *Kittel* inaccuracy penalties was the sum that HMRC *would have* had to pay, had those inaccuracies had not been corrected.

47. CFB submitted that the overall size of the penalties is very large and will be "financially crippling" to CFB; the penalties related to matters of some age, which, CFB submitted, are "unlikely to be repeated" – CFB now "does not trade in the same way". CFB, it said, had already "suffered greatly", by having its input tax claims denied. It submitted that it was not now "in the public interest" to damage CFB's business further by imposing the penalties, "threatening a long-standing British industrial company and the livelihoods of 300 employees".

48. For all these reasons, CFB submitted, the penalties are disproportionate and/or there are special circumstances so that they ought to be reduced, being circumstances which HMRC should have considered but did not.

49. CFB also made arguments based on s69C, inserted into Value Added Tax 1994 by Finance (No 2) Act 2017 with effect from 16 November 2017 (it did not, however, apply in relation to transactions (like the ones in this appeal) entered into before that date). Section 69C imposes liability to a penalty for transactions connected with VAT fraud of 30% of the potential lost VAT. By reason of subsection (12), a s69C penalty may not be imposed where the actions concerned have given rise to a Schedule 24 penalty. Prior to the enactment of s69C, HMRC had published a consultation document *Penalty for participating in VAT fraud* (on 28 September 2016); in the section headed "Option A – a fixed rate penalty", this document stated

> 3.3. The rationale for a 30% rate is that it is within the overlap of ranges of the current Schedule 24 penalty for both careless and deliberate inaccuracies …
>
> …
>
> 3.13. This option is consistent with the wider penalties principles outlined in the introduction. We believe a 30% rate is proportionate to the non-compliance, penalises those that participate in VAT fraud and provides a credible deterrent to others.
>
> 3.14. Distinguishing between careless and deliberate behaviours can be difficult, so a flat rate penalty would lead to a consistent and standardised approach where the knowledge principle is applied. It would also be more cost-effective than the status quo.

50. CFB argued that the 30% penalty percentage in s69C meant that the (higher) penalty percentages used for the penalties were disproportionate; it also argued that it was a "special circumstance" for Schedule 24 penalties to be imposed for the *Kittel* and zero rating inaccuracies after the enactment of s69C, given the policy rationale for enacting s69C.

Submissions on whether HMRC's decision on special circumstances was flawed

51. CFB criticised HMRC's 4 May 2018 decision (read with their "penalty intention letter" of 16 February 2018), saying that there was no evidence that HMRC "actively" considered whether there were special circumstances in this case and, even if they did, no evidence explaining what circumstances they did or did not consider. CFB submitted that HMRC's decision was also flawed due to inadequate reasons being given. CFB also submitted that the internal HMRC emails from July 2018 (put into evidence after the hearing, with the Tribunal's permission) show HMRC misunderstanding arguments made by EY in a letter of 12 June 2018 (about s69C and about the "procedural consequences" of the penalties having been raised only after time had expired for CFB to seek permission to appeal against the decision of the FTT in 2017). CFB submitted that HMRC's decision of 4 May 2018 was flawed because it did not take into account the arguments EY would raise in its 12 June 2018 letter.

52. CFB also argued that the HMRC's decision on special circumstances was flawed because the reconsideration by the HMRC team with ultimate responsibility, prefigured in the "reconsideration" letter of 13 September 2018, did not in fact take place; and this was contrary to CH170100 in HMRC's internal manual *Compliance Handbook*, which states that "if you have refused to make a special reduction and the person challenged that refusal, you must refer to the Specialist Technical Team …".

OUR ANALYSIS AND FURTHER FACTUAL FINDINGS

53. This appeal concerns two possible reductions to the penalties under Schedule 24, in exercise of the Tribunal's powers to substitute for HMRC's decision another decision HMRC had power to make – paragraph 17(2):

(1) reduction in the penalty percentage, to one reflecting the quality of CFB's disclosure of the inaccuracies in its VAT returns (this is paragraph 10)

(2) reduction considered right because special circumstances (this is paragraph 11) – but only if the Tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed – paragraph 17(3).

54. It is also about whether quantum of the penalties was proportionate (that 'proportionality' was an issue before the Tribunal was common ground between the parties, and, indeed, reflects the Upper Tribunal decision cited at [15] above).

55. The essential context for consideration of these matters is that

(1) CFB's VAT returns contained inaccuracies: namely, the *Kittel* inaccuracies and the zero rating inaccuracies; and

(2) those inaccuracies were deliberate on CFB's part, but not concealed.

