[2022] UKFTT 99 (TC)

TC 08429/V

VALUE ADDED TAX – restriction of deduction of input tax under the "Kittel" or "Fini" principles – whether input tax could be denied when the appellant made claims for inputs on supplies made by an associated company knowing that the associated company had not paid the output tax.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/00264 (V)

BETWEEN

GRANTHAM CEILINGS & INTERIORS LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE TRACEY BOWLER
SONIA GABLE

The hearing took place on 13-16 April 2021. With the consent of the parties, the form of the hearing was V (video) using the Tribunal video platform. A face to face hearing was not held because of the circumstances of the pandemic.

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

A summary decision was previously issued and the Appellant has asked for a decision setting out full findings and facts.

Mr Leslie Allen of Mischon de Reya for the Appellant.

Mr J. Millington, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents.

DECISION

INTRODUCTION

1. The Appellant ("GC"), a long established construction company, appeals against the decision of the Respondents ("HMRC") dated 8th August 2018 ("the Decision") refusing the Appellant's claim to the right to deduct input tax of £268,429 on supplies received from an associated company, Grantham Holdings Limited ("Holdings") during the 06/17, 09/17 and 12/17 quarterly VAT periods.

2. GC is a company which supplies building and construction services. Holdings had been set up for non-tax reasons to ring fence contracts with employees and subcontractors. It charged GC a management fee for the provision of its services. That supply was taxable for VAT purposes at the standard rate. Holdings never accounted to HMRC for the output tax due from it but GC claimed the VAT due on those supplies in its returns. After less than a year of operation, Holdings was placed into liquidation.

3. The Decision set out the basis of denial as being as result of HMRC being satisfied that either:

(1) GC had exercised the right to deduct for fraudulent or abusive ends; or

(2) transactions were connected with the fraudulent evasion of VAT and GC knew or should have known that this was the case.

4. The review confirmed this, relying on the assertion that the shared common directors of GC and Holdings would have known that Holdings would not account for the output tax due in relation to transactions between the companies.

5. The case is therefore about whether, and if so at what point, GC's behaviour in the context of the transactions and/or the claims made in its VAT returns was dishonest.

GROUNDS OF APPEAL

6. GC has set out the following grounds:

(1) Holdings was established in order to manage and implement a new payment bonus scheme. There was no intention to use the company for fraud or abusive ends;

(2) where GC has not paid Holdings in full the bad debt relief provisions of The Value Added Tax Regulations 1995 have been applied and the liquidator of Holdings is pursuing GC for settlement of the outstanding amounts as a debtor;

(3) at the time of the supplies made by Holdings to GC it was not known that, due to a serious problem with the contracts being undertaken by GC, substantial cash flow issues would occur. Therefore GC could not know or have reasonably known that the commercial issues of one contract would cause the liquidation of Holdings. The facts did not involve fraud but unfortunate commercial pressures; and

(4) on the facts of this matter HMRC have to prove dishonesty to a high degree of probability.

THE BURDEN OF PROOF

7. The burden of proof rests with HMRC. At the hearing it was recognised by Mr Allen that the ordinary civil standard of the balance of probabilities applies.

EVIDENCE

8. We have been provided with an evidence bundle running to 664 PDF pages. We also heard evidence for GC from Mr Green who set up GC; Mr Prescott who was a co-director of GC for most of the relevant period; Mr Grant who has worked for GC since 2007 and who was

appointed director of GC in January 2018; and Ms Brown and Mr Robinson of GC's firm of accountants – AP Robinson and Co. We also heard evidence from Officer Reed for HMRC.

9. Apart from Mr Green, the witnesses generally provided consistent evidence and answered questions in cross-examination directly. However, Mr Prescott was somewhat vague at times in cross-examination. In particular, when asked about whether VAT had been discussed at meetings, his knowledge regarding the VAT treatment of payments made by GC to GH, his discussions with Officer Read, and why he did not contact HMRC to ask for time to pay Holdings' VAT liability he repeatedly said that he could not remember. In such circumstances he therefore added little to the evidence of GC. Considering his memory problems, we have concluded that where his evidence on matters is otherwise inconsistent with other evidence, the other evidence should be preferred.

10. At times Ms Brown's evidence described what she thought she would have done in the circumstances rather than describing what she in fact did. However, she made this distinction entirely clear and explained that there were some matters which she simply could not remember. Mr Robinson's evidence was consistent, but at times it was clear that he was providing his opinion about matters such as, for example, whether GC and Holdings had a reasonable basis to conclude that debts would be paid depended upon the information provided to him by the business. Our role as fact finder means that we such opinion evidence must be assessed in the context of the evidence overall.

11. Officer Reed's Witness Statement and notes of meetings and telephone calls were not challenged and are therefore given full weight by us.

12. However, Mr Green's evidence displayed evasiveness and dissembling. For example, at one point when he was asked whether he was a director of GC, Mr Green said that he did not know, yet this is the man who set up the company and who has a long history of being a diligent and successful businessman. He frequently undermined his own Witness Statement and gave the impression that he had had little involvement in its drafting. At one point in the hearing he would not even accept that the sub-contractors were provided to GC through Holdings. He claimed that the contractors all in fact worked for GC and Holdings was just a paper company set up on the advice of the accountants for money reasons. The disconnect between his oral evidence and that in his Witness Statement was so great that Judge Bowler took the unusual step of checking with him part way through his evidence to ensure that Mr Green really wished to stand by his affirmation of his Witness Statement. Mr Green confirmed that it was indeed all correct even though his oral evidence frequently bore little relationship to his Witness Statement.

13. Despite this check and Mr Green's confirmation of his Witness Statement he later claimed part way through cross-examination that he had developed memory problems and could not remember much of that which was stated in his Witness Statement. No medical evidence was provided to show that Mr Green had any memory problems and, indeed, his representative had not identified any vulnerabilities of Mr Green before or at the start of the hearing. We were of the view that Mr Green was simply trying to find a way to avoid the issues being put to him by Mr Millington.

14. As a result of all these matters we have reduced the weight given to Mr Green's evidence. We give greater weight to contemporaneous evidence where it is inconsistent with Mr Green's evidence. We have also reduced the weight given to his evidence under general principles given the inconsistencies in it and the undermining of his own Witness Statement by his oral evidence at the hearing.

15. We have therefore made our findings relying on the evidence of other witnesses where there is inconsistency with Mr Green's evidence.

FINDINGS OF FACT

Background and operation of GC and Holdings

16. GC is a long-established company trading in the construction sector which was set up by Mr Green. It has been registered for VAT since 25 April 1994.

17. At the relevant times for the matters in this appeal the directors of GC were:

(1) Mr Green (throughout all the relevant VAT periods). He also owns more than 75% of the shares in GC;

(2) Mr Prescott (until 30 November 2017).

18. Holdings was incorporated on 20 December 2016. Mr Prescott was appointed a director of Holdings at the date of incorporation and was sole director for most of the relevant period. Mr Green was appointed director of Holdings on 14 December 201and Mr Prescott resigned as director on 2 January 2018. He ceased working for the companies around this time, although he agreed to continue to help to resolve the problems which had arisen.

19. Mr Prescott joined GC in January 2013 in order to run the company day-to-day once Mr Green had taken semi-retirement. He became a director of GC in October 2013. He was the main person involved with the operation of both GC and Holdings. He says in his Witness Statement that as the director of both companies he was involved with ensuring that payments to contractors were correct. However, he regularly reported to Mr Green and any major decisions had to be authorised by Mr Green.

20. Holdings was set up on advice from GC's accountants as a way of ring-fencing GC against employment status claims by sub-contractors. Holdings would employ staff and sub-contractors and charge a management fee to GC for providing services in doing so. Holdings was not VAT grouped with GC.

