[2019] UKFTT 655 (TC)

TC07430

Appeal number: TC/2016/6610

VAT –MTIC fraud or fraud connected with no supply - penalty assessed on a company for deliberate inaccuracy attributed to director under para 19 Sch 24 FA 2007 – whether inaccuracy "deliberate – whether attributable to director - if no supply made whether declaration of output tax was an inaccuracy within para 6(2) Sch 24 – whether para 5 Sch 11 treated VAT put on an invoice as output tax when no supply – Art 203 VAT Directive considered.

FIRST-TIER TRIBUNAL
TAX CHAMBER

LAURENCE DONNELLY **Appellant**

- and -

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

TRIBUNAL: JUDGE CHARLES HELLIER
CHRISTOPHER JENKINS

Sitting in public at Taylor House EC1R 4QU on 24 25 ,26, 27, 29 and 30 April 2019, with later written submissions

Momcilo Novakovic of Novakovic & Co for the Appellant

Jenny Goldring, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. Mr Donnelly was at material times the only director of Korum Wholesale Trading Limited ("KW"). KW made VAT returns for the periods 04/14, 07/14 and 10/14 (the "3 VAT Periods"). In total those returns declared output tax of £400,659.88 and input VAT of £399,857.88 leaving a small net VAT liability. Invoices were sent to HMRC which indicated that the outputs derived from sales to PWG Micro Brewers Ltd ("PWG"), of which a Patrick Galvin was a or the director, of 11 consignments of alcoholic drinks, and that the inputs derived from 11 matching consignments of drinks sold to KW by the proprietor of a business trading as Beehive Wine Stores. We refer to the transactions specified in these matching invoices as the "11 Deals".

2. HMRC began to investigate KW's activities in May 2014, and, following correspondence and discussions with Mr Donnelly and a Richard Galvin (the father of Patrick Galvin), they concluded that the supply to KW was connected to a fraudulent evasion of VAT by KW's supplier, and that KW, in the person of Mr Donnelly, knew of that connection. As a result they came to a decision that KW was not entitled to input tax credit in respect of the input VAT on the Beehive invoices on the basis of the judgement of the CJEU in *Kittel* v *Belgian State* C439/04 and C440/04 [2008] STC 1537 ("*Kittel*").

3. HMRC then concluded that the consequent inaccuracy in the VAT returns (namely the claim for the input tax under the invoices from Beehive) was deliberate, and had been concealed. As a result they imposed a penalty on KW under Schedule 24 FA 2007 of 95% of the amount of the input tax claimed, namely £379,864.98.

4. Finally HMRC decided that the deliberate inaccuracy was attributable to Mr Donnelly and notified Mr Donnelly under paragraph 19 Schedule 24 FA 2007 that he was liable to pay 100% of the penalty. Mr Donnelly appeals against that notice.

The relevant law

5. There was no dispute about the meaning or terms of the *Kittel* decision. A person is not entitled to input tax credit in respect of a supply to him if: (i) there has been a fraudulent evasion of VAT, (ii) the supply to him was connected to that evasion, and (iii) he knew or should have known that the supply was so connected. HMRC contended that each of these conditions was satisfied and that the condition in (ii) was satisfied because KW (in the person of Mr Donnelly) knew of the connection to fraud.

6. Schedule 24 FA 2007 contains the following provisions:.

> "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 [this includes a VAT return, and a return, statement or declaration in connection with a VAT claim] 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 P's liability to tax…

(3) Condition 2 is that the inaccuracy was careless or deliberate (within the meaning of paragraph 3…

…

3 (1) Inaccuracy in a document given by P to HMRC is

> …(c) deliberate and concealed if the inaccuracy is deliberate and P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure…

4 (1) The penalty payable under paragraph 1 is –

> …(c) for deliberate and concealed action, 100% of the potential lost revenue.

5 (1) "The potential lost revenue" in respect of an inaccuracy in a document … is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment…

6…(2) In calculating potential lost revenue where P is liable to a penalty in respect of one or more understatements in one or more documents relating to a tax period, account shall be taken of any overstatement in any document given by P which relates to the same tax period.

(3) In subparagraph (2)-

> (a) "understatement means an inaccuracy that satisfies Condition 1 of paragraph 1, and
>
> (b) "overstatement means an inaccuracy that does not satisfy that condition.

(4) For the purposes of paragraph (2) overstatements shall be set against understatements in the following order –

> (a) understatements in respect of which P is not liable to a penalty,
>
> (b) careless understatements,
>
> (c) deliberate but not concealed understatements, and
>
> (d) deliberate and concealed understatements.

10 (6) Where a person who would otherwise be liable to a 100% penalty has made a prompted disclosure, HMRC shall reduce the 100% to a percentage, not below 50%, which reflects the quality of the disclosure.

11 [provides for a reduction in special circumstances]

19 (1) Where a penalty under paragraph 1 is payable by a company for a deliberate inaccuracy which was attributable to an officer of the company-

(a) the officer as well as the company shall be liable to pay the penalty, and

(b)HMRC may pursue the officer for such portion of the penalty (which may be 100%) as they may specify by written notice to the officer.

7. Paragraph 19 provides paragraph 15, which provides that P may appeal against the decision of HMRC that a penalty is payable or its amount, has effect as if the penalty were assessed on the officer. Paragraph 17 provides that on such an appeal the tribunal may substitute for HMRC's decision another decision which HMRC had the power to make, although the tribunal's power in relation to the reduction of a penalty by reason of special circumstances paragraph 11 is engaged only if HMRC's decision was flawed – that is to say if it took into account irrelevant factors, ignored relevant factors, was made under a mistake of law or was such that no reasonable body could have made it.

8. Two issues of interpretation arise in relation to schedule 24. The first is the proper construction of "deliberate" in particular in paragraph 4 (2) schedule 24, and the second the proper construction of "attributable" in paragraph 19 (1).

9. In *HMRC v Raymond Tooth* [2019] EWCA Civ 826, the Court of Appeal held that where a person had submitted a tax return which contained an inaccuracy which he knew was an inaccuracy, the return could be said to contain a deliberate inaccuracy even though the taxpayer did not intend thereby to bring about an insufficiency of tax. That case related to the application of section 118(7) Taxes Management Act 1970 ("TMA") which provided that for the purposes of TMA references to a loss of tax being brought about deliberately included a loss of tax "which arises as a result of a deliberate inaccuracy". Paragraph 3(1)(c) Sch 24 defines an inaccuracy as "deliberate and concealed "if the inaccuracy is deliberate on P's part and P makes arrangements to conceal it…". It seems to us that there is no contextual difference which justifies a different approach to the words from that in *Tooth.* We regard a deliberate inaccuracy as an inaccuracy which the taxpayer knew was an inaccuracy when the relevant document was given to HMRC.

10. Mrs Goldring argues that the correct approach to the meaning of "attributable" is that adopted by the FTT in *Jason Andrew v HMRC* [2016] UKFTT 295 (TC), where the FTT found that a deliberate inaccuracy could be attributed to Mr Andrew where "he did not take any meaningful steps to satisfy himself of the accuracy of the information before completing and signing the return" and held that that constituted recklessness which "was well established as sufficient for these purposes" , relying on Lord Hershell in *Derry v Peak* 1886-90 All ER Rep1 at 22. In that passage Lord Hershell had said that fraud was proven when a false representation was made: (1) knowingly or (2) without belief in its trust or (3) recklessly careless whether it be true or false" although the third was but an instance of the second.

11. Mrs Goldring also referred us to *Farrow v HMRC* [2019] WLO 1406665 where the FTT asked itself whether there was evidence "to establish that the inaccuracy was attributable to the acts or omissions of the Appellant himself…and that [he] knew that his acts or omissions would bring about the [relevant inaccuracy]".

12. There is no definition of attributable in para 19 and it should bear its normal meaning. It seems to us that that meaning has something to do with having responsibility for something else, and, in the context of the attribution of a deliberate inaccuracy, carries with it a sense that the person to whom the action is attributed is in

some way blameworthy. Where a person does something which causes an inaccuracy and causes it to be deliberate there is no doubt that the deliberate inaccuracy is attributable to him. Where he fails to do something, which failure permits the deliberate inaccuracy or does or fails to do something which permits it, the position is more nuanced, and in our view it is generally only where he knew or had a duty to know whether his action or inaction permitted the inaccuracy or the deliberation of its making that, as a matter of ordinary understanding, one would say that the inaccuracy was attributable to him. Thus we would confine the reckless described in *Andrew* and the knowledge described in *Farrow* to situations where the taxpayer had a duty to avoid inaccuracy.

13. HMRC put their case on the basis that there was a supply of goods by KW - and thus an output tax liability, but that the input tax credit was denied in accordance with *Kittel.* On that basis they say that the inaccuracy was the claim to input tax in the VAT returns and the potential lost revenue would be the amount of that input tax. We consider later in this decision the possibility that there were no goods supplied to or by KW, and whether, in that case, there would have been two inaccuracies in its VAT returns: the inaccurate input tax declaration, and the inaccurate output VAT declaration.

The Evidence.

14. We heard oral evidence from Anne-Marie Harry, an officer of HMRC who had had dealings with a person trading as Beehive; from Matthew James Eaton, an officer of HMRC who led the investigation into KW's VAT returns; from Guy Bailey, an officer of HMRC with experience of excise duty administration; and from Mr Donnelly. We also had several bundles of copy documents.

15. We found Miss Harry and Mr Bailey to be truthful witnesses. We found Mr Eaton to be a careful, considered and truthful witnesses.

Mr Donnelly's evidence

16. Mr Donnelly said to us "my memory is not good", and indicated that it was hard to remember with any accuracy events which took place some six years ago. There were a number of occasions on which he said his memory failed which included the following:

(1) when asked whether the 11 Deals were the only transactions conducted in the 3 VAT Periods, he replied that he could not remember if that was the case, although on being referred to the VAT returns and other documentation, he accepted that it was;

(2) when asked what was the turnover of Korum Limited, another company of which of which he had at material times been director, and which was involved in building work, he said that although it was not millions he could not even give a rough idea;

(3) a contemporaneous note of a meeting with HMRC on 28 May 2014 indicates that when Mr Donnelley was asked who dealt with the VAT affairs of KW, Mr Donnelly said Novakovic & Co. In his first witness statement he said that Richard Galvin had taken the role in January 2014. In his oral evidence he

said that he could not remember from what dates Richard Galvin had taken this role, and thought that he had not been asked this question at the meeting;

But Mr Donnelly was able to recall that Mr Novakovic's firm was dealing with Korum Ltd (the building company)'s affairs at the relevant time, and that he had signed a form of authority (a 64-8) in January 2014 authorising, on behalf of KW, HMRC to deal with Richard Galvin;

(4) asked if he recalled receiving a copy of HMRC's Notice 726 (which deals with the risks of being made jointly and severally liable for unpaid VAT of another person) he said that he remembered receiving it, but not when he did so;

(5) having said in his first witness statement that he had had an informal discussion with Patrick Galvin about alcohol trading and had then had a discussion with Richard Galvin, who had told him he could help him get started in the trade, Mr Donnelly was asked which came first: who was the first person who gave him the idea of alcohol trading? He replied that he could not remember which it was but then seemed to recall that it was Patrick followed by Richard who said "give it a try";

(6) the name of KW was changed to KW from Korum Building & Refurbishment Limited in October 2013. Mr Donnelly could not remember whether this change was or was not on the advice of Richard Galvin.

17. Mr Donnelly's own oral and written evidence also indicated that he had made statements which were misleading, inaccurate or untruthful. Thus:

(1) Mr Jenkins asked him about the numbering of his invoices. Although Mr Donnelly said that the 11 Deals had been the only deals in the 3 VAT Periods, the invoice numbers were not sequential - there were gaps suggesting other transactions. Mr Donnelly explained that he wanted it to look to his customers as if he had done more deals - to make it look to Patrick Galvin that he was doing transactions with other people. If this answer was true it displayed in our view a willingness to deceive.

(2) He told HMRC on 28 May 2014 that he found suppliers by adverts and word-of-mouth. He said that he had done PWG's legwork in finding suppliers for the goods it wanted and had found Beehive on the Internet. In September 2014 he wrote to HMRC and said that he found his customers and suppliers by "word-of-mouth/Internet/Harpers Wine and Spirit News". But he told us that he had been given a list of a few potential suppliers by Richard Galvin of which he had contacted "maybe 3 or 4".

His explanation for the discrepancy was that he actually did would have "looked unprofessional". But, whatever the reason, one or other of the statements evidenced a lack of regard for the truth.

(3) At the meeting with HMRC on 28 May 2014 Mr Donnelly told HMRC that Patrick Galvin at PWG did not know how much KW paid for the goods it supplied to PWG. He also said he made a 0.25% profit, and indeed the invoices and purchase orders given to HMRC for the 11 Deals show, on the purchase order to Beehive, the price on the invoice to PWG "less commission 0.25%". But in his first witness statement Mr Donnelly says that in the first deal he added 2.5% to the bottom line but Patrick Galvin told him that he would have to knock the 2.5%

profit off the bill. He said Patrick explained that the lack of profit would not last for ever and after a couple of months he could put the 2.5% back on each trade.

It seems to us that unless Patrick Galvin knew how much KW was invoiced by Beehive he could not know whether it was a 2.5% or 0.25% profit that had been taken by KW. That suggests that his response to HMRC the meeting was at best inaccurate.