The "scheme" of Schedule 24, as relevant to this case

56. The scheme of Schedule 24, in the context of the facts of this case, is to penalise those who deliver VAT returns to HMRC containing inaccuracies (where those inaccuracies understate liability to VAT or inflate claims to repayment of input tax). To attract a penalty, the inaccuracy must be either careless or deliberate. The amount of the penalty is a proportion (expressed as a percentage) of "the potential lost revenue" or "PLR", meaning (here) *the additional amount due or payable in respect of tax as a result of correcting the inaccuracy*. The legislation (paragraph 5(2)) states that the italicised wording includes

(1) an amount payable to HMRC having been erroneously paid by way of repayment of tax, and

(2) an amount that would have been repayable by HMRC had the inaccuracy not been corrected.

57. Where (as here) the inaccuracy in the VAT return made by the taxpayer is deliberate (but not concealed), and there has been prompted disclosure of the inaccuracy, the penalty percentage under Schedule 24 is between 35% and 70%, depending on the quality of that disclosure. If the inaccuracy had been careless, the penalty range (with prompted disclosure) would have been 15% to 30%; if the inaccuracy had been concealed as well as deliberate, the range would have been 50% to 100%.

58. Schedule 24 also provides for penalties to be reduced, where it is right to do so because of special circumstances (paragraph 11).

Evidence and findings of fact about the quality of CFB's disclosure of the inaccuracies

59. The relevant period, in our view, for assessing the quality of CFB's disclosure of the *Kittel* and zero rating inaccuracies, is from the submission of the VAT returns containing the inaccuracy, to the raising of the assessments by HMRC correcting, or reversing, the inaccuracy. So:

(1) for the zero rating inaccuracies, it is the period from October 2012 to July 2014

(2) for the *Kittel* inaccuracies, it is the period from March 2013 to March 2015.

60. We had considerable documentary evidence before us of the quality of CFB's disclosure of the inaccuracies in these periods, in the form of correspondence between CFB and HMRC and notes of meetings between CFB and HMRC. As for witness evidence, of the three witnesses who gave evidence, Officer Lewis had no role in those CFB/HMRC interactions; Mr Booth had a very limited role in them; and Mr Ratcliffe played a significant

role. However, given that the interactions took place around a decade before the hearing (i.e. a very long time ago), we placed significantly greater weight on the documentary evidence than on any of the witness evidence; moreover, the question of the *quality* of disclosure is a matter of judgement for the Tribunal (albeit one based on the Tribunal's factual findings, based on evidence, as to what "disclosure", in the sense intended by the statute, actually took place).

61. Based on the evidence, we find as follows:

(1) the interactions between CFB and HMRC can be summarised thus: HMRC was undertaking an investigation, principally to see whether the *Kittel* principle applied to any of CFB's purchases on which it incurred input tax; it was HMRC taking the initiative to ask questions and reach conclusions on the basis of the answers given by CFB; the interactions were part of a process whereby HMRC "verified" the position in CFB's VAT returns; CFB was generally co-operative in its providing answers (including documentation from its records) to HMRC's investigative questions, although it did on occasion raise commercially-based reasons as to why it could not respond to the question as asked, or needed more time; however, CFB was not the 'initiative-taker' or the 'conclusion-drawer' in these interactions – its position was the more 'passive' one of responding to HMRC's questions as HMRC sought to satisfy itself of the accuracy of CFB's tax returns; and at no point did CFB tell HMRC that it knew of fraudulent VAT evasion in the relevant supply chains;

(2) there is thus no evidence of CFB telling HMRC about the *Kittel* or the zero rating inaccuracies; rather, the tenor of CFB's interactions with HMRC in the relevant periods, on the evidence before us, was that CFB stood by the accuracy of its submitted VAT returns;

(3) CFB did help HMRC quantify the *Kittel* and zero rating inaccuracies, in the sense that it responded with a reasonable degree of cooperativeness to HMRC's questions, which led to them quantifying the inaccuracies; albeit that the tenor of this "help" was indirect, in the sense that it was not expressed as help *in quantifying the inaccuracies*, and passive, in the sense that the nature and timing of the help was dictated by HMRC's questions; the "help" was not therefore 'proactive'; the reason being that CFB did not acknowledge the inaccuracies contained in its VAT returns;

(4) CFB did allow HMRC access to its records for the purpose of ensuring that the inaccuracies were fully corrected (this being HMRC's purpose at the time, rather than CFB's); the tenor of this was indirect and passive, in the senses (and for the reasons) explained immediately above.

