

[2010] UKFTT 238 (TC)

TC00537

Appeal number: LON/2004/0210

**FIRST-TIER TRIBUNAL
TAX**

ERF LIMITED

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS (VAT)**

Respondents

**TRIBUNAL: JUDGE ROGER BERNER
MR TYM MARSH (Member)**

Sitting in public at 45 Bedford Square, London WC1 on 15 – 19 March 2010

Paul Harris and **Ewen West**, instructed by **Clifford Chance**, for the Appellant

Nicola Shaw and **Michael Jones**, instructed by **the General Counsel and Solicitor to HM Revenue and Customs**, for the Respondents

DECISION

1. ERF Limited (“ERF”) appeals against assessments to recover amounts of overclaimed input tax and a civil evasion penalty. The assessments and the penalty arose in consequence of VAT returns dishonestly made by the financial controller and company secretary of ERF, Stephen Ellis, over the period 1996 to 2001. Following the discovery of financial irregularities and the suspension and subsequent sacking of Mr Ellis from his employment with ERF, an investigation was conducted under the new approach to investigations in civil evasion penalties (“the New Approach”). This involved the preparation of a number of reports by BDO Stoy Hayward (“BDO”), advisers to ERF. It is from the assessments and the penalty imposed in this connection that ERF now appeals.
2. ERF was represented by Paul Harris and Ewen West. Nicola Shaw and Michael Jones appeared for HMRC.
3. We heard oral evidence on behalf of ERF from Mr John Bryant who from November 1991 until his dismissal from ERF was its managing director. For HMRC we heard oral evidence from Miss Patricia Stocker, a Senior Officer, and Mr Philip Harold, a Higher Investigation Officer specialising in civil evasion casework. We also had an unchallenged witness statement from Mrs Kathryn Fereday, a Higher Officer. We also had a number of bundles of documents.

Jurisdiction: appeals out of time

4. Before turning to the substantive issues in this case we must first consider a submission on behalf of HMRC as to our jurisdiction in relation to appeals against the assessments dated 13 March 2001, 5 February 2002, 8 April 2002 and the amended assessment of 29 April 2002. (There is no dispute as regards jurisdiction in respect of the assessment dated 4 March 2004.) Put shortly, HMRC say that there has been no appeal in time in respect of these assessments, and that we should refuse any application to appeal out of time.
5. Following the hearing, and at our request made during the hearing, Mr Harris and Mr West provided us with a summary of the grounds on which each of the assessments was challenged, on an accounting period by accounting period basis. On the basis of that schedule we understand that there is in any event no challenge to the March 2001 assessment, and that the only challenges outside the March 2004 assessment are in respect of 01/00 in the April 2002 assessments (original and amended) and 07/00 in the February 2002 assessment.
6. Mr Harris argued that, properly understood, the notice of appeal in this case, dated 11 March 2004, is an appeal in respect of all the assessments. He said that it was common ground that the March 2004 assessment was a net balancing assessment and that this cannot therefore sensibly be understood except by reference to the previous assessments. He argued that it would not be possible for a tribunal to have regard only to the March 2004 assessment and to disregard

the others in coming to a view as to the true amount of tax for the relevant periods.

7. Considering the 11 March 2004 appeal on its face, we can see no force in any argument that this can be an appeal in respect of any assessment other than, as described by the notice itself, that “in the amount of £5,041,464 (by notice of assessment dated 4 March 2004)”. The notice of appeal refers to the previous assessments in order to explain the basis of the appeal against the March 2004 assessment, but, although it would have been possible to refer to the notice as an appeal against the earlier assessments, that was not done.
8. Even if the 11 March 2004 notice of appeal had constituted appeals against the earlier assessments, those appeals would have been out of time. Under rule 4 of the Value Added Tax Tribunals Rules 1986, which was the rule applicable at the material times, a notice of appeal had to be sent to the appropriate tribunal centre before the expiration of 30 days after the date of the document containing the disputed decision of HMRC. This was not done for the assessments in question, and so the appeals in respect of the 2002 assessments are out of time. The notice of appeal does not contain any application for permission to appeal out of time. We agree with Miss Shaw that this strongly indicates that the notice of appeal did not relate to the earlier assessments.
9. In their statement of case dated 28 February 2006 HMRC set out their position regarding ERF’s appeal, namely that it was in respect of the March 2004 assessment alone. Mr Harris argued that HMRC regarded the notice of appeal as an appeal covering all assessments, referring to the evidence of Mr Harold that “... within seven days of me assessing, ERF paid the penalty in full, and then ERF appealed everything we had done, including their own figures ...”. We do not consider that what Mr Harold had to say in this regard can necessarily be construed in the way Mr Harris argued for; in our view it could equally have referred only to the March 2004 assessment, as that was the only assessment (along with the penalty assessment) that emanated out of the New Approach process with which Mr Harold had been concerned and which commenced after the 29 April 2002 amended assessment. Irrespective of that, in our view the understanding of HMRC in this respect is not material to the question of what assessments were in fact appealed. Viewed objectively it is clear to us that it was the March 2004 assessment alone.
10. In their skeleton argument Mr Harris and Mr West ask the Tribunal to extend the time for appeals against the March 2001 (not now relevant), February 2002 and April 2002 assessments, using its discretion under rule 20 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (“the Tribunal Rules”). That rule refers to the Tribunal extending time for the notice of appeal under rule 5(3)(a). Alternatively, the Tribunal is asked to permit the notice of appeal to be amended so that the assessments can be brought within the present proceedings. Miss Shaw, rightly in our view, argued that both would be required. We therefore now turn to consider whether we will exercise our discretion in ERF’s favour.

11. Miss Shaw asked us to remind ourselves that, in deciding whether or not to exercise our discretion in this case, this is the most significant extension of time that the Tribunal can grant, because it gives the Tribunal a jurisdiction that it otherwise would not have. Miss Shaw argued that, as a minimum, ERF must demonstrate a good reason why the Tribunal should exercise its discretion. She referred us to the case of *Robertson v Bexley Community Centre t/a Leisure Link* [2003] EWCA Civ 576 in the Court of Appeal. That concerned a case under the Race Relations Act 1976 which had been brought out of time to an employment tribunal. The tribunal declined to exercise its discretion to consider the case out of time and allowed the appeal. The wording of the particular provision (s 68(6) of the 1976 Act) in issue in that case was not the same as the wording of rule 20 or rule 5(3)(a) of the Tribunal Rules. The employment tribunal and the Employment Appeal Tribunal had to consider whether it would “in all the circumstances of the case be just and equitable to consider [the appeal] out of time”.
12. The Court of Appeal held (at [24]) that the tribunal had a wide ambit within which to reach a decision. In the context of employment and industrial cases Lord Justice Auld went on to say (at [25]):

“It is also of importance to note that the time limits are exercised strictly in employment and industrial cases. When tribunals consider their discretion to consider a claim out of time on just and equitable grounds there is no presumption that they should do so unless they can justify failure to exercise the discretion. Quite the reverse. A tribunal cannot hear a complaint unless the applicant convinces it that it is just and equitable to extend time. So the exercise of discretion is the exception rather than the rule.”

Bexley Community Centre was referred to by the Upper Tribunal (Tax and Chancery) in *John Wilkins and others v Revenue and Customs Commissioners* [2009] UKUT 175 (TCC), to which Miss Shaw also referred. In *Wilkins* the Upper Tribunal (The President, Mr Justice Warren, and Judge Bishopp) remarked that the observation of Auld LJ in *Bexley* was “made in the context of an expressly more onerous test [and] should be treated with some caution in other contexts”. We likewise approach that observation cautiously. In our judgement the correct approach is to consider the exercise of our discretion in the context of the overriding objective of the Tribunal Rules, that of enabling the Tribunal to deal with cases fairly and justly (Rule 2). This involves balancing the interests of the parties.

13. Mr Harris argued that, if we found (as we have) that ERF’s appeal was out of time, there was nevertheless no prejudice to HMRC. HMRC had considered all the evidence and had formulated its case on the basis of the assessments as a whole. Miss Shaw submitted that there was prejudice. She referred us to the following passage from *Wilkins* (paras [45] and [46]):

“45. The 30-day time limit is long established and well-known, and is there for good reason. Contrary to the appellants’ argument, there

is prejudice to the government (or other taxpayers) in having to meet large, unexpected claims since they are disruptive of the government's planning of its income and expenditure. The time limit, short though it may be, is justified for that reason, and in the interests of legal certainty, and should not be lightly extended.

46. In this context, it is worth repeating what Henderson J said at paragraph 164 of his judgment in *Chalke*:

'It is apposite in this connection to have in mind the 'very illuminating general discussion' (as Lord Walker termed it in *Fleming* at paragraph 58) by Advocate General Jacobs in *Fantask A/S v Industriministeriet* (Case C-188/95) [1997] ECR I-6783, ('*Fantask*') where he emphasised at paragraph 71 of his opinion 'the need for states and public bodies to plan their income and expenditure and to ensure that their budgets are not disrupted by huge unforeseen liabilities', and in paragraph 72 'the need, recognised by all legal systems, for a degree of legal certainty for the state, particularly where infringements are comparatively minor or inadvertent'.' "

14. Miss Shaw identified three particular points in weighing up the competing factors that she argued come out against the exercise of our discretion to allow the appeals to proceed out of time:

(1) There is, as referred to in *Wilkins*, an obvious prejudice to HMRC in having to defend appeals against matters that were considered to be finally determined. That prejudice is the removal of legal certainty and finality.

(2) There has been inordinate delay in making the relevant appeals. Even if it had been correct that the March 2004 notice of appeal included appeals against the earlier assessments, such an appeal would have been two or three (depending on the assessment in question) years out of time. This increases to eight or nine years if the application is regarded as having been made in ERF's skeleton argument. Miss Shaw argued that ERF has not acted with a sense of urgency, reflecting one of the grounds on which the Upper Tribunal in *Wilkins* refused the appeal out of time.

(3) ERF was fully aware of its rights. The notices of assessment referred to the right of appeal, and rights of appeal were referred to in correspondence. ERF was represented by professional advisers.

15. The balance that needs to be struck between the different interests of the parties in seeking to achieve fairness and justice in an application to allow an appeal to be brought out of time is rarely a straightforward exercise. However, we are of the view that this is a case where the balance of the competing factors falls squarely against the exercise of our discretion to allow the appeals to proceed. Throughout the period of the investigation and the operation of the New Approach from October 2002 there was no question of any appeal having been made against the March 2001, February 2002 and April 2002 assessments in spite of the clear notification to ERF of its appeal rights. HMRC were in our view fully entitled to regard those assessments as finally determined, and to make the March 2004 assessment as a balancing assessment on that basis. The

March 2004 notice of appeal was not, and could not reasonably be considered to be, an appeal in relation to any assessment other than that of 4 March 2004. We accept the arguments of Miss Shaw. There was prejudice to HMRC. No reason for the failure to appeal in time has been proffered by ERF, and in those circumstances it would not, in our view, in any event be a sufficient reason for exercising our discretion in favour of ERF merely to say that HMRC had not suffered prejudice in the preparation of its case.

16. For these reasons we reject ERF’s application to appeal out of time in respect of the March 2001, February 2002 and April 2002 assessments. The only appeal for which we have jurisdiction therefore is that in relation to the 4 March 2004 assessment. However we have considered all the issues raised by ERF in respect of all the assessments, and set out our decisions on all those matters below.

Key dates

17. Before turning to the detailed findings of fact, we think it might be useful to set out here some of the key dates as this may assist the reader:

15 March 2001	Notice of assessment for £955,873 (plus interest)
14 January 2002	BDO/1 report finalised
5 February 2002	Notice of assessment for £305,078 (plus interest)
26 February 2002	Amended BDO/1 report submitted to Customs
8 April 2002	Notice of assessment for £2,055,711 (plus interest)
29 April 2002	Notice of amended assessment for £2,163,294 (plus interest)
July 2002	Customs’ “Accountant’s Report in Respect of Alleged VAT Fraud” (“Henderson Report”) finalised
31 January 2003	BDO/2 report submitted to Customs
29 July 2003	BDO/3 report submitted to Customs
17 February 2004	Customs issue Penalty assessment for £2,707,424
4 March 2004	Notice of assessment for £5,041,464 (plus interest)
11 March 2004	ERF submits notice of appeal

The facts

18. We make the following findings of fact from the oral and documentary evidence.

Background

19. ERF is a limited company, incorporated in England and Wales on 27 July 1933, whose principal business until 2003 was the manufacture of trucks.
20. Stephen Ellis joined ERF's employment in 1976, rising through the ranks of ERF's financial department to become financial accountant and, from April 1998, financial controller. He was also appointed company secretary in May 1998.
21. In June 1996 the entire share capital of ERF was acquired by a Canadian company, Western Star Truck Holdings Ltd ("Western Star").
22. Before the sale to Western Star, a director of ERF (Holdings) Plc, ERF's parent company, Mr John Hobbs, had overall responsibility for finance. Mr Ellis reported to Mr Hobbs. Mr Hobbs left in 1992 and was replaced by Mr Colin Fuller, who himself left six months after the Western Star acquisition. From that time Mr Ellis reported to the managing director, Mr Bryant, for line management purposes. Mr Ellis' financial monitoring and management activities were overseen by Mr Stewart Smith, a board member of Western Star.
23. In early 1998 Mr Ellis added to his responsibilities for ERF's accounts by taking over responsibility for the accounting of the other ERF group companies. At this time his financial monitoring and management activities were overseen by Mr David Burke, the Chief Financial Officer of Western Star.
24. In early 1999, MAN Nutzfahrzeuge AG ("MAN"), a German subsidiary of MAN AG, expressed interest in acquiring ERF. Following negotiation and due diligence, in which Mr Ellis was closely involved, providing information on behalf of ERF, MAN completed its acquisition of ERF from Western Star on 8 March 2000. Mr Ellis was paid a gratuity by Western Star, of £15,000, for his assistance in the due diligence process. Following the sale Mr Ellis remained as financial controller, but reported to Klaus Wagner who, at that time, was appointed by MAN as an executive director of ERF. Mr Ellis was supported by a team of around 15 accountants and trainee accountants in the accounts department. The accounts department also received accounting assistance from ERF's auditors.
25. From the time of the acquisition of ERF by Western Star to the sale of ERF to MAN, ERF's auditors had been Ernst & Young. Following the MAN acquisition, Deloitte & Touche were appointed as ERF's auditors. In the course of Deloitte & Touche's audit of the 31 December 2000 accounts a discrepancy between the purchase ledger and the purchase ledger control account was noted. This was reported to Mr Wagner who decided to strengthen ERF's accounting operations by employing a qualified accountant in a senior position. Ms

Stephanie Frobisher, who had been an audit manager on Deloitte & Touche's audit team for ERF, commenced work at ERF in June 2001.

26. Ms Frobisher began by sorting out the problems with the purchase ledger that had been identified by Deloitte & Touche. By early July that ledger had been brought under control and Ms Frobisher was in a position to begin reconciling the purchase ledger and the purchase ledger control account as at 31 March 2001. She found that it was impossible to produce a valid reconciliation. Mr Ellis was unable to provide an explanation for the discrepancy. Mr Wagner told Mr Bryant that there was a serious problem with the draft statutory accounts for the year ended 31 December 2000. It was agreed that Mr Wagner should alert MAN and enlist their help.
27. On 18 July 2001 Mr Wagner wrote to MAN to warn that the discrepancies so far discovered were only the tip of the iceberg and to request help from MAN's internal audit department in investigating the position. A special investigation was launched, and on 23 July 2001 Mr Ellis was suspended, on full pay, on the condition that he assisted ERF when required. Shortly afterwards Mr Bryant and Mr Wagner were also suspended on the grounds that as the two most senior managers they were accountable for the manner in which ERF, including its accounting function, had been run. By the beginning of August 2001 it had become apparent that there was a deficiency of approximately £100 million in the balance sheet of ERF as at 30 June 2001.
28. Before his dismissal, Mr Wagner wrote to Mrs Fereday on 2 August 2001 to advise her of a re-calculation of VAT from January to June 2001, and of the fact that the 06/01 VAT return had been adjusted to take account of the errors. We reproduce Mr Wagner's letter in full:

"Dear Mrs Fereday,

Your ref: 539 5309 24: VAT returns

ERF Limited, earlier in the year, unfortunately suffered a major crash in the accounting data when closing the 31st December, 2000 accounts. We thought the databases were repaired properly which, in June 2001, turned out not to be the case.