(4) On 15 January 2014 Mr Donnelly e-mailed Patrick Galvin saying that on receipt of his paperwork he would forward "an up-to-date stock list". Yet he told us that he held no stock and that his mode of operation was to await an order from Patrick and then to try to fulfil it by contacting suppliers. The e-mail was in our view intended to mislead those who might later be interested in his operations.

(5) In a letter of 9 October 2014 to HMRC's anti-money-laundering unit Mr Donnelly says:

> "stock is bought from my supplier Square Dranken and delivered to my account at Seabrooks, it is then sold to my customer [PWG] and delivered from Seabooks to Global Foods and Limited".[our underlining]

But Mr Donnelly told us that at this time his supplies had been from Beehive only and that he never received supplies from Square Dranken.

Asked about the apparent discrepancy, Mr Donnelly said that "is" represented his future intentions, rather than his past practice.

Even if "is" can be so construed, the statement was misleading and, in our view, discloses scant regard for accuracy.

(6) In his first witness statement Mr Donnelly said that his first meeting with Richard Galvin to discuss his business procedures and administration was in March 2014. In his second witness statement he said it was in January 2014. Later he told us he could not remember when it was.

It is possible that that meeting was even earlier than January 2014, but the differences in his formal evidence to the tribunal indicated a lack of care for accuracy and truth.

(7) Mr Donnelly told us that the reason he used Richard Galvin as his agent for VAT matters was that Mr Galvin made no charge. But Mr Eaton's manuscript notes of a telephone conversation with Mr Donnelly on 27 June 2014 record that, being asked why he had not supplied certain documents to HMRC, Mr Donnelly replied that that was "what he paid other people to do". We saw no reason to doubt Mr Eaton's record, Mr Donnelly's recorded response indicates a lack of regard for accuracy and a desire to mislead.

(8) At the meeting on 28 May 2014 with HMRC Mr Donnelly was asked whether he received credit from Beehive or paid up front. He replied that he paid up front through the bank and not in cash. But Mr Donnelly told us that the reason he chose Beehive as a supplier was because there was "only one that would give me credit and it was Beehive". He also told us that on at least one occasion cash had been paid to Beehive.

It seems to us that at least one of these statements must have been false.

(9) In his first witness statement Mr Donnelly says that before any transaction took place "we exchanged due diligence documentation." That indicates that the

exchange with PWG took place in or before March 2014 since the first Deal invoices are dated 3 March 2014. Mr Donnelly then says that he does not have a copy of these documents because he passed them all to Richard Galvin "as he was keeping my files", and in his oral evidence Mr Donnelly said that as soon as he got due diligence material he would go to Richard's office and put it on the due diligence files there. That suggests to us that the documents were passed to Richard Galvin at the latest in March 2014. But Mr Donnelly sent Richard Galvin an e-mail on 7 July 2014 copying to him the "due diligence pack" e-mailed to him by PWG dated 17 January 2014. Asked about the apparent discrepancy Mr Donnelly told us that he had also sent his documents to Richard Galvin at a later time "to show a paper trail". We found that unbelievable: we could see no reason, and Mr Donnelly could give none, for requiring a paper trail at that stage. We concluded that he was not giving a wholly truthful answer.

18. As a result of his evidence that his memory was poor (whether it was in fact poor or whether the professed lack of memory disclosed an unwillingness to answer a question), his willingness to mislead and his record of a lack of regard for truth and accuracy we approached Mr Donnelly's evidence with great caution.

Our findings of fact.

19. (In what follows we refer to "due diligence" documents. This refers to documents obtained and given by the participants which could give comfort about the existence, true name and trading activity of the person tendering them. We do not intend by using this appellation to indicate that the mere receipt of copies of such documents as were delivered would provide adequate comfort as to the existence or bona fides of the giver.)

20. Mr Donnelly had been in business on his own account, or through the medium of companies he owned, for more than 20 years. Prior to 2014 Mr Donnelly had operated companies which provided building services. One of these, Korum Limited, had been making supplies to Northampton University. That source of work had stopped in late 2013 or early 2014.

21. Richard Galvin was a long-standing friend of Mr Donnelly's father, and Mr Donnelly had known his son Patrick Galvin since childhood.

22. Richard Galvin was engaged in a business called Altion Consult which we understood to be the trading name of Altion Limited. It appeared from a website page exhibited by Mr Donnelly that Altion Consult supplied assistance with carrying out due diligence and other administrative tasks.

23. In the autumn of 2013 Mr Donnelly had a discussion, probably with Patrick Galvin, in which Patrick Galvin mentioned to Mr Donnelly the possibility of trading in alcohol. (A note of a meeting between HMRC and Patrick Galvin on 31 April 2015 records that Patrick Galvin said that Mr Donnelly had approached him about entering the trade; we make no finding as to who instigated the transactions). It is likely that it was following that conversation that, on 15 October 2013, Mr Donnelly procured the change of name of KW, and arranged for its VAT registration.

24. At some stage Richard Galvin became involved in KW's business but the evidence as to when he became involved was somewhat confused. In his first witness statement Mr Donnelly said that there had been a meeting with Richard and Patrick Galvin shortly after a telephone call from Richard Galvin in or around March 2014. In his second witness statement Mr Donnelly said that he had made a mistake in his first and that he should have said January 2014.

25. Richard Galvin sent HMRC a form signed by Mr Donnelly authorising Altion Limited to be KW's VAT agent (a form 64-8). This form is dated 29 May 2014, the day after HMRC's first visit to Mr Donnelly, but Mr Donnelly said that he had signed it in blank at his first meeting at Richard Galvin's offices - that is to say in January 2014. The story of the 64-8 is complicated by the fact that Richard Galvin also sent HMRC one of those forms for Korum Limited (the building company) and that it too bears Mr Donnelly's signature and the same date, 29 May 2014, but Mr Donnelly's oral evidence was that he had only signed one such form.

26. An e-mail from a Danielle Chapman at the address "@altion.co.uk" (the address used by Richard Galvin and which we believe is that of Altion Consult) of 29 January 2014, offers Mr Donnelly various services to assist with due diligence following a meeting between the writer and Richard Galvin. That gives credence to the possibility that there was a meeting with Richard Galvin in the offices of Altion Consult in January 2014.

27. Taking this evidence together we conclude that it is likely that Mr Donnelly had a meeting with Richard Galvin in late January 2014 in which Mr Donnelly was told that he needed to give and collect due diligence material. This conclusion as to the date is supported by an e-mail from Patrick Galvin to Mr Donnelly of 7 January to which Patrick Galvin attached copies of documents such as his passport and the VAT registration document for PWG (although Mr Donnelly told us that he had been given those documents in hard copy form the meeting as an example of what he had to give and collect).

28. It is possible that there was an earlier discussion between Mr Donnelly and Richard Galvin because KW's name was changed in October 2013 (to a name more consistent with alcohol trading) but that may have been at the suggestion of Patrick Galvin rather than his father.

29. We note that in a letter of 20 January 2014 to PWG Mr Donnelly asks that PWG pay the excise duty which would arise on the release of the goods from duty suspension on his behalf. That is indicative of preparatory activity in January 2014.

30. Mr Donnelly says that at a later meeting with Patrick and Richard Galvin, Patrick Galvin had said that he would be sending a purchase order for their first trade that but Mr Donnelly had been worried that he could not find suppliers. He says that Richard Galvin then gave him a list of a few numbers to call of which he called three or four, and found Riaz Ahmed at Beehive was the only one who would offer him credit. Mr Donnelly said that Riaz then assisted him throughout all his transactions, helping him draft purchase orders and telling him to whom to pay what and when.

31. Mr Donnelly said in his witness statement that Riaz had told him the details of a bonded warehouse, Seabrooks, and that this was "during one of our first transactions"

(although in his oral evidence he said that Richard and Patrick Galvin had introduced him to Seabrooks); he said that he contacted Seabrooks and discussed the opening of an account and had a meeting with a member of Seabrooks' staff in January 2014. HMRC's records show Seabrooks seeking to verify KW's VAT number on 12 February 2014. There is a record of Seabrooks seeking due diligence documents from KW in the same month but also a letter dated 19 March from Seabrooks to KW seeking due diligence documents and setting out Seabrooks' charges.

32. It is difficult to reconcile the dates of Seabrooks activity with Mr Donnelly's statement that Riaz told him about Seabrooks during the first transaction (invoices for which were dated 3 March 2014) and Mr Donnelly's statement that the list of potential suppliers from Richard Galvin was given to him in close anticipation of the first order from PWG. That difficulty is enhanced by a letter from Mr Donnelly to Patrick Galvin of PWG of 20 January 2014 in which Mr Donnelly says "... thanks for the orders, it looks as if there could be a potential here ..." which gives the impression that KW had received orders in January 2014.

33. We conclude that Mr Donnelly was given the list of suppliers early in 2014 (either by Patrick Galvin or Richard Galvin) and that by February he had made contact with Riaz and made an approach to Seabrooks.

34. We conclude that between October 2013 and the end of February 2014 Patrick and Richard Galvin were guiding Mr Donnelly through the steps which they considered were necessary for him to start participating in the activities which took place in March and subsequent months. He changed the name of the company to make it consistent with alcohol trading, obtained VAT registration, was given and told how to seek and provide "due diligence documentation", and given a list of potential suppliers, one of whom, Beehive, we believe they knew would say that it could supply the goods requested on credit.

The 11 Deals.

35. Richard Galvin sent HMRC copies of sales and purchase ledgers for the 3 VAT Periods 04/14, 07/14 and 10/14 together with invoices and purchase orders showing:

(1) For 04/14, nine transactions in alcohol in which KW had ordered from, and been invoiced by, Beehive, and had received purchase orders from, and had invoiced, PWG. The ledger and invoices showed sales of some £1,957k, purchases of £1,954K (a margin of £3,000 only), input VAT of £326,239 (as had been claimed on the VAT return for the period) and output VAT (similarly declared) of £325,586. Deals 1 to 3 were each dated 3 March 2014 and the invoices for this first day's activity totalled some £270,000.

(2) For 07/14 one transaction only, Deal 10, in which goods ordered from, and invoiced by, Beehive were invoiced to PWG, generating sales some £213,000, purchases of £212,000, input VAT of £35,349 and output VAT of £35,420, as declared on the VAT return for that period;

(3) For 10/13 one transaction only (Deal 11) in which goods invoiced by Beehive were invoiced by KW to PWG generating sales of £234,000, purchases of £234,000, input VAT of £38,922 and output VAT of £39,000, as declared on the VAT return for that period.

36. For each Deal the invoices showed that the goods that had been invoiced to KW by Beehive were in each case invoiced to PWG (although there were minor discrepancies in some of the documentation – see later). In the case of Deals 1 to 9 KW's purchase order to Beehive requested that the goods be delivered to Global Foods at an address in Cardiff and copies of invoices obtained from PWG indicated that PWG had invoiced Global Foods for goods of the same description. In the case of Deal 10, PWG's purchase order stated (unusually) "Please can the stock be delivered to my address Not to Global Foods", and there was no onward invoice from PWG before us. In the case of Deal 11 KW's purchase order asked for, and Beehive's invoice specified, delivery to an address in Melksham, but KW's invoice to PWG specified delivery to Global Foods in Cardiff. In the case of Deal 11 PWG invoiced the goods of the same description to Global Foods.

37. Mr Eaton's evidence of Global Foods' records showed 9 invoices from PWG being received by it in March 2014, none in April to July and one only in August 2014. There was also evidence from Global Foods' bank account of payments to PWG. There was evidence of the sale by Global Foods to various parties of the goods invoiced to it by PWG in March 2014. Although this was second-hand evidence (we did not hear from Global Foods) we conclude that it was likely that Global Foods received and sold goods of the description on PWG's invoices to it in Deals 1 to 9 and 11.

Deal 10

38. The purchase order from PWG for this Deal was dated 16 June 2014, asked for delivery to "my address Not to Global Foods" and specified a delivery date of 23 June 2014; KW's invoice to PWG was dated 17 June 2014 and was for delivery to Unit 4 Hilldrop Farm (PWG's stated address); Beehive's invoice to KW was dated 19 June 2014 and said it was for the delivery of the ordered goods to Unit 4.

39. Mr Donnelly's first witness statement said: that Patrick Galvin could not take delivery because he did not have enough space; Mr Donnelly had to look for storage "for a few days while Patrick Galvin made room"; Richard Galvin pointed Mr Galvin to lock up on a farm at Dustin in Northampton; Mr Donnelly passed the details to Beehive who instructed the driver to deliver to Dustin; he said that the goods went there but said that when he went to inspect a couple of days later he discovered that they were gone.

40. In his second witness statement Mr Donnelly said that Patrick Galvin did not want immediate delivery in June. He said that the goods were held by Riaz Ahmed, the proprietor of Beehive, until delivery was requested. The request was made in July 2014 but, when delivered Patrick Galvin, did not have enough space to take them and sent the driver away.

41. In his oral evidence Mr Donnelly said that he thought that between June 2014 and the end of 2014 (he said that Patrick Galvin later changed the delivery date to November/December 2014) the goods were held by Riaz and then delivered to PWG which could not take them; then, he said, in late 2014, they went to a farm at Garston.