21. From 1 April 2017 all contracts with sub-contractors were entered into by Holdings. As Mr Prescott recognises in his Witness Statement, the structure requires both companies to work together and co-operate in relation to payments between the two in order to ensure that the contract would be progressed for the client and sub-contractors were paid promptly. Both companies operated out of the same offices.

22. We are clear that those running the business were fully aware of Holdings being used as the company to employ sub-contractors. One central administration for the GC business managed the affairs of both GC and Holdings. Until 30 November 2017 Mr Prescott was a director of both GC and Holdings and continued to be a director of Holdings until early January 2018. He was the person who contacted HMRC (in particular Officer Reed) regarding tax issues and he was particularly involved in the preparation of the accounts, especially the calculation of the work in progress figure for GC, as we address further below. We therefore find that Mr Prescott was aware of the commercial pressures faced by the business as well as the mounting tax debts at all relevant times.

23. We are also clear, as stated, that Mr Green, as the person who originally set up GC, was a key person in the business. He was a director of GC throughout the periods in dispute. He did not become a director of Holdings until November 2017, but we have little doubt, considering the evidence overall, that he knew of Holdings, its operations and the fact that a failure of GC to pay Holdings directly caused Holdings to be in a position of being unable to pay its creditors. He denied knowledge of the details of the ongoing disputes faced by GC, but we do not accept his claimed lack of knowledge or interest in the significant matters which were affecting his companies. He clearly maintained real involvement in his business which he had built up over many years. The financial problems faced by GC were what Mr Prescott

described as causing "massive cash flow problems". We do not accept that Mr Green was unaware of them.

24. The evidence consistently portrays Mr Green as a man who was heavily involved in his business and paid particular attention to costs. He was sufficiently involved in the detail of how matters were being run to query a small levy, but claimed that he never discussed the VAT position of the companies or had any knowledge of the tax affairs of GC and Holdings. That claim is inconsistent with the evidence from others, including his accountants and we have given less weight to his claim with the result that we find that he was aware of the tax affairs of GC and Holdings, at all relevant times.

The VAT histories of GC and Holdings

25. Holdings registered for VAT with effect from 1 April 2017 with a declared business activity of the 'provision of staff / Human resources management consultancy services' and an estimated annual turnover of £100,000. The VAT application, received by HMRC on 21 February 2017, was submitted by Mr Prescott as director. Holdings declared its involvement with GC and requested an identical VAT stagger to GC.

26. Once Holdings was employing and engaging sub-contractors it charged a management fee for those costs to GC. That management fee was a taxable supply for VAT purposes. In turn, GC claimed the management charges in its VAT returns as inputs.

27. GC continued to make supplies and to purchase supplies other than from GH. As a result, its VAT inputs did not equal Holdings' VAT outputs.

28. Payments were made by GC to Holdings as shown in the Appendix to this decision. The payments reflect the cash payments made by Holdings to GC. These payments have been treated as gross, VAT inclusive amounts by HMRC even though, as we explain later, they were, in fact, net payments made by GC excluding VAT. The gross VAT inclusive payments and the VAT amount of those payments resulting from HMRC's approach is as follows:

VAT period	Total payments	Total VAT payable
06/17	£249,610.85	£41,601.81
09/17	£906,046.90	£151,007.82
12/17	£454,920.00	£75,820.00
Total	£1,610,577.75	£268,429.63

29. GC submitted VAT returns for the relevant periods, which may be summarised as follows:

Period	Outputs	Inputs	Output tax	Input tax	Net tax
06/17	£993,663	£1,302,638	£198,732	£223,399	-£24,667
09/17	£1,298,018	£1,291,880	£259,603	£257,106	£2,497
12/17	£416,577	£483,511	£81,722	£95,217	-£13,495

30. The operation of Holdings fundamentally changed GC's VAT profile. GC changed from being a company declaring and paying net VAT to HMRC, in amounts varying in the previous two years between £23,000 and more than £100,000, to being a company reclaiming input tax in its 06/17 and 12/17 returns of nearly £25,000 and more than £13,000 with a small payment of £2,497 due from it in respect of its 9/17 return.

31. Holdings' first VAT return should have covered the 06/17 quarterly period. Ms Brown explains in her Witness Statement that an attempt was made to submit the 6/2017 VAT return but it was not possible because Holdings was showing as a missing trader on HMRC's system. Holdings' first VAT return was therefore submitted for an extended 09/17 period. There is no suggestion that the extended period arose from anything other than correspondence issues. There was no plan to operate Holdings with an extended first period.

32. Holdings' VAT returns may be summarised as follows:

Period	Outputs	Inputs	Output tax	Input tax	Net tax
09/17	£1,216,849	£1,027,029	£243,369	£104,387	£138,982
12/17	£386,344	£254,116	£77,268	£30,939	£46,329

33. Holdings made no payment to HMRC in respect of its VAT liabilities. Holdings entered creditors' voluntary liquidation on 16 May 2018, on which date it ceased to trade. The statement of affairs of Holdings dated 8 May 2018 and signed by Mr Green on that date listed assets of £10,000 cash in hand and £280,723 debt due from GC, and debts of £1,684 to trade creditors and £318,755 to HMRC.

34. HMRC does not assert that the liquidation was part of any plan to avoid VAT or other tax liabilities.

An overview of the problems

35. The problems arose from the significant financial difficulties affecting GC and the fact that those involved failed to take into account the VAT implications of the new structure, particularly in the context of the cash flow of the companies.

36. When Holdings charged GC a management fee of £100, VAT of £20 should have been applied. The structure was designed to have no net cost to the business: GC would pay £20 VAT to Holdings and reclaim that amount as input tax. However, it was introduced into a situation where there were already significant problems which were not just timing or cash flow problems, but real risks of insufficient funds being received by GC as a result of disputes. The structure exacerbated the problems because the supplies made by some contractors did not attract VAT (because they were operating below the VAT threshold) but were converted into a taxable supply made by Holdings to GC.

37. Instead, of GC paying the management fee plus the VAT, GC paid Holdings the net fees (which it needed to pass to the contractors) only, i.e. the £100. Holdings should have accounted for £20 output VAT and GC would claim £20 input tax, but this did not happen because Holdings was not paid the VAT and consequently did not have the funds to pay HMRC. Despite this, GC claimed the £20 input tax which it had not paid. (It is recognised that a company may claim input tax before payment and the issue here is whether the claims here were made dishonestly.)

38. It is worth noting at this point that, as noted above, HMRC has treated the £100 as £83.33 of management charge and £16.67 of VAT. HMRC has therefore assessed GC for the £16.67, not the £20.

39. The directors of GC had no real regard at the time to whether the payments made to Holdings were VAT inclusive or VAT exclusive. They simply concentrated on ensuring that the right money was paid to the sub-contractors via Holdings so that they would continue to work. In the minds of those running the business, GC and Holdings were all one pot, although Mr Prescott accepted at the hearing that he knew that the management charge was a taxable supply which gave rise to an additional amount of VAT due from GC. As he also described at

the hearing, GC and Holdings were entirely dependent upon each other and in particular, Holdings depended upon GC having sufficient funds to pay it.

40. None of the payments made by GC to Holdings were anything other than payments for the management charge/construction services. There were no loans or other finance.

