TC03696

Appeal number: TC/2011/05366 & TC/2010/06875

PAYE – whether fraud of employee attributable to the First Appellant – yes – appeal dismissed – Discovery Assessments and Closure Notices – whether there was a discovery – whether vehicles owned by the company were pool cars – appeal allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

ISOCOM LTD	**First Appellant**
and	
GHOLLAM HUSAYN TAHMOSYBAYAT (known as Mr Bayat)	**Second Appellant**
and	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE JENNIFER BLEWITT
MR LESLIE BROWN

Sitting in public at North Shields on 12 and 13 March 2014

Mr R. Mullan, Counsel for the Appellant

Mr J. Daley, Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. By Notices of Appeal dated 20 August 2010 and 12 July 2011 the First and Second Appellants ("Isocom" and Mr Bayat" respectively) appealed against the following:

Isocom

Year	Assessment/Determination	Amount
1997/98	National Insurance Contributions ("NIC") under section 8 Social Security Contributions (Transfer of Functions, etc) Act 1999	£7,348.46
1998/99	As above	£4,057.52
1999/00	As above	£5,491.71
1997/98	PAYE under Regulation 80 Income Tax (Pay As You Earn) Regulations 2003	£5,059.46
1998/99	As above	£3,183.67
1999/00	As above	£4,856.02

Mr Bayat

Year	Discovery Assessment/Closure Notice	Amount	Penalty
2000/01	Discovery Assessment	£687.28 (subsequently amended to £1,488.08)	£206 (subsequently amended to £446)
2001/02	Discovery Assessment	£2,511.52 (subsequently amended to	£754 (subsequently amended to £921)

		£3,071.64)	
2002/03	Closure Notice	£1,054.18 (subsequently amended to £1,646.86)	£316 (subsequently amended to £494)
2003/04	Closure Notice	£16,146.70 (subsequently amended to £17,166.46)	£4,844 (subsequently amended to £5,150)
2004/05	Closure Notice	£1,494.02 (subsequently amended to £1,780.46)	£448 (subsequently amended to £534)

Preliminary Matters and Issues in the Appeals

2. The issue to be determined in respect of Isocom's appeal is whether HMRC were out of time to issue Regulation 80 determinations in respect of unpaid PAYE and NIC liabilities.

3. In relation to Mr Bayat's appeal the issues are:

(a) Whether there was a discovery in respect of car and fuel benefits;

(b) Were the discovery assessments made out of time; and

(c) Whether penalties were correctly imposed.

4. We should note at this point that although there are two separate appeals, we directed that the evidence should be heard together on the basis that the evidence of the two HMRC officers, Mr Stewart and Mr Bassett, and Mr Bayat, the Managing Director of Isocom and the Second Appellant, would overlap and potentially be relevant to both appeals.

5. As a preliminary point there were also a number of matters which formed the basis of the Discovery Assessments and Closure Notices when Mr Bayat's appeal first came before us. Those matters included car and fuel benefits, income from property and an increased capital gain on the disposal of a property. We were informed by the parties that the issues in respect of income from property and capital gains had been agreed and therefore the only issue remaining for us to determine was that in relation to car and fuel benefits and the consequential penalties. The car and fuel benefits upon which additional duties were assessed by HMRC are as follows:

Year	**Discovery**	**Amount**

	Assessment/Closure Notice	
2000/01	Discovery Assessment	£3,124
2001/02	Discovery Assessment	£5,521
2002/03	Closure Notice	£5,054
2003/04	Closure Notice	£5,315
2004/05	Closure Notice	£6,791

6. Furthermore, it was conceded on behalf of the First Appellant that the Regulation 80 determination and consequential NIC liability raised in respect of 2000/2001 were properly made and therefore the appeal against that period was withdrawn.

Grounds of Appeal

7. The grounds of appeal relied upon by Isocom as set out in its Notice of Appeal can be summarised as follows:

- NIC liabilities cannot be collected, if due at all, as a result of the Limitation Act 1980;
- The assessment is out of time;
- The Appellant informed HMRC of fraudulent actions relating to the company's PAYE and NIC payments by its former Accounts Manager in 2000 and there is therefore a reasonable excuse.

8. On behalf of Mr Bayat the grounds of appeal relied upon are:

- In each year of assessment the only company cars were those which met the criteria for pool cars;
- HMRC have no evidence to suggest that the company vehicles were not pool cars;
- The car benefits were first mentioned in correspondence from HMRC dated 28 September 2007 – 12 days before the assessments were raised – prior to which the HMRC officer responsible for raising the assessment had not requested any information relating to the company vehicles.

Legislation

9. There was no dispute as to the legislation applicable in this case. Regulation 80 of the Income Tax (PAYE) Regulations 2003 empowers HMRC, where it appears to them that PAYE income tax has not been properly accounted for, to *"determine the amount of that tax to the best of their judgment, and serve notice of their determination on the employer"*.

10. Section 8 of the Social Security Contributions (Transfer of Functions, Etc) Act 1999 confers on HMRC the power to decide whether a person is or was liable to pay contributions of any particular class and, if so, the amount that he is or was liable to pay.

11. Section 36 of The Taxes Management Act 1970 ("TMA") provides that the ordinary time limit for raising an assessment to income tax can be extended to 20 years:

"…for the purpose of making good to the Crown a loss of income tax or capital gains tax attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf may be made at any time not later than 20 years after the 31st January next following the year of assessment to which it relates."