42. In November 2014 Mr Eaton phoned Mr Donnelly and asked him if the goods had been delivered to PWG. Mr Donnelly said they had been. In his oral evidence Mr Donnelly said that he had assumed that to be the case.

43. In October 2014 HMRC wrote to Richard Galvin asking about the goods invoiced to PWG (for which Richard Galvin also acted) in Deal 10. Richard Galvin replied that PWG had had problems with storage and the supplier had temporarily taken them back to their premises (Richard Galvin must have known that KW had no premises and this must therefore have referred to Riaz, or another unknown supplier).

44. In October and November 2014 an officer of HMRC sought to examine the goods but had a slow response from Richard Galvin when he was asked where they were. But Richard Galvin e-mailed Mr Eaton on 10 December 2014 saying that after being turned away from PWG at Unit 4 Hilldrop Farm the stock was delivered to Unit 7B Broad Lane Farm, but was reloaded and delivered to Little Staughton airfield, and then moved again to Darlington Grange Farm in Northampton. In an e-mail of 18 December Richard Galvin confirmed that storage address. On 19 December officers of HMRC went to Darlington Grange Farm and could not find the goods. On 19 January 2015 Richard Galvin e-mailed HMRC to say that the goods had been stolen.

45. Mr Donnelly said in his oral evidence that KW had not been paid for Deal 10 by PWG and that KW had not paid Beehive (although it might have been the case that PWG paid Beehive "some money"). Nevertheless Beehive was content to participate in Deal 11.

46. We found the picture that Mr Donnelly sought to paint was unbelievable. It seemed improbable that goods ordered and invoiced in June 2014 on which duty must have been paid would be stored for six months without charge by, or payment to, Beehive. It seems improbable that after six months storage by Riaz the goods should be transported to PWG and turned away, and that alternative storage would be needed "for a few days" (when their delivery could surely have been deferred). It is unlikely that Beehive, which had invoiced goods valued at £222,000, would continue to wait for payment.

47. We also concluded that Richard Galvin's e-mails were attempts to delay and obfuscate and that the goods had never been stored at the places mentioned by him.

48. We concluded that both Mr Donnelly and Richard Galvin knew that the goods which were said to have been sold by Beehive, and by KW did not exist - that is to say neither party had any title in them or right to direct their delivery and that the accounts they gave to HMRC were intended to convince HMRC that they did exist. They were lying.

Anomalies in the documentation

49. HMRC point to a number of anomalies in the documents supporting the VAT returns for the 3 VAT Periods:

> (1) in Deals 1 and 4 PWG's and KW's purchase orders were both for 1584 cases of Smirnoff; in Deals 7 and 9 PWG's purchase order was for 1584 cases of Smirnoff but KW's purchase order to Beehive was for 1854 cases (probably a transposition error). The same price per case was invoiced by Beehive to KW (and, after adding it mark up, by KW to PWG) in each Deal;

(2) there are discrepancies in the percentage alcohol content between the Smirnoff orders and invoices in Deals 4, 8, 9, and 11: the PWG purchase order says 37.5% but KW's sales invoice states 35% or 35.35%.

50. These oddities indicate to us a lack of concern about the subject matter of the Deals.

Beehive: Ahmad/Ahmed

51. Mr Donnelly told us that he had made all 11 purchases relevant to this appeal from Riaz Ahmed (spelt with an "e") who traded as Beehive Wine Stores. Richard Galvin sent HMRC copies of 11 invoices addressed to KW on the printed paper of Beehive each of which stated that it was for the goods described in a particular purchase order from KW matching (save as noted above) the goods invoiced by KW to PWG. The VAT on those invoices from Beehive was the input tax claimed on the three VAT returns and denied by HMRC.

52. Richard Galvin also sent HMRC a copy of an e-mail of 14 March 2013 from Riaz Ahmed (e-mail address beehive wine@Outlook.com) to Mr Donnelly which attached to Mr Ahmed's "due diligence" material. This consisted of:

(1) a certificate of registration under the Money Laundering Regulations for Riaz Ahmad ("a") of Beehive Wine Store;

(2) a WOWGR registration certificate from HMRC for Riaz Ahmed ("e") trading as Beehive Wine Store;

(3) a VAT registration certificate for Riaz Ahmed ("e");

(4) a telephone bill in the name of R Ahmad ("a") of Beehive Wine Store; and

(5) a copy of a passport in the name of Riaz Ahmad ("a").

53. Miss Harry told us that on 7 August 2014 she visited Beehive Wine Store and spoke to Mr Ahmad who told her that 'Ahmad' was the correct spelling of his name and not 'Ahmed' (as had been recorded on HMRC's systems, which included an application completed in manuscript for VAT registration which had been made in the name of Riaz Ahmed ("e")). She did not say she saw a copy of his passport.

54. Miss Harry told us, and we accept, that the gentleman she saw:

(1) told her his e-mail address was beehivewines@hotmail.com and not that on the e-mails sent by Richard Galvin to HMRC;

(2) told her that he did not know of KW (and at a later visit confirmed that he had not traded with KW);

(3) when shown a copy of one of the Beehive invoices to KW which had been provided to HMRC by Richard Galvin, said that it was not one that he had supplied. He said that all Beehive's invoices were handwritten and not computer-generated; and

(4) said that he had not supplied to anyone the alcohol which was the subject of Deals 1 and 2.

55. In 2012 HMRC officers had visited Beehive's premises to discuss Beehive's trading practices. It appeared to have been the case that a number of his suppliers had

gone missing with (it seemed likely) unpaid VAT. The officers were told that the proprietor travelled to Belgium and France each week to pay his suppliers in cash but held no receipts.

56. In October 2015 HMRC revoked Beehive's registration under the Warehousekeepers and Owners of Warehoused Goods Regulations (WOWGR); Mr Ahmed appealed against the revocation. The FTT allowed the appeal but the UT set aside that decision, and following a second FTT hearing [2018] UK FTT 193 (TC), the appeal was dismissed. Each of the decisions described the appellant as "Riaz Ahmed" (with an "e").The decision in that second hearing records that the tribunal:

> "found Mr Ahmed's oral evidence, particularly under cross-examination, to be confused, inconsistent and contradictory and was often in conflict with other documentary evidence."

57. These latter circumstances call into question the veracity or identity of the person to whom Miss Harry spoke. Miss Harry provided no further evidence which would have enabled us to evaluate the reported evidence of the person she saw, and we feel unable to reach a conclusion as to whether or not it was true.

58. But it seems to us that, *assuming* that the goods on the invoices were in fact supplied by someone to KW, there are two possibilities. The first is that someone other than the true proprietor of Beehive Wine Stores (whether that was Mr Ahmed or Mr Ahmad) dealt with KW, pretending to be Beehive and using the true proprietor's VAT number, and did not pay the VAT on the supply to KW. The second is that the true proprietor did make the supply and then lied to HMRC when questioned about it. In either case, on the above assumption, there was a fraudulent evasion of the VAT on the supply.

Seabrooks and W5Ds.

59. At relevant times Seabrooks Warehousing Limited ("Seabrooks") maintained warehouses at which alcoholic drinks were stored in bulk.

60. When alcohol on which duty has not been paid (duty suspended alcohol) is held by an authorised warehousekeeper such as Seabrooks, various formalities are required to be fulfilled if the alcohol is dispatched, or if the person to whose account it is kept changes. Such a dispatch or the sale of the alcohol to a person who was not authorised to hold duty suspended alcohol causes a duty point to arise and the warehousekeeper to become liable to pay the duty.

61. In such circumstances the warehousekeeper would generally invoice the owner of the goods for the duty arising and might not release the goods until the duty had been paid (depending no doubt on the credit worthiness of the owner). Seabrook's practice was either to pay the duty and then invoice the customer or obtain the duty from the customer before releasing the goods and paying the duty to HMRC.

62. The payment of that duty may be deferred by up to 2 weeks if a suitably approved warehousekeeper submits a form W5D to HMRC in respect of the duty which becomes payable. The submission of the form W5D acts as a warrant for the removal from the warehouse of the previously duty suspended goods. The form W5D must describe the goods, specify their proprietor and the duty becoming payable, and bear a consecutive

reference number (a CRN). No two CRN's may be used in the same month. HMRC's systems do not automatically prevent such duplication but it would generally be picked up by inspecting officers if it happened. Seabrooks were approved for such duty deferral and submitted W5Ds daily to HMRC.

63. In July 2014 (following the 28 May 2014 meeting) Richard Galvin supplied HMRC with documentation in relation to Deals 1 to 9. Together with the invoices and purchase orders he sent 5 documents headed 'Excise Duty Invoice'. These did not appear to bear a sender's name or address but seemed to be addressed to KW and to be for consignments of cases of alcohol of numbers equal to those involved in Deals 1 to 9 (some of the excise duty invoices covering two or more such deals). The invoices were accompanied by copies of W5Ds[1] indicating deferral of duty of the same amounts as shown on related invoices. Each invoice bore a reference to the CRN on the related W5D. In each case the W5D specified the proprietor of the goods as KW.

64. HMRC's records however for W5Ds with the CRN numbers on those W5Ds show the same amounts of goods and duty but indicate that the proprietor of the goods was Bozwel Ltd, a company for which Richard Galvin also acted.

65. On 16 October 2014 Richard Galvin sent HMRC two further Seabrook W5Ds as "evidence that the duty had been paid". They were dated respectively 20 June 2014 (bearing CRN 614) and 21 August 2014 (bearing CRN 868), being dates one day different from the invoices in Deals 10 and 11. These also showed the proprietor as KW.

66. But the VAT number shown on 868 (August: Deal 11) was that of Bozwel Ltd rather than that of KW, and HMRC's records of Seabrook's W5Ds showed no record of a W5D with CRN 614 in June 2014.

67. We conclude that it is likely that: (i) all the W5Ds sent to HMRC by Richard Galvin were false, (ii) those for Deals 1 to 9 and 11 were amended versions of W5Ds originally referable to transactions in which Bozwel had removed goods held for it at Seabrooks, and (iii) that there was no document evidencing any payment of duty in relation to the goods which were described in Deal 10.

68. The first of these conclusions indicates that Richard Galvin (or Mr Donnelly) was attempting fraudulently to conceal an irregularity. The second raises the question whether all the Deals were fictitious and were merely paper replicas of deals under which Bozwel had supplied real goods to PWG or to someone else who had then supplied them to PWG. The third supports our earlier conclusion that no goods were supplied in Deal 10.

Payment of duty.

69. Seabrooks told HMRC that, although Excise duty invoices were addressed to the account holder, a trader did not need to have an account in order for it to pay duty to Seabrooks. It was thus possible for someone other than the person to whom an excise

[1] Mr Donnelly told us that he had received these forms W5D which he had passed Richard Galvin. Given that he professed not to understand the duty calculation or to know what Deals they were for, and given the evidence that they related to Bozwel , we conclude that they originated with Richard Galvin.

duty invoice had been sent to satisfy the recipient's liability by making payment directly to Seabrooks for that person's account.

70. In a letter of 15 March 2014 Riaz wrote to KW saying "I am also confirming that [KW] will be paying any duty directly to Seabrooks ...".

71. In a letter of 20 January 2014 to PWG from KW Mr Donnelly asks that PWG do him "a favour due to the high cost of these orders and the duty payment timescale can you pay the duty on my behalf".

72. On 7 February 2014 Patrick Galvin wrote to Global Foods with "regard to our potential business together, due to the size of the transactions would it be possible for you to pay the duty on our behalf to Seabrooks ...".

73. This chain of letters suggests that the duty to be paid before the release of the goods from Seabrooks would be paid directly by Global Foods.

74. That possibility is supported by: (i) the bank statements Mr Eaton told us that he was given by Global Foods which showed payments to Seabrooks as well as to PWG, although we were not able to identify in respect of what the payments to Seabrooks had been made, and (ii) a reply from Seabrooks to Mr Eaton's enquiry in relation to the 7 W5Ds described above in which Seabrooks indicated that: (a) the first 5 of the Excise Duty/W5D bills (Deals 1 to 9) had been paid by Global Foods; (b) that a duty invoice with CRN number 375 had been paid by Global Foods: this may have been a typographical error for the fifth W5D which had CRN 393, and (c) that the invoices relating to CRN 838 (which may have been a typographical error for 868) had been paid by Bozwel.

75. The picture is complicated by other evidence:

(1) on 28 July 2014 Richard Galvin e-mailed Mr Eaton and said: "our client ... has an agreement with his client to pay the duty portion of the goods ...". This we read as an assertion that KW had agreed with PWG that PWG would pay the duty, but Mrs Goldring read it as an assertion that KW would be paying the duty, and indeed in his first witness statement Mr Donnelly says that Riaz had told him that in order to get the goods released from the warehouse KW would need to pay the duty first. In that statement Mr Donnelly also says that in Deal 2 he paid the duty directly to the warehouse, and in relation to Deal 10 that he understood PWG paid the duty directly on this trade (suggesting that this was unusual). In his second witness statement he says that he paid the duty directly to the warehouse but that on occasion that the duty "was paid directly from the supplier" (we think it likely that that "supplier" is a misprint for "customer": PWG not Beehive). We take this as referable to Deal 10.