The chronology

41. During the summer of 2017 Ms Brown became aware that GC (and in turn Holdings which was reliant on payment from GC) was having what has been somewhat optimistically called "cash flow" issues. (We explain why we describe the issues in that way later in this decision.) In the middle of the year (and therefore around June 2017) Mr Green became aware that GC had a "serious cash flow problem", but he says in his Witness Statement that he thought it was a timing issue. Describing the issues as ones of "timing" is somewhat disingenuous. They were not simply timing matters: we set out later how the disputes with customers were causing real and significant reductions in the amounts being paid to GC. Obviously, if the settlements were agreed and all the monies received then they would be seen as matters of timing, but there is little evidence of what sort of time period Mr Green may have had in mind, beyond the fact that, as we explain later, Mr Green was not prepared to risk providing a personal guarantee to get a loan to bridge the "timing gap". Moreover GC never received significant amounts it had originally expected. If it could take years for a portion of the monies to be received we do not consider that the problems could reasonably be called "timing issues".

42. GC prepared its own accounts at all relevant times. GC's balance sheet as at 30 June 2017 showed capital and reserves of nearly £250,000, but Mr Robinson explained that a large proportion of this reflected the freehold property of £215,000 and a debt due on a contract of nearly £155,000. That contractual debt had been owed for some years and would not be turned into cash easily. GC had very little in the way of liquid assets. The fixed assets had been provided as security for GC's overdraft.

43. The profit and loss account as at 30 June 2017 showed a loss of nearly £160,000. GC's viability turned on the value of its work in progress which was stated to be more than £640,000. However, Mr Robinson was clear that there were problems with the valuation of the company's work in progress and, in particular, a lack of understanding by Mr Prescott who was responsible for producing the figure.

44. On 28 July 2017 Ms Brown advised the business to put money aside for Holdings' VAT payment, noting that this was a particular issue as it was a double length period for the first return. However, no one at the business took that step.

45. The actual date of submission of GC's VAT return for 06/17 is not shown by the evidence, but it is clear that the earliest date for submission was 4 August 2017, and, as explained below, HMRC were querying it by 22 August 2017. We therefore find it was submitted prior to 22 August 2017 and most likely at least a few days prior to that date (given HMRC's processing times).

46. On 18 August 2017 Mr Robinson and Ms Brown met with Mr Prescott to discuss the management accounts and, in particular, the value of work in progress and the balance sheet of GC. At the hearing Ms Brown said she was confident that VAT would have been discussed at that meeting. We have little doubt that it would have been, given the evidence of the minimal cash available to GC even at the end of June 2017 and the evidence that no one had acted upon Ms Brown's advice to reserve the VAT due from Holdings.

47. On 22 August 2017 Officer Reed had received an HMRC query about the repayment claim made by GC in its return for the period ending 06/07. It had been selected for verification as a result of the new claim for repayment for more than £24,000.

48. As a result of the query, on 23 August 2017 Officer Reed telephoned Mr Prescott to discuss GC's VAT repayment claim. Mr Prescott explained that the repayment was due to a restructuring involving the use of another company (i.e. Holdings) through which much of the sub-contracted work would be contracted and which had issued GC with a large invoice leading to the repayment. He said that the repayment to GC would be used by Holdings to make its due payment of output tax, but that did not happen.

49. Officer Reed followed that up with a call to Ms Brown and an email explaining that the repayment of VAT to GC had been withheld pending the resolution of queries. Ms Brown replied to Officer Reed in an email with information relating to what would have been Holdings' first return, showing output VAT in the sum of £75,472.89 in respect of charges to GC. This was reflected in the increased input tax shown in GC's return.

50. As a result of these clarifications Officer Reed submitted GC's 06/17 VAT return for authorisation and payment. However the £24,667 repaid to GC was not used to enable Holdings to make its due payment of output tax as Mr Prescott had previously said it would.

51. Mr Robinson's evidence was that in August 2017 there was no concern that the business would be unable to pay the debts due to HMRC. It was expected that contractual disputes would be generally resolved. Otherwise, he said that he would have been suggesting that insolvency advice was taken at that stage. However, his evidence was also that the accounts were "not very pretty" in August 2017. Whether a solvency concern arose depended entirely upon the information provided to him by the business. As late as 9 October 2017 Ms Brown says in an email that the figures for the June 2017 accounts were only just being finalised because of "to-ing and fro-ing over the work in progress figure". As explained above, the accountants found Mr Prescott, in particular, had difficulties with the work in progress calculations and retentions. Therefore the fact that Mr Robinson had not reached the point of concluding that either Holdings or GC would be unable to pay their debts in August 2017 must be taken into account by us in the context of accounting information, core components of which were of doubtful reliability.

52. We therefore assess the extent to which there was real concern as to whether the business would be able to pay the debts due to HMRC having regard to the evidence overall. We come back to this matter later.

53. On 26 September 2017 Mr Prescott told HMRC that nearly £50,000 owed for PAYE and CIS would be paid by 29 September 2017. In fact, payment was made of just over £55,000 on 3 October 2017, but that was the last date on which any PAYE and CIS was paid by Holdings. That payment related to month 5.

54. By 29 September 2017 Mr Green was asking the accountants for a copy of GC's quarterly accounts. A few days later Mr Prescott emailed Mr Green to explain that, while the six month accounts showed a loss of £159,000, the year to date profit was around £138,000 and the balance sheet of GC looked healthy. However, the existence of a healthy balance sheet taking into account work in progress as well as fixed assets would not necessarily translate into healthy liquidity. It did not in GC's case.

55. GC's financial position was sufficiently weak that in September 2017 Mr Green did not receive his expected pay. On 4 October 2017 Mr Green queried why a construction industry levy had not been paid. By that time more than £1.1 million had been paid by GC to Holdings, but no money had been put aside to pay Holdings' tax liabilities, despite the clear advice from the accountants.

56. In early November 2017 Holdings' VAT return was filed and Ms Brown attempted on behalf of Holdings to arrange a time to pay agreement with HMRC. Normally this contact

would have been made by Mr Prescott, but he was in hospital and Mr Green was abroad. Therefore Ms Brown stepped in. Ms Brown did not contact Officer Reed with whom Holdings and GC had regular contact and who had spoken to Mr Prescott regarding the £24,667 repayment. Instead she called HMRC's National Advice Service and requested a payment plan for Holdings' VAT liabilities. HMRC explained that they could not enter into discussions with her as they did not hold authority for her to act. Ms Brown reported back to the business that she could not progress a time to pay agreement and advised the business to contact HMRC directly in order to stop penalties and surcharges arising. She thought that they would do so. However, no further action was taken by the business to contact HMRC about a payment plan, or even to let Officer Reed know that there were financial, or cash flow problems, despite Ms Brown's advice.

57. By that stage Holdings owed HMRC nearly £139,000 in VAT as well as PAYE. It was abundantly clear to all involved with the business that GC was not in a position to put Holdings in sufficient funds to meet its liabilities; hence Ms Brown's approach to HMRC to discuss a time to pay arrangement.

58. GC was not even able to pay the £2,497 VAT due from it in relation to the 09/17 VAT period. A delayed payment request was made by Ms Brown on 7 November 2017 saying that it would be paid in full by 22 November 2017, but the payment was never made. It was later set against the repayment due on GC's 12/17 VAT return on 5 March 2018.

59. Evidence has not been provided to show the date of submission of GC's 09/17 VAT return, but we find on the basis of Ms Brown's request for delay payment made on 7 November 2017 that the return had been submitted by that date.

60. On 20 November 2017 HMRC called Mr Prescott about the outstanding PAYE. He said that payment of the outstanding £84,000 of PAYE and CIS would be made on 27 November 2017 for months 6 and 7. No such payment was made. We cannot see any basis for the assurance given by Mr Prescott in that telephone call. Eventually HMRC had to write off more than £134,000 in respect of Holdings' unpaid PAYE and CIS.