Therefore, we fully reconstructed the accounts for the business year ending 31st December 2000 and re-run all entries and transactions from 1st January, 2001 to the present date over the last weekend. After double checking the output, we had to realise that an important ledger with relevance to VAT was wrong in the periods January to May, 2001.

We have now done a comprehensive re-calculation of VAT due from January up to June, 2001 which shows a total January to May, 2001 overstatement in Box 4 by £3,804,667. The VAT return which we prepared for June, 2001 (copy attached) shows in Box 4 the regular June, 2001 amount of £2,579,180 netted with the aforementioned overstatement.

Remittance of the payment due as per that return has been transferred to HM Customs and Excise's account at the Bank of England.

We thank you for your understanding in this matter.

Yours sincerely,

K Wagner

Executive Director"

Mr Bryant's evidence

29. Mr Bryant was suspended from his position as managing director in August 2001, and his employment was subsequently terminated following a disciplinary meeting on 21 August 2001. He was not therefore able to give evidence in relation to the investigation of the VAT position.
30. We accept that Mr Bryant was not, up to the time of its discovery, aware of any dishonesty in connection with ERF's accounts or VAT returns. Mr Bryant, as managing director of ERF, had overall responsibility for the company's business. It was as a result of that responsibility that he was dismissed from his position. He was suspended for not reporting the financial irregularities to MAN. However, we accept that he was not himself aware, at the material time, of the irregularities, that he had relied upon Mr Ellis to provide accurate information on the financial position of ERF, and that he had expected Mr Ellis to alert him in respect of any problems relating to cash flow, funding, or other financial matters across all of the commercial activities of ERF.
31. Mr Bryant's main experience was as a production engineer, and he concentrated on production operations. He was not a financial expert. It is clear that Mr Ellis's frauds were intended to conceal the true state of affairs from Mr Bryant. In his evidence he described the confidence shown in Mr Ellis by others with a greater financial background, and he had no reason to suspect that such confidence was misplaced. We accept that it was not Mr Bryant's normal management practice, and that he did not consider it to be normal management practice, to work on the assumption that he was surrounded by dishonest staff. He also relied on ERF's auditors, Ernst & Young, to draw to his attention any inaccuracies in ERF's accounts or in the company's VAT returns. No such concerns were raised by Ernst & Young.
32. We accept that Mr Bryant bore responsibility for the financial irregularities by virtue of his position as managing director of ERF. As a result of his position he lost his job. He was held accountable for what had happened, but we do not find that he was to blame. He had a supervisory function in relation to Mr Ellis, and oversaw his work, but in each case this was an administrative function, and he was not concerned in any qualitative assessment of Mr Ellis' work. He was not involved in day-to-day accounting management at ERF. He signed (or a facsimile signature of his was affixed to) certain of the VAT returns, but he did so on the advice of Mr Ellis, on whom Mr Bryant relied.

33. HMRC argued that Mr Ellis' fraud was relatively unsophisticated, and Mr Ellis was cross-examined by Miss Shaw on this. We do not consider that Mr Bryant's evidence supports a finding as to the sophistication or otherwise of the fraud. All Mr Bryant could do was confirm that Stephanie Frobisher had found that she could not "complete a balance", a reference to the inability to reconcile the purchase ledger with the purchase ledger control account. This was not something that came out of the blue; as we have described, this discrepancy had been noted by Deloitte & Touche in their audit of the 31 December 2000 accounts. The discovery by Ms Frobisher was the start of a process that developed into findings of dishonest entries in the VAT returns.
34. Mr Bryant was also asked about the letter dated 2 August 2001 from Mr Wagner to Mrs Fereday. He confirmed that there was no crash of the accounting system; the system simply did not produce a balance. We find that there was no such crash in the sense of a computer hardware or software malfunction.
35. As a consequence of the frauds of Mr Ellis, Mr Bryant and other senior executives were unaware that ERF, far from being solvent, as the financial data purported to show, was in fact massively insolvent. Mr Bryant and his colleagues made decisions about the pricing of trucks and other overhead decisions on the basis of financial information that was not accurate. The false picture presented by Mr Ellis caused the company to make investments and other decisions, such as the building of a new factory, that were unlikely to have been made if ERF's true financial position had been known. We accept that in relation to the financial accounting fraud. Mr Bryant was also asked in cross-examination about the effect of the VAT frauds. He accepted that the effect of Mr Ellis' wrongful claims in respect of input tax was to provide ERF with a cashflow, and it was that cashflow that enabled it to trade. Mr Bryant also referred to a proposal that ERF stop making trucks. That proposal had been made before the sale to Western Star, and so goes to show only that there were trading difficulties that were known despite Mr Ellis' fraudulent design to obscure the true position. It is not possible on the evidence before us to conclude whether the VAT fraud, separately from the accounting fraud, had an overall adverse effect on ERF, by enabling it to continue to trade when, if the true facts had been known, a decision to cease trading might have been made sooner. All that can be concluded is that ERF did receive the benefit of the cashflow provided by the input tax recovery extracted from HMRC. The fact that it was unaware of its financial position as a result of the false accounting information being produced by Mr Ellis, does not alter the cashflow effect itself.

Mrs Fereday's evidence

36. We received the evidence of Mrs Fereday by way of a witness statement which ERF did not challenge.
37. Mrs Fereday first became involved with ERF's VAT affairs when, as part of a team carrying out audit and compliance work, she undertook an assurance visit to ERF on 4 August 2000. The purpose of the visit was to verify the 05/00

return which had been queried centrally. A full VAT return audit was also to be initiated, covering periods 09/99 to 04/00.

38. As a result of queries raised during this first visit, Mrs Fereday returned to ERF on 11 September 2000. During her visit she identified two key areas of concern. First, in some instances import VAT had been incorrectly accounted for and, in some instances, duplicated. An assessment was issued in this respect on 2 October 2000. Secondly, Mrs Fereday identified a number of manual adjustments to the trial balance report. These appeared to be accrued amounts, but there was no supporting documentation nor were any reversals evident in subsequent months.
39. Mrs Fereday wrote to Mr Ellis on 27 September 2000 requesting documentary evidence to support the adjustments, and evidence that the correct reversals had been performed. Following a reminder letter of 15 January 2001, Mrs Fereday wrote to Mr Ellis on 24 February 2001 to advise him that in the absence of any supporting documentation or reversals in subsequent months, the manual adjustments to the trial balance reports would be disallowed. An assessment was issued on 13 March 2001 for £955,873. This was the first assessment with which this appeal was concerned, but as noted above, ERF's challenge to it has not been pursued (and in any event we have determined that any appeal would have been out of time).
40. Mrs Fereday's evidence then refers to the letter she received from Mr Wagner dated 2 August 2001. Mrs Fereday replied on 15 August 2001 requesting further information about the errors identified and confirming details of a meeting to discuss the matter. That meeting was held at ERF on 21 August 2001 when Mrs Fereday, along with her line manager, Shirley Holland-Reid, met Stephanie Frobisher. It was at this meeting that Mrs Fereday was informed that Mr Bryant, Mr Wagner and Mr Ellis had been suspended because of balance sheet irregularities. Following that meeting Mrs Fereday wrote to Ms Frobisher on 28 August 2001 outlining what further information was required regarding the adjustments to the 06/01 return and reiterating the request made of Mr Ellis for evidence to support the previous adjustments made to ERF's VAT returns.
41. Mrs Fereday began maternity leave on 31 August 2001, leaving notes for her successor in relation to ERF, Miss Stocker. Following her return to work, in August 2003 Mrs Fereday participated in a review of the BDO report dated 16 July 2003 ("BDO/3") and wrote to Jane Earle of BDO with a list of queries, including a request for full documentary evidence in support of explanations provided. Mrs Fereday attended, with Mrs Stocker and Peter Blocksidge, a meeting at ERF on 4 September 2003 with Ms Earle and Alex Nicholls of BDO. We refer to this meeting further in our discussion of the evidence of Miss Stocker.

Miss Stocker's evidence

42. Miss Stocker took overall control of the VAT affairs of ERF in September 2001, following Mrs Fereday's departure on maternity leave. She led the audits undertaken and was involved in the identification of errors that resulted in the issuing of the assessments concerned in this appeal after that date. The assessing officer, who also prepared the schedules that were sent to ERF and signed the VAT 641s (Officer's assessment), was Peter Blocksidge, who has since retired from HMRC. Miss Stocker acted as "check officer" for the assessments dated 5 February 2002 and 8 April 2002 (amended 29 April 2002), and as counter-signatory for the 4 March 2004 assessment.
43. Along with Mr Blocksidge, Miss Stocker visited ERF on a number of occasions at the end of 2001. The meetings took place with Stephanie Frobisher on 29-30 October 2001, 26 November 2001 and 6 December 2001. At the meeting on 29 October Jane Earle of BDO (who had recently been appointed by ERF to act in relation to the VAT irregularities) was also present. We were shown a note (visit report) of those meetings which had been prepared by Mr Blocksidge, which detailed the checks undertaken and errors identified. In particular, in respect of the visit on 26 November it was recorded that, satisfactory evidence having been produced, the accrual for 05/01 of £1.1 million was accepted as correctly reversed in period 06/01.
44. On the basis of the visits undertaken by Miss Stocker and Mr Blocksidge, and the information provided, the 5 February 2002 assessment was issued in a net amount of £305,078. This included an amount of £1,323,000 owing to HMRC assessed as part of a net assessment for period 07/00 of £1,280,000.

BDO/1

45. On 20 December 2001 BDO wrote to Miss Stocker informing her that they had been in the process of compiling a report of their findings "which will include an approximation of VAT that has been underdeclared", and requesting a meeting to make a full disclosure of the VAT errors declared on ERF's VAT returns and to discuss the best way forward. A meeting was held at ERF on 15 January 2002. From Customs & Excise were Miss Stocker and Mr Blocksidge. Stephanie Frobisher attended for ERF and Jane Earle of BDO and two representatives of PricewaterhouseCoopers (representing Western Star) were also present. At that meeting Miss Stocker and Mr Blocksidge were presented with BDO's report of 14 January 2002 ("BDO/1") headed "ERF Limited VAT report". The report of the meeting summarises BDO/1 as follows:

"ERF has overclaimed VAT of approximately £10 million during the period 1 July 1997 to 30 June 2000.

The errors are as a result of journal entries; mainly input tax accruals debited to the input tax account but not reversed in the following period.

ERF's company secretary and financial controller, Steve Ellis, has said that he was responsible for the errors in ERF's VAT returns.

He has denied dishonest intent in relation to the VAT return errors.”

Amended BDO/1

46. Following the meeting BDO wrote to Mr Blocksidge on 26 February 2002 enclosing a copy of an amended report (“Amended BDO/1”). This, as the letter explained, was in consequence of further checks carried out on the 1997 accounting periods that had resulted in the identification of an additional number of journal entries, and further verification work had therefore been carried out. Certain entries had been added to the appendix (Appendix A) that contained the “Confirmed VAT return errors resulting from journal entries”, and a new appendix (Appendix B) had been added as “Questionable journal entries (unable to confirm if these entries were processed through the relevant VAT returns”, described in the letter as “unconfirmed journal entries”, which were journal entries that could not be proven to have resulted in an underdeclaration of VAT. Appendix B contains the following note regarding the questionable journal entries:

“The figures are classed as questionable for the following reasons (refer to Appendix C for further details):

- They do not have [a] supporting journal voucher to verify the nature and amount of [the] journal entry.
- The trial balance tests proved inconclusive as to whether the above figures were included on the VAT return or not.
- The journal reports for the above errors state that these entries were finalised after the date the VAT return was completed. This raises the question whether these figures appeared on the VAT return or not.
- Entries from 07/97 – 03/98 were finalised on 06 May 1998. This could suggest that these may have been finalised after the submission of the VAT return.”

47. Further detail was given in Appendix C, to which we need not refer here. It explains in greater detail that, for the reasons given, it was questionable whether the journal entries were included in the relevant VAT return.

48. It was on the basis of Amended BDO/1 that the 8 April 2002 assessment was issued in the net sum of £2,055,711. The amounts for the relevant periods were taken from Appendix A of Amended BDO/1, but limited to periods falling within the three-year time limit under s 77(1) VATA 1994 (“VATA”), on the basis, as Miss Stocker explained in her evidence, that at the relevant time she had not been informed that there was dishonesty allowing assessment to go back 20 years. Miss Stocker had not been trained to go back more than three years, and she said that the question of dishonesty was solely one for Mr Harold (who, as we shall describe, became involved later in 2002). As a result only periods from 03/99 included in Appendix A were assessed. Periods in Appendix A prior to that were not assessed. No periods included in Appendix B were assessed.

49. On 14 March 2002 Miss Stocker wrote to Ms Frobisher giving notice that assessments had been made and that confirmation of the Notice of Assessments would follow in due course, including any default interest. The letter stated that “It may be necessary to make further assessments once The Commissioners of Customs and Excise have made further investigations into the VAT declarations made by the company”. The evidence of Miss Stocker was that this was not intended to refer specifically to additional assessments in respect of the same periods, but was used generally in the sense of “other” assessments, covering any period, including (but not limited to) periods already assessed. Miss Stocker also said that she did not regard Amended BDO/1 as “the final story”. Mr Harris argued that, viewed in this light, the evidence of Miss Stocker as to what was meant by “further assessments” in her letter of 14 March 2002 was incomprehensible and at variance with the statutory scheme for VAT assessment. He points to the fact that Miss Stocker also accepted that further evidence of fact might come to light that could justify the making of further assessments for periods already assessed, and that was what happened in relation to a number of the periods. On this we accept the evidence of Miss Stocker. We do not consider that “further assessments” was confined to assessments in respect of the same periods. We consider that Miss Stocker was intending to refer generally to the possibility of more assessments being raised, including both assessments for the same and different periods.
50. Prior to the confirmation of the assessment of 8 April 2002 being issued, Ms Frobisher had, on 21 March 2002, written to Miss Stocker. We were not provided with a copy of that letter, but Miss Stocker refers to it in her reply (undated) in which she confirmed that the assessment had been amended to take account of a duplicated amount of £107,583 input tax overdeclared in January 2000. The letter explains that the overdeclaration had been included on the assessment raised on 13 March 2001, and that the amendment (which would exclude that sum as an amount owing to ERF) would therefore increase the net tax due to £2,163,294. On 29 April 2002 a “Notice of Amendment of Assessment(s) and/or Overdeclarations” was issued in this amount to reflect the amendment described in Miss Stocker’s letter.
51. In September 2002 Miss Stocker was contacted by Mr Harold of Law Enforcement. Mr Harold explained to Miss Stocker that he had arranged an opening meeting with ERF and its advisers to discuss the way forward with the investigation and to officially offer the New Approach. Mr Harold also explained at that time that ERF had requested that the department proceed with its investigation following the civil evasion penalty procedures open to them.
52. A meeting was held on 3 October 2002 between Mr Harold and Miss Stocker and representatives from ERF and its advisers along with advisers for Western Star. Miss Stocker’s role at this meeting was one of note-taker; she prepared the note of the meeting that was subsequently (following comments) agreed by ERF and the lawyers for ERF and Western Star. She took no active part in the meeting. We shall consider this meeting in greater detail in the context of Mr Harold’s evidence.

53. From the time of the 3 October meeting Mr Harold took control of the conduct of the investigation, keeping Miss Stocker apprised of the situation. In February 2003 Mr Harold sent Miss Stocker a copy of a further report produced by BDO on 31 January 2003 (“BDO/2”).

BDO/2

54. The front cover of BDO/2 contains only the name of the company “ERF Limited”, the date, 31 January 2003, and the name of the authors of the report, BDO Stoy Hayward. The contents page immediately inside the front cover refers to “VAT report”. The remainder of the pages of the report (other than the 13 appendices) are headed “Draft VAT report”. Paragraph 1.1 states that the contents of BDO/2 supersede Amended BDO/1.

55. Paragraph 2 of BDO/2 reads as follows:

“A significant development in [the] case is that Stephen Ellis (SE) has recently admitted to falsifying ERF’s VAT returns back to March 1996 and, possibly, December 1995 with the intended objective of dishonestly claiming money from Customs to overcome ERF’s financial difficulties.”