(2) In his oral evidence Mr Donnelly says that he paid the duty directly to Seabrooks when he was told to do so, although he could not tell us for which Deals. That was at odds with the letters referred to above and does not sit easily with the second-hand evidence of Seabrooks and Global foods that Global Foods paid Seabrooks.

(3) As we explain in the following section, KW's bank statements indicate that KW did pay monies directly to Seabrooks and that in large part these monies came from PWG.

76. We could not test what Global Foods had said that but we conclude that it is likely that amounts representing at least some part of the duty on the release of the goods described in Deals 1 to 9 were paid directly to Seabrooks by Global Foods. That however does not mean that the duty related to goods which had actually been supplied by Beehive to KW and by KW to PWG because the supply of the goods may have been from Bozwel to PWG and passed neither through Beehive nor KW.

Money movements.

77. In his first witness statement Mr Donnelly says that once Patrick Galvin received his invoice he would call to confirm receipt and say that funds would be in KW's account shortly; those funds would be used to pay Riaz or the warehouse (he says that Richard Galvin would call shortly after to make sure payments were to the right places). On some occasions, however, he says that Patrick paid in cash in which case Mr Donnelly insisted that the money be paid into KW's bank account. Mr Donnelly said he would make payments to Seabrooks when necessary to release stock for delivery: Riaz or Patrick would tell him what was required. In his second witness statement he says that as the deals were back-to-back monies were paid directly by PWG (to Beehive he said orally) and KW would receive only the net commission.

78. KW's bank statements for the period March to September 2014 paint a conflicting and different picture. Those statements evidence 13 sets of transactions in which there is a credit of a large sum (generally round tens of thousands of pounds) to the account closely followed by the payment out of most of it. The transactions were the following (aggregating payments from or to the same persons and treating cash deposits equal to amounts which were stated on receipts apparently given to PWG evidencing that it had paid KW):

79. The first (in March) is the receipt of £50,000 from PWG and its payment to Seabrooks.

80. The second is the receipt of £50,000 from PWG, the payment of £46,500 to Seabrooks and the withdrawal of £3,500 in cash.

81. The third is the receipt of £42,000 from PWG, the payment of £39,550 to Seabrooks and the withdrawal of £3,000 in cash.

82. The fourth (now moving into April) is the receipt (in three round sum tranches) of £20,000 from PWG and its withdrawal in cash.

83. The fifth (now in May) is the cash deposit of the £14,000 and its payment to "InterCostCo".

84. The sixth is the cash deposit of £16,680 and the payment of £16,000 to InterCostco.

85. The seventh is the cash deposit of £16,000 and its payment to InterCostco.

86. The eighth (now moving into June) is the receipt of £30,000 from PWG and its payment InterCostco.

87. The ninth is the receipt of £40,000 from PWG, the payment to InterCostco of £20,000 and the cash withdrawal of £20,000.

88. The 10th (in July) is the receipt of £50,000 from PWG and the payment to Seabrooks of the same amount.

89. The 11th (in August) is the receipt of £47,000 from PWG, a cash payment of £40,500 and a payment of £2,000 to Seabrooks.

90. The 12th (in September) is the receipt of £99,000 from PWG and the payment of £50,000 to Seabrooks, the cash withdrawal of some £37,000 and a payment of £10,000 to InterCostco.

91. The 13th is the receipt of £100,000 from PWG, the payment of £80,000 to Seabrooks, and cash withdrawal of £20,000.

92. In summary there were: 10 transactions of receipt from PWG totalling some £530k; cash receipts of some £47k; 6 sets of payments to Seabrooks totalling £319k; six sets of payments to InterCostco totalling some £107k and cash withdrawals of some £144,000.

93. Finally we note that the Excise Duty invoices (and the corresponding WD5s each specify an amount of duty. The total duty specified in the first five invoices is £1,178,000. The total amount paid from KW's bank account to Seabrooks was £373k. Thus if the invoices really were invoices to KW and if they were in fact satisfied some payment of them must have been made by another party.

94. The first three of the sets of transactions described above are not inconsistent with Mr Donnelly's description of the way in which payments were made – namely by PWG to KW, and then by KW to Seabrooks - but thereafter the correlation disintegrates.

95. Mr Donnelly made no mention of InterCostco in his first witness statement save to say that, having been put in touch with them by Richard Galvin and Beehive, he took steps to exchange due diligence information with InterCostco with a view to trading with more suppliers. However he exhibited to that statement a letter from Beehive of 15 April 2014 in which Mr Ahmed said "I would like you to start payments to InterCostco…I will contact you by phone when I require monies to be sent…".

96. The due diligence information Mr Donnelly obtained showed InterCostCo to be a Cyprus company and much of the information obtained was (we think) in Greek. HMRC's enquiries of the Cypriot authorities indicated that payments from KW were received and were sent on elsewhere on the instructions of a French bakery.

97. In his oral evidence Mr Donnelly said that InterCostco was a company to which he had sent money on behalf of, and on the instructions of, Beehive - being money for the goods rather than duty - but he did not know a lot about InterCostco.

98. It his oral evidence Mr Donnelly said he was not able to tie the receipts and payments in the bank account to any particular Deals. As a result he was not able to say

at any time how much of KW's debt to Beehive in respect of any particular deal he had paid off. Across the 11 Deals Beehive had invoiced KW some £2.4 million. The sum of: payments to Seabrooks, payments to InterCostco and the cash withdrawals from the bank amount to some £570k. Thus it appeared that some £1.8 million was still owing to Beehive. Mr Donnelly was not able to say whether this was the case and said that Beehive had not chased for payment although he suggested that PWG might have made direct payment (and later he said that he had asked Patrick Galvin to pay Beehive.)

99. In a similar vein invoices to PWG totalled some £2.4 million and only £534k (or £580,000 if all the cash receipts came from PWG) had been received so that, as Mr Donnelly accepted in his oral evidence, some £1.9 million could still be owed by PWG to KW. Mr Donnelly offered no cogent explanation of whether this had been paid in whole or in part, and if not why not. He made the transfers he was told to make. He was not able to produce any records relevant to these matters.

100. In relation to the cash withdrawals, Mr Donnelly said that on occasion he paid cash to Beehive; he produced a receipt on Beehive printed paper signed by a Mr Ahmed for £31,500 (this was dated 3 April 2013, before the Deals were invoiced, but that could have been a typographical error for 2014). At first Mr Donnelly said that he could not remember any other large payments to Beehive and could not recall where the balance of the £144k cash withdrawals had been applied, but after overnight reflection he said that all or most of the cash withdrawn was paid to Beehive. He said he did not hand it over himself (consistently with his evidence that he had not met Mr Ahmed) but "someone he sent down there" would have done so.

101. This was not believable: we cannot see why a receipt would be given for £31,500, but not for amounts totalling some £110k; it seems highly unlikely that more than £80,000 would have been paid in cash to someone Mr Donnelly had not met without some form of receipt; and that he entrusted such a transaction to an un-named "someone".

102. We conclude from this evidence that:

(i) payments were made to and from the bank account at the instruction of Patrick Galvin (or possibly Richard Galvin);

(ii) Mr Donnelly was told what to do and did it. He was not told, and did not enquire as to, the link between a payment and any particular Deal;

(iii) it is not clear that there was any link between a payment and particular Deal or the release of any particular goods from Seabrooks;

(iv) the lack of correlation between, on the one hand, KW's sales invoices and payments from PWG, and, on the other hand, Beehive's invoices and payments to Seabrooks and Beehive meant that Mr Donnelly must have realised that the account was being used as a means of transmitting monies rather than as a repository of payments in respect of invoices rendered to and by KW in relation to the supply and receipt of goods; and

(iv) monies were likely (because of our findings in relation to the WD5s and Excise duty invoices) to have been paid to Seabrooks but not on account of a liability of KW to Seabrooks; rather they were for the account of Bozwell or another person and may or may not have related to goods supplied to KW.

Information in relation to MTIC fraud and VAT returns.

103. KW's VAT return for 04/14 was submitted on 18 July 2014. The 07/14 and 10/14 returns were received by HMRC later. Mr Donnelly told us that he gave the invoices for the returns to Richard Galvin who dealt with the submission of the returns. He said that at the time they were submitted he considered them to be "an accurate reflection of what was going on."

104. At the meeting of 28 May 2014, which took place before the submission of any of these returns, Mr Eaton explained VAT fraud and gave Mr Donnelly a copy of HMRC's leaflet "How to Spot VAT Fraud" and HMRC's Notice 726.

105. Mr Donnelly, in his first witness statement, says that at the meeting of 28 May 2014 Mr Eaton "in effect called me a liar and accused me of being involved in "missing trader fraud" ... as he left he gave me a brief overview of what he was accusing me of and suggested I read the section on due diligence."

106. HMRC's leaflet "How to Spot VAT Fraud" sets out on various grounds for suspicion that a dealing linked to may be linked to VAT fraud. Among those grounds are:

(1) instructions to make payments to third parties or offshore,

(2) instructions to pay less than the full price ... to the supplier

(3) repeat deals done the same prices

(4) small or consistent profit

107. A trader is advised that it may protect its business by checking that the goods exist and upon the commercial viability of a transaction.

108. We think it is inconceivable that Mr Donnelly did not see these statements given his feeling that Mr Eaton had accused him of being involved in such fraud. By May he had been involved in 9 Deals which he must have known all displayed some or all of the grounds for concern listed in How to Spot VAT Fraud.

109. Notice 726 is longer and less approachable. It relates principally to joint and several liability in respect of certain specified goods which did not include alcohol. Mr Donnelly said he did not read it in detail. We think it likely that such was the case.

110. On 19 June 2014 an officer of HMRC sent KW a letter warning of the dangers of becoming connected to VAT fraud. It gave examples of previous indications of VAT fraud including unusual trading activities or arrangements incompatible with normal market behaviour. We believe Mr Donnelly would have read this and that he must have known that the Deals fell within these categories.

111. Mr Donnelly says that after a meeting on 28 May he spoke to Richard Galvin who reassured him that all was well. We do not believe that Richard Galvin's assurances can have affected any conclusion he would have come to in relation to whether or not his transactions were connected to fraud.

Were the goods purported to have been sold actually supplied?

112. There was little evidence that the goods described on the invoices for the 11 Deals had actually been supplied by or to KW.

113. Mr Donnelly was asked at the meeting of 28 May 2014 whether the goods actually existed. He replied yes they did. Given our view of Mr Donnelly's evidence this would be a very weak ground for concluding that a supply was made by KW. Even if the goods existed it would not be evidence of their supply by KW.

114. Save possibly in relation to Deal 10, Mr Donnelly did not attempt to inspect the goods[2]. He could not therefore affirm their existence. Even if he had said that he had inspected the goods KW was buying, we feel his evidence would not have been worthy of great reliance. He said that Beehive agreed to arrange their delivery but the Mr Ahmad of Beehive to whom HMRC spoke said that he had not sold such goods. The invoices from Beehive to KW from Beehive to KW described the goods as being sold to KW but the evidence of the same Mr Ahmad was that they were not his invoices. We did not hear from the author of the invoices, whoever that was.

115. KW's invoices described the goods as having been sold; the evidential value of those invoices is very limited: they were presented and made out by Mr Donnelly whose evidence we have found unreliable, and who made no checks that the goods existed or that the person from whom he received the Beehive invoice owned the goods or had power to sell them. We have noted the inconsistencies between the invoices and purchase orders which further reduce the value of the invoices as evidence that the goods were sold by KW.

116. There was evidence from PWG in the form of its invoices to Global Foods that it had sold goods of the same description to Global, but not only was there no evidence that anyone from PWG had inspected the goods but that evidence would not have precluded the possibility that PWG had obtained the goods from another source.

117. On 30 April 2015 there was a meeting at PWG's premises attended by three HMRC officers, Patrick Galvin, and Anthony Galvin (PWG's legal advisor and Patrick's brother). The note of the meeting exhibited by Mr Eaton indicates that Patrick Galvin was asked to explain the payment arrangements in relation to alcohol trades for duty and invoices. It records that he said that KW invoiced PWG which in turn invoiced Global Foods, but that it was agreed that Global Foods would pay the duty to KW's account with Seabrooks and that a running total was maintained of payments made by Global to Seabrooks which was deducted from the amount owed by Global to PWG. Patrick Galvin said that he would pay KW's invoices once payment had been received from Global Foods.

118. This suggests that KW was making supplies to PWG and that PWG were making onward supplies to Global. But (i) we did not hear from Patrick Galvin and could not test his reported statements, and (ii) his statements about payments do not easily lie alongside the payments shown as received from PWG in KW's bank statement. We regard this as only weak evidence that KW received or made supplies.

[2] Mr Donnelly told Mr Jenkins that he went to inspect the premises at which the goods for Deal 10 were to be held after delivery by Riaz but that such a visit was unusual.

119. Whilst there was some evidence that goods of the relevant description had been received by Global Foods, the WD5s indicated that they had been owned by Bozwel (having been held for it at Seabrooks) and, there was no evidence to indicate that they had been supplied from Bozwel to a chain which included Beehive or KW.

120. As we note later, Richard Galvin had been made liable for a penalty assessed on Reddrock Ltd (of which he was a director) on the basis that it had fraudulently claimed input tax on non existent supplies. That suggests the possibility that Richard Galvin's association with KW may have involved similar activities.