61. Meanwhile, Mr Robinson had started to refer potential lenders to the business from the summer of 2017. One lender was prepared to offer a loan of £150,000 in early November 2017, but required a personal guarantee from Mr Green which he refused to give. His evidence at the hearing on this matter was particularly consistent and he makes clear that he was concerned that repayments would not be made and his personal guarantee would be called upon. He was not prepared to take that risk even for the amount of £150,000. We conclude that he was therefore fully aware of the precarious position of the business and that there was a real risk that the loan would not be repaid.

62. GC continued to pay Holdings with the money being directed entirely to the sub-contractors and none of it being used by Holdings to pay the outstanding VAT. Mr Green met with Mr Robinson on 15 December 2017. Mr Robinson has provided a copy of his handwritten note from the meeting which identifies that GC had a VAT liability of £2,497 which was to be paid that day, but no such payment was in fact made. The note shows clearly that the VAT and PAYE position of Holdings was discussed as well as the problematic cash position of GC.

63. On 12 December 2018 a meeting was held with a potential liquidator, but neither GC nor Holdings was put into liquidation at that point.

64. In January 2018 GC claimed repayment of a further £13,495.19 of input tax for the 12/17 period despite the fact that Holdings had never paid any of its output VAT and the evidence before us shows that it clearly was not in a position to do so and could not reasonably to expect to do so.

65. On 4 January 2018, Mr Prescott returned Officer Reed's call to discuss the PAYE position for Holdings. He said that he had spoken with his agents and an insolvency practitioner as he had been advised he may need to wind up Holdings. However, there were outstanding invoices and once those were paid the outstanding amounts due to HMRC would be paid. The reason the payments had not been made was that he had had an accident causing him to be in hospital for 3 days and off work for the 3 weeks before the call.

66. On 5 January 2018 Ms Brown emailed Mr Prescott to inform him about a letter from HMRC threatening to wind-up Holdings. Mr Prescott replied to say that the letter had been sent by HMRC prior to his telephone conversation on 4 January 2018. He said that he had told HMRC that he would revert to them with proposals by 18 January 2018. There is no evidence that he or any other representative of the business went back to HMRC with proposals.

67. On 24 January 2018 Holdings engaged an insolvency practitioner.

68. On 7 February 2018, Officer Reed received a further VAT repayment query from within HMRC in connection with the VAT return submitted by GC for the period ending 12/17. Officer Reed could see that Holdings had not made any payments and had an outstanding debt of £185,000. On contacting Ms Brown, Officer Reed was told that GC had completed its latest VAT return itself.

69. After making enquiries with GC directly Officer Reed was provided with journal entries showing management charges from Holdings to GC. Officer Reed did not consider that the journal entries constituted proof of payment. On 2 March 2018 Officer Reed received a copy of GC's VAT return data, including its purchase and sales ledgers, for the 12/17 VAT period from the company. The repayment claim was shown to relate to 'Management Charges' that she understood to have been charged by Holdings to GC. She was concerned that Holdings had not paid any of the VAT due respect of its returns and that this could be because GC had not paid sums owed to Holdings which gave rise to the repayment claim. However, she concluded that GC could make an adjustment in its next 03/18 VAT return under the bad debt regulations if that was so. She was not told that Holdings had engaged an insolvency practitioner the previous month.

70. By 18 May 2018 Ms Brown was again in contact with HMRC asking for a time to pay arrangement, this time for GC.

71. Officer Reed wrote to GC on 25 May 2018 explaining the requirement to adjust future VAT returns where input tax had been claimed in respect of amounts that had not been paid. She asked for bank statements from June 2017 to show payments had been made to be provided by 8 June 2018.

72. There was no response to Officer Reed's letter of 25 May 2018 and therefore on 12 June 2018 she wrote to GC to say that, as there was no evidence of payment in relation to the supplies from Holdings, she would disallow the associated input tax and issue an assessment. The assessment was for the sum of £152,580 – the total input tax claimed by GC in the periods 06/17 and 12/17.

73. Officer Reed was then sent copies of GC's bank statements showing payments made by GC to Holdings. Those payments are set out in the attached Appendix. Officer Reed subsequently discovered that Holdings had been placed into voluntary liquidation. That had taken place on 16 May 2018.

74. Officer Reed then concluded that GC had claimed the input tax in the knowledge that Holdings would not pay the associated output tax. She withdrew her assessment for the sum of £152,580 and issued the assessment that is the subject of this appeal. That covered not only the 06/17 and 12/17 periods but also the 09/17 period. Officer Reed treated the payments made

by GC to Holdings as being gross payments of the management charge and VAT. She has explained that she did this to ensure that only the VAT component of the monies actually paid to Holdings would be denied and not any which could have been subject to the bad debt provisions.

75. HMRC records show that on 29 June 2018 it was recorded that GC was unable to pay its liabilities in full due to bad debts. The company advised that action such as reducing outgoings would be taken to ensure that the payments could be made.

76. Throughout its life, Holdings paid all other trade creditors (save for a de minimis amount) and left the monies owed to HMRC as a debt.

77. There was no further attempt to enter into a time to pay agreement with HMRC beyond the one made by Ms Brown. We were told that it had been calculated that the business would need at least five years to pay the monies owed to HMRC and the accountants advised that HMRC would not give such a prolonged period of time to pay. That in itself is indicative of the depth of the problems faced and how there was no realistic prospect of paying Holdings' VAT liabilities in a significantly shorter period.

78. The statement of affairs shows that at liquidation Holdings owed only £1,684 to trade creditors out of a turnover of £1.6 million, but HMRC was owed £318,755. The debt owed to HMRC was made up of amounts owed for VAT, PAYE and the Construction Industry Scheme. More than £260,000 of the amount owed to HMRC reflected overdue VAT.

79. The liquidator's report of 3 June 2019 shows that at the time Holdings was placed into liquidation a sum of £280,723 remained payable by GC to Holdings.

80. However, the liquidator's report also shows that the liquidator had instructed solicitors to issue a winding up petition against GC, but when the liquidator was advised of HMRC's action against GC, the liquidator concluded it was no longer appropriate to proceed with recovery action in respect of the debt due from GC. That was because Holdings owed money to HMRC but HMRC's action meant that HMRC were also seeking the same debt from GC. The outcome of the litigation could therefore affect the debt owed by Holdings and as a result the liquidator decided that its outcome should be awaited. At that point GC had only repaid £1000 of the amount owed to Holdings.

81. Therefore, even in June 2019, GC was unable to pay the amount owed to Holdings and only avoided being wound up by virtue of the action taken by HMRC and the liquidator's approach thereto.

82. It was agreed that GC would pay £500 per month towards the debt owed by it, but GC stopped doing so in October 2019 after paying only £5000.

83. HMRC records show that GC finally entered into a time to pay agreement in February 2020.

The causes of the problems

84. The evidence for GC repeatedly came back to the issue of what were described as "cash flow problems" which GC blamed for the problems faced by Holdings. Mr Grant and Mr Prescott provided the most detailed evidence regarding disputes, although neither could provide details such as when the related contracts started and ended with any confidence.

85. Mr Robinson provided clear evidence that everyone involved in the construction industry knows that the full amount of expected payments will not be received on contracts. Every year the position of contracts and the value of work in progress would be discussed in detail between Mr Robinson and those running the business, in particular, Mr Green and Mr Prescott. The evidence is clear that in 2017 unusually problematic disputes were faced by GC.

86. There was one significant dispute ongoing in the summer of 2017. It had started in October 2016 before Holdings had been set up. It did not relate to work carried out by subcontractors when they were engaged through Holdings; the contract had ended in early 2017. However, it had a significant impact on GC's cash flow. GC had expected to receive more than £290,000 under the contract and nearly £213,000 was disputed. It only received £29,000 in October 2018. Mr Grant describes this as having "heavily contributed to severe cash flow issues" and told us that it was not expected to resolve quickly.