The report contains an extensive summary of the process of interviewing Mr Ellis and the admissions made by him. We had in evidence transcripts of the relevant interviews with Mr Ellis. These included a transcript of a meeting on 19 November 2002 at which Mr Ellis was interviewed by Leigh Williams of Slaughter and May and by representatives of BDO at which Mr Ellis admitted for the first time his deliberate failure to reverse accruals reflected in certain VAT returns. Mr Ellis explained at that interview that to preserve cash in ERF’s business he had put in false accruals which he was not going to reverse in the following accounting period. He had continued to do this as a means of keeping the business going. He then had formed the view that to try and put matters right, by changing what he had been doing, would simply raise questions as to what had already been done.

56. In a subsequent interview, on 27 November 2002, Mr Ellis expanded on this. He was asked if he had ever intended that the money recovered from Customs would be repaid. His response was that he might have intended, at the time of an accrual, to reverse that, but that once it had not been reversed there was a vicious circle where the focus was on maintaining the positions and keeping things consistent. He also explained that part of this consistency involved making payments (overpayments) of VAT. This, he said, provided an opportunity to potentially reclaim more at a later stage. His primary aim was to maintain consistency, a factor he confirmed in a written statement made by him on 2 December 2002 in which he describes his fraudulent activity in respect of the VAT returns.
57. BDO/2 includes the following summary in response to a spreadsheet provided by Mr Harold at the meeting on 3 October 2002:

“(a) To date, culpable VAT arrears of £13.37 million have arisen, of which £7.63 million remains outstanding;

(b) In addition, non-culpable VAT arrears of £1.99 million have arisen of which only £(807,000) has been assessed. The total arising in the last three years results in a repayment of approximately £(160,000) to claim from Customs;

(c) It can be demonstrated that the additional errors identified by Customs of £1,041,055 are, in fact, legitimate claims for input tax (refer to the notes to Appendix C²); and

(d) as a result of SE’s admissions, there appear to be culpable errors of approximately £390k arising in March 1996, together with possible culpable VAT errors in December 1995 and January 1996 ... These will be confirmed in due course.”

The explanation for point (d) in the report is that Mr Ellis’ recollection was that batches totalling approximately £390,000 had been made up of fictitious VAT invoices in relation to which he had created false input VAT entries. This was something that was to be confirmed once a particular accounting system had been restored.

58. It was put to Miss Stocker in cross-examination that she could readily have reached an honest and bona fide assessment based on the work that culminated in BDO/2. Miss Stocker’s evidence, which we accept, was that she did not believe she could have done so, as BDO had said to Mr Harold that they were not happy with the figures and required further time to do some more investigation.
59. In July 2003 Miss Stocker attended a meeting with Mr Harold at the offices of BDO in London. At that meeting Mr Harold accepted a disclosure report dated 16 July 2003, entitled Supplementary VAT Report (“BDO/3”) which was said to be a final and complete disclosure of all the irregularities, both culpable and otherwise. Miss Stocker was provided with a copy of that report.
60. Following receipt of BDO/3 Miss Stocker’s team, Mr Blocksidge and Mrs Fereday, who had returned from her maternity leave, conducted an examination of the contents and prepared a list of queries which were sent to Jane Earle of BDO on 26 August 2003. One of those queries related to the 06/01 period. Miss Stocker’s team considered that BDO/3 had not taken into account certain payments that they considered had been made. These were an amount of £4.1 million treated as assessed for 02/01 and 05/01 and other items of £232,000 that was considered to have been adjusted in recalculations of earlier periods.
61. These queries were discussed at a meeting with BDO attended by Miss Stocker, Mr Blocksidge and Mrs Fereday on 4 September 2003. The meeting notes record the following:

“Jane and Alex [BDO] did not agree with our [Customs’] 6/01 calculation (£1,101,941 due back to trader) and provided their version. They thought that £230,058.81 was still due to C&E!!

Their calculations contained £1,100,000 'already paid' and £232,000 'other payment'.

They were not only correctly bringing in assessments made but also payments figures which in my opinion is not correct procedure. Under and over declarations are very different to under and over payments.

In effect they were saying that the £1.1M being shown as an underdeclaration in May was to be accepted as a valid accrual but the reversal not made was an underdeclaration in June.

The £232,000 was for old periods and surely must have been adjusted already in the recalculations of earlier periods.

We could easily accept it because of the 12/99 query.

A new file – '5X New Assessment Schedule' was prepared to reflect the changes.

Overall tax due increases from £4,809,440 to £5,041,440."

62. In January 2004 Mr Blocksidge prepared a schedule for the purpose of making an assessment. That schedule takes as its starting point for each period from 03/96 to 12/01 the figure from Appendix B of BDO/3, subject to certain adjustments, in particular to avoid double-counting amounts already assessed. For period 02/01 the sum of £3,000,000 is deducted as already assessed, and for the period 05/01 the sum of £1,100,000 is similarly deducted. For 06/01 the entry states "Appendix B states tax due is £798,570" (this is in contrast to the other entries which state simply "Appendix B"), and the figure used by Mr Blocksidge here is £798,570.
63. On 13 January 2004 Miss Stocker wrote to Jane Earle at BDO enclosing a schedule of the proposed assessment to be issued. The schedule sets out for each relevant period of assessment from 03/96 to 12/01 the amount of underdeclared VAT, the amount of overdeclared VAT and a net liability (or repayment amount) for the period in question. The total net amount is stated to be £5,041,464. In all but one of the periods the starting point is the figure in Appendix B of BDO/3, and there are adjustments as in Mr Blocksidge's schedule for amounts already assessed, including those of 02/01 for £3,000,000 and 05/01 for £1,100,000. The exception is period 06/01. In that case the starting point is the Customs reconstructed figure of (£3,533,429.92) due to ERF, described as "June 01 assessment of £4.3M excluded". But this is then brought back to the same net figure that would have applied if the starting point had been the Appendix B figure of £798,570, by adding back as amounts owing from ERF to Customs an "accrual reversal" of £1,100,000 for 05/01 (where the accrual of that amount had been accepted as valid), an "other payment" of £232,000 and an amount "already assessed" of £3,000,000.
64. Miss Stocker's evidence was that the amount of £4,100,000 was paid to HMRC because it was included in the 06/01 return. There was an assessment in relation to £3,000,000, but this was reversed for a later period, as a means of applying interest in respect of late payment. But it was not a sum paid on an assessment. This was shown to be the case by a review of the schedule to the 5 February

2002 assessment. The figure of £3,000,000 was included in an amount due to Customs in period 02/01, and this was reversed out by a contra entry showing the same sum as due from Customs to ERF for period 06/01.

65. Miss Stocker confirmed, as we have described above, that the £4,100,000 was taken into account by Mr Blocksidge when he was putting together his schedule in connection with the March 2004 assessment. She said that when a reconciliation with the figures in BDO/3 was being carried out, the £3,000,000 would have to be taken into account separately, as Appendix B of BDO/3 had been prepared otherwise than by reference to the figures on the 06/01 return. She said that her understanding was that BDO had taken the £4,100,000 into account in another way. Asked to explain this, Miss Stocker took us first to the 05/01 return, to demonstrate how the calculations were made. Box 1 of the return showed VAT due in the period on sales and other outputs of £3,086,922.35. That figure was reflected in Appendix A3 to BDO/3, being part of the reconciliation of BDO's reconstructed VAT position with ERF's VAT returns. Also included is the figure of £115,864.56 derived from Box 2 of the return, VAT due in the period on acquisitions from other EC member states. The total of these figures, £3,202,766.78, in Box 3, appears in Appendix A3 as the figure for "Reconstructed Outputs".
66. That dealt with the output side of the equation, which was perfectly straightforward. Turning to the input tax, Box 4 on the return (VAT reclaimed in the period on purchases and other inputs (including acquisitions from the EC)) shows a figure of £3,301,545.42. In Appendix A3, the adjusted total for reconstructed input tax is £2,201,703.39. Apart from a few pence, the difference between these two numbers (£1,099,841.90) is then carried to Appendix B of BDO/3. An amount of £1,099,841 was then included in Mr Blocksidge's schedule as the Appendix B starting point, but this was then adjusted by the deduction of two amounts, £1,100,000 as a VAT underdeclaration already assessed and £157 as a VAT overdeclaration. As the net figure arrived at was £(2), this was ignored and no assessment was raised in March 2004 for period 05/06.
67. Turning now to period 06/01, Miss Stocker again took us to the VAT return. This was the return on which ERF had made the original adjustment referred to in the letter from Mr Wagner dated 2 August 2001. According to that letter, an adjustment of £3,804,667 had been made to the Box 4 figure that would otherwise have been £2,579,180. (We assume this was a net adjustment as it was accepted that – as Ms Frobisher had explained in a letter to Mrs Fereday received by Customs on 20 August 2001 – the payment made for 06/01 had included a £4.1 million input error.) The result was a negative amount in Box 4 of £1,225,486.38, resulting in a payment to Customs. This was therefore no longer a deduction from output tax due, but an addition to it. On the output tax side, a comparison of the Box 3 figure (£3,106,825.59) with the reconstructed figure in Appendix A3 (£3,747,780.77) revealed an underdeclaration of output tax of £640,955.18.

68. Miss Stocker attempted to reconcile the figures in the return with the amount shown in Appendix B of BDO/3 as VAT due to Customs (£798,570.08). However this was not possible. We heard no evidence from BDO. We have therefore had to seek to reach our own conclusions on the basis for the calculation of that figure. On the evidence before us it has not proved possible to achieve a reconciliation of the figures. We consider, however, and we find as a fact, that in arriving at the figure in Appendix B, BDO did not take into account any amount in respect of prior discrepancies that had been paid to Customs through the mechanism of the 06/01 return. If that had been done, then the figure would have reflected the negative amount of £1,225,468.38 as well as the reconstructed input tax of £2,948,898.12, and would have resulted in an adjustment on the input tax side of £4,174,384.50. This would not have been logical, as it would be comparing the reconstructed position to amounts that did not belong to the 06/01 period. The logical course therefore, and the one we find BDO adopted, was to ignore the adjustments that had been made to the 06/01 return. Unfortunately, that still does not explain the figure in Appendix B of £789,590.08 owing to Customs. If the adjustment is ignored in looking purely at the figures in the 06/01 return, a comparison with Appendix B shows underdeclared output tax of £640,955.18 and an amount of underdeclared input tax of £369,718.12, giving a net liability of £271,237.06.
69. Following Miss Stocker's letter of 13 January 2004, there was further correspondence in which PwC and Clifford Chance asked for more time to consider the assessment schedule. Before any agreement was reached, the assessment was notified by letter dated 18 February 2004 and the assessment was issued on 4 March 2004 in the sum of £5,041,464.

Mr Harold's evidence

70. The matter of ERF first came to the attention of Mr Harold when he was contacted by Phil Knaggs, an investigator in the Criminal Investigation team based in Manchester. Mr Harold was asked if he could attend a meeting at ERF's offices in order that his knowledge of the civil evasion procedure could be sought if required.
71. Mr Harold referred to the letter of 2 August 2001 from Mr Wagner. He said that as a result of this letter and the earlier March 2001 assessment, the case had been reported to the Law Enforcement section of Customs to consider the possibility that criminal offences had been committed by the company and its officers and employees. As a result a summary report was prepared. We were shown a copy of a report dated 1 October 2001 by Mark Emmett, a Customs officer who was an Accountancy Bursar, to Bill Geddes of Law Enforcement setting out the reasons for the referral. This report describes the background to the case and expresses the view that:

“... although the company itself is the primary victim of these financial irregularities, the Department has ‘effectively been used as a bank’ to support these ‘financial/balance sheet irregularities’! The suspension of the individuals (John Bryant, Chief Executive & Klaus Wagner,

Chief Financial Officer – both Directors of the Company, and Steve Ellis, VAT contact and other financial responsibilities) has demonstrated the high level at which these ‘financial irregularities’ have occurred, and I am therefore of the opinion that they knowingly submitted false VAT returns to the Department.”

72. Amended BDO/1 was received by Customs in February 2002. The papers were then passed to David Henderson, a departmental forensic accountant, for his opinion. Mr Henderson completed his report in July 2002.
73. In his report, Mr Henderson considers Amended BDO/1 and states that his review findings indicated that the methodology used to identify the errors was sound, and, on the whole, the conclusions of Amended BDO/1 were accurate. In relation to the questionable entries that were included in Appendix B to Amended BDO/1, Mr Henderson says that his findings indicated that, whilst the methodology used to identify the errors was fundamentally sound, different conclusions could be drawn in certain instances. As a result, he arrived at a net liability of £13,869,840.85, which he classified as £13,178,501.38 “Erroneous” and £691,339.47 “Questionable”. He concludes:
- “Given the evidence of fraudulent activity currently available and ERF’s willingness to cooperate in the investigation, it appears that a negotiated settlement may be the best option to pursue in order to bring this matter to a swift and cost-effective conclusion.”
74. In relation to Mr Henderson’s report, Mr Harold’s evidence was that, although Mr Henderson’s opinion regarding evidence of fraud informed the department, it was not something on which Customs could base a final assessment or penalties.
75. Mr Harold explained the New Approach to civil evasion penalties. It was established to provide a time- and cost-efficient means of investigating potential VAT frauds. Its purpose was to put in place a procedure whereby the taxpayer is asked to assist in establishing the amount and extent of the arrears and the reason those arrears arose, and encourages the taxpayer’s cooperation. That cooperation is rewarded by offering significant reductions in any penalty for dishonest evasion that is applied. We would add that, of course, another advantage for the taxpayer is that possible criminal proceedings are thereby avoided.
76. A meeting took place on 21 August 2002 at which, on behalf of Customs, there were present Nick Shaw and Phil Knaggs of Law Enforcement Criminal, and Mr Harold. There were representatives of ERF, MAN and BDO, along with advisers for ERF and Western Star. At that meeting it was made clear that Customs believed the New Approach should be offered. As regards dishonesty, views were expressed by the advisers to ERF and Western Star that there was no dishonesty, or at least that the question was an open one. Alternatively, the question was raised whether even if Mr Ellis were found to have been dishonest, that dishonesty would not attach to ERF.

77. Following the meeting, on 3 September 2002, Leigh Williams of Slaughter and May, acting for ERF, sent a fax to Mr Harold, requesting that Customs proceed with the investigation under the New Approach. In reply on 5 September 2002 Mr Harold asked for details of the officers of the company who would be attending the New Approach opening meeting, and sent Mr Williams a copy of the form of the opening letter that would be sent to the company. That letter was sent to Dr Raab at ERF on 10 September 2002. Its first paragraph reads:

“We have grounds to believe that there are irregularities in the VAT affairs of ERF Limited, of which you are executive director of finance, that require investigation. The investigation will be conducted with a view to the imposition of a civil penalty under s 60(1) of the Value Added Tax Act 1994 for fraudulent conduct, should our suspicions be confirmed. The investigation is not, at this point, with a view to your prosecution for VAT evasion.”

78. Accompanying this letter was a copy of the VAT information sheet 01/02 “Statement of Practice”. That statement set out that it was the intention of Customs to reach an agreement with the taxpayer about how much was due, and how much was to be paid and when, including any VAT, penalties and interest. It also set out the possible reductions in respect of the penalty of 100% of the agreed irregularities of tax. It said:

“Reductions from the 100 per cent penalty figure will normally be made, to the maximum percentages specified, as follows:

- Up to 40 per cent – early and truthful explanation as to why the arrears arose and the true extent of them; and
- Up to 40 per cent – fully embracing and meeting responsibilities under this procedure by, for example, supplying information promptly, including full written disclosure, attending meetings and answering questions.

These may be aggregated.

In most cases, therefore, the maximum reduction obtainable will be 80 per cent of the tax underdeclared. In exceptional circumstances however, consideration will be given to a further reduction. For example, where you have made a full and unprompted voluntary disclosure.”

79. Prior to the opening meeting, Mr Harold received and reviewed two large boxes of papers he received from Mr Knaggs. It was clarified in evidence that these did not contain financial information or accounting records, but were records of internal e-mails, internal memos, and copies of interviews that BDO had conducted with Mr Ellis and Mr Bryant, along with sundry business records. Mr Harold read through these papers to give himself a working understanding of the case.
80. The opening meeting was held on 3 October 2002, attended, as we have seen, by Mr Harold and Miss Stocker (as note taker), and by representatives of ERF, BDO and advisers. Mr Harold is recorded as having said at the meeting that the

reason for the investigation was that the actions of Mr Ellis had tied ERF into a series of dishonest acts and omissions. He also advised the meeting that he considered the acts and omissions of Mr Ellis were dishonest rather than reckless and that Customs would have to issue a penalty for dishonest conduct. In cross-examination Mr Harold explained, and we accept, that he was here referring to the common ground between himself and ERF that Mr Ellis had acted dishonestly in how he had managed the accounting affairs of ERF. At that point it was still being maintained that there were no dishonest VAT omissions. At this point it is clear, and we find, that Mr Harold had no more than a strong suspicion as to the dishonesty in relation to VAT.