121. KW's bank statements, showing payments to it from PWG were potentially evidence that some supply had been made by it to PWG. But the payments received by KW fall way short of the amount invoiced and even if Mr Donnelly's evidence that the payments (for the goods and the duty) were short-circuited - going from Global or PWG to Seabrooks or the initial supplier (Beehive, Bozwel or another), the lack of any record of what was paid to whom and for what mean that little, if any, weight can be attached to such payments as were made as evidence of KW's supply of the goods.

122. In his evidence Mr Eaton said that if this was an MTIC fraud it was unusual because normally in such frauds the goods were exported but here it appeared that noted goods of the sort invoiced ended up with Global Foods and been sold by them to Hammonds of Knutsford or a cash and carry. He said that on the basis of the information he possessed, that he thought that there had been a supply of goods. We were not as convinced by the evidence.

123. We did not find the representations made on behalf of Mr Donnelley at the hearing to be evidence that KW had made a supply.

124. We find that the evidence does not show that it is more likely than not that KW made (or received) the supplies described in the 11 Deals.

What did Mr Donnelly know?

125. For the reasons which follow we conclude that at the time the VAT returns were submitted Mr Donnelly knew that the transactions represented by the invoices in the 11 Deals were connected to fraud of some sort. That fraud could have been evasion of VAT by a person in the chain of supply to KW or the fraudulent use of KW's or others' VAT invoices in respect of non-existent supplies to claim input VAT.

126. We so find, first, because the following facts individually provoke the suspicion that KW was not engaged in a bona fide activity, and taken together permit no reasonable conclusion other than that there was a connection to fraud:

(1) Patrick Galvin at PWG gave KW orders for large quantities of alcohol and the only person who Mr Donnelly could find to make the supply was Beehive, one of the few companies on the list provided by Mr Galvin's father, Richard Galvin;

(2) for each and every Deal Beehive was able to supply precisely the quantities ordered by PWG;

(3) Beehive was the only supplier who agreed to give credit to KW. KW was a company with almost no net assets run by a person who, according to Mr

Donnelly, Beehive had not met: it was not a company which could be regarded as a good credit risk, even for the amount of the first Deal (some £185,000), let alone for all the 4 Deals invoiced on 3 March 2014 for a total of some £872k.

(4) Beehive imposed no terms and conditions of supply in transactions where there could be breakages, theft, wrong specifications, old stock and difficulties over payment. It imposed no payment terms.

(5) starting from scratch, £872,000 of Deals were agreed for the first day of trading;

(6) KW did nothing which gave value to PWG: if PWG had dealt directly with Beehive it would have had to provide the same paperwork (but with Beehive's name on it rather than KW's) and make the same telephone calls which KW made to Beehive. Richard Galvin could have provided Beehive's name to PWG as easily as he provided it to KW. Beehive, said Mr Donnelly, took care of delivery - and the delivery address was on the orders produced by PWG (and by KW to Beehive). KW did not hold, store or even inspect the goods which were said to have been sold. We do not believe that, after the first deal at least, Mr Donnelly approached any potential supplier other than Beehive: Patrick Galvin could have done exactly the same, cutting out KW. There was no commercial reason for KW's presence in the chain;

(7) indeed it appeared that PWG knew the price invoiced by Beehive since Mr Donnelly told us that KW made, and was allowed only a 0.2% markup on the price he paid, and unless PWG knew the price invoiced by Beehive, Patrick Galvin could not have (as Mr Donnelly said he did) required him to limit KW's markup to 0.2%;

(8) PWG's customer was known to Beehive in each Deal as the delivery address was shown on the order from KW. If these were genuine transactions it was odd that after the first few Deals, Beehive did not deal directly with Global Foods;

(9) the lack of any documented connection between KW's invoiced amount and payments received or one between the amounts invoiced to it by Beehive and payments made to Beehive, coupled with Beehive's apparent acquiescence in leaving very substantial amounts outstanding without chasing payment;

127. These factors indicate that the only explanation of the Deals were that they were connected to fraud and we do not believe Mr Donnelly thought otherwise.

128. But if Mr Donnelly had any doubts they must, in our view, have been dispelled by HMRC's notice "How To Spot VAT Fraud", a notice we found he read and must have understood before the returns were submitted. Of the grounds for suspicion in that notice four were present in KW's transactions:

(1) instructions were received to make payments to third parties, and offshore: and whereas the payments to Seabrooks might have been understandable in the light of the need to pay duty, there was no explanation for the payments to InterCostco;

(2) the full price appeared never to have been paid to Beehive;

(3) the prices invoiced by Beehive in each of the deals for the same goods were almost exactly the same; and

(4) KW took a small, consistent, profit.

129. But more than that, it seems to us that Mr Donnelly's actions indicated that he knew he was engaged in something dodgy:

(1) he did not take care of the details of the invoices and purchase orders. That indicated that he knew it did not matter precisely what was being supplied: all that really mattered was the production of a VAT invoice.;

(2) he kept no records of what he owed to Beehive or was owed by PWG, merely paying and receiving monies as he was told. (Mr Donnelly said at one point in his evidence he did keep those records and gave then to the Official Receiver when KW was in liquidation. The Official Receiver's report said he received no records. We declined to accept Mr Donnelly's evidence on this point.) That indicates that he knew that what KW owed or was owed did not matter: all that mattered was the production of an invoice and paper trail;

(3) his answers to HMRC's question at the meeting of 28 May 2014 included answers which were untrue or evasive: he made no mention of Richard Galvin's involvement; he suggested that no credit was given or taken; he said he could not "off the top of his head" remember the value of the trades (although later he suggested a figure for those already undertaken); he said that he had found Riaz on the internet. He had no need to be so evasive as if he had not known or, at that stage, strongly suspected that the Deals were connected to fraud;

(4) he did not attempt to inspect the goods KW was buying and selling. That indicates that he knew it did not matter what whether or in what state they existed.

130. Mr Novakovic argued that a number of factors indicated that Mr Donnelly did not in fact know of the connection to fraud:

(1) Mr Donnelly was new to alcohol trading and naive. The scale and complexity of the business was beyond his understanding. He did not know enough of how the industry worked to become suspicious.

But the factors we have listed above are not specific to alcohol trading. We are unable to conclude that, because this was alcohol trading, a different approach should be expected to credit, to the finding of suppliers, to the possibility of short-circuiting a supply chain where the supplier had the details of eventual destination of the goods, or to the making of payments to supplier and their receipt from customers. The factors which give rise to the smell which arose from these transactions would arise whatever the nature of the goods.

Further it seems to us that there were reasons why Mr Donnelly should have been suspicious of Richard Galvin's bona fides. It was odd that Richard Galvin should volunteer to act free of charge for KW but not for Mr Donnelly's other company Korum. It was odd Richard Galvin should ask him to sign an incomplete form 64-8 (as Mr Donnelly said he had). It was odd that Richard Galvin gave a list of suppliers to Mr Donnelly when he could have given it Patrick Galvin, his son.

(2) He says the arrangement under which KW took a fixed small return on his purchases and sales was a sensible commercial deal for someone learning the trade and seeking to build the business.

But what is suspicious is that KW did nothing for the (modest) return and that Mr Donnelly knew that PWG must have known the price being paid invoiced to KW.

(3) He says that Mr Donnelly bought and sold goods and market value: those were commercial deals.

But it was not the prices at which the goods were invoiced which gave rise to suspicion but the other circumstances of KW's activities. There was no evidence that the parties that the prices were at market rates in any event.

(4) He says Mr Donnelly did not understand the warnings given by HMRC at the 28 May 2014 meeting, and was understandably confused by Notice 726 which did not deal with alcohol trading and related to joint and several liability.

But even if Mr Donnelly did not understand Notice 726, we have concluded that he did understand and read the notice How to Spot VAT Fraud.

(5) He says that in response to HMRC's approaches Mr Donnelly sought the advice of Richard Galvin who assured him that all was well. Mr Donnelly relied upon Mr Galvin and that reliance was reasonable: he had known him for a long time and had no reason to doubt his knowledge or bona fides.

We accept that Mr Richard Galvin may have assured Mr Donnelly that all was well, and we also accept that he persuaded Mr Donnelly to carry on despite HMRC's visits and the concerns to which it gave rise. We accept that Mr Donnelly had known Richard Galvin for a long time. But Richard Galvin offered no explanation to Mr Donnelly of any of the suspicious circumstances. While we consider it possible that Mr Donnelly was browbeaten into continuing to conduct Deals (and acquiesced in the submission of the VAT returns) we do not believe that the pressure brought by Richard Galvin can have changed Mr Donnelly's understanding that these activities were connected with fraud.

(6) He says that having no doubts about the integrity of Patrick Galvin and Richard Galvin, Mr Donnelly had no cause to be suspicious of his transactions with them and so no reason to know that his transactions were (either unreal or) connected with fraud.

However even if Mr Donnelly had no doubts about the integrity of Patrick Galvin and Richard Galvin (and we treat his assertions that this was the case with great caution), the reasons for concluding that these Deals smell of fraud must have caused doubts as to their integrity. We do not believe that he honestly thought that their involvement meant that there was no connection to some fraud.

(7) He says that Mr Donnelly acted as a puppet for Richard Galvin (or Richard Galvin and Patrick Galvin) who told him what to do. He says they controlled KW's business through Mr Donnelly; Richard Galvin deliberately misled Mr Donnelly as to the nature of his transactions and their VAT treatment. Richard Galvin kept Mr Donnelly in the dark in the knowledge that if things went wrong Mr Donnelly would be a scapegoat.

We accept that Mr Donnelly did those things which Patrick Galvin and Richard Galvin asked him to do. They determined some of the activities of KW through Mr Donnelly. But we consider that Mr Donnelly did what he was asked in the knowledge that these were not commercial transactions and must have been linked to fraud.

They may not have told him the true nature of the business in which they knew KW was engaged, but Mr Donnelly acquiesced in those activities and for the

reasons already set out we believe that he knew that what he was asked to do was connected with some fraud.

(8) He says that as part of the orchestration of fraud and its cover-up Richard Galvin provided misleading Excise Duty Invoices, manufactured Exercise W5Ds and prepared VAT returns for KW which fraudulently claimed input VAT. Mr Donnelly did not know of that activity and did not authorise it.

We accept that it is likely that Richard Galvin produced a number of misleading Exercise Duty Invoices and fraudulent W5Ds, and that Mr Donnelly may not have known that they were fraudulent (he gave us the impression that he did not understand their content). But the nature of those documents was not the connection to fraud of which Mr Donnelley knew and, even if those documents had been genuine, they would merely have confirmed that duty had been paid on certain goods. As Mr Donnelly was not able to say on which goods the duty had been paid or how the duty had been calculated, they cannot have given much comfort to him as to the bona fides of the Deals.

Conclusion: the right to input tax credit in relation to the 11 Deals.

131. We conclude that either:

(i) if each of the Deals involved the supply of goods from Beehive to KW and from KW to PWG, then in relation to each Deal:

(a) someone had fraudulently evaded VAT on the supply to KW; so that KW's acquisition was connected with that VAT fraud; and

(b) KW through Mr Donnelly knew of the connection of the Deals to fraud;

and accordingly that KW was not entitled to credit for input tax on any Deal; or

(ii) if none of the Deals involved the making of a supply to or by KW, then no VAT supply was made by or to KW with the result that no input tax credit was available to KW (and, but see below, no output tax due on its purported supplies).

132. Thus in either case we conclude that KW was not entitled to the input tax which had been claimed in the returns for the 3 VAT Periods.

The penalty.

133. Paragraph 1 Schedule 55 FA 2007 makes a person ("P") liable to a penalty if P gives HMRC a VAT return which contains an inaccuracy which amounts to an understatement of P's liability to tax, and the "inaccuracy was careless or deliberate". If a taxpayer's action was deliberate and concealed the penalty is 100% of the "potential lost revenue" but is subject to a reduction for disclosure and special circumstances.

(i) An inaccuracy which amounts to an understatement of P's liability to tax.

134. Paragraph 28(d) Schedule 24 provides that a reference to understating a VAT liability includes a reference to overstating entitlement to a VAT credit.

135. We have found that KW was not entitled to VAT credit on any of the 11 Deals. As a result there was an understatement of its liability to VAT for the purposes of

paragraph 1 Schedule 55 in each of the VAT returns at issue. That is the case whether or not there was an overstatement of its output tax liability (see below).

(ii) A deliberate inaccuracy

136. The knowledge necessary to make a finding of a *deliberate* inaccuracy might lie with Mr Donnelly or Richard Galvin.

Mr Donnelly

137. It seems to us that if Mr Donnelly knew that the goods were not in fact supplied, then he would have known that no input tax credit was due. There was no direct evidence to this effect but Mr Donnelly knew the basic architecture of VAT and it is fundamental that VAT is creditable only on actual supplies made to a trader. He says he gave Richard Galvin the invoices on which input VAT was claimed and his acceptance before us of responsibility for those returns indicates that he knew that they claimed input tax on the Beehive invoices. If there was no supply he would thus have known that they were inaccurate returns. That would mean that the inaccuracy was deliberate on KW's part.

138. If there was in fact a supply of goods but the supply was connected with VAT fraud we have found that Mr Donnelly (and therefore KW) would have known of that fact. What is less clear is whether he would have known that as a result credit for the input tax was not due. At the time of the visit by HMRC on 28 May 2014 Mr Eaton explained how MTIC fraud worked but there is no evidence that he explained that knowledge of connection to fraud meant that input VAT was not recoverable.