Conclusions as to the quality of CFB's disclosure, and whether this was reflected in the penalty percentages

62. Based on the findings above, we find that the *quality* (including timing, nature and extent) of CFB's disclosure of the *Kittel* and zero rating inaccuracies was distinctly "so-so" (by which we mean "basic" quality as opposed to "high" quality or "poor" quality):

(1) CFB did not tell HMRC about the inaccuracies; it responded to HMRC's queries and left it to HMRC to *find* the inaccuracies;

(2) on the other hand, CFB was generally co-operative in providing what HMRC asked for; there were, however, certain things that CFB said it would not do or provide, for commercial reasons such as resources or concerns about confidentiality;

(3) CFB was in no sense 'proactive' in its disclosure of the inaccuracies; it *responded* to questions and requests from HMRC; had CFB tried to anticipate HMRC's questions, help and information could have been provided somewhat earlier;

(4) in our view, this essential 'passivity' in disclosure is not 'high' quality disclosure in the context of a company that *knew* that there was fraudulent VAT evasion in some of its supply chains, and whose VAT return inaccuracies were *deliberate*.

63. We conclude that the 'so-so' quality of CFB's disclosure of the inaccuracies is well reflected in the penalty percentages; the penalty percentage in respect of the *Kittel* inaccuracies is exactly midway the permitted range for penalties of this nature; the penalty percentage in respect of the zero rating inaccuracies was slightly more generous; HMRC did not argue that the latter should be changed and, in the circumstances, we are satisfied that it, too, reflects the quality of CFB's disclosure, as slightly adjusted for the circumstances of the disclosure as regards the zero rating inaccuracies.

Right to reduce the penalties due to special circumstances?

Jurisdictional question – was HMRC's decision on paragraph 11 flawed?

64. As we only have jurisdiction in this matter if HMRC's decision in respect of the application of paragraph 11 was flawed, we first make findings of fact about HMRC's decision making, as follows:

(1) HMRC's "penalty intention letter" of 16 February 2018 stated that HMRC did not consider there to be any special circumstances which would lead them to further reduce the penalties;

(2) EY made representations on "special circumstances" in a letter of 12 June 2018. It argued that the following were special circumstances:

(a) the amount of the penalty, being higher than the percentage in an HMRC consultation document of 28 September 2016

(b) there had been no other FTT cases involving Schedule 24 and an MTIC case

(c) the knowledge principle in *Kittel* is different to the test for a "deliberate" penalty

(d) the penalty was raised only after the FTT decision on the underlying assessment

(e) Schedule 24 has a compliance intention; it is to encourage taxpayers to avoid inaccuracies in tax returns; penalties should only have been assessed on the first of the inaccuracies;

(3) HMRC's letter of 13 September 2018 "reconsidering" the penalties, referred in some detail to the representations made by EY in the 12 June 2018, including as to special circumstances. It said that "independent review" (by another office of HMRC) would begin on issue of that letter. It also said that if this review upheld the penalties, "then the team with final responsibility across HMRC for special reduction will give the matter further consideration";

(4) HMRC's "review conclusion letter" of 4 October 2018 also referred to EY's 12 June 2018 letter and the points raised by it, including the points raised as to special circumstances;

(5) at the hearing, HMRC Officer Lewis said in cross examination that the HMRC specialist team on "special reductions" had not, in fact, reviewed the matter following

the upholding of the penalties by the reviewing officer; counsel for HMRC at the hearing said this was a "new" point and asked the Tribunal for permission to submit evidence, post-hearing, to show that such a review had taken place; we gave permission for this; however, the materials submitted by HMRC after the hearing – internal emails from July 2018 – did not indicate that "the team with final responsibility across HMRC for special reduction" had in fact reconsidered the matter following a decision by the reviewing officer;

(6) we conclude, on the balance of probabilities, that, contrary to the indication in HMRC's "reconsideration" letter of 13 September 2018, there was no further consideration of the matter by the "final responsibility" team at HMRC dealing with "special reductions", following the reviewing officer's decision to uphold the penalties.