81. On 3 October 2002 ERF replied to the four questions put to it by Customs in the context of the New Approach. Question 4 was: “Were you aware that any of the VAT returns were incorrect or incomplete at the time they were submitted?” The company’s answer was:

“The incorrect VAT returns were signed by Stephen Ellis (finance controller and Company Secretary of ERF Limited) and John Bryant (Chief Executive Officer of ERF Limited). The incorrect VAT returns were all prepared by Stephen Ellis (regardless of whether he signed them or not). Stephen Ellis has specifically denied dishonesty in relation to the incorrect VAT returns he prepared and/or signed. However, ERF Limited accept that a possible interpretation of the evidence is that Stephen Ellis knew, or was reckless to the fact, that at least some of the incorrect returns which he prepared and/or signed were incorrect. As regards John Bryant’s state of mind, ERF does not know what the position is. The current board of ERF Limited has no grounds to believe that any past or present officer or employee of ERF Limited knew that any of ERF Limited’s VAT returns were incorrect when they were submitted.”

82. At the opening meeting it was stated that ERF would be submitting a further report. Whilst the company had effectively answered “no” to Question 4, they wanted to investigate more deeply, looking in more detail at the actions of Mr Ellis and others. At the conclusion of the meeting Mr Harold agreed to send BDO a copy of the schedules produced by Mr Henderson. His view was that this was appropriate as Mr Henderson’s own figures had been derived from BDO/1.
83. BDO/2 was submitted by ERF at the end of January 2003. As we have described, this report revealed culpable arrears of £13.37 million, broadly in accordance with the arrears calculated by Mr Henderson. It also, for the first time, acknowledged the dishonesty of Mr Ellis. Mr Harold’s evidence, which we accept, was that BDO/2 was not treated as a final disclosure report because BDO had suggested in the report that a further reconciliation of the figures would be required in order to establish ERF’s true VAT position and that accordingly ERF’s arrears could not be reliably calculated at that time. BDO say (at section 7.2 of the report):

“... it may well be that an analysis of ERF’s VAT returns based solely on the extent of the false accruals in the accounting system, as set out in section 3, will significantly overstate ERF’s true liability to Customs. In order to assess the extent to which ERF’s VAT returns differed from its true VAT position, it will ultimately be necessary to reconstruct the correct position for each period in question, rather than simply to identify the extent of the false journals created by SE. This is, of course, a significant exercise.”

84. Mr Harold attended a meeting at ERF on 21 February 2003. At the commencement of that meeting Leigh Williams of Slaughter and May, on behalf of ERF, referred to BDO/2 and in particular to section 7.2 and the need to reconstruct the accounts to arrive at a true tax liability. He expressed concern that Customs may not have understood the weight of that paragraph in relation to the rest of the report. Mr Harold reiterated that Customs’ main objective was to establish the true liability and he therefore accepted the need to obtain accurate figures. Although the initial examination revealed a potential culpable underdeclaration of £13.37 million, it was only reasonable to examine the accuracy of the base figures. Given the amounts involved, Mr Harold said that it would be unreasonable not to allow this further time for examination and reconstruction. There were two sets of minutes of the meeting of 21 February 2003, one by Customs and one by Clifford Chance. Neither set of minutes records Mr Harold as saying that he would accept BDO/2, but it is recorded in Mr Harold’s report to HQ Policy dated 20 August 2003 (at para 5) as follows:

“5.1... given the content of the report I was happy to start by accepting the report and explaining that I would be content to take the disclosure without any need for any further work. As expected the room were of the view that the suggested review could significantly reduce the liability and also the amount subject to penalty. I countered that the investigation was such that I believed to look any deeper would more likely result in an even larger liability being found.

5.2 Both sets of advisers said that they wished to be given time to conduct the review, given the size of the case I conceded that I would be being unreasonable to refuse but I insisted on a selected review and if the findings were inconclusive that the review be halted so as not to draw out the disclosure process. As with our earlier meeting I agreed a timescale of three months to complete the findings.”

85. Mr Harold confirmed in oral evidence that he did hold the view, when he expressed it at the meeting on 21 February 2003, that he was content to take the disclosure of BDO/2 without further work. He did explain to ERF and BDO that he would accept the figures in BDO/2. But ERF and BDO had been adamant that those figures were not correct and that they would be significantly reduced by the further investigation that would be carried out. In those circumstances Mr Harold had also formed the view that it would be completely unreasonable not to allow the further investigation to be done.
86. On 19 March 2003 BDO wrote to Mr Harold setting out its reasons for wishing to carry out more extensive work to establish ERF’s true VAT liability. In that

letter BDO explained that the investigation up to that time had concentrated on the journal entries made directly to the VAT control account by Mr Ellis. The letter then states:

“This approach assumed that the primary data (i.e. the original sales and purchase invoices) posted to the BaaN accounting system was reliable and the problems related exclusively to journal entries. However the forensic examination that BDO have been running in parallel with the VAT investigation has cast doubt on whether this is, in fact, the case. Our suspicion that it is not arises from the fact that, although ERF reported profits in its management accounts between 1996 and 2001, our forensic investigation has found that ERF was, in fact, making substantial trading losses during this period. Depending on where the losses were occurring and their extent, ERF may, at times, have been, in fact, in a VAT repayment position or a small VAT payment position rather than a large VAT payment position as the VAT report suggests.

We now propose to try and verify ERF’s VAT Control Account by sampling primary documentation over a sample three month period. The exercise will follow a sample of sales/purchase invoices through to the VAT Control Account from the primary documentation. Sampling in this way should allow us to draw conclusions as to whether the VAT Control Account is correctly recording the VAT on sales and purchases. If we conclude that it is materially correct, we may be able to establish ERF’s true position from BaaN reports on input and output VAT and disregard the journals posted to the VAT Control Account.”

87. On 29 July 2003 BDO sent to Mr Harold what they described in their letter as the final copies of their reports dated 31 January 2003 (this was BDO/2) and 16 July 2003 (“BDO/3”). BDO/3 is described on its face as a Supplementary VAT Report. It refers to the extensive testing exercise and subsequent analysis foreshadowed in the 19 March letter, and summarises the detailed methodology of the reconstruction exercise in the following terms:

“3.1 The aim of this supplementary report is to set out BDO’s findings of an exercise to reconstruct ERF’s actual tax liability. This reconstructed VAT liability has been compared with ERF’s VAT returns to arrive at an amount of VAT owing to Customs for the reconstruction period.

3.2 The methodology, as set out below, splits the reconstruction exercise into several phases:

- (a) Calculate true output tax and input tax on underlying transactions for each month;
- (b) Adjust the true output tax/input tax figures for acquisition tax and import VAT, arriving at the true VAT return figures for boxes 3 and 4 retrospectively (referred to in Appendix A as ‘reconstructed box 3 figure’ and reconstructed box 4 figure’ respectively);

- (c) Compare the reconstructed box 3 figure and reconstructed box 4 figure to the amount of VAT actually declared in boxes 3 and 4 of ERF's VAT returns, the differences being amounts owed to/from Customs;
 - (d) Reconcile the differences arising between the reconstructed box 3 figure/reconstructed box 4 figure and the figures declared on ERF's VAT returns to non bona fide journal entries and other errors;
 - (f) Formulate a schedule of the reconciling items identified at (d) above, with a narrative detailing the value and nature of the items, together with supporting evidence where available."
88. BDO/3 concludes that the calculation of VAT within BaaN was reliable and accurate (except for non bona fide journal entries) and that the VAT transaction history report in BaaN had been used as the basis for reconstructing ERF's true VAT position for the relevant period.
89. The final result of BDO's work in numerical terms was set out on Appendix B of BDO/3. A comparison of this with the corresponding analysis in BDO/2 (Appendix B2) shows that for the vast majority of the accounting periods in question (from 07/97 to 12/01) BDO discovered additional errors for all but two of the periods (04/98 and 07/99). The net result was that the culpable errors increased from what had been the position according to BDO/2 (£13.37m) to £13.8 million. This figure represented the net culpable arrears, taking into account both amounts of over-claimed input tax and overpayments of VAT in some periods.
90. A final meeting was arranged with all interested parties and this took place on 23 July 2003 at the London offices of BDO. At that meeting Mr Harold formally accepted BDO/3.

Penalty

91. BDO/3 itself had concluded that a total sum of approximately £13.8 million was subject to penalties under s 60 VATA. It argued that Mr Ellis' actions were against the interests of ERF and that consideration should be given to an argument that Mr Ellis' dishonesty should not be imputed to ERF. It also suggested that Customs might consider increasing the usual maximum reduction from 80% by a further 5% in the circumstances of the case in the light of the cooperation and assistance given to Customs in the investigation.
92. Mr Harold prepared a report for HQ Policy, date stamped 20 August 2003, of his findings and conclusions. He recommended that the penalty reduction should remain at 80%. In his view the case did not warrant any exceptional reduction. The result, on his recommendation, was that the penalty be set at the standard minimum of 20% of the culpable (net) arrears of £13.8 million, resulting in a penalty of some £2.76 million. He also recommended that the penalty should be applied to ERF and not to Mr Ellis, on the basis that all of the dishonestly reclaimed VAT had been paid directly into ERF's bank account and

no evidence had been found to show that Mr Ellis had extracted it or had benefited personally.

93. We heard evidence on the way in which Mr Harold calculated the penalty. We were taken to the letter that Mr Harold wrote to ERF on 17 February 2004 giving notice of the penalty assessment (and from which ERF appeals). That letter refers to the amount evaded, £13,831,086, and to the penalty amount being an amount equal to the amount of tax believed to be evaded as reduced by Customs. It then says that Customs' decision has been "exceptionally" to reduce the penalty to £2,707,424, "being one fifth of the amount believed to be evaded". There is then a schedule of the penalty analysed on a period by period basis showing the maximum penalty (i.e. 100% of the tax) and an 80% reduction in each case. The figures in the schedule are not totalled.
94. On its face, the letter gives the clear impression that the penalty has been assessed on the net culpable arrears, and mitigated by 80%. Such a calculation would have accorded with the report submitted by Mr Harold. It would also have been consistent with a report prepared by Mr Harold's line manager, Ian Riley, dated 21 August 2003 which supported Mr Harold's recommendation of 80% mitigation, but recommended that, having regard to the way in which the evasion had been carried out, involving both under-declarations (£19,426,865) and over-declarations (£5,595,000), it would be inequitable to apply a 20% penalty to the gross arrears and that accordingly, if 80% mitigation were allowed, the calculation would have to be 14.24% of the gross arrears (so applying mitigation of 85.76%).
95. That is not in fact what happened. Mr Harold's view at the time the penalty was assessed was that there was only a period of two years from the determination of the assessment within which a penalty could be assessed in relation to the tax evaded. That meant that, from his point of view, only periods assessed in April 2002 and March 2004 could at that stage be assessed to penalties. What he in fact did, therefore, was to take those periods for which a positive amount had been assessed, and applied a 20% penalty to those periods. This meant that the penalty was being assessed on gross under-declarations, without netting off for over-declarations. The total gross figure on which the penalty was assessed was £13,537,188 rather than the net figure of £13,831,086 which had appeared to have been the basis of the penalty assessment. Mr Harold did not accept in cross-examination that the fact that these figures were similar was no more than a coincidence, but in our view it clearly was, and we so find.
96. Mr Harold defended his decision to proceed on this basis despite the views expressed by his line manager, and his own report that had made recommendations on the footing that the net culpable arrears would be assessed to penalties by arguing that this was being fair to the trader. The gross basis, taking the two in time assessments, was lower than the net basis overall. Mr Harold's view was that, as there was no obligation to net off, the use of a gross basis in these circumstances was reasonable. In cross-examination Mr Harold was taken to materials that demonstrated that, before assessing on a gross basis

for the two most recent assessments, he had actively considered whether it would be possible, as a matter of law, for the earlier assessments to be withdrawn and re-issued in order to bring them within the scope of the penalty assessment. Mr Harold had finally been persuaded by his colleagues to make the assessment on the original basis, namely taking into account only the later two assessments. We accept that in exploring the way in which the penalty was to be assessed, Mr Harold was doing no more than attempting to arrive at what he considered to be the correct penalty. However, we do not accept the logic of the way in which he decided to proceed on a gross, as opposed to a net, basis. That is a matter which we shall discuss further when we deal with the penalty assessment.

Discussion

97. The main contentions of ERF are:

- (1) that the assessment of 4 March 2004 was not made within the statutory time limits and accordingly is invalid;
- (2) that Customs were outside the statutory time limits in relation to particular items for certain periods;
- (3) that the amended assessment of 29 April 2002 is invalid;
- (4) that there was an error in the assessment for the period 06/01 that entitles ERF to a repayment; and
- (5) that the penalty assessment was calculated incorrectly and/or should be further mitigated in the circumstances of this case.

Assessments out of time

98. ERF submits that assessments in relation to a number of periods that were assessed on 4 March 2004 were not made within the relevant statutory time limits.
99. The relevant statutory provisions are contained in sections 73 and 77 VATA, the material parts of which (as applicable to this appeal) are set out below:

73 Failure to make returns etc

- (1) Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.
- (2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—
 - (a) as being a repayment or refund of VAT, or
 - (b) as being due to him as a VAT credit,

an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly.

...

(4) Where a person is assessed under subsections (1) and (2) above in respect of the same prescribed accounting period the assessments may be combined and notified to him as one assessment.

...

(6) An assessment under subsection (1), (2) or (3) above of an amount of VAT due for any prescribed accounting period must be made within the time limits provided for in section 77 and shall not be made after the later of the following—

- (a) 2 years after the end of the prescribed accounting period; or
- (b) one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge,

but (subject to that section) where further such evidence comes to the Commissioners' knowledge after the making of an assessment under subsection (1), (2) or (3) above, another assessment may be made under that subsection, in addition to any earlier assessment.

...

(9) Where an amount has been assessed and notified to any person under subsection (1), (2), (3), (7), (7A) or (7B) above it shall, subject to the provisions of this Act as to appeals, be deemed to be an amount of VAT due from him and may be recovered accordingly, unless, or except to the extent that, the assessment has subsequently been withdrawn or reduced.

...

77 Assessments: time limits and supplementary assessments

(1) Subject to the following provisions of this section, an assessment under section 73, 75 or 76, shall not be made—

- (a) more than 3 years after the end of the prescribed accounting period or importation or acquisition concerned, or
- (b) in the case of an assessment under section 76 of an amount due by way of a penalty which is not among those referred to in subsection (3) of that section, 3 years after the event giving rise to the penalty.

(2) Subject to subsection (5) below, an assessment under section 76 of an amount due by way of any penalty, interest or surcharge referred to in subsection (3) of that section may be made at any time before the expiry of the period of 2 years beginning with the time when the amount of VAT due for the prescribed accounting period concerned has been finally determined.

...

(4) Subject to subsection (5) below, if VAT has been lost—

(a) as a result of conduct falling within section 60(1) or for which a person has been convicted of fraud, or

(b) in circumstances giving rise to liability to a penalty under section 67,

an assessment may be made as if, in subsection (1) above, each reference to 3 years were a reference to 20 years.

...

(6) If, otherwise than in circumstances falling within section 73(6)(b) or 75(2)(b), it appears to the Commissioners that the amount which ought to have been assessed in an assessment under that section or under section 76 exceeds the amount which was so assessed, then—

(a) under the like provision as that assessment was made, and

(b) on or before the last day on which that assessment could have been made,

the Commissioners may make a supplementary assessment of the amount of the excess and shall notify the person concerned accordingly.