87. Mr Prescott explains in his Witness Statement that the departure of a contract manager and quantity surveyor at the beginning of 2017 created severe difficulties in resolving disputes.

88. Mr Green says in his Witness Statement that he became aware in the middle of 2017 that GC had a serious "cash flow" problem. We consider this to be a more accurate reflection of the position than some of his oral evidence seeking to downplay the issues.

89. So, by the middle of 2017 GC was facing significant problems in paying bills, with little prospect of a quick resolution.

90. Two more disputes arose in October 2017 and November 2017 in which the amounts disputed were just over £375,000 and nearly £123,000. Only £113,000 of the first was awarded to GC in April 2019 after significant legal and other costs of around £50,000-£60,000 were incurred. More than £80,000 of the second was agreed payable to GC in a settlement in May 2018.

91. Mr Robinson told us that although a dispute notice might arise at a particular date (so, for example, in October 2017 and November 2017 for the latter two disputes described above) there will have been some weeks of discussions before that point in which it would become increasingly clear that problems were arising.

92. Mr Prescott says that all three disputes "caused massive cash flow problems" for GC.

93. Given the evidence we have seen, we conclude that describing the issues as "cash flow problems" glosses over the more fundamental problems faced by the business. These were not situations where money was simply slow in being received, but the parties knew it was coming. Significant amounts were being disputed. Out of £711,000 being disputed only £222,000 was received and that was only after GC had incurred significant additional legal and other costs. It therefore failed to receive more than £0.5 million.

94. Considering the evidence overall about the disputes faced by GC, the contact with and advice from GC's accountants and GC's general lack of liquidity as shown in its accounts, we are clear that by June 2017, GC was facing very real problems in paying Holdings the invoiced management charges together with the VAT due thereon. It chose to make payments net of VAT hoping that more cash would be just round the corner, even though there was little basis for that hope.

95. In August 2017 Mr Prescott told HMRC that the £24,000 reclaim would be used for Holdings' payment of VAT, but it was not. The reserve advised by the accountants was not made. The actions reflect the financial problems faced by GC, which the evidence shows continued for a significant period after the liquidation of Holdings.

HMRC'S CASE

96. HMRC say the Decision is based upon the following principles:

> (1) The right to deduct may be denied where the taxpayer knew or should have known that its transactions were connected to the fraudulent evasion of VAT, per *Axel Kittel -v- Belgian State; Belgian State -v- Recolta Recycling SPRL* (C-439/04 and C-440/04), and/or

(2) The right to deduct ceases to exist 'where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent or abusive ends' per *S Fini H -v- Skatteministeriet* Case C-32/03.

97. In his skeleton argument Mr Millington relies on the cases of *Medallion Europe Limited -v- HMRC* [2015] UKFTT 0406 (TC) and *Victoria Walk Limited -v- HMRC* [2016] UKFTT 0687 (TC) to submit that *Kittel* is not limited to MTIC cases. He submits that it is not necessary for HMRC to allege or prove a premeditated, co-ordinated scheme to defraud HMRC of output tax on intercompany transactions. There is no allegation that Holdings was established to pursue a fraud against HMRC.

98. Mr Millington notes that both *Medallion Europe* and *Victoria Walk* were decided with reference to the now superseded test for dishonesty contained in *R v Ghosh* [1982] 1 QB 1053. He submits that the Supreme Court decision of *Ivey v Genting Casinos (UK) Ltd* [2017] UKSC 67 must now be applied. There is no requirement that a person appreciates their actions are dishonest. Instead, what the person knows or believes is judged by reference to the principles of ordinary, decent people.

99. Mr Millington submitted that Holdings traded to the detriment of HMRC by incurring output tax liabilities on supplies made to GC at a time when it knew that those liabilities would not, or could not, be satisfied. Applying the approach set out in *R v Grantham (Paul Reginald)* [1984] QB 675 (albeit with some caution given that it was a case considering the approach to a judge's direction) there is ample evidence to show Holdings must have been aware that funds would not become available to pay its debts to HMRC when they became due or shortly thereafter. Such conduct was dishonest applying *Ivey*.

100. Mr Millington says that the Court of Appeal's conclusion in *Mobilx* that the principle of legal certainty means that the right of an innocent third party to deduct input tax cannot be vitiated by fraud of the supplier or another person in the supply chain where he is not aware and could not have been aware of any connection to the fraud at the time of the transaction, is unarguable in the context of MTICs. However, he submits that where there is an inextricable connection between the supplying and receiving parties to a transaction a taxpayer should not be entitled to rely upon the principle of legal certainty to provide everlasting protection. This was reflected in the decision in *Victoria Walk*, but he recognised that the tribunal in *AMW Estates Ltd v HMRC* [2020] UKFTT 0410 (TC) disagreed with that approach. It concluded that the correct analysis should rely upon *Fini* and recognised that where a supplier in a transaction involving two connected parties is acting fraudulently then so too must be the recipient of the supply because the recipient must have the same knowledge.

101. In this case HMRC have denied GC's entitlement to the right to deduct based not only on *Kittel* but also *Fini*. Therefore the timing concerns identified in *Mobilx* would not apply. At the hearing Mr Millington summarised the position following *AMW* as follows: if GC was dishonest at the time of its supplies *Kittel* applies, but if at the time of its VAT return submission, *Fini* applies.

102. Officer Reed explained in her Witness Statement that she denied the value of the VAT on the actual payments made by GC to Holdings in each period so that only the VAT component of the monies actually paid by GC, and not any which could have been subject to bad debt provisions, would be denied.

103. At the hearing Mr Millington submitted that the evidence showed that the business limped through the whole of 2017. Holdings paid all of its trade creditors and ignored its VAT debts. Mr Prescott and Mr Green had been clear that keeping the business going by paying the sub-contractors was the most important matter at the time. Mr Green had even described the activity as "robbing Peter (I.e. HMRC) to pay Paul (i.e. contractors)".

104. He submitted that there had not been a cogent, innocent explanation to rebut the evidence from the facts, particularly taking account of the fact that Holdings had never paid any of the VAT debt at all. He submitted that the evidence shows that all involved were aware of the financial problems in the summer of 2017.

105. Mr Millington submitted that Mr Green's evidence had been internally inconsistent and inconsistent with that provided by Mr Robinson. As a result it should be given less weight.

106. Although the burden of proof was on HMRC the lack of evidence to support an innocent explanation on matters such as the contract lengths in the cases of the disputes blamed for the cash flow problems, and the likelihood of receiving some or all of the money quickly enough to fund Holdings' VAT liability, was marked. The evidence showed that there was never a point when GC could honestly believe that Holdings would pay the VAT due from it.

107. The evidence showed that by August 2017 it was known that Holdings would not be able to pay the VAT due from it and by November 2017 the evidence was overwhelming.

108. In relation to Mr Allen's submissions regarding HMRC's overall fiscal position, the case of *Caltel Telecom Ltd and another v Revenue and Customs Commissioners (no 2)* [2009] STC 2164 was relied upon.

GC'S CASE

109. GC denies dishonesty. HMRC accepts that Holdings was not established to pursue a fraud against HMRC and there is no allegation that the underlying transactions were in any way fraudulent. There is no allegation that the liquidation of Holdings was a contrived liquidation. HMRC are using their powers to assess in order to usurp the function of the liquidator who has stopped seeking any further repayments from GC until the matter is concluded.

110. Mr Allen submits that it was only in early 2018 that it became clear that disputes with third parties would not be settled quickly. Even after Holdings was put into liquidation, GC sought to agree with the liquidator time to pay the outstanding debt and was seeking time to pay the debt due to HMRC. These cannot be the actions of a dishonest trader. In January 2018 when it was clear that the amount of input VAT recovered exceeded the amounts actually paid, GC carried out a bad debt relief adjustment reducing the amount of its input tax.

