Choose your partners carefully

Les Howard reviews the Sandham Upper Tier case and explains its implications for partnership liability.

In her recent study ('Tax Fraud and Selective Law Enforcement') tax academic Rita de la Feria comments that HMRC fraud management has tended to make innocent victims of fraudulent behaviour liable for the VAT losses. This is much cheaper than prosecuting the perpetrators and recovering the stolen money. In practice, this approach leaves some taxpayers vulnerable to substantial financial losses.

This article comments on a recent Upper Tier Tax Tribunal case, where the innocent business, a partnership, engaged an agent who entered into fraudulent transactions on their behalf. Although there are plenty of the usual missing trader intracommunity (MTIC) fraud issues considered by the First Tier Tribunal (FTT), this case addresses the personal liability of partners, where the Partnership is the innocent party, although also naïve in some respects. Nicholas and Charlotte Sandham operated a scrap metal business, Premier Metals Leeds. The FTTdecision (para 36-75) describes the history of the business.

In particular, the partners asked a Jonathan France to join them as a consultant, paying a retainer plus profit share. Mr Sandham had known France for many years and had seen that he had been very successful in business. France was therefore engaged without written contract. Mr Sandham made no further checks. He did not know that France was a disqualified Director, that he had recent (at the time) convictions for fraud and perjury and had received prison sentences of 10 years. In the four months – from December 2012 to March 2013 – France was involved in the partnership he negotiated 56 deals in which HMRC denied input tax of around £2m. At the end of March 2013, the business was incorporated.

In the next five months, a further 195 transactions where conducted, and input tax of over £9m denied. HMRC stated that the transactions were connected with the fraudulent evasion of VAT and that the Partnership (and then the company) knew or should have known of such a connection. This was the basis of the denial of the input tax. In the world of MTIC, this is standard wording.

The FTT accepted that Mr and Mrs Sandham became the victims of a cynical and carefully planned deception. However, the FTT also found that the Sandhams failed to take reasonable care in allowing France to enact the transactions as he did. The second issue in the Appeal is the 'knowledge or means of knowledge' issue. Did the Sandhams know, or should they have known, that the transactions were connected to the fraudulent evasion of VAT? On this question, the Tribunal found in favour of the taxpayers.

The first issue is the relevant one for the purpose of this article. It is the 'attribution of knowledge' issue. Was France's actual knowledge that the transactions were connected to the

fraudulent evasion of VAT properly attributed to the partnership? On this question, the Tribunal found against the taxpayer. The partnership Appealed to the Upper Tier, where they lost. The FTT concluded (para 123): “It is sufficient for the purposes of determining this issue that Mr France arranged and conducted the transactions on behalf of and in the name of the partnership with their due authority to act as an agent, even though he went beyond the terms of that authority in that the transactions were connected to the fraudulent evasion of VAT.” Many taxpayers are not aware with the nuances of VAT law. This is where a proactive Accountant has an opportunity to appraise his/her new client of the relevant issues. And, when a business diversifies, a further opportunity. VAT Act 1994, s45 contains the provisions for Partnerships. S45(3) provides for personal liability for each member of a Partnership.

Even after leaving the Partnership, the person is liable for VAT due for the periods during which he/she was a member. S45(2) provides that a person is deemed to remain a member until HMRC are notified of the relevant change. (At the time of writing, I am in correspondence with HMRC over a VAT assessment made on a Partnership two years after a person left. But, since he failed to notify HMRC, he has remained personally liable for a substantial assessment and penalty.) In the Sandham case, the Upper Tier carefully considered the attribution of the knowledge of the agent to the principal. If I, as principal, engage a third party to perform certain tasks on my behalf, the agent’s knowledge is deemed to be my knowledge.

A carefully worded document, agreed by both parties, is an obvious solution. It need not be a lengthy document. But the reality is, in the SME world in which most of us work, that seems unnecessarily formal and administratively burdensome. But lack of such a document can leave one or both parties seriously out-of-pocket. Again, another area where accountants can give timely advice. In the MTIC situation, an innocent party caught up in the supply chain may not quickly appreciate the different criteria applying to ineligibility to input tax and criminal liability. HMRC are not accusing them of deliberate wrong-doing. But they remain liable for input tax (this is part of the argument in Rita de la Feria’s study).

The QC for the taxpayer in Sandhams argued that the ’distinct and unusual features’ in this instance should allow the Tribunal to vary its approach to the issue of attribution. Such features were taken into account by both Tribunals, but those features could not, of themselves, relieve the Partnership of its legal liability. Counsel also argued that the extent to which France acted outside his instructions and authority should assist the Partnership’s argument. In response, the Upper Tier highlighted that he had entered into those transactions on the Partnership’s behalf, therefore he entered into transactions connected with fraudulent evasion on the Partnership’s behalf.

The Upper Tier agreed with HMRC that the Partnership’s position here contained an inherent contradiction One other factor which our firm has seen is that HMRC correspondence is often poorly worded and badly argued. (It is annoying as an advisor, having worked hard to bring a carefully nuanced and well-referenced argument, for HMRC to reject with sloppy correspondence!) The real problem is that the decision has been made and an assessment issued. The taxpayer is forced into the difficult binary decision of paying up or funding an

appeal. This is the link to the Upper Tier decision: https://www.bailii.org/uk/cases/UKUT/TCC/2020/193.html

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