100. It was common ground that, there having been dishonest conduct, the three-year restriction in section 77(1) did not apply in this case, and that this had been extended to 20 years by virtue of section 77(4). In the circumstances of the March 2004 assessment the only relevant question was whether the assessments had been made within one year after evidence of facts, sufficient in the opinion of Customs to justify the making of the assessment, came to their knowledge.
101. The provisions regarding time limits contain protections for both the taxpayer and HMRC. They are designed to protect the taxpayer from suffering prejudice if assessments are unduly delayed, and at the same time to avoid prejudice to HMRC in enabling HMRC to make further assessments under section 73(6) in respect of periods already assessed where further evidence of fact becomes available, and supplementary assessments under section 77(6) if those are made within the time limits applicable to the original assessment.
102. The legal principles to be applied in respect of section 73(6)(b) were examined by Mr Justice Dyson in the High Court in *Pegasus Birds Ltd v Customs and Excise Commissioners* [1999] STC 95. The learned judge set out (at pp 101 to 102) six principles:

“The legal principles to be applied

1. The commissioners' opinion referred to in s 73(6)(b) is an opinion as to whether they have evidence of facts sufficient to justify making the assessment. Evidence is the means by which the facts are proved.

2. The evidence in question must be sufficient to justify the making of the assessment in question (see *Customs and Excise Comrs v Post Office* [1995] STC 749 at 754 per Potts J).
 3. The knowledge referred to in s 73(6)(b) is actual, and not constructive knowledge (see *Customs and Excise Comrs v Post Office* [1995] STC 749 at 755). In this context, I understand constructive knowledge to mean knowledge of evidence which the commissioners do not in fact have, but which they could and would have if they had taken the necessary steps to acquire it.
 4. The correct approach for a tribunal to adopt is (i) to decide what were the facts which, in the opinion of the officer making the assessment on behalf of the commissioners, justified the making of the assessment, and (ii) to determine when the last piece of evidence of these facts of sufficient weight to justify making the assessment was communicated to the commissioners. The period of one year runs from the date in (ii) (see *Heyfordian Travel Ltd v Customs and Excise Comrs* [1979] VATTR 139 at 151, and *Classicmoor Ltd v Customs and Excise Comrs* [1995] V&DR 1 at 10).
 5. An officer's decision that the evidence of which he has knowledge is insufficient to justify making an assessment, and accordingly, his failure to make an earlier assessment, can only be challenged on *Wednesbury* principles, or principles analogous to *Wednesbury* (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223) (see *Classicmoor Ltd v Customs and Excise Comrs* [1995] V&DR 1 at 10–11, and more generally *John Dee Ltd v Customs and Excise Comrs* [1995] STC 941 at 952 per Neill LJ).
 6. The burden is on the taxpayer to show that the assessment was made outside the time limit specified in s 73(6)(b) of the 1994 Act.”
103. Mr Justice Dyson went on to give further consideration to principles (4) and (5). Having rejected an argument on behalf of *Pegasus* that the test in section 73(6)(b) is an objective one, he considered the question as to whose opinion falls to be considered where there is more than one officer involved in the investigations leading up to the making of her assessment. In his view “[t]he person whose opinion is imputed to the commissioners is the person who decided to make the assessment” (see p 102). But, as the learned judge further explained, it does not matter that the person who decided to make the assessment may not be the person who first acquired knowledge of the evidence of the facts which are considered to be sufficient to justify the making of the assessment. The knowledge of all officers who are authorised to receive information which is relevant to the decision to make the assessment is imputed to HMRC.
104. What we need to decide in this connection is which of the Customs officers decided to make the March 2004 assessment. This will commonly be, but need not necessarily be, the officer who signs or countersigns the assessment, or the person who may be described by HMRC as the assessing officer. Where the

assessing officer relies upon others to decide when sufficient factual evidence has been obtained, and does not exercise independent judgement in this respect, then the officer or officers so relied upon may be found to have decided to make the assessment. In this case it is clear that the assessment of 13 March 2001 was decided to be made by Mrs Fereday, and that the assessments made in February and April 2002 were decided to be made by Mr Blocksidge, who was the assessing officer in those cases, and by Miss Stocker who was the check officer. On the other hand, the position regarding the March 2004 assessment is less clear, and requires examination.

105. In common with the February and March 2002 assessments, Mr Blocksidge was the assessing officer for the assessment in March 2004. Miss Stocker was the counter-signatory and another officer, Mark Flanagan, was the “check officer”. However, the process which resulted in the issue of the March 2004 assessment did not only involve these three officers; it also involved Mr Harold. From the evidence we conclude that the role of Mr Harold was very distinct from that of the assessing officers. Mr Harold’s role was to investigate. His training was in the investigation of fraud and evasion. His function was not to decide upon an assessment, but to ascertain the facts and, in the context of the New Approach, to facilitate and encourage the cooperation of ERF and its advisers.
106. Although present at meetings with Mr Harold, Miss Stocker did not play an active part in the investigation. Her evidence, which we have accepted, was that she provided information to Mr Harold when he requested it, but beyond that all the investigation work under the New Approach was conducted by Mr Harold. Miss Stocker did not participate in decisions taken by Mr Harold in the conduct of that investigation, including any relevant decision about the dishonesty of Mr Ellis. Miss Stocker’s evidence, on the other hand, was that she took the decision to make the March 2004 assessment after she had been informed by Mr Harold that BDO/3 had been accepted. The decision to accept BDO/3 as the final report in the investigation was therefore that of Mr Harold and not that of Miss Stocker. But thereafter, up to the time of the March 2004 assessment, Miss Stocker and Mr Blocksidge, along with Mrs Fereday, were fully concerned in the process of using the factual evidence contained in BDO/3 to determine what was to be assessed. It was they who conducted an examination of the contents of BDO/3 and sent to Jane Earle of BDO a list of queries. They, and not Mr Harold, attended the meeting with BDO to discuss those questions. Mr Blocksidge prepared the spreadsheet reconciling the figures in BDO/3 with the amounts to be assessed, and Miss Stocker wrote to BDO in January 2004 with the schedule of the proposed assessments.
107. On the basis of these findings, we consider that the decision to make the assessments was made by Mr Blocksidge as assessing officer, and by Miss Stocker as counter-signatory. Mr Harold made the decision to accept BDO/3 as the culmination of his investigation, but that was not the decision to assess. There was still work to be done by Miss Stocker and her team before a decision to issue the assessment could be made, and we find that it was Miss Stocker and Mr Blocksidge who made that decision, and not Mr Harold, whose role (other

than in respect of the penalty determination) had ended before the decision to issue the assessment was made.

108. In *Pegasus Birds*, Dyson J considered the question of the circumstances in which it is possible to challenge the opinion of HMRC. It was common ground in that case, as in this, that in forming their opinion of what evidence of facts is sufficient to justify making the assessment, HMRC must have regard to their obligations to act to the best of their judgement, as expressed in *Van Boekel v Customs and Excise Commissioners* [1981] STC 290. The judge said (at pp 102-3):

“Thus, they must perform their function honestly and bona fide, and fairly consider all the material placed before them, and, on that material, come to a decision which is reasonable. In some cases, the taxpayer may complain that the commissioners have made an assessment on insufficient material. In other cases, the complaint of the taxpayer may be that, in the light of the evidence of which they were aware, it was wholly unreasonable for the commissioners to delay making the assessment. In both cases, an appeal will succeed if it is shown that the commissioners' approach was wholly unreasonable, and fails to pass a test akin to the *Wednesbury* test. I recognise that this is a high hurdle for the taxpayer to surmount, but Parliament has entrusted these matters to the judgment of the commissioners, and it is right that challenges to the exercise of judgment should only succeed when something has gone seriously wrong.”

109. After discussing *Cumbrae Properties (1963) Ltd v Customs and Excise Commissioners* [1981] STC 799 in the High Court, and the decision of the VAT and Duties Tribunal (Stephen Oliver QC) in *Classicmoor* [1995] V&DR 1, Dyson J continued(at p 104):

“The appellant has to show that the decision of the commissioners was perverse or wholly unreasonable. It is clearly established that a tribunal will not set aside an assessment where there is a challenge to the exercise of best judgment, save on grounds similar to *Wednesbury* grounds (see, eg, *Rahman (trading as Khayam Restaurant) v Customs and Excise Comrs* [1998] STC 826 at 835–836 per Carnwath J). If the matter is viewed through the prism of s 84(10), what is under challenge is the opinion of the commissioners. That seems to me to be closely analogous to a case such as *John Dee Ltd v Customs and Excise Comrs* [1995] STC 941 at 952). That case concerned an appeal against a decision of the commissioners in relation to the requiring of security. The relevant statutory provision was: 'Where it appears to the Commissioners requisite ... they may require a taxable person ... to give security ...' (see para 5(2) of Sch 7 to the Value Added Tax Act 1983). The Court of Appeal held that, in deciding whether it appeared to the commissioners requisite to require security, the tribunal had to consider whether (using shorthand) they had acted unreasonably in the *Wednesbury* sense.

The question for the tribunal on an appeal, therefore, is whether the commissioners' failure to make an earlier assessment was perverse or wholly unreasonable.”

110. We proceed now to apply the principles set out in *Pegasus Birds* to the facts of this case. The first question is: what were the facts which, in the opinion of Miss Stocker and Mr Blocksidge, justified the making of the assessment? We have no hesitation in concluding that these were those derived from BDO/3, along with the facts, such as the making of the earlier assessments, which led to the adjustments to the figures in Appendix B of BDO/3 that were set out in the assessment schedule.
111. The second question is: when was the last piece of evidence of these facts of sufficient weight to justify the making of the assessment communicated to Customs (including to officers other than Miss Stocker and Mr Blocksidge)? In our judgement the last such piece of evidence was BDO/3, which was received on 16 July 2003. The assessment made on 4 March 2004 was therefore made within one year of that date and was accordingly in time by virtue of section 77(6) VATA.
112. We now turn to consider whether, as Mr Harris argued, there was an earlier time at which Customs had sufficient evidence on which an assessment could be justified, and whether it was wholly unreasonable or perverse for Customs at any of those times to have delayed the making of the assessment, so that if the earlier assessment was made more than one year after that time it would be out of time. Mr Harris submitted that there were a number of occasions on which Customs had sufficient evidence to justify the making of an assessment. We consider each of those submissions in turn.

Amended BDO/1

113. Mr Harris argued that, in relation to Amended BDO/1, Miss Stocker had, on 8 April 2002, assessed for some periods on the basis of the figures set out in Appendix A of Amended BDO/1 (confirmed VAT return errors). In relation to period 06/00, the figure identified in Appendix A as overpaid input tax (£1,323,000) was assessed (as part of an amount of £1,355,415) in March 2004. Mr Harris argued that as this amount was confirmed in Amended BDO/1, and Miss Stocker had assessed on the basis of other confirmed amounts set out in Appendix A to that report, this was evidence of fact sufficient to justify an assessment in the Appendix A amount.
114. Miss Stocker's evidence was that she considered at the relevant time that this amount had already been assessed, and that for this reason the amount was not assessed on the basis of the facts made available to Customs in Appendix A of Amended BDO/1. But in respect of this amount the assessment in question had in fact been made on 5 February 2002, as part of a net assessment of £1,280,721, for the wrong period: 07/00 instead of 06/00. The figure was clearly stated in Appendix A to relate to 06/00.

115. As a separate question, but one which it is convenient to address here, it was argued that since the amount of £1,323,000 was originally assessed on 5 February 2002 in respect of the wrong period (07/00 instead of 06/00), that amount fell to be repaid to ERF. We have decided above that ERF's appeal in respect of the assessment of 2 February 2002 is out of time, and we have refused permission to appeal late. However, if this appeal were to have proceeded, to succeed with this challenge ERF would have to show that the decision to assess this sum on 2 February 2002 for 07/00 was wholly unreasonable or perverse. ERF has not, in our view, demonstrated that. There may have been an error in the making of the assessment for the wrong period, but in our view an error of this nature is not something that can be challenged on the basis that it is wholly unreasonable or perverse. It is not disputed that there was a liability in this amount (subject to the out-of-time assessment argument), and the conduct of Customs did not result in any double-counting, or over-assessment. Assessing for a later period than ought to have been the case would have reduced the interest payable. We therefore find that Customs did not act wholly unreasonably or perversely in assessing the sum of £1,323,000 for period 07/00 in the 2 February 2002 assessment.
116. Mr Harris argued that it was in these circumstances wholly unreasonable and perverse for Miss Stocker, when she was assessing for periods on the basis of the facts as set out in Appendix A of Amended BDO/1, which provided new evidence of fact as to the correct accounting period for which the £1,323,000 should be assessed, not to have assessed for 06/00, where the reason for not doing so was that she wrongly believed that amount to have been already correctly assessed, when it had not been assessed for the correct period, and that was apparent on the face of Appendix A. We do not agree. We do not think it was either wholly unreasonable or perverse for Miss Stocker to have taken the view, in April 2002, that on the basis that the amount had already been assessed, no assessment of the £1,323,000 should be made at that time. Thereafter, once the investigation had started, it was not unreasonable or perverse for Customs to have taken the view that there was not evidence of facts sufficient for further assessments, including any that might relate to 06/00 and 07/00, to be made, until that investigation had been completed. The investigation was completed only when BDO/3 was delivered, and until that time it was not unreasonable or perverse for Customs not to have made assessments for all periods included in the investigation, even where it turned out, with hindsight, that relevant facts in relation to particular individual periods were available at an earlier stage.
117. Miss Stocker did not assess for all of the periods for which confirmed amounts were set out in Appendix A. She did not assess for periods prior to 03/99 because she was of the view that she did not have evidence of dishonesty at that time and could therefore assess back as far as three years only. Mr Harris argued that, in the light of this fact, and the fact that, for accounting periods within the three-year period, Miss Stocker had self-evidently concluded that Appendix A provided sufficient evidence of facts to justify the making of the April 2002 assessment, the actual evidence of the dishonesty on the part of Mr Ellis, and by association of ERF, was accordingly the last piece of the puzzle,

and that as soon as sufficient evidence of dishonesty had come into the possession of Customs the time started running on the one-year period within which the assessment had to be made for the remaining periods in Appendix A.

118. Mr Harris put forward a number of possible times before which, he submitted, Customs had the relevant evidence of dishonesty. The first such time was 26 February 2002, when Amended BDO/1 was delivered to Customs. Mr Harris put forward five points in this connection:

(1) In the law enforcement paper dated 1 October 2001 Mr Emmett had stated his opinion that ERF must knowingly have submitted false VAT returns.

(2) The letter from Klaus Wagner of 5 August 2001, coupled with Stephanie Frobisher's explanation of the issue that followed, made clear that there were two accrual amounts of £1.1 million and £3 million that had not been reversed. Coupled with the previous history back to 1994 when, to Customs' knowledge, the same issue as to failure to reverse accruals had arisen, that, argued Mr Harris, is clear evidence of fact on which Customs could have formed the opinion that there was dishonesty.

(3) Mr Harold accepted in his evidence that the view adopted by Customs at the outset of the investigation was that Mr Ellis must have been dishonest, although Mr Ellis himself did not admit to that dishonesty in relation to VAT until some time later.

(4) Customs were aware at the very start of their investigation that Mr Ellis and the two most senior executives of ERF had been suspended.

(5) It was a matter of public record that, at the date of Customs' first visit to ERF in connection with this matter on 15 October 2001, there was a £100 million hole in the balance sheet of ERF.

119. Mr Harris argued that, for these five reasons, there was at February 2002 clear evidence of dishonesty, and at least one officer of Customs had formed the opinion that this amounted to dishonesty in relation to VAT. We do not agree. The most that could be said up to February 2002 is that Customs had information on which it was entitled to investigate possible dishonesty. Although we accept that the information available to Customs contains a number of pointers towards dishonesty, that in our view is far from being evidence of fact sufficient to justify the making of assessments on that basis. We do not consider that, exercising best judgement, an assessment that relied upon dishonesty could have been justified in February 2002. It was not wholly unreasonable or perverse for such assessments not to have been made at that time, or within one year after that time.

120. Mr Harris next referred us to the Henderson report. In that report, completed in July 2002, Mr Henderson had analysed Amended BDO/1 and, argued Mr Harris, had formed the view that ERF had engaged in "fraudulent activity". But the report simply refers to "evidence of fraudulent activity currently available" in the context of pursuing a negotiated settlement. In our view this cannot be

read as confirming that Mr Henderson had taken a view, let alone reached a conclusion, as to dishonesty. The existence of some evidence of fraudulent activity was not sufficient to justify an assessment on this basis in July 2002.