12. Section 9A TMA 1970 provides:

[(1) An officer of the Board may enquire into a return under section 8 or 8A of this Act if he gives notice of his intention to do so ("notice of enquiry")—

(a) to the person whose return it is ("the taxpayer"),

(b) within the time allowed.

13. The power to assess is contained within section 29 TMA 1970:

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment—

(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
(b) that an assessment to tax is or has become insufficient, or 5 (c) … the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—

(a) in respect of the year of assessment mentioned in that subsection; and
(b) in the same capacity as that in which he made and delivered the return,
unless one of the two conditions mentioned below is fulfilled.

(5) The second condition is that at the time when an officer of the Board—

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or
(b) informed the taxpayer that he had completed his enquiries into that return, the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

14. The legislation relating to pool cars is found in section 159 Income and Corporation Taxes Act 1988 (for the periods up to and including 2002/03):

(1)This section applies to any car in the case of which the inspector is satisfied (whether on a claim under this section or otherwise) that it has for any year been included in a car pool for the use of the employees of one or more employers.

(2)A car is to be treated as having been so included for a year if—

(a)in that year it was made available to, and actually used by, more than one of those employees and, in the case of each of them, it was made available to him by reason of his employment but it was not in that year ordinarily used by one of them to the exclusion of the others; and

(b)in the case of each of them any private use of the car made by him in that year was merely incidental to his other use of it in the year; and

(c)it was in that year not normally kept overnight on or in the vicinity of any residential premises where any of the employees was residing, except while being kept overnight on premises occupied by the person making the car available to them.

(3)Where this section applies to a car, then for the year in question the car is to be treated under sections 154 and 157 as not having been available for the private use of any of the employees.

(4)A claim under this section in respect of a car for any year may be made by any one of the employees mentioned in subsection (2)(a) above (referred to below as "the employees concerned") or by the employer on behalf of all of them.

(5)On an appeal against the decision of the inspector on a claim under this section all the employees concerned may take part in the proceedings, and the determination of

the body of Commissioners or county court appealed to shall be binding on all those employees, whether or not they have taken part in the proceedings.

(6)Where an appeal against the decision of the inspector on a claim under this section has been determined, no appeal against the inspector's decision on any other such claim in respect of the same car and the same year shall be entertained.

15. Section 167 of Income Tax (Earnings & Pensions) Act 2003 provides (in respect of periods 2003/04 onwards):

(3) In relation to a particular tax year, a car is included in a car pool for the use of the employees of one or more employers if in that year—
(a) the car was made available to, and actually used by, more than one of those employees,
(b) the car was made available, in the case of each of those employees, by reason of the employee's employment,
(c) the car was not ordinarily used by one of those employees to the exclusion of the others,
(d) in the case of each of those employees, any private use of the car made by the employee was merely incidental to the employee's other use of the car in that year, and
(e) the car was not normally kept overnight on or in the vicinity of any residential premises where any of the employees was residing, except while being kept overnight on premises occupied by the person making the car available to them.

<u>*Authorities*</u>

16. We were referred to the following authorities:

- *Gilbert (Inspector of Taxes) v Hemsley* [1981] STC 703
- *Industrial Doors (Scotland) Ltd v HMRC* [2010] TC 00571
- *Demibourne Ltd v Revenue and Customs Commissioners* [2005] STC (SCD) 667
- *New Image Training Ltd v HMRC* [2012] UKFTT (469) (TC)
- *Bilta (UK) Ltd (in liquidation) and others v Nazir and others* [2013] STC 2298
- *L H Bishop Electric Company Ltd v HMRC* [2013] UKFTT 522
- *Bristol & West PLC v Revenue and Customs Commissioners* [2014] UKUT 0073
- *Norman v Golder* (CA) 171 L.T. 369

- *T Haythornthwaite & Sons v Kelly* (11 TC 657)
- *Nicholson v Morris* (52 TC 95)
- *Hurley v Taylor* (71 TC 95)
- *1st Stop Shop v Kelly* (FTT TC 02222)
- *PMS International Group v Weare* (FTT TC 02181)
- *Autowest Ltd v Cowan* (FTT TC 01299)
- *Clixby v Poutney* (1968) 44 TC 515

Background Facts

17. Isocom is a specialist micro-electronic manufacturing company which employs 9 staff in Washington, Tyne and Wear. It supplies components approved to military standards which are used in defence and space applications. Mr Bayat was responsible for technical matters, engineering and production. From 1997 he was also the signatory to PAYE and NI cheques and P35 Returns required by the Inland Revenue (hereafter referred to as "HMRC")

18. On 5 January 2004 HMRC began an Employer Compliance Review into Isocom as a result of which it formed the view that discrepancies existed in the company's records and additional duties were due to the Revenue. In particular HMRC relied on the P35s and records of wages submitted.

19. Isocom had employed an internal accountant from 1999 to 2000 called Mr Hecham Ismail. There was no challenge to Mr Bayat's evidence that during Mr Ismail's period of employment he had fraudulently diverted monies by way of cheque payments from Isocom intended for HMRC to himself. This theft had been reported by Mr Bayat to Northumbria Police in November 2000 and as a result Mr Ismail was convicted of theft and kindred offences on 26 July 2001.

20. On 18 August 2000 HMRC received three P35s submitted on behalf of Isocom which purported to relate to the periods 1997/98, 1998/99 and 1999/2000. The P35s, which understated the amount of tax due, had been falsified and were not those which had been signed by Mr Bayat.

