Predator and prey?

Indirect Tax

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Adrian Houstoun looks at the challenges faced by SAOs

Key Points

What is the issue?

HMRC considered that the appellant, a SAO, breached the main duty in paragraph 1 of Schedule 46 by failing to conduct, or have in place any system of, selective or ‘thematic’ testing or sampling of figures in the ICE VAT returns, or of individual transactions to ensure that the figures in the returns were correct.

What does it mean to me?

It is clear that HMRC considers test checking to be a requirement, and all SAOs should at least consider whether they need a system of test checking, and also consider whether they should use an external firm to test that their tax systems are appropriate, which will at least make someone else culpable.

What can I take away?

With Making Tax Digital just round the corner, especially for VAT, SAOs should also consider whether their tax systems are sufficient to deal with obligations under this new regime.

In one of David Attenborough's TV programmes, he featured a giraffe being stalked by a pair of lions but, despite their cunning trap the giraffe escaped and the lions left empty-handed. The odds were heavily in favour of the lions and stacked against the isolated giraffe, but the lions were let down with their execution, and perhaps also with the selection of their target. The same might be said of HM Revenue & Customs (HMRC) which, in 2009, received considerably enhanced powers for dealing with the senior personnel of large companies, where there are tax issues, but have HMRC, unlike the lions succeed or have they failed?

HMRC's updated powers first came into force in 2010 and, in a particular recent case, they used them and alleged that a finance director had breached his duty as the senior accounting officer (SAO) of the group, under the new regulations. However, the Judge in this case decided that HMRC's penalties should be rescinded. The Judge, Sarah Falk, also criticised HMRC for the manner in which it conducted the process and its handling of the SAO's appeal to the Tribunal.

The Finance Act 2009 introduced the concept of SAO and their personal responsibility for tax accounting systems and accurate tax returns. SAOs of qualifying companies and groups became responsible for taking reasonable steps to establish, maintain and monitor the adequacy of the accounting systems used for creating tax returns and settling tax liabilities. The SAO also became responsible for providing a certificate to HMRC on the adequacy of their systems for each financial year. During the period following the publication of the Finance Bill and before the passing of the Act, the definition of a qualifying company was relaxed so that, when enacted, it applied to UK companies in the same group whose turnover is £200 million, or whose gross balance sheet assets are £2 billion. Failure to comply with

the legislation results in a £5,000 personal liability of the SAO. As only cases that go to Court are in the public domain, there is no information available as to whether any SAOs have been assessed and paid their liability; however, a case has now been heard and the decision released in respect of a particular SAO who did not accept the penalties assessed on him and appealed the penalty to the First tier Tax Tribunal.

The appellant was Kreeson Thathiah who was finance director of the Lenlyn Group, a private group of companies, whose members included International Currency Exchange plc (ICE), and which provided currency exchange and other financial services. ICE was also the representative member of the VAT group, which was partially exempt for VAT purposes and operated a partial exemption special method (PESM) for determining its recoverable input tax.

Mr Thathiah ceased working for the Lenlyn Group in Spring 2014 and, following his departure, KPMG, on behalf of ICE, made an error correction notification for the VAT returns from March 2010 to January 2014, with an estimated under declaration of VAT of £1.36 million. Mr Thathiah met with HMRC in January 2015, following which HMRC issued him with two assessments of £5,000 each, for the years to 29 February 2012 and 28 February 2013. It was against these two assessments that Mr Thathiah appealed, perhaps in part due to the impact that having such assessments might have on his CV and reputation as an accountant who operated in the highly regulated area of financial services, a point upon which the Tribunal made comment. Mr Thathiah was unrepresented and conducted the appeal at Tribunal on his own. He had received no assistance, information or other support from the Lenlyn Group. Concerns within HMRC in relation to taxpayer confidentiality also appear to have been the cause of Mr Thathiah not receiving any details of the contents of KPMG’s error correction notice until it was provided as an exhibit to a witness statement during the course of the appeal. No additional detail in relation to the VAT position of the ICE VAT group or the final outcome of the error correction notice had been provided to him beyond some limited comments in oral evidence and submissions at the hearing.