121. Mr Harold and Miss Stocker had a meeting with ERF and various professional advisers (for ERF and Western Star) on 3 October 2002. This was the meeting to discuss proceeding under the New Approach. Mr Harris referred to the minutes of that meeting where Mr Harold was reported as saying that there must have been dishonesty in respect of Mr Ellis' dealings with VAT and that he considered that the acts and omissions of Mr Ellis were dishonest rather than reckless. In his evidence, whilst accepting that he had expressed the opinion that Mr Ellis was dishonest, Mr Harold also said that he had reached no conclusion on this matter as he retained an open mind. That, in our view, is confirmed by the fact that it was at that stage not accepted by ERF that Mr Ellis had been dishonest and ERF wanted to investigate more deeply, looking in detail at the actions of Mr Ellis and others. Mr Harold confirmed that he would await a further disclosure report.
122. The question for us is whether, in the light of the expression of view by Mr Harold in October 2002, this can be regarded as the last piece of the puzzle in relation to the earlier periods in Appendix A of Amended BDO/1 that had not been assessed in April 2002. We do not consider that it can. It is important, in our view, to have regard to the context in which Mr Harold expressed his opinion. The New Approach was relevant only to a case where the circumstances suggested that dishonesty might be a factor. The fact that an investigation proceeds on the footing of the New Approach cannot itself be decisive of a finding of dishonesty. That depends on the circumstances. The investigation will commonly involve consideration of the dishonesty question as well as a financial audit. That was the position in this case. Mr Harold was doing no more than stating a starting point for Customs in respect of the adoption of the New Approach. Indeed, part of what Mr Harold had to say about Mr Ellis' dishonesty was to make the obvious point about how difficult it might be to persuade a tribunal that Mr Ellis had been dishonest with regard to his handling of company affairs, but not in relation to VAT. That view could not, we consider, be regarded as a view on the question of dishonesty sufficient to justify the making of an assessment. It was not even a settled view of Mr Harold himself, as he accepted that further enquiries ought to be made.
123. Mr Ellis admitted his dishonesty in relation to the Appellant's VAT returns and records in interviews with BDO on 19 and 27 November 2002, and he gave a written account of that dishonesty on 2 December 2002. Mr Harold learned about these admissions when he received BDO/2. BDO/2 was dated 31 January 2003, and so we find that Customs would have received this information early in February 2003.
124. We accept that, on receipt of BDO/2, Customs had evidence of fact of the dishonesty of Mr Ellis, and through him the dishonesty of ERF. The question then is whether that could fairly be regarded as providing the last piece of the

puzzle in relation to the unassessed periods in Appendix A of Amended BDO/1, which at the time of the delivery of Amended BDO/1 had been described as confirmed VAT returns errors resulting from journal entries. In our view this was not then the last piece of the puzzle. It would have been if Amended BDO/1 had been the last word on the figures. But it was not. The instigation of the New Approach process, and the further enquiries and investigations on the part of BDO that this entailed, meant that the figures in Amended BDO/1 could no longer reasonably be relied upon by Customs in the making of an assessment. Indeed, Amended BDO/1 had been expressly superseded by BDO/2 (albeit that BDO/2 was expressed as a draft report). The fact of confirmation of dishonesty was a piece of a puzzle, but it was a piece of a different puzzle than the one that had Amended BDO/1 as another piece. The receipt of the fact confirming dishonesty did not complete the puzzle so as at that stage to provide Customs with sufficient evidence to justify the making of an assessment, because part of the requisite factual evidence, namely the figures, had become uncertain, and remained outstanding, as a result of the further work being carried out by BDO. For these reasons we find that it was not wholly unreasonable or perverse for Customs not to have raised assessments or the remaining periods in Appendix A to Amended BDO/1 on receipt of the confirmation of dishonesty in BDO/2.

125. We turn now to Mr Harris' submissions in relation to Appendix B to Amended BDO/1. Appendix B sets out the questionable journal entries that, for the reasons explained in Amended BDO/1, could not be confirmed as having been processed through the relevant VAT returns. Mr Harris argued that the only difference between Appendix A (confirmed errors) and Appendix B (questionable journal entries) was one of labelling by a third party; that opinion was irrelevant as the only opinion that counted was that of Customs. He argued that Miss Stocker's evidence showed that Appendix B shows amounts that are probably owing and that the detailed reasons for these amounts being questionable were reasons of which Miss Stocker had prior knowledge.
126. We do not consider that the Appendix B figures can come anywhere near to providing evidence of fact sufficient to justify the making of an assessment on those figures. It was clear from Miss Stocker's evidence that she did not consider this information was a sufficient basis for assessment. In our view in this respect her judgement cannot be faulted. Miss Stocker based her conclusion on the fact that BDO were clearly stating that they had been unable to confirm if the questionable journal entries had been processed through the relevant VAT return. Mr Harris argued that, by reference to section 73 VATA, the whole purpose of making VAT assessments is in circumstances where the VAT return is incomplete or incorrect, and so the absence of confirmation that entries had been processed through a VAT return could not preclude an assessment. We do not accept this argument. In the circumstances of this case the relevant errors were, largely, in respect of claims for input tax recovery. Those claims could only have been made through a VAT return, and in the absence of confirmation that the journal entries in ERF's accounting records had been included in a VAT return, there would have been no such errors to assess.

127. Mr Harris raised the further argument that since Customs had the VAT returns they could themselves have made the necessary matches and that this was therefore evidence of fact that was in the possession of Customs. In this connection we need to consider the report of Mr Henderson dated July 2002. Mr Henderson had been asked to consider significant misdeclarations of VAT by ERF. We have summarised above the conclusions he drew. Whereas the total net liability for questionable journal entries in Appendix B to Amended BDO/1 was £3,817,479, the corresponding figure in Mr Henderson's report was £536,422.47. The question we have to consider is whether this demonstrates that Customs had, when Mr Henderson had reported, sufficient evidence of fact in relation to the remaining Appendix B amounts to justify at that stage an assessment. It is clear that, at the time of making his report, Mr Henderson had sufficient material on which to base his own findings. However, we are not satisfied that this was sufficient factual evidence to justify an assessment. We base that conclusion on the following factors:

(1) Mr Henderson's report makes clear that the figures he puts forward are merely indicated by his findings, and could not be regarded as confirmed.

(2) The conclusion of Mr Henderson's report is that a negotiated settlement might be the best option to pursue. In the context of such a course (which was adopted), we do not consider that it was wholly unreasonable or perverse for Customs not to have relied upon the indications of the figures in Mr Henderson's report to make an assessment.

(3) The relevant period for this purpose can only be 06/99. (The prior periods would fall out of account because of absence of sufficient evidence of dishonesty for the same reasons we have found in relation to Appendix A.) For that period Appendix B showed an output tax liability of £230,732. That period is shown in the schedules to Mr Henderson's report as "culpable", but only in the sum of £51,080.92. This is expressed to relate to "VAT and stock accounts – not reversed 07/99" and it is noted that further validation is required, namely to agree a revised under-declaration. In those circumstances it cannot be said that Mr Henderson's finding in respect of this amount was at that stage sufficient to justify an assessment.

128. Accordingly, we do not consider that the failure by Customs to make assessments based on Appendix B of Amended BDO/1, either at the time of that report or following Mr Henderson's report, was wholly unreasonable or perverse.

Henderson report: 06/99

129. In relation to the Henderson report, Mr Harris argued that for one specific period, 06/99, the exact figure identified in the report, £51,081, was never subsequently adjusted as the result of any further investigation by BDO or HMRC. That period was not assessed until the March 2004 assessment and so, argued Mr Harris, that particular assessment must be time-barred.

130. We do not agree. If the relevant legal test was simply to look for the amount actually assessed and then determine when facts establishing that amount were first available to HMRC, we could see the force of Mr Harris' argument. But that is not the test. The relevant time is when the last piece of factual evidence of sufficient weight to justify the making of the assessment was communicated to HMRC. Knowledge of the number alone is not necessarily sufficient. We find in this case that it was not sufficient, as it was merely one element of an overall investigation that was far from being finalised at the date of the Henderson report. It could not therefore at that stage be relied upon, any more than reliance could have been placed on other figures which did in fact change between the date of the Henderson report and the receipt of BDO/3. In our view it was certainly not wholly unreasonable or perverse for HMRC not to have formed the opinion that the 06/99 figure was a sufficient fact to justify an assessment.

BDO/2

131. Mr Harris argued that the fact that BDO/2 revealed total VAT arrears of £13.37 million which substantially mirrored the arrears calculated by Mr Henderson demonstrates that at the stage of BDO/2 HMRC had the opinion that the amounts set out in BDO/2 were the amounts they could properly assess having regard to the *Van Boekel* test. HMRC could at that stage have made an honest and bona fide judgement on the materials placed before them without the need to make exhaustive enquiries.
132. Mr Harris argued further that the evidence of Mr Harold clearly showed that he had been content, at the February 2003 meeting, to accept BDO/2 as ERF's disclosure without the need for any further work. We have found this to be a fact. We have also found that Mr Harold formed the view that it would have been unreasonable not to have allowed further investigation to be carried out in the face of the strongly held belief on the part of BDO that the figures were not correct and would be significantly reduced by further investigation.
133. We do not regard the evidence of the February 2003 meeting as evidence of Mr Harold forming an opinion for the purposes of assessment. It was an attempt, in what we would regard as a quasi-negotiating meeting, to suggest to ERF's advisers that further investigation could be futile, or more likely counter-productive. If that suggestion had been accepted, it would then have been possible to find that at that time Mr Harold had formed the opinion that sufficient evidence of fact was available and that, although the final decision to assess would have been that of Miss Stocker and her team, the relevant date from when the one year period for assessment should run was the date of the receipt of BDO/2. But, that suggestion having been rejected by ERF, the further work that was done by BDO that resulted in the production of BDO/3 in our view means that only on the receipt of BDO/3 did HMRC have sufficient evidence on which to base an assessment.
134. The context in which BDO/2 was produced was the New Approach. According to that approach it was accepted by both HMRC and ERF that the investigation

would be carried out by ERF. Whilst that work was continuing, whatever the thoughts of HMRC officers as to its likely outcome might have been at any stage, in the exercise of their best judgement, it was neither perverse nor wholly unreasonable for them not to make an assessment until the investigation was complete. Until BDO had produced their final report nothing that had previously been provided in BDO/2 could be regarded as complete or conclusive, and in our view it was reasonable for HMRC not to regard the information in BDO/2 as evidence of facts sufficient in their opinion to justify the making of the assessment. Mr Harold's expression of willingness to accept BDO/2 was overtaken by his actual acceptance of the further investigation to be carried out by BDO. It is not enough that there merely be evidence of facts. That evidence must be sufficient, taking into account the obligation to exercise best judgement, to justify the making of the assessment. That does not simply refer to the quantum of the evidence, but it refers also to its quality. Mr Harold, by accepting the further investigation, was accepting that BDO/2 did not have the necessary quality of factual evidence on which an assessment could be based.

135. Mr Harris placed considerable reliance on a decision of the VAT and Duties Tribunal (Chairman: Mr Paul Heim CMG) in *Lazard Brothers & Co Ltd v Customs and Excise Commissioners* (No 13476), which he argued was decided on facts analogous to those in this case. In *Lazard Brothers* there was no question of dishonesty, but the case concerned various adjustments that fell to be made to Lazard's input tax recovery under its partial exemption method. The Customs officer had written to the company on 22 March 1993 stating that it was his intention to raise an assessment based on the then available information as soon as possible to avoid an assessment out of time. He then requested the company to prepare various schedules based on the available facts. As noted by Dyson J in *Pegasus Birds* (at page 104), [t]he classification and further calculations were not further evidence of facts." The tribunal held that on the evidence the commissioners had formed the opinion that they had sufficient evidence, and that they did in fact have that evidence. The tribunal did not find it necessary to consider the argument that it was unreasonable for the commissioners not to have formed the opinion that they had sufficient evidence, as they found that they had in fact formed that opinion. Nor did the tribunal expressly state that it was wholly unreasonable or perverse for the commissioners not to have made the assessment within one year of 22 March 1994, but Dyson J in *Pegasus Birds* (at page 104h) was of the view that this was how the tribunal's decision should be interpreted.
136. Mr Harris relied in particular on the following passage from *Lazard Brothers* (at pp 24-25):

"The Tribunal considers that in forming their opinion of what is evidence of facts sufficient to justify the making of an assessment, the Commissioners are bound to have regard to the obligations upon them as defined by the judgment in the appeal of *Van Boeckel*. The obligation on the Commissioners is inter alia to make an honest

judgment to come to a view as to the amount of tax due. They must fairly consider all material placed before them and as long as there is some material on which the Commissioners can reasonably act they are not required to carry out investigations which may or may not result in further material being placed before them. This means, in the view of the Tribunal, that in judging what evidence is sufficient, they may not neglect the consideration that they can assess without exhaustive enquiries and on the material which is before them. That does not mean that they cannot seek for further material if they desire, but it does mean that they are not free to conclude that it can only be sufficient in their opinion if it is exhaustive. In the present appeal it is conceded that the Commissioners could have assessed before they did, on the basis of the facts in their possession. They decided to seek further information from the appellant in the form of schedules including calculations, on which Mr Abel wished to seek agreement. That appears to the Tribunal to be a perfectly proper approach, for the reasons given by Mr Abel, but it would not suffice to displace the obligation on the Commissioners to act to the best of their judgment, nor to stop time from running. Requiring the taxpayer to prepare his own assessment is another thing. The obligations [sic] on the Commissioners to exercise the best of their judgment is not an obligation which the Commissioners can delegate to the taxpayer. Further it is relevant to the Commissioners' powers to assess to the best of their judgment that the desire to reach an agreement with the taxpayer, though laudable, is not one which should of itself be taken to interrupt the running of time limits imposed by statute.

It follows that insofar as the Commissioners argue that they might have made an assessment on the evidence of facts available in March 1993, having made calculations thereon, they could nevertheless form a better judgment after having asked the appellant to make those calculations with a view to reaching a negotiated or agreed assessment, that argument would not be a justification for time not running against them.

On the basis of the evidence before the Tribunal, the Tribunal finds that when Mr Abel wrote his letter of 22 March 1993, it can only have been on the basis that evidence of facts, sufficient in his opinion and thus in the opinion of the Commissioners to justify the making of the assessment had already come to his knowledge. That evidence had come to the knowledge of the Commissioners with the confirmation given by Mr Blackburn of Mr Abel's findings, on 7 September 1992. The fact that he wished for the information which he had discovered to be classified and calculations made thereon does not alter the conclusion that the basic facts were already in the hands of the Commissioners, and that they had reached the opinion that they were sufficient.

The Tribunal does not consider that the making of the calculations upon facts in the possession of the Commissioners comes within the terms of evidence of facts sufficient to justify the making of the assessment. The making of the assessment is the exercise of the Commissioners' judgment upon the facts."

137. On this basis Mr Harris argued that, as in this case, the reason that Customs were seeking further information and waiting and then missing the time limit was because they had a view to “reaching a negotiated or agreed assessment”. This, in essence, is what the New Approach is about. But, Mr Harris submitted, the desire to seek agreement does not override the statutory time limits. The statutory scheme provided for in sections 73 and 77 VATA seeks to balance certainty for the taxpayer (by providing reasonable limitation periods) with an ability for HMRC to reconsider their previously raised assessments if new material comes to light. The power for HMRC to make a further assessment is designed to cover precisely the circumstances where HMRC acquire new evidence of fact, the only limitations on its use then being that an assessment has already been raised for the period in question, that they act within the one-year period and that they comply with the three-year or 20-year longstop period as appropriate.
138. We agree that, in the circumstances of *Lazard Brothers*, the further information requested with a view to a negotiated or agreed assessment would not prevent the statutory time limits from running. But the reason why that was the case in *Lazard Brothers* was because the commissioners had already formed the view that evidence of facts sufficient in their opinion to justify the making of the assessment had already come to their knowledge. We make no such finding in this case in relation to BDO/2. On the contrary we find that neither Mr Harold nor Miss Stocker, and consequently not Customs, had formed the view that the facts available were sufficient to justify the making of the assessment, in Mr Harold’s case in the light of his conclusion that it would be reasonable to permit BDO to continue its investigation. Furthermore, in the circumstances of this case, we do not consider that the failure to form that view in relation to BDO/2 was either wholly unreasonable or perverse. Indeed, as we have stated above, we consider that it was reasonable, and indeed perfectly proper, on the part of Customs to have formed the opinion that evidence of facts sufficient to justify an assessment had not come to their knowledge until they received BDO/3.
139. Mr Harris argued that in the event BDO/3 itself demonstrates that no new evidence of fact was required beyond that which was available at the time BDO/2 was delivered, referring specifically to the methodology set out in Section 3 of BDO/3. We do not agree that BDO/3 encompassed no further evidence of fact. The calculation of the true output tax and input tax included a three-month sampling exercise to check the BaaN accounting system for completeness and accuracy. The conclusion that the BaaN report correctly reported VAT in the wider reconstruction period was itself new evidence of fact. Furthermore, as we have described above, an assessment must be justified not only on the quantum of the facts, but on the sufficiency of their quality. The detailed methodology described in BDO/3 demonstrates quite clearly, in our view, that prior to that work being undertaken, and the receipt of BDO/3, Customs could not be regarded as having acted wholly unreasonably or perversely in not making assessments on the basis of BDO/2.