21. Genuine P35s existed for the same periods, which had been prepared by an external bookkeeper and former HMRC employee Mr Young, on behalf of Isocom. The completed Returns, which contained accurate figures, had been sent to Mr Bayat to sign prior to their respective due dates for submission. The dates shown on the Returns as having been signed by Mr Bayat were 30 April 1998, 10 May 1999 and 19 April 2000.

22. On 31 May 2006 HMRC opened enquiries into Mr Bayat's Self Assessment Returns for the years ended 5 April 2003, 5 April 2004 and 5 April 2005.

Evidence

23. We heard evidence from the following witnesses:

- Mr Stewart, the HMRC officer responsible for conducting the enquiry into Isocom's PAYE and NI liabilities for the period 1997 to 2001;
- Mr L. Bassett, the HMRC officer responsible for conducting enquiries into Mr Bayat's personal tax affairs;
- Mr D. Young, a former HMRC employee who acted as an independent PAYE consultant for Isocom from 1997 to 2005; and
- Mr Bayat, the Managing Director of Isocom.

Evidence of Mr Bassett

24. Mr Bassett was responsible for checking the tax affairs of Mr Bayat whose tax returns for the years ended 5 April 2003, 5 April 2004 and 5 April 2005 were submitted late and received by HMRC on 27 April 2006. On 31 May 2006 Mr Bassett issued Enquiry Notices under section 9A TMA 1970 to Mr Bayat for each year. Until 28 September 2007 Mr Bassett's enquires focussed on, in the main, rental incomes, capital expenditure and capital gains in respect of 4 properties with which we are not concerned in this appeal.

25. On 28 September 2007 Mr Bassett wrote to the Mr Bayat's accountants, Mitchell Gordon, stating that Closure Notices and Discovery Assessments would be raised based on the information supplied and that he intended to include car and fuel benefits on the basis that the review carried out by Mr Basset's colleague, Mr Stewart, had established that Isocom's company cars did not qualify as pool cars and therefore were chargeable as benefits in kind.

26. Mr Bassett issued the Closure Notices and Discovery Assessments on 10 October 2007.

27. Mr Bassett subsequently attended a meeting with Mitchell Gordon on 23 September 2009 at which he explained that car and fuel benefits were chargeable as no records had been provided to support a "pool car argument", such as mileage records. An insurance quote which had been produced by the Appellant did not indicate the type of insurance taken out and was therefore rejected by Mr Bassett as evidence supporting the contention that the two vehicles in question were pool cars.

28. In oral evidence Mr Bassett confirmed that his opinion had not changed that Mr Bayat was correctly assessed for car and fuel benefits. He explained that no P11Ds had been submitted by the Company and no benefits declared in its tax returns. He believed that the benefits arose and that there had therefore been a discovery.

29. He stated that he had been told by Mr Stewart that the company had not kept adequate records. Although Mr Bassett could not recall the exact conversation, he had

understood Mr Stewart to have indicated that there were grounds upon which to assess Mr Bayat for fuel and car benefits. He explained that given the point at which this information became known to him, he did not have time to visit the premises, speak to any of the employees or conduct any further enquiries; he was about to issue the Closure Notices and as Mr Stewart had established that car and fuel benefits had not been declared he had taken the decision to assess those benefits.

30. Mr Bassett explained that no evidence had been provided by the company to prove that its vehicles were pool cars. He accepted that he was unaware at the time of raising the assessments that Mr Bayat owned private vehicles nor had he been aware where the company cars were kept overnight.

Evidence of Mr Stewart

31. Mr Stewart's written evidence set out a chronology of the discussions and correspondence between HMRC and Mr Bayat. On 5 January 2004 Mr Stewart informed Isocom of his intention to review the employer and contractor records between 19 January 2004 and 30 January 2005. On 24 February 2004 Mr Stewart met with Mr Young to collect the company's payroll records and on 3 December 2007 Mr Stewart issued formal assessments to Isocom.

32. In his oral evidence Mr Stewart confirmed that the assessments remain unpaid. He accepted that Mr Bayat had made payments to HMRC but explained that those payments covered the amounts shown on the forged P35s as opposed to the amounts lawfully due.

33. Mr Stewart accepted that he had not considered whether the assessments were raised out of time. He also explained that Isocom would not necessarily have been chased by HMRC for the P35s relating to 1997/98 and 1998/99 which were not received.

34. As regards the fraud by Mr Ismail, Mr Stewart had not investigated the matter as he did not believe it was relevant. He acknowledged that Mr Bayat had provided the names of HMRC employees he had spoken to after discovering the fraud but stated he had not been able to find out any information beyond that provided by Mr Bayat.

35. Mr Stewart explained that his involvement with the car and fuel benefits assessed by his colleague was limited to a conversation with Mr Bassett in which he had intended to convey the message that the records should be checked to ascertain whether any benefits arose. He confirmed that he had not personally carried out a check.

Evidence of Mr Bayat

36. The witness statement provided by Mr Bayat in respect of both appeals was lengthy and we do not propose to repeat the contents in any great detail. The principal points can be summarised as follows.

37. Isocom was founded in 1982 and Mr Bayat joined the company in 1987 as an electrical engineer. In 1990 he left to run his own company and in 1994 the opportunity arose for Mr Bayat and a colleague to acquire shares in Isocom. He became the managing director in 1994.