111. Mr Allen agrees that *Kittel* is not limited to MTIC cases. However, he submits that the facts in *Medallion Europe* and *Victoria Walk* were very different. In particular, in *Medallion*, if the taxpayer had not been found liable there was no other way for HMRC to receive the money in liquidation. That is not the case here: the liquidator would pursue Holdings' other creditors. In *Medallion* the FTT found the case difficult where there was no return for 31 periods; here a much shorter period of time is involved.

112. Mr Allen agrees that the correct test for dishonesty is set out in *Ivey*. However, even as late as December 2017 GC took the view that if the payments could be obtained from the third parties with whom they were in dispute then the debt to HMRC could be paid in full. At the times when the input tax was incurred and claimed by GC there is no doubt that they were not being dishonest. They held a reasonable belief that the debt to HMRC would be paid.

113. Even when the liquidation was entered into, Holdings arranged a time to pay arrangement with the liquidator which would have taken some years. The intention to pay the debt was clearly shown.

114. Mr Allen submits that the case of *Davies and Dan Ltd and Anor v Revenue and Customs Commissioners* [2016] EWCA Civ 142 should be applied to determine the required level of knowledge. That should be judged by reference to the "no other reasonable explanation" test. In this case there were no suspicious circumstances. The cash flow difficulties ended up forcing

Holdings into liquidation and before doing so GC believed it would be possible to settle the debts to HMRC. The liquidation was not pre-planned in anyway and it was understood that the liquidator would continue to pursue the debt owed to Holdings by GC. That process should have been allowed to run its course.

115. Mr Allen refers to the Insolvency Act 1986 and the rules dealing with preferences. In this case HMRC are putting themselves in a position whereby if someone is at risk of going into liquidation they should repay their monies to HMRC before any other creditor. There is already a process and procedure for the debt owed to HMRC to be recovered.

116. At the hearing Mr Allen submitted that there was little evidence of any real concerns when supplies were made in April, May and June 2017. Mr Green was not involved with the operation of the companies until after July 2017. The key was what the directors of GC believed at the relevant times. Even as late as December 2017 GC's advisers were saying that if the trade debts were paid all would be well. The evidence showed that GC encountered a very disappointing set of debt settlements.

117. In this case there was a reasonable explanation for the actions taken: they enabled the continuation of the underlying business. Mr Green's unblemished history in business for more than 50 years should be taken into account. It was not unreasonable at the age of 74 for him not to wish to provide a personal guarantee for loan finance.

118. If the accountants had thought that there was no reasonable prospect of GC obtaining sufficient sums for the debts to be met they would have advised of the need for liquidation and that did not happen until the start of 2018.

119. Mr Allen cautioned against reliance on *R v. Grantham* given that the case solely concerned whether a judge had made an allowable direction.

120. No adverse inference should arise from the poor memory of Mr Green or Mr Prescott given that the events had taken place some four years before the hearing.

THE LAW

121. The right to deduct input tax from the VAT that a taxable person is liable to pay derives from Articles 167 and 168 of Council Directive 2006/112/EC.

122. In accordance with those provisions, ss 24-26 Value-Added Taxes Act 1994 ("VAT") contain the primary legislation setting out a taxable person ability to obtain credit for input tax as provided more fully in the VAT Regulations 1995. Those provisions are not in dispute in this case. Instead HMRC relies on the case law principles set out in the CJEU decisions in *I/S Fini H v Skatteministeriet* (C-32/03) ("*Fini*") and *Axel Kittel -v- Belgian State; Belgian State -v- Recolta Recycling SPRL* (C-439/04 and C-440/04).

123. In *I/S Fini H v Skatteministeriet* (C-32/03) ("*Fini*"), the ECJ held that the right to deduct cannot be relied upon for fraudulent or abusive ends and that it is a matter for the national court to determine whether this is the case.

124. In *Kittel*, the ECJ held that the national court should refuse the right to deduct input tax where the taxable person claiming the input tax on his purchase knew or should have known that the supply giving rise to the input tax was connected to fraud but that, in the absence of such actual or constructive knowledge of the fraud by the claimant, the right to deduct remained intact notwithstanding that it was connected with fraud by the supplier or by a person higher up the supply chain.

125. In other cases in this tribunal judges have considered the scope and application of *Fini* and *Kittel* in the context of transactions between related companies. It is accepted by GC that transactions between related companies can fall within the scope of the *Fini* and *Kittel*

principles and that those cases can be applied outside the context of MTIC cases in which they are most commonly engaged.

126. There has been some difference of opinion in this tribunal in the cases of *Victoria Walk* and *AMW Estates Limited* as to whether *Kittel* is restricted in its application to situations where there was the relevant knowledge of the fraud when the input tax became chargeable. In *Victoria Walk* the Tribunal decided that if at any stage in the transaction or reporting one of the parties was engaged in fraud that might vitiate its rights under the VAT system, then the other must equally be regarded as so engaged, with the result which was "not so much an application of the *Kittel* extension to the basic principle, but of the basic principle itself". The basic principle to which the Tribunal referred was that a person who is engaged in fraud cannot establish that the objective criteria which determine the scope of VAT and the right to deduct input tax have been met.

127. In *AMW Estates Limited* the Tribunal disagreed and decided that where there are associated companies, HMRC can deny a credit for input tax in reliance on both *Fini* and *Kittel* if the requisite fraudulent intent is shown to have existed when the input tax becomes chargeable (i.e. when the supplies were made); whereas if the requisite fraudulent intent arises only after that time, HMRC are limited to relying on *Fini*. We are aware that this decision has been granted permission to appeal to the Upper Tribunal.

128. In this case the parties agreed that we do not need to decide whether we agree with the approach of *AMW Estates Limited* or *Victoria Walk*. HMRC has relied upon both *Fini* and *Kittel*. That is because the result of the HMRC's reliance on both *Kittel* and *Fini* (assuming the narrower application of *Kittel* adopted in *AMW Estates Limited)* is that:

> (1) if we find that fraudulent intent only arose after the supplies were made and therefore input tax had become chargeable and the right to recover had arisen, the input tax recovery can be challenged by relying on the fraudulent intent of GC either in its own right or through GC's shared knowledge of Holdings' fraudulent intent applying *Fini*;
>
> (2) if we find that fraudulent intent arose at the time the supplies were made the input tax recovery can be challenged by relying on GC's knowledge of Holdings' fraudulent intent applying *Kittel*.

129. We have focussed this decision on whether the requisite intention arose at the time at which GC made its claims for input tax in its returns because in the circumstances of this case that would be the least demanding case for HMRC to prove.

130. However, *Kittel* and *Fini* are not just concerned with timing. *Fini* addresses a person's own fraud; whereas Kittel addresses knowledge of a supplier's fraud. We agree though with the conclusions in *Victoria Walk* and *AMW* that it makes little sense to distinguish the knowledge of the supplier and the purchaser where the two parties are connected. This is particularly the case here where Holdings and GC were run as one pot.

131. There is no case law setting out the exact parameters of what constitutes fraud, but some guidance can be obtained from *R v Grantham*. Although it was concerned with a direction made by a judge we do not consider that detracts from the fact that the Court of Appeal considered fraud could be found where a person realised at the time when the debts were incurred that there was no reason for thinking that funds would become available to pay the debt when it became due or shortly thereafter.

132. Even if we discounted the relevance of the *Grantham* decision, as Mr Allen submitted we should, the parties agreed that the underlying issue is whether GC was dishonest. Although we are not bound by these decisions, we note and agree with the approach in *Medallion Europe* and *Victoria Walk*, where the First-tier Tribunal in each case effectively equated fraudulent

conduct with dishonesty. Notably, each of those cases involved facts which significantly overlap with those in this case.