139. By the time the VAT returns were made Mr Donnelly would have seen, and we believe read and understood, the leaflet How to Spot VAT Fraud. That notice said, under the heading How does this affect you?:

> "if you knew or should have known other connection with fraud HMRC may refuse your VAT claimed.

But that is not the same as saying that input tax was not claimable: it suggests that it might not be, but “may” indicates a possible discretion on HMRC’s part

140. Notice 726 deals with joint and several liability and does not deal with *Kittel* denial. Even if Mr Donnelly had read and digested all of it, it would not have told him that his input tax was not creditable.

141. In their letter of 19 July 2014 to KW, HMRC said that "if a business was not able to establish an audit trail for the supply ... you may be denied input tax". But it seems that the 04/14 VAT return was filed on 18 July before that notice was sent to KW. Mr Donnelly is unlikely to have been aware of its warning until after that return was filed. Further the warning is of potential denial, not a statement that the input tax was not claimable.

142. Accordingly, if there were supplies of goods on which on *Kittel* principles input tax was not creditable, then we are unable to conclude that Mr Donnelly knew that the claim to input VAT was inaccurate.

143. For the reasons set out above we consider that for an inaccuracy to be deliberate the taxpayer must know that the relevant piece of information is wrong. Thus Mr Donnelly's state of mind does not justify a finding that the inaccuracies in KW's returns were deliberate.

Mr Richard Galvin

144. Richard Galvin was in 2008 the sole director of RedRock limited. HMRC decided to disallow input tax on input VAT claimed in RedRock's VAT return for the period ending February 2008. One reason for HMRC's decision was that the supplies to which the relevant (input) invoices related had not taken place. RedRock appealed to the FTT and in 2012 the FTT rejected the appeal.

145. Evidence was given at that hearing by Richard Galvin and by Stephen Donnelly, Mr Donnelly's father. The FTT found Richard Galvin's evidence "unsatisfactory and unreliable in a number of respects". The FTT rejected Mr Stephen Donnelly's evidence that the supplies in question were made by a company owned by himself and Richard Galvin to RedRock. RedRock appealed unsuccessfully to the Upper Tribunal in 2014.

146. In June 2013 HMRC assessed RedRock with a penalty in respect of the input tax claimed on the supplies which had been denied on the grounds that they had not taken place. They also sought under section 61 VAT Act (VAT evasion: liability of directors etc), a predecessor of paragraph 19 Schedule 24, to recover the penalties from Richard Galvin. Richard Galvin appealed to the FTT. HMRC applied to strike out his appeal. The tribunal struck it out and a later application for its reinstatement was refused by the FTT in 2016.

147. We conclude from this that Richard Galvin was well aware that no input tax was allowable by reference to an invoice if the supply is stated on the invoice had not been made.

148. After the meeting of 28 May 2014 Mr Donnelly said that he received comfort Richard Galvin that the MTIC and VAT fraud issues raised by HMRC at that meeting should not concern him. Mr Donnelly's evidence on this point is supported by the form 64-8 which Richard Galvin sent to HMRC on the day after the meeting and also by Richard Galvin's later correspondence will HMRC.

149. We conclude that Richard Galvin would have been aware by the end of May 2014 at the latest that input VAT was not creditable if the supply was connected with VAT fraud and it was known, or should have been known that such was the case.

150. Richard Galvin supplied HMRC with copies of KW's VAT account and the associated invoices. He sent HMRC a copy of KW's VAT return.

151. Richard Galvin received the paperwork form Mr Donnelly. He knew the circumstances of KW's activities; he knew it had received orders from PWG and had used Beehive, one of the suppliers whose contact details he provided, to source the goods ordered by PWG, he knew (from KW's bank statements copies of which he sent to HMRC) of the dodgy financial arrangements surrounding those supplies. He therefore knew or should have known that either the goods did not exist (as had been

found to be the case by HMRC in relation to his dealings with RedRock) and/or that the transactions were connected with fraud

152. As a result we consider that he knew that no VAT credit was available in relation to the 11 Deals.

153. Thus if Richard Galvin prepared the VAT returns then he knowingly included a claim for input VAT which he knew was not due. That was a deliberate inaccuracy. Richard Galvin acted for KW and his actions in preparing returns are, in our view, to be taken to be those of KW[3]. Thus his preparation of the returns gave rise to inaccuracies in the returns given to HMRC which were deliberate on KW's part.

154. Even if Richard Galvin did not prepare the VAT returns he sent HMRC a copy of KW's sales and purchase ledgers and summaries of its VAT returns for the 3 VAT periods. These documents claimed input tax under the 11 Deals. They therefore "contain [ed] an inaccuracy which amount [ed] to ... an understatement of a liability to tax" within paragraph 1 Schedule 24. Richard Galvin would, in our view, have known this. The inaccuracy was therefore deliberate. That was the case whether or not a supply was made.

155. We conclude that whether or not a supply was made there were inaccuracies in the VAT returns for the 3 VAT Periods which were deliberate

(iii) Concealment.

156. An inaccuracy is concealed if "P makes arrangements to conceal it (for example by submitting false evidence in support of an inaccurate figure)" (paragraph 3(1)(c) schedule 24).

(a) if there was no supply

157. We have found that W5Ds sent to HMRC by Richard Galvin were false. It seems to us that they were tendered in support of the input VAT claims because they purported to indicate that the value of the goods (and thus the VAT) was high and that the duty had been paid on them. They may also have been submitted as evidence of the existence of the goods.

158. Richard Galvin also sent copies of the invoices from Beehive for the Deals to HMRC. If no supply was made these were false documents tendered in support of an inaccurate input tax VAT claim.

159. In an e-mail of 16 October 2014 Richard Galvin told Mr Eaton that the goods were delivered directly. He e-mailed Mr Eaton on 10 December 2014 telling him that where the goods in Deal 10 were stored. If no supply was made these were false statements in support of the inaccuracy in the VAT returns. Richard Galvin's activities

[3] We note that para 18 Sch 24 contains specific provisions in relation to the actions of agents, and that these provisions do not expressly deem the deliberate action of an agent to be the action of the taxpayer. But the provisions relate to the doing of something by the agent rather than the nature of an inaccuracy. We do not regard them as indicating that a deliberate action by someone who acts for a company is not a deliberate action by the company for the purposes of the schedule.

were clearly on behalf of KW and should in our view be treated as arrangements made by KW to conceal the inaccuracy.

(b) if there was a supply

160. If, on the other hand of the supply took place at input tax was not claimable by virtue of *Kittel*, there was in our view concealment of that fact because:

(1) no mention of the inaccuracy was made to HMRC;

(2) due diligence material was sent to HMRC giving the impression that KW had no doubts about the bona fides of Beehive;

(3) when asked by HMRC in letters of 23 March 2015 and 23 September 2015 how the inaccuracies arose Mr Donnelly made no reply.

161. Accordingly we find that, whether or not a supply was in fact made, KW concealed the inaccuracy in its returns from HMRC.

(iv) Reductions in the penalty

162. Paragraph 10(6) Schedule 24 provides that where a person who would be liable to a 100% penalty (as is the case for a deliberate and concealed inaccuracy – see para 4(1)) has made prompted disclosure to HMRC (as KW did by submitting, albeit with some delay, copies of documents sought by HMRC) HMRC may reduce the penalty to a percentage not below 50% to reflect the quality of the disclosure.

163. HMRC made a small reduction of 5% in the penalty for the limited disclosure made by KW. We see no reason to interfere with that conclusion.

164. A penalty may also be reduced under paragraph 11 schedule 24 if there are special circumstances.. It seemed to us that there was no such circumstance applicable to KW which would warrant consideration of a reduction in the penalty. HMRC noted in the penalty explanation letter of 23 November 2015 that there were no such circumstances. Accordingly we should not interfere with that decision.

(v) The potential lost revenue.

165. Absent reduction under the provisions above, paragraph 4 schedule 24 provides that the penalty payable for deliberate and concealed action is 100% of the "potential lost revenue". Paragraph 5 provides that this is the additional amount of tax which is due as a result of correcting the inaccuracy. The claim for input VAT was an inaccuracy. The result of correcting the claim is that no credit is available against KW's output VAT. As a result of the additional tax due is the amount of the input tax input VAT claimed.

166. If KW made supplies in the 11 Deals, the analysis stops here and the amount of the potential lost revenue (and so the amount of the 100% penalty) is the input tax claimed by KW on the 11 Deals.

167. However, if no supply was made it seems to us that the analysis is different. The difference arises because, if there was no supply, the output tax declared on KW's

return was not output tax within the meaning of section 24(2) VATA which defines output tax to mean “VAT on supplies [the taxpayer] makes”.

168. If there was no output tax then the question arises as to whether there was a second inaccuracy in KW’s VAT returns, namely the declaration of output tax when none was due.

169. If that is the case then paragraph 6(2) becomes relevant.

170. Paragraph 6(2) provides that in calculating the potential lost revenue where P is liable to a penalty in respect of "one or more understatements", account shall be taken of any “overstatement” in the same period.

171. Paragraph 6(3)(a) provides that "understatement" means an inaccuracy which satisfies Condition 1 of paragraph 1 Sch 24. Condition 1 is that the inaccuracy amounts to an understatement of P’s liability to tax. By paragraph 28(d) a reference to understatement of a liability to VAT includes a reference to overstating entitlement to credit. Thus KW's inaccuracies in relation to its input tax are understatements for the purposes of paragraph 6(2). Hence account must be taken of any overstatement.

172. Paragraph 6(3)(b) provides that an "overstatement" means an inaccuracy which does not satisfy Condition 1. If KW’s VAT returns should have shown no output VAT the statement in them that there was such VAT was an overstatement for these purposes because it was not an inaccuracy which amounted to an understatement of KW's liability to VAT.

173. If no supply was made in the 11 Deals no output tax is due. If the VAT returns submitted by KW require the output tax due to be stated, then filling in that part of the return with the VAT shown on the invoices to PWG was an overstatement for the purposes of paragraph 6. That means that account has been taken that overstatement in calculating the potential lost revenue.

174. If the only relevant entries required on the VAT return were output tax and input tax this would mean that there was no lost revenue. In that case the penalties would be nil.

175. When we asked in HMRC about this line of argument they submitted that paragraph 5 schedule 11 VATA had the effect that the amount shown as VAT on the invoices was recoverable as a debt due to the Crown and thus even if there was no supply "that does not alter the fact that output tax is still due".

176. In response we put the following argument to the parties.

177. Paragraph 5 schedule 11 provides:

> *(1) VAT due from any person shall be recoverable as a debt due to the Crown.*

178. This prescribes the recovery of VAT: it does not turn any debt to the Crown into VAT.

(2) Where an invoice shows a supply ... as taking place with VAT chargeable on it, there shall be recoverable from the person who issued the invoice an amount is equal to that which is shown on the invoice as VAT.

179. This makes the amount shown as VAT recoverable. It does not make the amount shown output VAT.

(3) subparagraph (2) applies whether or not

... (b) the supply shown on the invoice actually takes or has taken place

... any sum recoverable from a person under this subparagraph shall, if it is in any case VAT be recoverable as such and shall otherwise be recoverable as a debt due to the Crown.[our underlining]

180. This tailpiece distinguishes between true VAT (VAT which is "recoverable as such") and VAT shown on an invoice which is not VAT because there is no supply. Where there is true VAT it is recoverable under the provisions relating to VAT including those permitting the offset of input tax) ; if the amount is not VAT it is not recoverable under the accounting provision of the Act..

181. Section 1 VATA provides that value added tax is charged on supplies and "references to VAT are references to value added tax". There is no extension of the meaning of VAT to encompass debts to the Crown under para 5 Sch 11.

182. Thus if there was no supply, no VAT arose, although a debt use the Crown did. There was therefore no output VAT because that is defined by section 24(2), and no amount of output VAT should have been shown on the return.

183. As a result, unless the return required under regulation 25 lawfully required the making of a particular entry for amounts arising as debt due to the Crown as a result only of paragraph 5 schedule 11 (and HMRC do not so assert), there was no requirement to state any amount in respect of output tax or other debts to the Crown on the invoices for the 11 Deals..

184. We sought the parties' written submission on these issues after the hearing. We were grateful for HMRC's submissions. None were received from the Appellant.

185. Mrs Goldring argued that the declaration in a VAT return of an amount as output VAT where that VAT was that stated on an invoice in respect of which no supply had been made was not an "inaccuracy" (so that as a result it did not have to be taken into account (by deduction) in calculating the potential lost revenue).

186. She argued that UK domestic legislation must be interpreted in accordance with Article 203 of the Principal VAT Directive. Article 203, is part of Section 1 of Chapter 1 of Title XI of the Directive. Section 1 is subtitled (and concerned with) "Persons liable for payment of VAT to the tax authority". Article 203 provides simply:

"VAT shall be payable by any person who enters the VAT on an invoice."

187. HMRC assert that even if paragraph 5 Schedule 11 VATA does not (under a construction by reference to its words and context) deem the amount of VAT on the invoice or entered on the VAT return to be VAT, Article 203 does. Accordingly they

say that the amount declared as output tax by KW was output tax and there was no inaccuracy.

188. In support of this argument Mrs Goldring says that what Art 203 directs to be payable is VAT, not an amount due. She also drew our attention to three authorities.