38. Mr Bayat's responsibilities included the strategic direction of the company, the design of new products and technical engineering. Processing the payroll was always outsourced and between 1997 and 2005 Mr Bayat provided the necessary information to Mr Young for the PAYE and NIC calculations to be carried out. At the end of each tax year Mr Young also prepared the company's P35 and P14. Mr Bayat would sign the returns and give them to the office staff to post. A copy of the documents was retained by the company.

39. In 1999 Mr Bayat met Mr Hechman Ismail via Business Link when he was looking to employ a bookkeeper. Mr Ismail was employed by the company and given responsibility for the company's tax affairs, including the issuing of cheques to HMRC. Mr Ismail left the company on 31 October 2000.

40. Mr Bayat subsequently discovered that Mr Ismail had fraudulently diverted company cheque payments intended for HMRC to his own bank account by substituting his name as payee and forging Mr Bayat's signature.

41. Mr Bayat told us that upon making this discovery he immediately informed the police and contacted HMRC to ascertain what payments had been made. He had spoken to Mrs C. Luke at the Sunderland office on 13 November 2000, Myra at Central Office on 28 November 2000 and Mrs Findlay at the Accounts Office in Cumbernauld on 29 November 2000. Mr Bayat also exhibited a number of faxes which confirmed this contact.

42. In respect of the three P35s received by HMRC on 18 August 2000, which purported to relate to 1997/98, 1998/99 and 1999/2000 Mr Bayat confirmed that the documents were forged and were not those which had been prepared by Mr Young or signed by him. He explained that the first time he had seen the forged documents was at a meeting with HMRC on 16 November 2005.

43. As to why the genuine P35s had not been received by HMRC, Mr Bayat confirmed that the returns would have been given to the office staff to post and he could only speculate that the company's relocation in 1998 may have caused confusion within HMRC. He explained that he was aware of the due dates by which the returns had to be filed and stated that as far as he was aware the returns had been signed and posted prior to the deadlines.

44. In respect of the assessment for car and fuel benefits Mr Bayat explained that the first time he was aware of this issue was 28 September 2007. The company had purchased a Vauxhall Vectra pool car in 2000 on a 3-year lease agreement. The vehicle was replaced in 2003 when the lease expired. A pool car was needed to visit customers and suppliers, attend meetings and collect visitors from local stations and airports. The vehicle was available for the business use of all employees and was used

on average 3 or 4 days each week. It was kept overnight in a locked compound at the rear of the company's premises. Mr Bayat told us that employees could pick up the car from the compound and return it as soon as the business activity was completed. If it was required for an early morning start the employee was permitted to take the vehicle home overnight. The rules for use of the pool car were set out in the company's handbook which expressly forbade use of the vehicle for private purposes. Mr Bayat stated that between 6 April 2000 and 5 April 2005 he owned variously over that period four private vehicles and he therefore had no need to use the pool cars for private use.

45. In his oral evidence Mr Bayat was referred to HMRC telephone logs which showed contact made by HMRC with the company. On 30 June 2000 HMRC recorded "spoke to a Frenchman" who we were advised by Mr Bayat would have referred to Mr Ismail. The log recorded that HMRC advised that the P35s for 1997/98 to 1999/2000 were overdue and penalties may be incurred. HMRC recorded further contact with Mr Bayat on 3 July, 7 July, 26 July, 31 July and 4 August 2000. Mr Bayat did not recall any of the telephone calls and provided bank statements which confirmed he was out of the country on business at some point over that period. He noted that the telephone calls were made when Mr Ismail was working at Isocom and suggested that Mr Ismail may have pretended to HMRC that he was Mr Bayat.

46. In respect of the company's handbook on pool cars Mr Bayat explained that this had been created at the suggestion of the Chamber of Commerce. He had been advised by his representatives that as the vehicle was only used by employees for business activities there was no requirement for records to be kept. Mr Bayat stated that he had not disclosed the handbook to HMRC until 2013 as it was on the advice of Counsel that he did so.

47. Mr Bayat clarified that until a meeting with HMRC in 2005 he had been wholly unaware that the 1997/98 and 1998/99 P35s had not been received by HMRC.

Evidence of Mr Young

48. Mr Young gave evidence on behalf of HMRC. He confirmed that since retiring from HMRC he carried out work for small companies such as Isocom assisting with PAYE and payroll matters. Mr Young told us that Mr Bayat provided all necessary information to him by phone each month from which the records were produced. The completed returns were sent to Mr Bayat to sign along with a summary of the amounts owed to HMRC. Mr Young identified the genuine P35s as those which had been completed by him prior to the due dates for submission.

Submissions

49. We were helpfully provided with skeleton arguments by both parties which were expanded upon in opening and closing submissions.

Submissions on behalf of the Appellants:

Isocom

50. Generally in tax appeals the burden of proof will be on the taxpayer to establish the facts upon which he relies to oppose an assessment. That general principle is subject to two important exceptions which apply in the present appeal:

- Where HMRC allege fraud or negligence the burden of proving such lies with HMRC; and

- Where there has been a discovery assessment the burden rests with HMRC to show that the conditions for an assessment under section 29 TMA have been satisfied.

51. Mr Mullen contended that as NIC is neither a tax nor a duty HMRC will have to look to the County Court to enforce the debt. A defence under the Limitation Act 1980 will apply as HMRC made its decision in respect of NIC in December 2007 and failed to make a protective claim. The effect of this is, Mr Mullen argued, that irrespective of the Tribunal's decision HMRC will be unable to enforce the debt.