HMRC’s case was in essence a very simple one. It was that the appellant breached the main duty in paragraph 1 of Schedule 46 by failing to conduct, or have in place any system of, selective or ‘thematic’ testing or sampling of figures in the ICE VAT returns, or of individual transactions to ensure that the figures in the returns were correct. Instead, he relied excessively on variation testing, i.e. simply comparing

figures with those in previous returns. By not undertaking any selective testing, consistent errors will not be picked up and can become embedded in the system.

The Tribunal made the following findings:

- Mr Thathiah joined the group in 2005, became group finance director in 2007, and his departure in 2014 was due to a disagreement which had nothing to do with the VAT errors.
- In or around 2010 there had been a restructuring designed to increase senior management oversight, and an employee Marc Gil had been appointed tax manager. He was sent on a KPMG training programme and given a £7,500 per quarter tax training budget with that firm, which was usually fully utilised, and approximately seventy calls to KPMG concerned VAT.
- Mr Thathiah also relied on another senior employee, Kerry Penfold, who became group financial controller, and had been trained by a big four firm, and had experience of working in a large banking business–although she was not a tax specialist.
- Mr Gil was responsible for the VAT returns which Ms Penfold was responsible for checking.
- The appellant relied on KPMG's annual audit, which included a full substantive review of VAT calculations
- KPMG was engaged to handle negotiation and agreement of a new partial exemption special method with HMRC.

Judge Sarah Falk also expressed her concern about several aspects of HMRC's handling of the case:

- Although the Tribunal was appreciative that HMRC had concerns about taxpayer confidentiality, in denying the appellant any real detail of the errors identified by KPMG, until a late stage of the appeal, was unfair to the appellant.
- Placing significant reliance on what was said at the meeting in January 2015 in respect of which Mr Thathiah had no chance to prepare, and had not seen the error correction notice, meant that HMRC's attempt to rely on that meeting had to be treated with caution.
- Careful allowance needs to be made due to the HMRC officer who dealt with the case, as well as with the appeal, not having been involved with ICE at the time the errors took place.

- It was not clear to the judge that HMRC had made sufficient allowance for the fact that Mr Thathiah was unrepresented and had had no access to support or information from ICE or Lenlyn Group.
- HMRC's evidence did not draw a distinction between different sizes of financial services businesses, and assumed that all companies over the Schedule 46 threshold would be judged by the same standard, whether they were just over the threshold, or a major financial institution with a large tax department.
- The legislation required the SAO to take 'reasonable steps', but instead HMRC first focused on whether or not Mr Thathiah had a 'reasonable excuse' which was incorrect.

As mentioned above, HMRC's case was that by not performing or arranging for selective testing, Mr Kreeson had failed to take a reasonable step. However, the Judge said that the absence of selective testing can lead to errors becoming embedded and, therefore, in principle such testing must be desirable. However, the question was whether, in the circumstances of this case, selective testing was a reasonable step. The judge was not satisfied that it was, due to the significant other system controls that were in place and the work and involvement of KPMG, in respect of which the Judge observed that when HMRC decided to raise the penalty there was no discussion by HMRC at that meeting of the work that KPMG had done in connection with VAT. The judge therefore cancelled the two assessments. Hopefully, Mr Thathiah has ended up with a clean record and a CV unsullied by the Lenlyn experience, much like the giraffe who escaped unscathed from the lions.

Lessons to be learned

What should other SAOs learn from the case, and should all SAOs make certain that their company has a system involving selective testing? That will materially depend on what other controls the company has in place to generate accurate tax returns, and settle its liabilities on a timely basis. It will also depend on the size of the organisation, if a company is over the threshold by a relatively small amount it will have different requirements to those of a massive organisation. If, like Lenlyn Group, the company has a retainer with a professional tax adviser firm – and the retainer is made good use of – and also has several tax staff with segregated duties, it may be possible to ensure accurate tax returns without test checking. It is clear, however, that HMRC considers test checking to be a requirement, and all SAOs should at least consider whether they need a system of test checking, and also consider whether they should use an external firm to test that their tax systems are appropriate,

which will at least make someone else culpable. With Making Tax Digital just round the corner, especially for VAT, SAOs should also consider whether their tax systems are sufficient to deal with obligations under this new regime.