189. The first was *Stroy trans EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalneneito* C-642/11 ("*Stroy trans")*. Stroy trans bought and sold fuel. The local fiscal authority concluded that some transactions had not taken place: *Stray trans* had not been supplied with the fuel. The fiscal authority denied Stroy trans credit for the input tax claimed but claimed from its supplier payment of the VAT on Stroy trans' supplier's invoice. The Court was asked whether Art 203 required payment even if there had been no supply and whether refusing the input tax credit was permitted if the supplier of the invoice had been required to make payment of the VAT stated on the invoice.

190. The CJEU said that the right to deduct input tax did not extend to VAT payable under Art 203 solely because the VAT had been put on an invoice – the right to deduct arose from receiving a supply. But it said, at [32], that the obligation under Article 203 seeks to eliminate the risk of loss of revenue which the right of deduction (of the addressee of the invoice) might otherwise entail, and, having regard to that objective and the possibility that an issuer may be able to correct an improper invoice where it had eliminated any risk of tax loss, Article 203 must be interpreted as meaning ([38]) that:

> "the VAT entered by a person on an invoice is payable by him regardless of whether a taxable transaction actually exists".

191. The Court held that the fiscal authorities could deny the right to deduct input tax even if the VAT on the fictitious output remained payable: the exercise of the right to deduction did not extend to VAT payable under Art 203 solely because it was entered on an invoice.

192. HMRC refer to the recognition by the Court that the prevention of possible evasion is an objective recognised by the Directive in Art 273 and say that it would be contrary to the spirit of the Directive if a person who had actually made a supply but whose input VAT was denied under *Kittel* principles because he has participated in a fraud was in a worse position than someone who had participated in a fraud where there was no supply.

193. The second case was *EN.SA Srl v Agenzia delle Entrate – Direzione Regionale Lombardia Ufficiio Contenzioso* C-712/17 ("ENSA"). In that case there was a series of fictitious transactions between companies in a group which included EN.SA. In those transactions electricity had purportedly been sold in a circle from one of the companies to the next at the same price. There was no loss of tax revenue. The local fiscal authority rejected ENSA's claim for input tax credit because there had been no actual transmission of energy and thus no supply to it, but it required VAT to be accounted for the VAT on the invoice for the fictitious supply by it. The authority also imposed a penalty equal to the improperly deducted VAT.

194. The CJEU considered the principal VAT neutrality, set against it the objective recognised in *Stray trans* of the prevention of tax evasion which Article 203 sought,

and held that proportionality required the obligation under Article 203 not to go beyond what was necessary to achieve that object. It concluded:

> 26. In the light of the foregoing, the answer to the first two parts of the question referred is that, in a situation, such as that at issue in the main proceedings, in which fictitious circular sales of electricity made between the same traders and for the same amounts did not cause tax losses, the VAT Directive, read in the light of the principles of neutrality and proportionality, must be interpreted as not precluding national legislation which excludes the right to deduct VAT relating to fictitious transactions while requiring the persons who enter VAT on an invoice to pay that tax, including for a fictitious transaction, provided that national law allows the tax liability arising from that obligation to be adjusted when the issuer of that invoice, who was not acting in good faith, has, in sufficient time, wholly eliminated the risk of any loss of tax revenue, this being a matter for the referring court to ascertain.

195. The Court then considered whether the penalty was disproportionate. We consider that issue later.

196. The third case was *Umaad Butt v HMRC [2019] EWCA Civ 554*. Mr Butt had been assessed with a penalty under the provisions of the, now repealed, section 60 and 61 VATA. Those provisions were similar to those under which Mr Donnelly was assessed. As in Mr Donnelly's case the assessment arose because the company of which Mr Butt was a director had been found to have dishonestly (rather than deliberately) evaded VAT in claiming input VAT on transactions it knew or should have known were connected to MTIC fraud and which were so connected.

197. Mr Butt appealed against the penalty on the basis that the CJEU's case law, in particular *Kittel*, could not be relied upon to impose penalties in the absence of specific implementing legislation. It was accepted that *Kittel* affected the construction of the domestic provisions relating to input tax deduction but it was argued that later CJEU decisions could not modify the effect of section 60 so as to extend the circumstances in which a penalty (which was treated as a criminal for the purposes of the Human Rights Convention) could be imposed.

198. The Court of Appeal dismissed the appeal. It held that judgements of the CJEU could have the effect of imposing obligations on a taxpayer which changed the previously recognised meaning of EU legislation or principle [38]. It held that section 60 provided a clear and an ambiguous basis for the penalty and since the company was not entitled to a credit the company, and so Mr Butt could be liable to the penalty. An EU judgement merely clarified and defined the scope of the law which ought to have been applied from the start [41].

199. HMRC say that Article 203 "defines and clarifies the scope of Schedule 24 of the Finance Act 2007 and paragraph 5 of Schedule 11 VATA 1994…and is properly to be read into the domestic legislation to enable a penalty to be issued in [a] 'no supply scenario'". They say it enables this by clarifying that the output tax declared on the invoices is 'VAT proper' as opposed to "deemed VAT" in accordance with Schedule 11 paragraph 5 VATA".

200. In reaching its conclusion the Court of Appeal considered the judgement of the CJEU in *Procura della republica* Joined cases C-74/95 and C-129/95. In that case an

Italian decree defined a "worker" in a particular way and imposed criminal liabilities on employers who failed to comply with its provisions. The question referred to the CJEU was whether the interpretation of "worker" in the decree should be affected by the wider definition of "worker" given in the Directive. The Court said:

> "23. It has consistently been held (see, for example, Case C-168/95 Arcaro [1996] ECR I-0000, paragraph 36) that a directive may not of itself create obligations for an individual and that a provision of a directive may not therefore, as such, be relied upon against such a person.
>
> "24. It is true that the national court must apply its domestic law as far as possible in the light of the wording and the purpose of the Directive so as to achieve the result it seeks to achieve … However, that obligation on the national court to refer to the content of the Directive when interpreting the relevant rules of its national law is not unlimited, particularly where such interpretation would have the effect, on the basis of the Directive and independently of legislation adopted for its implementation, of determining or aggravating the liability in criminal law of persons who act in contravention of its provisions (see in particular Case 80/86 *Kolpinghuis Nijmegen* [1987] ECR 3969, para 13).
>
> 25. More specifically, in a case such as that in the main proceedings, which concerns the extent of liability in criminal law arising under legislation adopted for the specific purpose of implementing a directive, the principle that a provision of the criminal law may not be applied extensively to the detriment of the defendant, which is the corollary of the principle of legality in relation to crime and punishment and more generally of the principle of legal certainty, precludes bringing criminal proceedings in respect of conduct not clearly defined as culpable by law. That principle, which is one of the general legal principles underlying the constitutional traditions common to the Member States, has also been enshrined in various international treaties, in particular in Article 7 of the Convention for the Protection of Human Rights and Fundamental Freedoms (see, inter alia, the judgments of the European Court of Human Rights in *Kokkinakis v Greece*, 25 May 1993, Series A, No 260-A, paragraph 52, and in *S. W. v United Kingdom and C. R. v United Kingdom*, 22 November 1995, Series A, No 335-B, paragraph 35, and No 335-C, paragraph 33).
>
> 26. The national court must therefore ensure that that principle is observed when interpreting, in the light of the wording and the purpose of the Directive, the national legislation adopted in order to implement it."

201. The CJEU therefore declined to answer the question about the scope of the term "worker" in the Directive, since even if it bore a wider meaning than that set out in the Italian decree, that could not affect the progress of the criminal prosecution against a person in the context of which the questions had been referred.

202. HMRC accept in Mr Donnelly's appeal that the penalty under paragraph 19 is a criminal penalty for the purposes of the Human Rights Convention.

203. Whilst the Court of Appeal in *Butt* accepted that the principle in *Procura* applied just as much to an a CJEU judgement as a Directive it distinguished *Procura* on the basis that that case, unlike Mr Butt's, was one where the domestic law was narrower than the directive. There was nothing in section 60 which expressly limited the circumstances in which the penalty can be imposed to cases where, for example, the

transactions were entirely fictitious. No changes were needed to VATA in order for the conditions for the application of sections 60 and 61 to be met in that case

204. In *Butt* the CJEU jurisprudence did not affect the definition of the offence: it did not require an extensive reading of section 60. But it affected the determination of whether the company was entitled to an input tax credit, the answer to which question which determined whether a condition for the offence was satisfied. That, the Court held, did not involve any change to the definition of the offence. Given the Court's acceptance that there was not difference in this regard between the effect of an unimplemented Directive and a decision of the CJEU, HMRC say that if the effect of Art 203 is to require para 5 Sch 11 to be read differently that is not impermissibly changing the definition of the offence in Sch 24. That we accept, but the premise of the argument is that Art 203 requires a change to para 5.

Discussion: Art 203.

205. There is no doubt that, whilst a Directive cannot create obligations on citizens, domestic legislation implementing a Directive should be construed so far as possible consistently with the Directive (see *Procura* [23 and 24] quoted above) and in order to achieve the result pursued by the directive and thereby comply with Community obligations (see *IDT [79]).* This form of construction can include reading words into, or recasting the words of, that domestic legislation. But this principle has limits: one is that it should not adopt a meaning inconsistent with a fundamental feature of the legislation (see *Ghaidan v Godin-Mendoza* per Lord Nicholls in relation to the Human Rights Act, adopted by Arden LJ in relation to VAT in *IDT at [86]).* A second limitation was that expressed by the CJEU in *Procura* at [24 and 25] (see above)

206. But the first step is to decide what EU principles and Art 203 require.

207. Art 203 says "VAT shall be payable by any person who enters the VAT on an invoice." Plainly this enjoins Member States to require persons who put VAT on invoices they issue to account for the amount of that VAT, but does it require member States to treat the amount paid as VAT or as output VAT? In the context of the Directive does VAT mean the tax or the amount?

208. Article 23 lies in the provisions of Title XI which relate to the obligations of taxable persons. The overall aim of those provisions is to create obligations. Article 203 lies in Chapter 1 of those provisions dealing with the obligation to pay. These provisions are not concerned with whether an amount is VAT or not: they are concerned with creating obligation and collecting the tax. Within Chapter 1 Section 1 which is subtitled (and concerned with) "Persons liable for payment of VAT to the tax authority" deals with who is liable to pay and Article 203 lies therein. The position of Article 203 in the Directive does not therefore suggest that it has a function in relation to the way a Member State must treat the amounts to be paid under it.

209. Can any assistance be drawn from the purpose of Article 203? In *Stroy trans* Article 203 was interpreted by the CJEU as seeking to eliminate the loss of revenue (arising from the failure of anyone to make payment) where the holder of an invoice with VAT on it claimed input tax when no one had accounted for that tax. The CJEU's phraseology is directed to that purpose, not to whether the sum required to be paid what was not VAT. It concluded that it meant that:

"the VAT entered by a person on an invoice is payable by him regardless ...".

210. This is a statement about liability, not about the nature of the payment.

211. Further, because Article 168 gives the right to deduct VAT due or paid in relation to an input, the neutrality of the tax does not require that the VAT shown on an invoice be VAT: what is deductible is the VAT due on the relevant supply (as the Court noted in *Stray trans* the right to deduction is dependent upon an actual supply and not upon VAT which is payable solely because it is put on an invoice). Thus where the VAT on an invoice is accounted for under Art 203 the amount paid does not play a role as VAT in the operation of the neutral VAT system in which VAT is chargeable on the price of a supply after deduction of the VAT borne directly on the cost components (Article 1(2)): the deduction arises from the VAT due on the input.

212. It did not seem to us that the judgement of the CJEU in *EN.SA* required an interpretation of Art 203 which required the liability of the invoice giver to be treated as VAT. It confirmed that Article 203 required EN.SA to pay the VAT it had put on the invoice for the fictitious supply, although subject to a requirement that the national rules permit later adjustment. That confirms the liability of the invoice giver but does not help in determining whether or not Article 203 required it to be treated as VAT.

213. The Court, as we have related, also addressed the question of the proportionality of the penalty. That issue we address elsewhere in this decision, but we saw nothing in the discussion of that matter which bore on whether the sums payable under Art 203 had to be treated as VAT.

214. We conclude that Article 203 does not require that the amount which becomes payable by virtue of it is to be treated as VAT for the purposes of the implementation of the Directive.

215. HMRC in effect argue that the permission given to Member States by Art 273 (which permits Member States to impose such other obligations as they shall deem necessary to prevent evasion) and the inherent objective of avoiding non taxation (see Arden LJ in *IDT at [95]),* require Art 203 to be interpreted as imposing a duty on Member States to equate the liability under Art 203 to a liability to pay VAT. But the countering of avoidance sought by the Directive is achieved by the obligation to pay; HMRC's ostensible argument that the penalty should be assessed as if what was collected from the invoice writer was in all cases VAT arises from the mechanism which the UK legislature has adopted for the imposition of penalties. That mechanism can be reviewed in the light of the Directive but cannot affect the interpretation of the Directive. The mechanism of providing for a penalty as a means of countering avoidance is permitted, where 'necessary', by Art 273, but is not part of what is enjoined by the Directive. As such how the penalty is calculated is not a concern relation to the interpretation of Art 203 or 273, although the requirement that it be "necessary" may, as *Procura* shows, raise issues of EU law.