52. As regards the assessments in respect of PAYE Mr Mullen submitted that the question for the Tribunal is whether HMRC were out of time to make the assessment. The usual period available to HMRC where there is a discovery can be extended to 20 years by virtue of section 36 TMA 1970:

"An assessment on any person (in this section referred to as "the person in default") for the purpose of making good to the Crown a loss of income tax or capital gains tax attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf may be made at any time not later than 20 years after the 31st January next following the year of assessment to which it relates."

53. The burden of proving fraud or negligence rests with HMRC and the fact that HMRC did not receive the company's P35 returns for 1997/98 and 1998/99 is insufficient to discharge that burden. Furthermore HMRC have produced no evidence to support its assertion that the returns were not received. Mr Bayat gave oral evidence as to the system in place for completion and posting the returns and Mr Young confirmed that the returns had been completed prior to the due date. HMRC have failed to establish that the returns were not posted and therefore negligence on the part of Isocom has not been established.

54. As to the issue of fraud Mr Mullen submitted that there was no real challenge to Mr Bayat's evidence that he was not responsible for sending in the forged P35s. The issue for the Tribunal is whether the fraud perpetrated by Mr Ismail can be attributed to the company. It was accepted that there had been a loss of tax but one which was caused by the fraudulent conduct of an employee seeking to defraud Isocom and therefore such conduct cannot be attributed to the company.

55. In the alternative Mr Mullen submitted that once the Appellant had informed HMRC of the fraud in 2000 it could no longer be said that the loss of tax was attributable to fraud or negligence on the part of Isocom; the loss of tax was due to HMRC's failure to address the matter.

56. Mr Mullen referred us to a number of authorities more about which we will say in due course. In essence he submitted that a fraud had been perpetrated against Isocom, with HMRC as a collateral casualty, and therefore Mr Ismail cannot be said to have been acting on behalf of Isocom. In support of this argument the Appellant relied on *Bilta (UK) Ltd (in liquidation) and others v Nazir and others* [2013] STC 2298 in which the application of the *Hampshire Land* principle was considered (emphasis added):

"*Therefore, although the Hampshire Land principle is often referred to in cases dealing with the attribution to a company of the acts of its directors and others, the principles applied to determine liability for unlawful conduct more generally are not limited to asking whether the director is likely to have wished to keep knowledge of his fraud secret. They involve the application of a more fundamental rule accepted by this court in Belmont and also in Stone & Rolls that the law will not attribute the fraud or other unlawful conduct of the director to the company when it is itself the intended victim of that conduct. This, as I explained earlier, is a question to be determined in the context of the proceedings in which attribution is relied on. In a liability case the company will not be the victim for purposes of the attribution rule. But where the company makes the claim based on the director's breach of duty it is the victim and Belmont confirms that the law will not allow the enforcement of that duty to be compromised by the director's reliance on his own wrong.*"

Mr Bayat

57. Mr Mullen submitted that as Mr Bayat's written evidence in respect of pool cars had not been challenged in cross-examination the Tribunal must accept it and conclude that the two vehicles owned by the company were pool cars.

58. Furthermore, the entire basis of HMRC's assessment had been based on a misunderstanding between the HMRC officers; Mr Stewart intended that his colleague should consider whether car and fuel benefits were assessable and Mr Bassett believed his colleague had considered the issue. It was clear from the evidence that HMRC had failed to give any consideration as to whether car and fuel benefits were assessable and in the absence of such proper consideration there cannot be said to have been a discovery.

59. If the Tribunal is satisfied that there was a discovery Mr Mullen submitted that the evidence of Mr Bayat, taken together with insurance quotes provided and handbook which expressly referred to use of the company's pool cars should be accepted as evidence that the two vehicles in question were pool cars. Further, the conditions set out in section 167 ITEPA 2003 are satisfied in that the cars were available to all employees, they were used to meet the company's business needs, they were not ordinarily used by one employee to the exclusion of others, any private use was incidental and the cars were stored at the company's premises. There is no statutory requirement that written records relating to the use of pool cars be kept and therefore the absence of such is not fatal to Mr Bayat's case.

60. In addition, the discovery assessment for 2000/01 was outside the normal time limits and can only apply if HMRC can establish fraud or negligence. HMRC have failed to discharge the burden of proof on this issue.

61. The penalties arising as a result of the car and fuel benefits assessed should not be upheld as HMRC have failed to prove fraud or negligence on the part of Mr Bayat.

Costs

62. Mr Mullen submitted that it had been unreasonable for HMRC to pursue the appeal against assessments in respect of car and fuel benefits and requested that an order for costs be made against HMRC in respect of this part of the appeal.

Submissions of HMRC

Isocom

63. It was submitted on behalf of HMRC that revenue which is lawfully due has not been paid by the Company. There is a clear under-declaration of PAYE and NIC which is demonstrated by computerised payroll records uplifted from Mr Young which show a higher tax and NIC than those returned on the P35s submitted in August 2000. The figures assessed as owing to HMRC are based on the difference between the computerised payroll records and the returns sent in to HMRC. It was noted by HMRC that the discrepancies on the P35s sent to HMRC covered two tax years prior to the employment of Mr Ismail.

64. No evidence was submitted to prove that Mr Ismail was responsible for submitting the forged P35s and even if the Tribunal accepts that this was the case Mr Ismail was acting on behalf of Isocom and consequently the assessments were validly made within the extended 20-year period. Isocom did not suffer as a result of the fraudulent conduct of its employee; rather HMRC and ultimately H M Exchequer suffered the loss as a result of non-payment by Isocom of PAYE and NIC deducted from employees remuneration for the years in question. HMRC asserted that it was unaware of the forged P35s until Mr Stewart's intervention in February 2004 and it has no evidence to support Mr Bayat's contention that he informed HMRC about the fraud in 2000.