133. In *Medallion Europe* a remarkably similar factual scenario was involved in which one company made supplies to the appellant where both of them were under common control, there was no intention to set up a scheme to defraud the revenue and payments were made to workmen to enable the business to continue rather than to HMRC. *Victoria Walk* similarly involved a supply of management and construction services by one associated company to another.

134. However, both of those cases applied the test to determine dishonesty in *R v Ghosh* [1982] 1QB 1053 which has subsequently been superseded (as acknowledged by both parties) by the test set out in *Ivey v Genting Casinos* (UK) Ltd [2017] UKSC 67 at para 74:

> "When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement that the defendant must appreciate that what he has done is, by those standards, dishonest."

135. Notably, *Ivey* makes clear that there is no requirement that the taxpayer in a case such as this must appreciate that what he has done is, by the standards of ordinary decent people, to be dishonest.

136. Mr Allen says that we should apply the "no other reasonable explanation" approach set out in *Mobilx* as shown by *Davis and Dan*. However, we consider that the "no other reasonable explanation" approach does little more than require the Tribunal to consider the totality of the evidence and the explanations given by an appellant in determining whether the requisite knowledge arises, or should be treated as having arisen.

137. Finally, we address the submissions made by Mr Allen about the ability of HMRC to rely on its claim in the liquidation process, the application of bad debt relief and the existence of established procedures to deal with any preference given prior to insolvency. However, we do not consider that any such process and remedy detracts from the issues before us which fundamentally are concerned with whether GC acted dishonestly such that it lost its right to deduct input tax attributable to the Holdings' supplies. In that regard we consider the decision in *Caltell Telecom Ltd* to be informative. Although that case was considering a different point concerning the ability of HMRC to claim more than their loss, we consider that the principles should be applied in the context of Mr Allen's submissions. In particular, we refer to paragraphs 96 – 99 of that decision in which Mr Justice Floyd said:

> 96. In my judgment there is no principle which requires HMRC to acknowledge a claim to repayment to the extent that the claim exceeds HMRC's tax loss. … The question is accordingly whether the taxpayer has or does not have the right to deduct or reclaim his input tax in respect of an individual transaction. Consideration of this question does not justify recourse to the overall fiscal impact on HMRC of all the transactions in the chain.
>
> 97…But, once it is established that a taxpayer has, by his purchase, participated in the fraudulent evasion of VAT, it seems to me to be impossible to argue that, by withholding repayment of VAT in respect of that very

> purchase the taxpayer is being subjected to a disproportionate remedy. In fact, to use the VAT legislation to achieve any benefit from such a purchase seems to me to be wrong in principle.
>
> 98. Thirdly, although fiscal neutrality is a fundamental feature of the system of VAT, and the right of any trader to deduct input tax is an important feature of the system of ensuring fiscal neutrality (see e.g. *Kittel* at [48]), the fiscal neutrality of an individual transaction will, as *Kittel* shows, have to give way to the objective of combating fraud.
>
> 99. It seems to me that the objective of not recognising the right to repayment is not simply to ensure that the exchequer is not harmed by fraud: the objective includes combating fraud and discouraging taxpayers from entering into transactions of this nature. In that context, considerations of fiscal neutrality of the impugned transaction are, it seems to me, beside the point."

DISCUSSION

138. As explained, the primary issue for us is whether GC acted dishonestly and if so at what times it did so. Clearly a company's honesty must be judged by reference to those running it and, in particular, its directors. Mr Green was director of GC at all relevant times. Although he was not a director of Holdings until November 2017, he was involved in all significant issues regarding the operation of the business and we have found that the evidence shows that all involved viewed the two companies as effectively one pot. In addition, Mr Prescott was sole director of Holdings until November 2017, during which time he was also director of GC. Throughout that period his knowledge and intent are therefore also of particular importance.

139. It is possible we could conclude that GC was not dishonest at certain times in the period in dispute, but was dishonest at other times; or, of course, that it was not dishonest at all.

140. In this context it is helpful to note particular dates and events in the timeline as follows:

(1) Holdings' VAT registration on 1 April 2017;

(2) the first payment made by GC to Holdings for the taxable supplies made by Holdings on 22 May 2017;

(3) submission of GC's VAT return for the 6/17 period which occurred between 4 and 22 August 2017;

(4) the submission of Holdings' VAT return in early November 2017;

(5) the submission of GC's VAT return for the 09/17 period shortly before 7 November 2017;

(6) the submission of GC's VAT return for the 12/17 period in January 2018.

141. The first relevant VAT return to which the *Fini* principles could be applied was therefore submitted in early August 2017 and therefore the first period we consider is around that time.

142. It is clear to us, and not disputed, that there was no co-ordinated plan to avoid VAT. It is also clear (and indeed recognised by the witnesses) however, that those running the businesses of GC and Holdings prioritised the payment of trade creditors over HMRC. We understand the commercial drivers behind this which were amply described by Mr Prescott and Mr Green. If the contractors were not paid, the business could not function. However, the question for us is whether the actions and intent overall of those involved in the context of the submission of GC's VAT returns were dishonest.

143. The particular factors which weigh against finding dishonesty are:

(1) The consistency of the witnesses for GC in describing the problems often faced by those operating in the construction industry as a result of disputes and negotiation of contracts. Their evidence shows that cash flow problems frequently arise in that industry; and

(2) The evidence of Mr Robinson that in August 2017 there was no concern that the business would be unable to pay the debts due to HMRC.

144. Considering these factors further, we note that there was always an inbuilt cash flow issue given the way the business was conducted. GC would pay contractors (via Holdings) for work done on a monthly basis and for supplies. It would then submit a valuation to the customer who would have one month to agree the valuation and then one further month before payment was due if the valuation was agreed. Therefore even in the absence of any disputes there was always a time lag of at least two months between costs being incurred and customers paying.

145. As we have explained the new structure exacerbated the standard cash flow issues. In some cases sub-contractors could be operating under the VAT threshold and therefore their non-taxable charges were converted into taxable charges when passed through Holdings. Ms Brown commented that this was no more than a cash flow issue as there would be a charge and a reclaim, but that assumes that the companies would be in a sufficiently healthy state to manage that issue.

146. We heard from several witnesses that cash flow issues resulting from disputes are endemic in the construction industry and that disputes generally resolve. However, we did not hear that those involved expected the particular disputes identified as causing the problems to resolve quickly and, in particular, during 2017. These problems were described as "unusual", "causing massive problems" and "very significant". As we have found, the way in which the disputes progressed and the loss of more than £0.5 million bears witness to the seriousness of the problems, which were more than simply matters of timing.

147. If GC had financial problems then so did Holdings. The priority for the business was to ensure that the contractors were paid as without them they could not continue operating, and we are clear that throughout the operation of Holdings, payments were made by GC net of VAT as a result of the financial problems. However, GC's financial problems were deep-rooted and long-standing. It is notable that the first dispute which we are told by GC set in train the payment problems was nothing to do with work engaged through Holdings. That contract had finished before Holdings operated. By August 2017 the business was facing two more disputes because, as we have explained, the actual disputes would have been preceded by weeks of problems and discussions about the relevant contracts.

148. Turning to the evidence of Mr Robinson (who told us that in August 2017 there was no concern that GC would be unable to pay its debts as otherwise insolvency would have been advised), as we have explained earlier that evidence must be considered in the context of the other evidence about assessment of the value of assets in its accounts which supported Mr Robinson's conclusion. In particular, the work in progress was valued by Mr Prestcott and there were real concerns about his ability to do so.