216. Thus we see no other reason for interpreting Art 203 as requiring that the amount payable as a consequence of that article be treated for all purposes as VAT.

217. The next question is whether the UK's domestic legislation properly enacts the Directive. That question can be asked in relation to both para 5(2) Sch 11 and para 6

Sch 24 (although if it is argued that para 6 Sch 24 should be read differently that differentiates the argument from that in *Butt).*.

218. The form of para 5(2) schedule 11 (as we have construed it) achieves the object of revenue protection. If input tax is claimed in relation to an invoice it insures that the revenue representing that credit is received. It also satisfies the CJEU's paraphrase that "the VAT entered by a person on an invoice is payable by him regardless of whether a taxable transaction actually exists".

219. Thus unless Article 203 is properly to be regarded as requiring that the amount payable is VAT for all purposes (and we have concluded that it is not) , there is no need to consider whether para 5 can be construed so as to conform with the Directive, because it does.

220. The penalty regime of Sch 24 provides for penalty obligations imposed by the UK. So long as those provisions are proportionate to the aim of preventing evasion, the nature of the regime and the size of the penalties it prescribes are matters of discretion for the UK and, although they may be construed as part of the permission to enact anti-evasion measures, there is nothing in the Directive which requires a particular interpretation.

221. That leaves the question whether, because it must have the object of preventing evasion, para 6 Sch 24 should be construed as imposing a penalty which is calculated in such a way that a liability under para 5 Sch 11 is to be treated as output VAT for the purposes of para 6. In this regard it is true that if a penalty were larger it could be more of a deterrent. But if para 5 were construed so that in all such cases that liability were output VAT the provision would in circumstances similar to those in *EN.SA* be disproportionate. On the interpretation of Sch 24 and para5 we have adopted that result is avoided. It seems to us that the legislation has avoided that result, and that the pervading purpose of preventing evasion does not justify its resurrection.

222. If, contrary to the construction of Article 203 advanced above, it does require the amount of VAT shown on the invoice to be treated as VAT for the purposes of the Directive, the question arises as to whether para 5 can be construed to have that effect, or whether para 6 schedule 24 can be construed as containing a provision which requires para 5 to be so construed for the purposes of that paragraph.

223. The tailpiece of para 5(3) states:

> "and any sum recoverable from a person under [subparagraph (2)] shall, if it is in any case VAT be recoverable as such and shall otherwise be recoverable as a debt due to the Crown."

224. A construction of paragraph 5(2) which treats the sum recoverable as "real" VAT when it is not would make the final 12 words of this provision otiose and seems to us to go against the grain of the provision which carries with it an intention that there is a difference between real VAT and amounts equal to VAT. (A result which is reflected in the provisions for accounting for and paying VAT in sections 24, 25 and 26 VATA. Although such VAT is a debt due to the Crown by virtue of para 5(1), those provisions do not deal with the debts arising under para 5(2) which are not VAT.)

225. In *Butt* the Court of Appeal distinguished *Procura* on the grounds that in that case the national law was narrower than the Directive (and, because this was a criminal penalty for Human Rights Convention purposes, could not be widened by reading in the definition in the Directive), whereas in *Butt* the national law definition of the action necessary to give rise to the penalty was already clear. The issue in this appeal as to the proper interpretation of 'VAT' or 'output tax' does not affect whether or not an activity is subject to penalisation but affects the size of the penalty which may be exacted. *Procura* is therefore not strictly relevant to that issue, but we regard it as persuasive that if Article 203 does require the invoice giver's liability to be treated as VAT where there is no supply, that requirement of the Directive should not be read into para 5 or para 6 Sch 24 if it is not there already.

226. We conclude that neither the Directive nor the general principle of preventing avoidance require para 5 Sch 11 to be construed in such a way that a person who has incurred a liability to make payment by putting VAT on an invoice when he has not made the corresponding supply is to be treated as having incurred output tax, or para 6 Sch24 to be construed in such a way that for the purpose of calculating the penalty para 5 Sch 11 should be so construed.

Potential Lost Revenue – Conclusion

227. As a result we conclude that if there was no supply there was no potential lost revenue and the maximum amount of the penalty is nil.

228. On the other hand if there were supplies but *Kittel* applied, output tax remained due on KW's supplies and there was no overstatement within paragraph 6(2). On that basis the potential lost revenue was the amount of input VAT claimed and the maximum penalty was correctly calculated.

The attribution to Mr Donnelly: paragraph 19 Schedule 24

229. Paragraph 19 applies where "a penalty under paragraph 1 is payable by a company for a deliberate inaccuracy which was attributable to an officer of the company". We note that these words are concerned with the attribution of the deliberate inaccuracy. Thus both the inaccuracy and its deliberateness must be attributable to the officer. Thus the way in which the inaccuracy arose, the actions or inactions and the knowledge or conduct which made the inaccuracy deliberate are potentially all relevant to the apportionment of the penalty to an officer but not any participation in its concealment.

(i) Who were the officers of KW?

230. Paragraph 19(3) defines "officer" in a case of a company to mean "a director (including a shadow director within the meaning of section 251 Companies Act 2006) …or a secretary". That enactment provides that a shadow director means:

> "a person in accordance with whose directions or instructions the directors of the company are accustomed to act";

but subsection (2) provides that:

> "a person is not be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.

231. Mr Donnelly was the only director of KW. He was therefore an officer.

232. Were Richard Galvin or Patrick Galvin shadow directors?

233. Mr Donnelly's evidence was that Richard Donnelly would call him to check on what was going on. Although Mr Donnelly painted a picture of his relationship with Richard Galvin in which Richard Galvin was very persuasive in telling him not to worry after HMRC's visit and relation to certain later transactions (which are not directly to relevant as appeal), his evidence did not go so far as to say that in any particular part of KW's activity, other than his dealings with HMRC and marshalling of due diligence material, Mr Donnelly acted in accordance with Richard Galvin's directions.

234. In relation to his dealings the HMRC and his marshalling of due diligence material Mr Donnelly's evidence was that he acted on Richard Galvin's advice in an area in which he believed that Richard Galvin had professional expertise. Whilst there was no evidence that Richard Galvin had a recognised professional qualification, he plainly had expertise derived from the appeals with which he had been concerned and could fairly be said to have acted in a in "a professional capacity" in his dealings with HMRC and in advising Mr Donnelly, even though some of his actions could be said to have been unprofessional.

235. As a result we find that to the extent Mr Donnelly was accustomed to act in accordance with Richard Galvin's instructions as regards dealings with HMRC and due diligence material that did not make Mr Richard Galvin a shadow director. He was therefore not an officer who could be made liable for the penalty under paragraph 19.

236. In relation to Patrick Galvin, Mr Donnelly's evidence was that he made payments to and from KW's bank account in accordance with Patrick Galvin's instructions (but also on Beehive's instructions). There was no documentary or other evidence to support that evidence in relation to any single payment other than the otherwise unexplained nature of the bank account entries. We conclude that in this respect Mr Donnelly was accustomed to act in accordance with Patrick Galvin's instructions but there was no cogent evidence that as a general matter Mr Donnelly would arrange for KW to do what Mr Donnelly was told by Patrick Galvin. Therefore we do not find that Patrick Galvin was a shadow director.

(ii) attribution to other persons or officers.

237. It seems to us that paragraph 19(1)(b), which provides that HMRC may pursue an officer for "such portion of the penalty ... as they may specify" taken with paragraph 19(2), which does not allow HMRC to recover more than 100% of the penalty, allows for an apportionment of the penalty between two or more officers on the basis of their culpability for the penalty. In other words the degree to which the deliberate inaccuracy was attributable to each of their actions or omissions.

238. Mrs Goldring says that if another officer of the company had been issued with a penalty notice the tribunal would need to ensure that HMRC did not recover more than 100% of the penalty under the notices, but she submits that no other officer has been issued with a personal liability notice and that as HMRC are now out of time to issue a notice to any other officer the question of apportionment between officers is academic. That approach seems to us to treat paragraph 19 as a mechanism whose purpose is only

the recovery of a penalty. That seems to us to give insufficient weight to the fact that what is being pursued is a penalty – something assessed for a civil wrongdoing – and the attribution of a portion of that penalty which carries with it a sense that the portion should be based to some extent on culpability and not solely on having been the holder of an office. But in this case we have found that there were no other officers.

239. That leaves the question as to whether account should be taken in any apportionment of the activities of persons who were not officers. It seems to us that the object of paragraph 19 is to ensure that those who control a company do not permit or cause the company to commit deliberate inaccuracies in returns the company makes to HMRC. On that basis the fact that conduct giving rise to a deliberate inaccuracy penalty could be that of a person who was not a controller of the company is not intended to affect the potential liability of a controller, and 'controller' for these purposes is defined as directors and shadow directors. As a result even if the deliberate inaccuracy was also attributable to the actions of one or other of the Mr Galvins that cannot affect the amount properly apportioned to Mr Donnelley.

(iii) Attribution to Mr Donnelley.

240. Mr Donnelly was a director. He had a duty to ensure that KW's VAT returns were properly completed. He must in our view have been aware of that duty, and indeed he accepted that such was the case. His actions in giving the purchase and sale invoices to Richard Galvin permitted the inaccurate returns to be submitted and permitted Richard Galvin to do so deliberately. We conclude that the deliberate inaccuracies were attributable to Mr Donnelley. Since no other person had control over KW we see no reason for the portion of the penalty to which he is made liable should be less than 100%.

Proportionality

241. In ENSA Court held that the fine levied in that case was disproportionate.It said:

> 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 it pursues.
>
> 43.In the second place, in a situation such as that at issue in the main proceedings, the principle of VAT neutrality also precludes the imposition of a penalty such as that provided for by national law. In that situation, as before stated in paragraph 33 above, compliance with the principle of VAT neutrality is ensured by the possibility, to be provided for by the Member States, of correction any tax improperly invoiced in the case where the issuer of the invoice show that he acted in good faith or where he has, in sufficient time, wholly eliminated the risk of any loss of tax revenue.
>
> 44. However, as the Advocate General has stated in point 57 of her opinion, the imposition of a fine equal to the full amount of tax improperly deducted leads to

the possibility of adjustment in respect of the tax liability under Art 203 of the VAT Directive being redundant. Even if, in the absence of a risk of loss of tax revenue, that liability can be adjusted, an amount equal to the tax improperly deducted remains due by reason of that fine.

45. Consequently, the answer to the third part of the question referred is that principles of proportionality and VAT neutrality must be interpreted as precluding, in a situation such as that at issue in the main proceedings, a rule of national law under which the unlawful deduction of VAT is penalised by a fine equal to the amount of the deduction made.

242. HMRC say that in that case the fictitious sales did not give rise to any loss of tax because of the circular nature of the transactions; in Mr Donnelley's case there was a loss of tax which meant that the penalty in his case was proportionate.

243. If there were no supplies in the 11 Deals to or by KW then it seems to us that, even if we are wrong in our interpretation of para 5 Sch 11, the reasoning of the Court applies and a penalty of 100% of the input tax erroneously claimed is disproportionate.

244. If there were supplies but the input tax was not allowable under *Kittel* principles then because, by reason of the fraud in the chain of supply thee was a loss of tax, the reasoning does not apply, and the penalty is not disproportionate.

Conclusions

245. If each Deal involved a supply of goods by KW we would find:

(1) The supply was connected to fraudulent evasion of VAT;

(2) KW knew that the supply was so connected;

(3) As a result no input VAT credit was available in respect of the supply to KW but output VAT was due on the supply by KW;

(4) As a result KW's VAT returns were inaccurate because they claimed input VAT on the supply;

(5) Richard Galvin knew that the returns were inaccurate for these reasons and his knowledge can be imputed to KW;

(6) Thus the inaccuracy was deliberate; it was also concealed, and KW became liable to a penalty for deliberate inaccuracy of up to the amount of the input tax claimed;

(7) The discount of 5% from the maximum .penalty given by HMRC for cooperation should not be disturbed, not any reduction made for special circumstances; and

(8) The deliberate inaccuracy was attributable to Mr Donnelley and the penalty should be apportioned to him in full

246. So that on that basis we would dismiss the appeal.

247. On the basis that each of the Deals did not involve a supply of goods by or to KW we would find:

(1) No input tax credit was available in relation to each of the purported supplies to KW;

(2) No output tax was due in relation to each of the purported supplies by KW;

(3) As a result there were two inaccuracies in KW's VAT returns: one understatement and one overstatement;

(4) The inaccurate understatement was deliberate because Richard Galvin knew that no input tax credit was available;

(5) The company was liable to a penalty of up to 100% of the potential lost tax;

(6) Taking account of the overstatement the potential lost tax as a result of the inaccuracy was nil. Any other result would be disproportionate;

(7) As a result the penalty assessable on the company was nil;

(8) Therefore no penalty could be apportioned to Mr Donnelley.

248. On this basis we would allow the appeal.

249. The onus is on HMRC to prove the amount of the penalty in an appeal of this nature. They therefore need to prove that there was a supply. For the reasons given above we were not persuaded that it was more likely than not that the Deals did involve a supply of goods. Therefore we conclude that no penalty can be apportioned to Mr Donnelley.

250. The appeal is allowed.

Rights of Appeal

251. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 29 OCTOBER 2019