Mr Bayat

65. The Closure Notices arose from enquiries into the Income Tax Self Assessment returns relating to the years ended 5 April 2003, 5 April 2004 and 5 April 2005. The Discovery Assessments for the years ended 5 April 2001 and 5 April 2002 arose as a result of information obtained through the enquiries. The discovery made by HMRC related to motoring expenses contained in the Appellant's records. The onus rests with the Appellant who has provided no documentary evidence such as mileage records to support his assertion that the Company cars were pool cars. The insurance quotes provided refer to business use being added to the insurance which covered use for social, domestic or pleasure purposes.

66. The Tribunal must have regard to the criteria set out in section 167 ITEPA 2003. HMRC submitted that the Appellant has failed to demonstrate the conditions set out therein are satisfied as no documentary evidence has been adduced to substantiate the Appellant's contentions.

67. Mr Daley submitted that the Appellant's failures to declare income from property and make a return of benefits in kind was negligent and therefore penalties are properly chargeable.

Costs

68. Mr Daley submitted that it would not be appropriate to award costs against HMRC and the powers the Tribunal has in respect of costs should be used sparingly and only in exceptional circumstances.

Discussion and Decision

Mr Bayat's appeal

69. We should note at the outset that we found Mr Bayat to be an honest and credible witness and we accepted his evidence in its entirety.

70. In respect of the discovery assessments and closure notices which related to car and fuel benefits we were satisfied that the two vehicles in question were pool cars. The evidence before us on behalf of the Appellant consisted of the written and oral evidence of Mr Bayat, the company handbook and a vehicle insurance quote from NFU Mutual to Mr Bayat/Isocom confirming a policy taken out with effect from 6 July 1999 from which time various vehicles were covered for the use of employees in connection with the business of Isocom.The handbook and insurance quote confirmed the evidence given by Mr Bayat as to the procedures in place for use by employees of the pool cars over the relevant periods.

71. In reaching our conclusion we also had regard to the provisions of section 167 ITEPA 2003 and section 159 ICTA 1988. We were satisfied from Mr Bayat's evidence that the two vehicles were made available to and actually used by more than one employee. We accepted that the vehicles were made available by reason of the employee's employment and that neither vehicle was used ordinarily by one employee to the exclusion of the others. We were satisfied on the oral evidence of Mr Bayat that private use of the vehicles was prohibited save for where that private use was incidental and that the car was kept at the company's premises except where it was required overnight by an employee for business purposes.

72. Whilst we acknowledged the submissions on behalf of HMRC that it is clearly best practice to have records such as those suggested by the Mr Bassett, we note that such documents are not required by statute and we took the view that in an office with only a small number of employees use of the pool cars could be easily controlled without formal processes. In those circumstances we were satisfied that the company's lack of records was not fatal to the case.

73. We therefore allow the appeal of Mr Bayat in respect of the discovery assessments and closure notices relating to car and fuel benefits.

74. Our finding that the two relevant vehicles were pool cars did not require us to consider the issues raised by the Appellant as to whether there was a discovery and whether the discovery assessment for 2000/01 could be extended beyond the normal time limits on the basis of fraud or negligence. However we pause to observe at this point that we had concerns as to whether the provisions of section 29 TMA were satisfied. The Upper Tribunal case of *Charlton & Others v HMRC* [2013] STC 866 (at paragraph 24) provides helpful guidance on the subject of discovery. In applying the principles set out therein, although we were satisfied that HMRC have made a "discovery" for the purposes of s 29 TMA 1970 on the basis that the existence of the cars came to HMRC's attention as a result of a compliance visit which was new information, we had doubts as to whether, given the misunderstanding between the officers which formed the basis of the assessment taken together with a lack of any investigation, the discovery was a reasonable conclusion from the evidence available to the officer.

75. Furthermore section 29 TMA 1970 gives taxpayers certain protections against potential discover assessments. One of two conditions must be satisfied in order for HMRC to be able to assess (s 29(3)). The first condition is that the potential tax loss "*was attributable to …negligent conduct on the part of the taxpayer or a person acting on his behalf*" (s 29(4)). We noted and agreed with the comments of Judge Khan in *PMS International Group PLC* [2012] UKFTT 504 (TC):

"The word "neglect" has to be read as requiring a level of culpability and not merely mistake. The Courts for many years took the view that negligence in relation to tax statutes means to act in an imprudent or unreasonable manner and in order to establish this an objective test was applied, which compared the actions of the individual with those of a reasonable and prudent individual in similar circumstances. It was therefore possible for an individual to be negligent while acting innocently."

76. We observe that HMRC did not pursue the element of neglect in respect of fuel and car benefits, its argument being based on Mr Bayat's failure to disclose income from property which was not a matter upon which we were required to make any findings of fact. On the evidence before us HMRC may well have struggled to discharge the burden of proof in this regard.

77. TMA 1970 also sets time limits on HMRC's ability to raise discovery assessments. Under s 34 the "ordinary time limit" is four years after the end of the relevant tax year. Section 36 extends that time limit where fraud or negligence is established. Again this aspect of the appeal was not pursued with any real vigour and we had doubts as to whether HMRC had discharged the burden of proof in respect of 2000/01 and 2001/02.