149. We recognise that we need to consider the knowledge of those involved at the relevant times and we are looking at evidence with the benefit of hindsight. However, the evidence shows that there was little basis for the claimed hope that the money problems would soon be resolved. The disputes took until May 2019 to resolve and even after that resolution GC faced liquidation because it continued to be unable to pay its debt to Holdings. |We do not consider the hope of money being received in such circumstances provides a reasonable explanation for the conduct in relation to the VAT returns.

150. We consider that Mr Robinson's evidence is insufficient to counter the conclusions that we derive from the evidence overall that, even in August 2017, it was very likely that Holdings would be unable to pay the VAT due to HMRC in any reasonable time period. That conclusion is reinforced by the fact that Mr Prescott asked for the repayment of the £24,667 to GC on the basis that it would be passed to Holdings for it to pay its VAT bill and then GC retained it. No explanation was offered by Mr Prescott to us for the assurance given to HMRC about the destination of the money, or the failure to carry it out. Given the evidence overall regarding the financial position of GC, we find little basis other than to conclude that when Mr Prescott told Officer Reed that the £24,000 would be used to pay Holdings' upcoming VAT bill, he knew that this was very unlikely to take place. We find that this behaviour was dishonest. If he had been open and honest with Officer Reed, when she had raised the query with him, Mr Prescott would have explained the financial difficulties faced by the business.

151. That dishonesty does not in itself determine whether the submission of the claim earlier in the month was also dishonest, but it is relevant in considering the knowledge and intent of GC just a short period before given that very little changed in the interim. We also satisfied that the evidence overall leads us to conclude that the submission of GC's VAT return in August 2017 was done knowing that Holdings was very unlikely to be able to pay its VAT liability. We agree with Mr Millington's submission that, in effect, GC was using its VAT repayment claims as a form of loan, albeit one which the lender, HMRC, had not been asked to approve.

152. We recognise that Holdings was able to pay PAYE and CIS payments start of October 2017, but this money had been withheld from employees' and contractors' pay. In addition, the ability to do so must be set against the inability to pay Mr Green his salary in September or even to pay the small construction industry association levy of £2,497 in November 2017.

153. The evidence shows that as time progressed through 2017 there was no greater basis for those involved to conclude that Holdings would be able to pay its VAT liabilities. Indeed, matters deteriorated as the second and third construction disputes formally started. In November 2017 Ms Brown told the business to contact HMRC to seek a time to pay arrangement, but this step was not taken. The evidence was that HMRC was not asked for a loan through a time to pay arrangement because it was known that Holdings would not get the five year period estimated to be needed. That in itself is consistent with concluding that GC's claim for input tax was made knowing that Holdings would not, in any reasonable time period, be able to pay its VAT liability.

154. The evidence is consistent in showing that Mr Green did not want any of his companies to go into liquidation. That was a matter of pride for him. However, at the end of the day he was not prepared to risk his own assets in order to secure a loan to deal with the cash flow problems faced by his business. Mr Green's concerns about offering a personal guarantee sum up the precarious situation GC and therefore Holdings faced. Those concerns were particularly evident in the context of the loan offered at the start of November at around the very time GC submitted its 09/17 return. We recognise that Mr Green was around 74 years old at the time, but that does not detract from the fact that he perceived real risk in offering a personal guarantee for the loan and that is not consistent with claimed confidence that monies would start flowing and Holdings would be able to pay the VAT owed.

155. GC submitted its 09/17 return in early November 2017. On 7 November 2017 Ms Brown contacted HMRC to say that the amount of just £2,497 would be delayed. In fact, it was not paid. The depth of financial problems is illustrated by the problems with paying this relatively small amount.

156. By 20 November 2017, only a couple of weeks after submission of the GC 09/17 VAT return, Mr Prescott was telling HMRC that payment of the outstanding £84,000 of PAYE and CIS would be made on 27 November 2017, yet again such assurance came to nothing and the payment was not made. Just three weeks later a meeting was held with a potential liquidator.

157. The GC return for 12/17 was submitted in January 2018 - the same month in which an insolvency practitioner was appointed for Holdings. Yet still GC claimed the input VAT which it had not paid, knowing Holdings would not be able to pay its VAT det to HMRC and still without any contact with HMRC to explain the situation. Indeed, in Mr Prestcott's call with Officer Reed to discuss the outstanding PAYE, he noted the possibility of Holdings being wound up but said that the outstanding amounts due to HMRC would be paid. We see no basis for this assurance. By this time there could have been no basis to expect that Holdings would pay its VAT liabilities. Finally, Holdings was put into liquidation even though it was in fact GC which was in financial difficulty. Indeed, Holdings would have had a healthy balance sheet if there had been a reasonable prospect of realising the debt owed to it by GC.

158. We were repeatedly told that those involved thought that if the disputes were settled GC would pay Holdings, but that was a very significant caveat. We readily accept that if the disputed money had been received the outstanding amounts would have been paid by GC to Holdings. Furthermore, this is not a case of a pre-planned fraud or an MTIC arrangement. However, making the GC reclaims for VAT which had not been paid to Holdings and which GC knew Holdings would be unable to pay to HMRC given the deep-rooted financial problems was dishonest when the approach required by *Ivey v Genting* is applied of that of the ordinary decent person.

159. We recognise that the business was facing real commercial and financial pressures, but, despite advice to do so, it failed to take the open and honest course of contacting HMRC to explain the problems faced. Instead, Mr Prescott provided reassurances to HMRC that money would be forthcoming and even caused a repayment to be made on the basis that it would be used to fund Holdings' liability. Even if it was thought that the likely period for a time to pay arrangement would be insufficient, those involved would be presenting a very different case before us if the step of speaking to HMRC about the financial problems had been taken.

160. For all these reasons we therefore conclude that:

(1) submission of GC's VAT returns in August 2017, November 2017 and January 2018 was done knowing that Holdings would not pay its VAT liabilities and

(2) GC's claims for input tax made in respect of the 06/17, 09/17 and 12/17 periods were made dishonestly.

CONCLUSION

161. The appeal is dismissed. The decision of HMRC dated 8 August 2018 refusing GC's claim to deduct input tax of £268,429 on supplies received from Holdings during the 06/17, 09/17 and 12/17 quarterly VAT periods is confirmed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

162. 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.

TRACEY BOWLER
TRIBUNAL JUDGE
Release date: 16 MARCH 2022

Appendix - Transfers from GC to Holdings

Period	Transfer	VAT period	Total for period	VAT element
22-May	£6,900.00			
25-May	£16,000.00			
09-Jun	£6,000.00			
09-Jun	£37,049.94			
12-Jun	£50,000.00			
16-Jun	£10,000.00			
22-Jun	£102,079.21			
26-Jun	£3,181.70			
29-Jun	£18,400.00	06/17	£249,610.85	£41,601.81
07-Jul	£101,292.80			
20-Jul	£139,070.77			
21-Jul	£52,000.00			
04-Aug	£130,836.00			
07-Aug	£3,000.00			
16-Aug	£2,000.00			
17-Aug	£125,000.00			
23-Aug	£4,000.00			
24-Aug	£21,333.05			
31-Aug	£78,514.28			
31-Aug	£105,000.00			
18-Sep	£93,000.00			
29-Sep	£51,000.00	09/17	£906,046.90	£151,007.82
03-Oct	£52,000.00			
03-Oct	£63,000.00			
13-Oct	£38,000.00			
16-Oct	£1,320.00			
19-Oct	£50,000.00			
27-Oct	£81,300.00			
06-Nov	£1,000.00			
10-Nov	£45,000.00			
24-Nov	£35,000.00			
04-Dec	£3,000.00			
08-Dec	£36,000.00			
20-Dec	£16,300.00			
21-Dec	£33,000.00	12/17	£454,920.00	£75,820.00
TOTAL				£268,429.63