65. The question before us is whether HMRC's decision in respect of the application of paragraph 11 was flawed; in our view, the reference here to "HMRC's decision" is to their decision as upheld after statutory review, per s83F Value Added Tax Act 1994 i.e. it is not a reference to HMRC's letter of 4 May 2018 (assessing the penalties), in isolation. We base that view on s83G Value Added Tax Act 1994, which ties the bringing of an appeal to the statutory review process; it is also in keeping with the thinking (in respect of similar statutory language) in *Atom Supplies Ltd (t/a Masters of Malt) v HMRC* (Judge Jonathan Richards and Mr Robinson) [2015] UKFTT 0388 (TC) at [51-52], with which we respectfully agree.

66. In our view, HMRC's decision in respect of paragraph 11, as so understood, was not flawed (when considered in the light of principles applicable in judicial review proceedings): it took into account all material matters; it did not take into account immaterial ones; it was not irrational or perverse, on the evidence before HMRC. The fact that HMRC, in their reconsideration letter of 13 September 2018, indicated that there was going to be further consideration of the matter by a "final responsibility" team at HMRC dealing with special reductions, if the reviewing officer upheld the penalties, and this did not in fact happen, does not render HMRC's decision unfair or unlawful, as

(1) the review decision letter, in the event, dealt with the "special circumstances" issue adequately; it took EY's representations into account (and adequately understood them); it did not make any material error of law in its consideration of the issues; it did not reach a perverse or irrational conclusion; there was, in effect, no unfairness or injustice to CFB as a result of the "further consideration" by the HMRC "final responsibility" team not having occurred; and

(2) it seems to us, on the evidence before us, inevitable that, even if the HMRC "final responsibility" team had reconsidered the matter, the decision would not have been different.

67. It follows that we have no jurisdiction to rely on paragraph 11 to any different extent than HMRC did.

68. In case we are wrong in the foregoing analysis of jurisdiction, we will go on to consider paragraph 11 ourselves; however, because the relevant issues overlap, we will do so after we have considered whether the penalties are disproportionate.

Are the penalties disproportionate?

69. Our starting point is that the scheme of Schedule 24, as described at [56-58] above, is a proportionate one: indeed, at the hearing, CFB accepted this.

70. Many of CFB's arguments as to why Schedule 24, despite being a proportionate regime, creates a disproportionate outcome *in this case*, go to the nature of the law that gives rise to the lion's share of the "PLR" in this case, namely, the *Kittel* principle, disallowing

input tax incurred in transactions where (as here) the recipient of the supply knew of the connection to fraudulent VAT evasion. CFB, in effect, argues that it is disproportionate to apply Schedule 24's (otherwise proportionate) penalty percentages to *Kittel*-based "PLR" because *Kittel*

(1) does not require the taxpayer in question to have been, itself, fraudulent; and

(2) does not stop HMRC from disallowing input tax, in respect of *every* supply in a chain of supplies connected to fraudulent VAT evasion (and even where output tax on the supply in question has been accounted for); so HMRC may have been "recompensed" (or more than recompensed) for any output tax not accounted for (due to fraud) in that chain of supplies.

71. In our view this is a flawed argument:

(1) *Kittel*-based disallowance of input tax is well-settled law; the aspects of it which CFB highlights, immediately above, are commonplace and inherent to it; as Moses LJ explained in *Mobilx v HMRC* [2010] EWCA Civ 517 at [41], *Kittel*

> *enlarged* the category of participants [in fraudulent VAT evasion] to those who themselves had no intention of committing fraud but who by virtue of the fact that they knew or should have known that the transaction was connected with fraud, were to be treated as participants. Once such traders were treated as participants their transactions *did not meet the objective criteria* determining the scope of the right to deduct.

(2) The emphasised (by us) wording in the above indicates both the breadth of the *Kittel* principle and its being core to the allowability of input tax.

(3) It seems to us that inaccuracy in VAT returns in the form of *Kittel*-based disallowance not being made, is as much to be discouraged (and so penalised) as other sorts of inaccuracy in tax returns. It is not therefore disproportionate to apply a proportionate regime, like Schedule 24, to *Kittel*-based disallowance of input tax, as to any other sort of "PLR".

72. Moreover, the arguments above, based on features inherent to the *Kittel* principle, are not distinctive to CFB or its circumstances; on the contrary, the application of *Kittel* in CFB's case is an ordinary application of the principle to just the sort of set of facts it was designed to apply to i.e. one where the taxpayer was not fraudulently evading VAT, but had knowledge of the connection to fraudulent VAT evasion by someone else in the supply chain. CFB's arguments above are therefore more a complaint about the *Kittel* principle *in general*, than an argument that the application of *Kittel* to CFB's circumstances *in particular* is disproportionate.