78. As a result of our findings in respect of car and fuel benefits, it follows that the appeal against any portion of the penalties imposed which relate to car and fuel benefits is also allowed.

79. As to the issue of costs, we considered our powers under Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 which provide as follows:

"The Tribunal may only make an order in respect of costs…if the Tribunal considers that a party of their representative has acted unreasonably in bringing, defending or conducting the proceedings…"

80. The Rules make clear that the proceedings should be considered as a whole. The assessments in respect of fuel and car benefits formed only part of Mr Bayat's appeal and we were not informed as to how agreement was reached by the parties in respect of the matters pertaining to income from properties and capital gains. In those circumstances we were not satisfied that HMRC had acted unreasonably such as to justify an order for costs.

Isocom

81. HMRC did not concede the point that collection of NIC may be barred by the Limitation Act 1980. Enforceability of the debt is not a matter upon which this Tribunal has jurisdiction and we have therefore proceeded to determine the issue on the basis of whether the amounts are lawfully due.

82. We accepted Mr Bayat's evidence regarding the system in place for completion and posting of PAYE returns and payments. We were satisfied that Mr Bayat's evidence was corroborated as far as it could be by Mr Young who was aware of the procedure in place and completed the relevant documents prior to their due dates for submission.

83. We noted that HMRC's assertion that the returns for 1997/98, 1998/99 and 1999/2000 were not received by the due date was unsupported by evidence. Even accepting that this was correct, we were satisfied that non-receipt of itself is not sufficient to demonstrate negligence on the part of the Appellant and therefore HMRC failed to discharge the burden of proof on the issue of negligence.

84. We then turned to the issue of fraud. We accepted Mr Bayat's evidence that he was not responsible for sending in the falsified P35 returns which were received by HMRC on 18 August 2000. Taken together with the fact that Mr Ismail's employment covered this date and his subsequent conviction, we were satisfied that Mr Ismail sent in false P35s which understated Isocom's PAYE liability.

85. Although HMRC appeared at times to challenge the contention that Mr Ismail was responsible for the forged returns and underpayments, it follows on either case that the company did not discharge its true PAYE liability and tax was, and remains, lawfully due.

86. The question for us to determine is whether the acts of Mr Ismail can be attributed to Isocom.

87. We carefully considered the authorities to which we were referred and we note that we had a great deal of sympathy for the situation in which Mr Bayat now finds himself as a result of the actions of another about which, we accepted, he was wholly unaware.

88. In the case of *Clixby v Poutney (H M Inspector of Taxes)* 44 TC 515 the High Court stated:

"…I do not find it in the least surprising that Parliament, when it decided in 1942 to allow assessments to be reopened and penalties claimed at any distance of time if fraud or wilful default was proved, should have wished the provisions which it was enacting to extend to cases where the fraud or wilful default was committed by an agent and it could not be proved that the taxpayer was privy to it…it would be unfortunate if a taxpayer could escape liability by saying: "It is true that you have proved that my agent committed fraud on my behalf; but you have failed to prove that I was privy to it, and as you did not discover it until after six years had expired I can take – and propose to take – advantage of it."

89. We considered the distinction Mr Mullen sought to draw on the basis of Isocom as a victim with HMRC as a secondary victim. On this issue we found the case of *Bilta* helpful. The extract to which we were referred by Mr Mullen must be read in the context of the full judgment and not in isolation. The judgment provides a detailed analysis of the circumstances in which attribution of fraud may or may not be appropriate. The Court held:

"It is, however, clear from the decisions I have just referred to that whilst the acts and intentions of the directors or other senior representative will usually be attributed to the company for the purpose of establishing personal liability for the conduct complained of, the process of attribution is not an automatic one dependent only upon the individual responsible for the unlawful conduct occupying a sufficiently senior position in the management of the company. In both McNicholas and Morris v Bank of India the defendant company deployed an argument that it should not be made personally liable for the consequences of its employees' actions because it was also at least a secondary victim of those actions. In McNicholas the employee's fraudulent conduct had caused direct loss to the Commissioners and in Morris to the creditors of BCCI. But it had also exposed the company in both cases to a secondary liability to pay compensation for the loss which it had caused. The argument was rejected. As Mummery LJ said in Morris at [114]:

"Clearly there are some circumstances in which an individual's knowledge of fraud cannot and should not be attributed to a company. The classic case is where the company is itself the target of an agent's or employee's dishonesty. In general, it would not be sensible or realistic to attribute knowledge to the company concerned, if attribution had the effect of defeating the right of the company to recover from a dishonest agent or employee or from a third party. Mr Moss argued that there should be no attribution of knowledge as this was a case in which BoI was the "secondary victim" of Mr Samant. His actions were harmful to the interests of BoI, as he had exposed it to the risk of potential liability for fraudulent trading. We have no hesitation in rejecting that submission. If it were correct, it would never be possible to attribute the knowledge of the individual to a company under s 213. That is contrary to the

agreed position that a company is capable of being made liable under s 213. Knowledge of fraud may be attributed to a company even though such attribution may expose it to the risk of liability under s 213."

The point being made in this passage is that attribution of the conduct of an agent so as to create a personal liability on the part of the company depends very much on the context in which the issue arises. In what I propose to refer to as the liability cases like El Ajou, Tan, McNicholas and Morris, reliance on the consequences to the company of attributing to it the conduct of its managers or directors is not enough to prevent attribution because, as Mummery LJ pointed out, it would prevent liability ever being imposed. As between the company and the defrauded third party, the former is not to be treated as a victim of the wrongdoing on which the third party sues but one of the perpetrators. The consequences of liability are therefore insufficient to prevent the actions of the agent being treated as those of the company. The interests of the third party who is the intended victim of the unlawful conduct take priority over the loss which the company will suffer through the actions of its own directors.