140. In making our findings regarding BDO/2, we do not place any weight on the fact that BDO/2 was expressed as a draft report. Having regard to the February 2003 meeting, BDO/2 was clearly not regarded by ERF or BDO as the definitive position. On its own terms BDO/2 clearly envisaged a reconstruction of the correct VAT position for each period, an exercise recognised to be significant and one which, in the event, resulted in substantial revisions of figures for individual periods of assessment. We consider that such an exercise, whatever its outcome, falls well outside the parameters of the further work that was envisaged in *Lazard Brothers*.

BDO/2: 03/96

141. In relation to BDO/2 Mr Harris referred us in particular to period 03/96. He said that the amount of £390,000 referable to that period was clearly identified in BDO/2 and that there were detailed explanations given in BDO/2 for how that figure came about. In March 2004 this figure was included as part of the global assessment, and it did not change from the time it was identified in BDO/2, which was more than one year before the March 2004 assessment. Notwithstanding that the figure of £390,000 remained unaltered, we do not consider that there was anything unreasonable or perverse in Customs not forming the opinion at the time of BDO/2 that it had sufficient evidence in this respect to justify the making of an assessment for 03/96 in that sum. The fact that one figure out of a global report containing references to numerous accounting periods and numbers does not change as a result of further consideration does not make the conduct of Customs wholly unreasonable or perverse.
142. Furthermore, we do not accept that the amount of £390,000 could in any respect be regarded as a confirmed figure at the date of BDO/2. Para 4(2)(d) of that report stated the opposite conclusion:

“As a result of SE’s admissions, there appear to be culpable VAT errors of approximately £390k arising in March 1996, together with possible culpable VAT errors in December 1995 and January 1996 (paragraphs 6.6(j), 6.6(k) and 6.7 below refer). These will be confirmed in due course.”

The report goes on to make the point that the figure of £390,000 was based on Mr Ellis recollection that the batches totalling £390,000 were made up of fictitious invoices, and that this was to be confirmed once a particular accounting system had been restored. This apparent error could not, in our view, have been regarded as sufficient evidence on which to base an assessment.

Period 07/00

143. One of the elements on which the balancing assessment made on 4 March 2004 for 07/00 was a sum of £45,568 due to HMRC. Mr Harris argued that this figure was derived from the VAT return submitted by ERF in respect of period 07/00 and received by Customs on 5 September 2000 which had been amended on 6 October 2000. The effect of the amendment was to increase the amount of

VAT reclaimed on the original return (£3,270,233.62) to £3,315,801.73, a difference of £45,568. Mr Harris argued that by dint of this Customs had evidence of fact in respect of this amount at the date of the VAT return in 2000, and that they are accordingly out of time in assessing that amount only in March 2004.

144. An examination of the circumstances shows immediately why this argument falls to be rejected. There was nothing at the time of the original VAT return or the amendment to it in 2000 that would justify Customs making an assessment. The effect of the amendment was to increase by £45,568 the amount of input tax being claimed by ERF. The reason why the sum of £45,568 was included as an adjustment in the March 2004 assessment was that in putting forward its figures in BDO/3, BDO had used the original VAT return and not the amended one. That meant that in reaching a figure for VAT that had been wrongly recovered by ERF, BDO/3 had recorded the lower figure and had therefore under-reported the error by £45,568.
145. It will be apparent from this that the only reason why Customs included the figure of £45,568 in the calculation for the March 2004 assessment in respect of 07/00 was that BDO/3 contained an error in this respect. The fact that the error was identified by comparing an original and amended VAT return from 2000 is not relevant to the question of when Customs had sufficient evidence on which to base the March 2004 assessment. That assessment, as we have found, was based on evidence of fact contained in BDO/3. No error could have been discovered in relation to the facts disclosed in BDO/3 until BDO/3 had been received by Customs. Accordingly, until the discovery of that error after receipt of BDO/3 Customs could not have had sufficient evidence on which to justify (or even make) an assessment in respect of the £45,568, and the inclusion of that amount in the March 2004 assessment in respect of period 07/00 was therefore in time.

Amended assessment: 29 April 2002

146. We have refused permission to appeal out of time in respect of the assessment made on 8 April 2002 and the amended assessment made on 29 April 2002. However, we address here a submission by Mr Harris that ERF is entitled to payment of £107,583 on the basis that this amount appeared in the assessment of 8 April 2002 as an amount owing to ERF for the period 01/00 and was then reduced to zero in the amended assessment. The effect was to increase the amount assessed from £2,055,711 to £2,163,294. Mr Harris argued that there is no statutory power to amend an assessment and accordingly that the 29 April 2002 amended assessment was invalid.
147. The circumstances of the amended assessment were as follows. In its assessment of 13 March 2001 Customs assessed for a number of periods, including 01/00. The calculation in respect of that assessment is detailed in the sheets attaching to the assessment and shows, in relation to 01/00, that the sum of £107,583 was taken into account as a deduction in calculating tax under-declared for that period of £605,873. When the assessment of 8 April 2002 was

made, it again included as a deduction the same amount of £107,583. This error had in fact been pointed out to Customs in advance of making their assessment. Stephanie Frobisher had written to Miss Stocker on 21 March 2002 in reply to an assessment schedule sent to Miss Frobisher on 14 March 2002 to draw Miss Stocker's attention to the duplication. Miss Stocker replied by undated letter to confirm that the assessment had been amended to take account of the duplicated amount.

148. It was common ground that there is no power to amend an earlier assessment. This is clear from *Ali (t/a Vakas Balti) v Revenue and Customs Commissioners* [2007] STC 618 (see, in particular, per Lloyd LJ at [9]). It is not possible, for example, for time limits to be circumvented by HMRC amending an in-time assessment when a further assessment would be out of time. Miss Shaw argued that even if the amended assessment were to be invalid, so that the only assessment under consideration was the 8 April 2002 assessment, nevertheless the Tribunal was required to identify amounts that were not due to ERF on that earlier assessment and to deny repayment of £107,583. We do not agree with this submission. The appeal of ERF in this respect (had we allowed an appeal to have been made out of time) is against the amended assessment. If we were to decide that the amended assessment is invalid, there is nothing more for us to decide in that respect. If it were otherwise the same argument could be made in the case of an out-of-time amendment where an over-deduction was sought to be reversed.
149. Miss Shaw then argued that the only issue was one of labelling. The 29 April 2002 assessment was described as an amended assessment, but the question is: is it an assessment? Miss Shaw submitted that unequivocally it is, and in support she referred us to *House (trading as P&J Autos) v Customs and Excise Commissioners* [1996] STC 154. In that case in the Court of Appeal it was held that there was no statutory provision which prescribed the form of notification of assessments. In his judgment (with which the other members of the court agreed) Sir John Balcombe said (at page 161):

“As I have already said, neither the Act nor the regulations require any specified form of notification but, as Woolf J said in the *International Language Centres* case, and I repeat:

“... the taxpayer is entitled to be informed in reasonably clear terms of the effect of the assessment...”.

It seems to me that he was so informed in this case. There reached to him together on the same day something headed — on the face of it, a formal document — ‘Notice of Assessment’, giving the total sum which was alleged to be due from him, £147,000 and, while that document itself did not, in terms, refer to any accompanying schedules, the schedules which, in fact, accompanied that document with the letter of 24 May showed, with complete clarity, how that sum was made up.”

150. Miss Shaw submitted that this was exactly what the 29 April 2002 amended assessment document did. It set out in clear terms the amounts which ERF was

being asked to pay. It divided them up into the relevant accounting periods. There could have been no confusion on the part of ERF.

151. In *House*, Sir John Balcombe continued (at page 161):

“As Mr. Cordara [counsel for the taxpayer] fairly admitted, it might have taken him half-an-hour at most — one suspects, with a calculator, rather less — to add together the various sums in the different VAT periods under the three schedules, and he would soon have arrived at the total which was said to be due from him.

That being so, is there any reason why we should not let common sense apply and say that the taxpayer was here given proper and adequate notification of the basis upon which he had been assessed?”

The learned judge then went on to consider the decision of the VAT and Duties Tribunal in *Bell v Customs and Excise Commissioners* [1979] VATTR 115 and remarked that a document entitled notice of assessment, even in an official form, should not be given an importance which it cannot properly bear. The only requirement is that the amount has been assessed and is notified to the taxpayer (see section 73(9) VATA).

152. We agree with Miss Shaw. It is correct that it is not possible to backdate a further assessment in respect of a particular period by amending an earlier assessment. The amendment can only be treated as an assessment of an amount notified to the taxpayer at the date it is communicated to him. However, the fact that an assessment is given the label “amended assessment” and is given the same reference number as the original assessment does not alter the fact that an assessment has been made and has been notified to the taxpayer. This accords entirely with common sense.
153. The notification that was sent to ERF on 29 April 2002, with its accompanying schedules was in our view a sufficient explanation in clear terms of the amount due. The change for the period 01/00 from a deduction of £107,583 to nil was clearly signposted and ERF could have been in no doubt as to the position. Accordingly, the 29 April assessment was a valid assessment in respect of that sum of £107,583.
154. That is not quite the end of the matter. Although the point was not argued before us, case law of the tribunal (see, for example, *Jeudwine v Customs and Excise Commissioners* [1977] VATTR 115; *The Far East Restaurant*, VAT decision no 11008) indicates that there can only be one tax assessment at any one time for any one period. The question therefore is whether there was more than one assessment for the relevant period, which in this case was 01/00. In our view the answer is no; the amended assessment of 29 April 2002 was the only assessment in respect of that period.
155. The original notification of the assessments for various periods from 03/99 up to 01/00 gave ERF notification, not of any assessment for 01/00, but of a credit in respect of that period which was netted against the assessments for the periods

for which an amount of VAT due had been assessed. There was no assessment at that time in respect of period 01/00. Customs had the power then, under section 73(2) VATA to reverse the amount of such credit for 01/00. The notice of amended assessment notified ERF of this assessment by showing the amount for 01/00 as zero rather than as a credit for £107,583 that had appeared in the earlier notification. The total amount assessed therefore increased by the sum of £107,583. This represented the amount of the assessment under section 73(2) in respect of the period 01/00.

156. Accordingly, we reject ERF's claim that the sum of £107,583 is repayable to it.

March 2004 assessment: period 06/01

157. We have described in our findings of fact the process by which Miss Stocker and Mr Blocksidge arrived at the March 2004 assessment in respect of the 06/01 period. Mr Harris argued that the calculation of the liability in respect of that period relied upon, firstly, a sum of £1.1 million shown as owing to Customs for the period which HMRC accept represents a validly reversed accrual and which should not therefore form part of any assessment. Secondly, he argued that the calculation relied on the inclusion of a sum of £232,000 shown as owing to Customs that Customs considered had already been taken into account in the calculation of earlier periods and which similarly should not form part of any assessment.

158. We have found that the approach adopted by Customs in the manner in which the assessment amount for 06/01 was calculated was wrong. It was wrong to take as the starting point the sum of £3,533,429.92 due to ERF and then to bring that back to the same net figure that would have applied if the starting point had been the figure in Appendix B of BDO/3 of £798,570 by adding back as amounts owing from ERF to Customs an "accrual reversal" of £1,100,000 for 05/01 (where the accrual of that amount had been accepted as valid) and the amount of £232,000 which Miss Stocker and Mr Blocksidge had considered must have been adjusted in the recalculations of earlier periods. The effect was to bring back into account the sum of £1,100,000 that had been deducted in Mr Blocksidge's schedule in respect of period 05/01. There is no specific adjustment in the schedule for the £232,000, but we accept that this must have been taken into account for an earlier period.

159. We have found as a fact that, in arriving at its own figure in Appendix B for the period 06/01 (£798,570.08), BDO did not take into account any amount in respect of prior discrepancies that had been paid through the mechanism of the 06/01 return, and that this was the logical, and in our view correct, approach. We consider therefore that the correct approach for Customs would have been to take as the starting point the figure of £798,570 in Appendix B and to adjust that for the amounts of £640,955 already assessed as due to Customs from ERF and the figure of £72,444 already assessed as due to ERF from Customs, both of which were included as additional adjustments in Mr Blocksidge's schedule. If this had been done, the net figure arrived at would have been £230,059, the very

same figure that was assessed on the basis of Customs' own – erroneous – calculations.

160. Mr Harris did not seek to argue that the 06/01 assessment should be set aside. His argument essentially was on the double-counting that was apparently done in respect of the sums of £1,100,000 and £232,000. We consider that the correct approach, as set out by Carnworth LJ in *Pegasus Birds* in the Court of Appeal [2004] STC 1509 (at page 1519) is for us to consider:

“... whether the defect is so serious or fundamental that justice requires the whole assessment to be set aside, or whether justice can be done simply by correcting the amount to what the Tribunal finds to be a fair figure on the evidence before it. In the latter case, the Tribunal is not required to treat the assessment as a nullity, but should amend it accordingly.”

161. Although we consider that the calculation made by Customs in respect of the 06/01 assessment was incorrect, we do not consider that in the event the defect was so serious or fundamental as to require the assessment to be set aside. On the evidence before us we have been unable to reconcile the Appendix B figure with the numbers in the 06/01 return itself, but that is doubtless explained by the fact that BDO had material available to it when constructing BDO/3 that we have not. We therefore consider that the best evidence we have of the correct starting point for the 06/01 assessment is the figure that BDO included in Appendix B of BDO/3, namely £798,570. Adjusting that for the amounts (£640,955 and £72,444) set out in Mr Blocksidge's schedule as already assessed gives a net figure of £230,059, which was the figure actually assessed.
162. Calculated in this manner, which we consider to be correct, the sums of £1,100,000 and £232,000 would not be included as further amounts due to Customs and there would therefore be no double counting. We conclude therefore that those amounts are not repayable to ERF, and that the assessment of £230,059 in respect of 06/01 should be upheld.

Penalty

163. We now turn to consider ERF's appeal against the penalty. ERF was notified of the assessment to a penalty under section 60(1) VATA by letter dated 17 February 2004. The notice of appeal dated 11 March 2004 included an appeal against the decision to impose the penalty.
164. ERF challenges the penalty on two grounds. The first is on the assessment of the penalty itself and the way in which it has been calculated. The second is on the ground that the 80% mitigation applied by Customs in assessing the penalty is insufficient and that the penalty ought to be mitigated for all periods down to nil (100% mitigation) or at any rate by a substantially greater percentage than 80%.

Calculation of the penalty

165. At the material time section 60(1) VATA provided as follows:

In any case where—

(a) for the purpose of evading VAT, a person does any act or omits to take any action, and

(b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability),

he shall be liable, subject to subsection (6) below, to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by his conduct.

166. Subsection (3) of section 60 provides for the construction of the amount of VAT “evaded” or “sought to be evaded”:

The reference in subsection (1) above to the amount of the VAT evaded or sought to be evaded by a person's conduct shall be construed—

(a) in relation to VAT itself or a VAT credit as a reference to the aggregate of the amount (if any) falsely claimed by way of credit for input tax and the amount (if any) by which output tax was falsely understated; and

(b) in relation to the sums referred to in subsection (2)(a), (c) and (e) above, as a reference to the amount falsely claimed by way of refund or repayment.