73. Nor, in our view, are the penalties here rendered disproportionate because the "PLR" in this case was the amount HMRC *would have had* to pay CFB, if the inaccuracies had not been corrected: it is proportionate, in our view, in a regime designed to encourage and ensure compliance with the law, to levy the penalty on the outcome that would have ensued from the inaccuracy contained the VAT return, even if, in the event, and due to HMRC's investigations and caution, that (incorrect) outcome did not ensue.

74. As to the European case law cited by CFB:

(1) In *Farkas*, the parties to a transaction operated the "ordinary" VAT system, whereas they should have been operating the "reverse charge" system; this meant that the tax authorities were paid the right amount of VAT by the seller – but they should have received this from the buyer under the "reverse charge"; a penalty of 50% of the

VAT involved was imposed on the buyer. For the CJEU, this was an "infringement of an administrative nature"; there was no loss of revenue for the tax authorities; and no evidence of fraud.

In our view, CFB's case is quite different: *Kittel*-based disallowance of input tax is far from being an "infringement of an administrative nature", as shown by the quotation from *Mobilx* and discussion above.

(2) *EN.SA* concerned fictitious circular sales of electricity at the same prices between companies in the same group (for reasons unconnected with VAT or tax). The CJEU first held that input tax on these transactions could be disallowed, even though output tax on the same transaction remained payable – provided that the output tax liability could be adjusted when issuer of the invoice had "wholly eliminated the risk of any loss of tax revenue". The CJEU then went on to find that a fine imposed on the disallowed input tax was disproportionate, due to the fact that no tax revenue had been lost (due to the output tax paid); and also due to the principle of neutrality, as it was envisaged that the output tax on the fictitious transaction would be "corrected" when the risk of any loss of tax revenue had been eliminated.

This is again quite different to CFB's case: this was a very unusual set of circumstances, with "fictitious" transactions within a single corporate group, and where the risk of tax loss to the revenue could be eliminated; the *Kittel* principle, in contrast, involves non-fictitious transactions and chains of transactions connected with fraudulent VAT evasion.

75. We also do not accept CFB's arguments based on s69C: the facts that

(1) Parliament enacted a different (and alternative) penalty with a 30% fixed rate; and

(2) HMRC stated in a prior consultation document that, in their view, this fixed rate was proportionate

do not mean that the higher penalty percentages in these Schedule 24 penalties are disproportionate, for a number of reasons:

(a) Parliament did not make any changes to Schedule 24; section 69C is an *additional*, alternative measure in circumstances where the taxpayer has *Kittel*-required knowledge

(b) what HMRC say in a consultation document is not determinative; moreover,

(i) HMRC did not express the view in that document that Schedule 24 penalty percentages were *not* proportionate, and

(ii) the same consultation document described an alternative penalty regime ("option B" – not ultimately enacted) that had 25% and 50% penalty rates

(c) it seems to us that s69C is a blunter instrument than Schedule 24, though one that is perhaps easier (and cheaper) for HMRC to use: what is "proportionate" in the s69C context does not determine what is proportionate in the Schedule 24 context; it is, in the popular expression, an "apples and oranges" situation, such that one cannot infer anything about the proportionality of the penalties in this case, from the fixed rate enacted in s69C.

RIGHT TO REDUCE PENALTIES BECAUSE OF SPECIAL CIRCUMSTANCES?

76. For reasons very similar to those in the preceding section about proportionality, we would not have found there to be special circumstances making it right to reduce the penalties, even if we had jurisdiction in the matter: as we say at [72] above, the penalties are based on what seem to us an ordinary application of the *Kittel* principle to just the sort of facts it was designed to apply to; nor, as we say at [73], is there anything "special" about the PLR in this case being the amounts HMRC would have had to pay to CFB, had the *Kittel* inaccuracies not been corrected; and, consonant with what we say at [75] above, the enactment of s69C, being a different (and alternative) penalty regime, did not create "special circumstances" for the purposes of these penalties under Schedule 24. The negative financial effects on CFB of paying the penalties were asserted in general terms (see [47] above) but not expanded upon or proved in evidence; on the information before us, they do not comprise special circumstances making it right to reduce the penalties.

CONCLUSION

77. It follows from the foregoing that the appeal falls to be dismissed: HMRC's decisions to raise the penalties are affirmed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

78. 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.

ZACHARY CITRON
TRIBUNAL JUDGE

Release date: 19th APRIL 2024