But, in a different context, the position of the company as victim ought to be paramount. Although the loss caused to the company by its director's conduct will be no answer to the claim against the company by the injured third party, it will and ought to have very different consequences when the company seeks to recover from the director the loss which it has suffered through his actions. In such cases the company will itself be seeking compensation by an award of damages or equitable compensation for a breach of the fiduciary duty which the director or agent owes to the company. As between it and the director, it is the victim of a legal wrong. To allow the defendant to defeat that claim by seeking to attribute to the company the unlawful conduct for which he is responsible so as to make it the company's own conduct as well would be to allow the defaulting director to rely upon his own breach of duty to defeat the operation of the provisions of ss.172 and 239 of the Companies Act whose very purpose is to protect the company against unlawful breaches of duty of this kind.

Although not referred to or cited to the Court of Appeal in Belmont, the non-attribution to the company of its directors' fraudulent conduct is said to rest upon what I shall refer to for convenience as the Hampshire Land principle…

As mentioned earlier, the argument for the company had been that the loss which it would suffer by being made to compensate the Commissioners for their loss of VAT was sufficient to prevent the dishonesty of the employees being attributed to the company. In the passage quoted, Dyson J rejects the argument just as this court did in Morris (see [32] above). In Stone & Rolls Rimer LJ at [55] said:

"The McNicholas case [2000] STC 553 shows that, in assessing whether the Hampshire Land principle applies, it is not appropriate to factor into the consideration the adverse consequences to the company when and if the fraud is found out."

But it does not follow from this that secondary damage of the kind relied on unsuccessfully in the liability cases will not be sufficient to prevent attribution when it forms the subject matter of the action by the company against those whose breach of

duty has caused it. In that context the damage is not secondary but primary and the company is the direct victim of the breach of duty relied on.

Much of the argument which Mr Sumption QC directed to this point was based on the passages in McNicholas and Morris which I quoted earlier at [32] and [42]. But those, as I have said, were both cases in which the claim in issue was one made against the company based on the fraud of its directors or employees. The court was not concerned with what the position would be if the claim was being made against the directors or their accomplices for fraud or breach of fiduciary duty against the company and Rimer LJ, I think, accepted this at least implicitly by his rejection of Mr Sumption's second line of argument and by what he said at [71] and [72] about the auditors' reliance on the decisions in McNicholas and Morris:

"[71] I find it a little surprising that the McNicholas and Bank of India cases emerge as authorities contributing to the jurisprudence on the application of the Hampshire Land principle. They were both concerned with fixing liability on a company at the suit of a third party and a central question in each was whether the relevant statutory policy (respectively the VAT legislation and the insolvency legislation) required the attribution to the company of the acts of its agents, being agents who were not its directing mind and will. Once, as in each case it did, the court held that the applicable policy did require such attribution, I find it difficult to see on what basis it was considered that such attribution could or might be trumped by the Hampshire Land principle, which is primarily concerned not with a company's liabilities to others but rather with its claims against others.

[72] But, surprising or not, there is no escaping that both in the McNicholas case and in the Bank of India case the court discussed the scope of the Hampshire Land principle. In my judgment both cases support Mr Sumption's submission that the principle will ordinarily only apply in circumstances in which the agents intend to harm the company (the McNicholas case [2000] STC 553, para 56), or it is the target of their acts (the Bank of India case [2005] 2 BCLC 328, para 118), and that it is not enough to engage the principle that an agent's acts may result in harm to the company. In the former case it made no difference that the agents' frauds were found out and resulted in material harm to McNicholas in the shape of assessments to tax of more than £1m: see [2000] STC 553, para 1; and in the latter case it made no difference that Mr Samant's actions resulted in BoI being made liable under section 213 to a judgment of over US$80m: see [2005] 2 BCLC 328, para 1. In both cases the companies were, in the phrase used in argument, left "holding the baby", just as the company is said to have been here. Both authorities support the view that being a "secondary" victim of this nature is not enough to engage the principle; what counts is the identification of the victim against whom the fraudulent acts are directed. The logic underlying this approach is that it is irrelevant in the present context to take account of the adverse consequences to the fraudster of being a fraudster: those are simply the consequences that the law visits on fraudsters, but they do not, in the present context, make the fraudster a victim. Whilst I recognise the Arab Bank case [1999] 1 Lloyd's Rep 262 as pointing in a different direction, I take the view that this court in the Bank of India case preferred and approved the reasoning in the McNicholas case, and in my judgment we should take our lead from the Bank of India case."

90. It seems clear to us that *Bilta* provides support for the proposition that attribution of fraud to a company is appropriate in circumstances where a company would suffer loss by compensating HMRC for a loss of tax which was properly due.

Conversely such attribution would not be appropriate where there is an action by a company against those whose breach of fiduciary duty has caused damage.

91. In those circumstances we reluctantly concluded that the actions of Mr Ismail can be properly attributed to Isocom. It follows that the element of fraud has been established and the extended time limit in respect of PAYE and NIC liabilities applied. PAYE and NIC lawfully due remain payable by Isocom and the appeal is dismissed.

92. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JENNIFER BLEWITT
TRIBUNAL JUDGE

RELEASE DATE: 10 June 2014