167. HMRC's position is that “aggregate” in section 60(3)(a) means “total” and not “net” so that all amounts owed by ERF to Customs at the relevant time must be added together without any deduction for amounts owed by Customs to ERF, since those sums do not constitute VAT falsely claimed or falsely understated. Whilst accepting that “aggregate” means “total”, the argument of Mr Harris was that section 60(3) says nothing about the case that arises here, namely where false input tax credit overclaims have been combined with overstatements of output tax and false input tax credit overclaims as part of the same dishonest scheme. He argued that the statutory phrases “VAT evaded” and “... the amount (if any) falsely claimed by way of credit for input tax ...” are capable of bearing a “net” interpretation, such that the “amount” of input tax that ends up being “falsely claimed” is arrived at once one has taken into account the net overpayments, whether inter- or intra-period, and it is the net amount that is the VAT evaded.
168. We do not consider that section 60 is capable of bearing that interpretation. In our view, section 60(3) clearly requires only credits for input tax and understatements of output tax to be taken into account. These are the amounts lost to HMRC. The description of what amounts to VAT evaded or sought to be evaded in section 60(3) is exhaustive and cannot be construed otherwise than on those terms, for example to include a deduction for overpayment of output tax or for any underclaim of input tax credits. The essence of section 60 is to provide for a clearly-defined amount of the penalty, which can then be reduced as appropriate through mitigation. That is the effect of the phrase “... equal to the amount of VAT evaded...” in section 60(1). This is logical, as section 60

itself does not afford any discretion to HMRC in the amount of the penalty. Consequently, there is no scope for having alternative methods of calculation of the penalty, for example on a gross or net basis. The statute has chosen the gross basis, and that is the only basis on which the penalty, subject to mitigation, can be assessed.

169. Mr Harris referred us to HMRC guidance “Off-setting of tax between periods in Civil Evasion Penalties”, and argued that this suggested that HMRC’s submission on the interpretation of section 60 was surprising. We do not think it is. The guidance itself (correctly in our view) notes that there is no legal obligation to conduct inter-period netting. It goes on to say that occasionally “for equity reasons” exceptional offsetting should be carried out so that the culpable arrears amount is equal to the net tax arrears over the entire period. We think Mr Harris’ submission confuses the nature of HMRC’s practice in relation to offsetting. The reference in the guidance to “equity reasons” demonstrates, in our view, that this is not a matter of calculation (under section 60), but one of mitigation (under section 70). That accords with our own view of the scheme of the legislation.
170. We do not accept therefore that section 60 permits netting, and we reject ERF’s argument on that basis. There was, however, one further issue on the question of the calculation of the penalty. It was common ground that a penalty under section 60 could lawfully attach only to amounts that were evaded dishonestly. Mr Harris referred us to three amounts mentioned as part of the reconciling items in BDO/3, namely £150,556.31 (which should have been £159,556.31), £1,270 and £20,259 in periods 06/01, 08/01 and 09/01 respectively. These amounts were described as “Calculation and transposition errors in ERF working papers” and as representing “various differences occurring in the detailed VAT workings”. Mr Harris argued that, on their face, these amounts were not referable to dishonest errors and ought not therefore to have been included in calculating the amounts assessed to the penalty.
171. We agree with Mr Harris in this regard. Miss Shaw argued that the burden of proof was on ERF in this respect and referred us to the statement in BDO/3 that concluded that the whole amount of the overclaimed VAT (including the three figures referred to) should be subject to the section 60 penalty. She pointed out that no evidence had been received from BDO itself. We are satisfied that ERF has discharged the burden of proof in this respect. On the balance of probability, we find that these three amounts were included in the calculation of the penalty assessment, and were wrongly so included. The penalty should be reduced accordingly.

Mitigation

172. We now turn to the question of mitigation. That is provided for by section 70 VATA as follows:

70 Mitigation of penalties under sections 60, 63, 64 and 67

(1) Where a person is liable to a penalty under section 60, 63, 64, 67 or 69A, the Commissioners or, on appeal, a tribunal may reduce the penalty to such amount (including nil) as they think proper.

(2) In the case of a penalty reduced by the Commissioners under subsection (1) above, a tribunal, on an appeal relating to the penalty, may cancel the whole or any part of the reduction made by the Commissioners.

(3) None of the matters specified in subsection (4) below shall be matters which the Commissioners or any tribunal shall be entitled to take into account in exercising their powers under this section.

(4) Those matters are—

(a) the insufficiency of the funds available to any person for paying any VAT due or for paying the amount of the penalty;

(b) the fact that there has, in the case in question or in that case taken with any other cases, been no or no significant loss of VAT;

(c) the fact that the person liable to the penalty or a person acting on his behalf has acted in good faith.

173. It was common ground that, in assessing the penalty, the Tribunal can use its own discretion to reduce its amount. It is not confined to considering the reasonableness of the decision taken by HMRC with respect to mitigation. The Tribunal has the power to reduce the level of mitigation set by HMRC (in this case Customs set it at 80%), but HMRC have not argued that any such reduction should be made. Accordingly we confine ourselves to considering the extent to which, if at all, we ought to further reduce the penalty including, as Mr Harris invited us to do, down to nil.
174. In exercising our discretion, Mr Harris submitted that we should do so by applying the principles of equality, fairness and, in particular, proportionality. Mr Harris referred us to *Lindsay v Customs and Excise Commissioners* [2002] EWCA Civ 267, a case concerning penalties for failure to pay excise duties, which included both forfeiture of the tobacco products on which the duty was payable and forfeiture of the car in which those products were carried. It was held by the Court of Appeal that the issue was whether the commissioners' policy was liable to result in a penalty in the individual case that was disproportionate having regard to the policy's legitimate aim to prevent the evasion of excise duty.
175. Mr Harris took us to a number of passages from *Lindsay*, but we need not refer to them, as the principle was uncontroversial. Also uncontroversial, and common ground, was that the aims of a penalty under section 60 are the punishment and deterrence of VAT evasion that has involved dishonesty. Here we were referred by both parties to *Han & Yau and others v Customs and Excise Commissioners* [2001] EWCA Civ 1048 from which, in the judgment of Potter LJ at [72] the reference to punishment and deterrence derives. Miss Shaw also drew our attention to paragraph [75] where the deterrence element is

made referable to members of the public at large, and not to the individual on whom the penalty is levied. Mr Harris was disposed to argue that because ERF was effectively out of business (and continuing in existence only for the purpose of this appeal) a penalty could not be a deterrent. But this is not sustainable in the light of what Lord Justice Potter said, and, if we may respectfully say so, would not accord with common sense.

The nature of the dishonesty

176. The punishment and deterrence is in respect of the dishonesty. It was not argued by ERF that the dishonesty of Mr Ellis could not be imputed to it, and so it was common ground that the dishonesty in question was that of ERF. Nevertheless, Mr Harris argued that in assessing the size of the penalty there needed to be an analysis of how the dishonesty occurred and who was actually responsible for it. In applying only an 80% mitigation to the penalty, Mr Harris argued that Customs failed to take account of the fact, firstly, that the dishonesty was totally and deliberately concealed by Mr Ellis from all other personnel at ERF. As a result, Mr Harris says, of HMRC's unduly narrow analysis, ERF has been assessed not only for the entire amount of underlying VAT for all periods (together with default interest) but it has also been penalised for all periods for which a penalty has been assessed. This, argued Mr Harris, is not equitable, fair or proportionate, particularly given the fact that HMRC have taken no action against Mr Ellis.
177. In his submissions Mr Harris also referred to ERF's rights under the Human Rights Act 1998. No issue was taken on this by HMRC. Essentially it amounts to a requirement that there must be reasonable foundation for the penalty, the penalty must not be arbitrary and it must not be disproportionate.
178. We do not consider that the factors surrounding the dishonesty in this case are such as to justify any further mitigation of the penalty. The dishonesty in question is that of ERF through one of its officers. It is that dishonesty that is being punished, and dishonesty of such a nature that is sought to be deterred in relation to the taxpaying community at large. We agree with Miss Shaw that it does not matter whether Mr Ellis was acting contrary to the interests of ERF or not. ERF had a responsibility to ensure that its returns were not dishonest and that it did not dishonestly evade VAT. A company can operate only through its officers. Accordingly, a company must ensure that, through its officers, it does not dishonestly evade VAT. If it does evade VAT, then the dishonesty is that of the company, and it is both proper and proportionate to penalise the company in that respect. In this case the only direct beneficiary of the dishonest evasion was ERF. We accept that Mr Ellis had his own interests in mind when submitting the false VAT returns, and that he thereby retained his job, but this was not a case where an employee has himself misappropriated the funds extracted from HMRC. The circumstances of this case do not, in our view, justify further mitigation on that ground, nor on the ground that, in the event, ERF has suffered as a result of Mr Ellis' dishonest conduct.

The suspension and dismissal of Mr Ellis

179. Mr Harris argued that another factor that ought to be taken into account in mitigation is that promptly upon discovery of the fraud Mr Ellis was suspended from his employment. His employment could not be terminated immediately because his assistance was required to uncover the various facets of the fraud. It was terminated once BDO had compiled sufficient evidence to put together BDO/1. Miss Shaw submitted that this was an argument of “good faith” and precluded from consideration by section 70(4)(c) VATA. We do not agree that this was within the category of “good faith” as provided for by section 70. This is apt, in our view, in relation to the conduct giving rise to the penalty, and not to actions taken thereafter (such as, for example, cooperation with an HMRC investigation). Nevertheless, we do not find that in this case the suspension and termination of Mr Ellis’ employment can justify further mitigation. The discovery of Mr Ellis’ fraudulent activity, and his consequent suspension and dismissal, had the result, no doubt, of preventing further fraudulent evasion (and therefore further potential penalties), but it did nothing in respect of the earlier dishonesty.

Disclosure and cooperation

180. Furthermore, we do not consider that the involvement of BDO in assisting with the disclosure and cooperation is an example of good faith within section 70 (4)(c), so it too is not thereby precluded from being taken into account. We do take this into account, but we consider that, having regard to all the circumstances, an 80% mitigation is sufficient to give full credit for the disclosure and cooperation provided by ERF and its advisers.

181. In relation to one specific period, 03/96, Mr Harris argued that ERF made a full and unprompted disclosure. Mr Harris submitted that the penalty for the relevant amount £390,000 should, on this basis, and by reference to HMRC’s own guidance, be mitigated down to zero. We are ourselves of course not subject to HMRC guidance in our consideration of the appropriate level of mitigation of the penalty, but in any event we agree with Miss Shaw in this connection that the action of ERF did not amount to a voluntary disclosure of the nature which would lead us to conclude that 100% mitigation would be appropriate. ERF did nothing more than make an entry in its VAT return, and did not make a full disclosure. The disclosure that was made by ERF fell far short of the true level of the arrears and did not refer to dishonesty. We consider that no further mitigation is appropriate in respect of disclosure.

Payment of tax in full

182. We also bear in mind that ERF was not put into insolvent liquidation, and that funds were introduced by its parent company to enable it to pay in full all amounts owing to HMRC. Here Miss Shaw invited us to disregard this as it related to the insufficiency of funds of ERF for paying the VAT, or alternatively was another example of good faith that should be ignored by virtue of section 70(4). We do not consider that either of these exceptions applies. This is not an argument in relation to an insufficiency of funds, as sufficient funds have been

provided; it is an argument that account should be taken of the fact of payment in full. Nor does the good faith exception apply here; the good faith is not that of ERF, nor anybody acting on its behalf, but that of its parent company. Nevertheless, having taken the fact of full payment into account, we do not consider that this merits further mitigation beyond 80 per cent.

Netting

183. We have referred above to our view that the question of netting falls to be considered, not as an element of the base calculation of the penalty, but as a possible mitigating factor. Mr Harris argued that the penalty should be mitigated so as to reflect the effect of netting. We have carefully considered the evidence on the way in which Mr Harold arrived at the penalty calculated on a gross basis, despite the headline figure in his letter of 17 February 2004 being the net amount of the VAT assessed. We have also considered the views expressed by other Customs officers to the effect that a net basis penalty would be appropriate in this case.
184. Our task is to assess the penalty. Our jurisdiction does not encompass considering whether Customs acted fairly and reasonably in the manner in which they assessed the penalty. We do not believe, however, that the evidence in this case of the manner in which the penalty was assessed, in particular Mr Harold's decision to assess on a gross, rather than net, basis reflects well upon Customs. If within Customs it was considered right to calculate the penalty on a net basis, we cannot see how it could be reasonable to assess on a gross basis, having excluded periods for which no penalty could be levied, and to seek to justify that on the basis that the resultant gross-based penalty was lower than the net-based penalty would have been taking into account the excluded periods. Furthermore, we regard it as unsatisfactory that the February 2004 penalty notification was so misleading as to the basis of calculation.
185. That said, we have to consider the question of mitigation using our own discretion. We shall take into account the arguments in favour of a net basis in that exercise, but we do not regard the unsatisfactory process whereby the original calculation was made, or the views of Customs officers, as material to our own separate evaluation.
186. In considering whether the penalty should be further mitigated to reflect netting, we accept that there may be circumstances where overpayments of VAT ought properly to be taken into account in assessing the level of mitigation. This could be the case, for example, where a genuine attempt had been made to restore amounts to Customs that had previously been evaded. Mr Harris argued that Mr Ellis' fraud inherently involved both under- and over-declarations of VAT over the entire range of periods that had been assessed. Consequently, it was submitted, it would be inequitable for ERF to be penalised on the full amount of every under-declaration in every period without also taking into account that the same dishonest scheme involved overpayments to Customs in many periods.

187. We do not agree that in this case we should mitigate the penalty in order to achieve a net effect. Whilst it is correct that Mr Ellis procured that ERF made certain overpayments of VAT in certain periods, we are satisfied on the evidence before us that Mr Ellis' motivation was not to purge his dishonesty or make restoration to Customs, but to attempt to present a consistent picture so that his frauds would remain undetected, and that he would be able to continue to perpetrate those frauds. The overpayments were part of the continuing fraud, and not restorative. This, in our view, is not something that merits a netting approach, and is not therefore a reason to mitigate the penalty so as to achieve a net effect.

Summary

188. For all these reasons we have decided not to make any further reduction to the penalty by way of mitigation. The only reduction therefore is to exclude the aggregate sum of the calculation and transposition errors from BDO/3 (which we have found were non-culpable) in the sum of £181,085.31 from the penalty assessed. Rounding up to £181,086, and taking 20% of that figure, the penalty therefore falls to be reduced by £36,217.20.

Summary of conclusions

189. We summarise here in outline the conclusions we have reached based on the above discussion:

(1) The assessment of 4 March 2004 was made within the statutory time limits and accordingly is a valid assessment in respect of all relevant periods. The decisions by Customs not to make assessments in respect of any of the periods assessed in the March 2004 assessment until after the receipt of BDO/3 were not wholly unreasonable or perverse.

(2) In relation to period 03/96, it was not wholly unreasonable or perverse for Customs not to have assessed the sum of £390,000 at any time before the receipt by Customs of BDO/3. The assessment of 4 March 2004 in respect of this amount was within the statutory time limit.

(3) The appeal against the assessment dated 5 February 2002 was out of time and we have refused permission to make a late appeal. On the substantive issue in relation to period 07/00, it was not wholly unreasonable or perverse for the amount of £1,323,000 to have been assessed for 07/00.

(4) The appeal against the amended assessment dated 29 April 2002 was out of time and we have refused permission to make a late appeal. On the substantive issue, the 29 April 2002 assessment was a valid assessment.

(5) In respect of period 06/00 it was not unreasonable or perverse for Customs not to have assessed the sum of £1,323,000 prior to the receipt of BDO/3 and the resulting 4 March 2004 assessment.

(6) In relation to period 07/00, the inclusion of the sum of £45,568 in the March 2004 assessment was within the statutory time limit, and there was no

time earlier than the date of receipt of BDO/3 at which Customs had evidence of facts sufficient to justify an assessment in respect of that amount.

(7) With respect to period 06/01, the amount of the assessment made in March 2004 is confirmed and no amounts are repayable to ERF.

(8) As regards the calculation of the penalty, an aggregate sum of £181,086 should be taken out of account in the assessment of the penalty, resulting in a reduction of £36,217.20 in the amount of the penalty. Otherwise, the penalty has been properly calculated on a gross basis, subject to mitigation.

(9) On the question of mitigation of the penalty, we make no further reduction in the amount of the penalty beyond the 80% reduction granted by Customs.

Decision

190. For the reasons we have given, we allow the appeal against the penalty in part, by reducing the penalty by the sum of £36,217.20. In all other respects we dismiss ERF's appeals.

Costs

191. At the commencement of the hearing we directed that, these proceedings being "current proceedings" for the purpose of Schedule 3 to the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009, pursuant to paragraph 7(3) of that Schedule Rule 29 of the VAT Tribunals Rules 1986 should apply, and that Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 should be disapplied.

192. As HMRC have substantially succeeded in these proceedings, we award costs to HMRC, to be assessed if not agreed.

Interest

193. The parties have liberty to apply in respect of the outstanding issue relating to interest.