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The Reasonable Senior Accounting Officer

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Eight years after the tax reporting regime for Senior Accounting Officers ("SAOs") was introduced, we have had our first tax case regarding the imposition of penalties on a SAO for failing to comply with his obligations under the regime. The First-tier Tribunal's decision is notable for several reasons. The matter had a number of odd facts which, to put it bluntly, meant that the odds were stacked against the taxpayer, a Mr Kreeson Thathiah. Despite that, Mr Thathiah, who appeared in person, successfully managed to get the penalties levied on him discharged. The fact that HMRC lost is noteworthy in itself given that the subject-matter relates to allegedly errant taxpayer behaviour, where it would be surprising for a taxpayer to win given the checks and balances HMRC take before beginning litigation. But despite HMRC's contentions, the Tribunal found the taxpayer's behaviour acceptable.

The SAO regime was introduced by the Finance Act 2009. It imposes duties on SAOs of large companies or corporate groups. The facts in the tax case involve a group, not a single company so I will refer to groups from now on. The SAO is defined as the officer or director who, in the company's reasonable opinion, has overall responsibility for the group's financial accounting arrangements. Commonly, this is the group finance director.

The "main duty" of the SAO requires him to take "reasonable steps" to ensure that the group establishes and maintains "appropriate tax accounting arrangements". These are defined as arrangements that enable all group companies' tax liabilities to be calculated accurately in all material respects. This means the affairs of each individual group company, since we do not have the concept of consolidation for tax purposes. More specifically, the SAO must take reasonable steps to monitor the arrangements and to identify any deficiencies. He is then required to provide an annual certificate to HMRC either saying the arrangements in place are "appropriate" or, if not, to explain why. If a SAO fails to comply with the main duty, he is personally liable to a penalty of £5,000. However, no penalty can be levied if the SAO can show he had a "reasonable excuse" for the failure.

Mr Thathiah had been employed as the finance director of the Lenlyn group. The group included a company called International Currency Exchange plc ("ICE"). The Tribunal noted that neither party had provided much information about the business of the group, except that it was engaged in providing financial services. For VAT purposes, financial services generally involve the making of

exempt supplies, which in turn restricts the ability of the group to recover VAT on its input supplies. The group was, therefore, partly exempt and operated a partial exemption special method ("PESM") for recovering VAT on its inputs.

The taxpayer provided the statutory certificates for the group for 2011, 2012 and 2013. These were all unqualified i.e. they made no mention of any shortcomings in the accounting arrangements. But he left the group in 2014. After he left, the group's accountants, KPMG, made an error correction notification to HMRC in relation to ICE's VAT affairs. This related to errors in ICE's VAT returns between 2010 and 2014. As a result of the errors, the overall increased liability was @£1.4m. During the relevant years, Mr Thathiah was the SAO and had signed the certificates.

Despite severing his connection with the group, in 2015 Mr Thathiah agreed to meet HMRC to discuss the errors. No-one from the Lenlyn group attended and, indeed, the taxpayer received no help at all from his former employer. HMRC were also not forthcoming about the nature of the errors notified by KPMG. They refused to show him the error correction notices. They cited taxpayer confidentiality as a reason for non-disclosure. Mr Thathiah was faced with having to answer allegations regarding his failures without being given the chance to understand the basis of the allegations. Despite this odd state of affairs, HMRC appear to have placed great significance on his inability to offer credible explanations at that meeting. Later that year, HMRC issued two penalty assessments on him for £5,000 each for 2012 and 2013 in relation to the VAT errors. As the Tribunal noted, the amount at stake was modest, but there were clearly reputational risks for the taxpayer if the penalties stuck, as well as damage to his employment prospects; the latter was particularly pertinent given he had left the group.

HMRC had taken the view that the taxpayer had not taken reasonable steps to ensure that the VAT accounting arrangements for ICE were proper.

The main thrust of HMRC's case was that the taxpayer had failed to put in place a system to test selectively whether figures in ICE's VAT returns, or relating to individual transactions, were correct. Rather, he relied simply on comparing figures with those in previous years' returns. This failure amounted to reasonable steps not being taken, and therefore a breach of the main duty, so HMRC said.

The Tribunal found that, although given limited resources by his former employer, the taxpayer had made a number of improvements and introduced processes during his time in that employment in relation to the group tax function. He established a small team comprising a tax manager and a group financial controller, who was a qualified accountant. Both had been provided with suitable training for their functions. They reported to him. He arranged for external support to be provided by KPMG. In particular, KPMG had negotiated the PESM with HMRC and were key in providing the VAT function to the group since there were no internal VAT specialists. He introduced a group tax policy document. He had asked his employer for more resources, but his requests had been rejected.

The Tribunal found that there was gradual improvement to the tax function against a "backdrop of limited resources and repeated requests by [the taxpayer] for additional resources."

There were, therefore, no defects in overall procedures or delegation which could have justified penalties. The issue boiled down to the narrower question whether the failure to do selective testing for VAT amounted to a failure to take reasonable steps.

Mr Thathiah argued that he had done whatever he could with the resources available. He delegated the VAT compliance function to his tax manager, who was supervised by the group financial controller. He relied on KPMG's detailed work in agreeing the PESM with HMRC and on the checks they made as part of the annual audit. He also took comfort from the open dialogue with HMRC's own VAT specialist in connection with the application of the new PESM.

The Tribunal found the taxpayer's arguments convincing and decided that HMRC had not satisfied their onus of showing that the lack of selective testing meant that the taxpayer had failed to take reasonable steps in relation to ICE's tax accounting arrangements.

The key to the case's outcome lies in the following sentence from the decision of the Tribunal (Judge Sarah Falk):

"The question of whether the appellant took "reasonable steps" is clearly an objective one, which in my view must be determined by reference to all the circumstances."

This shows that, despite the objective nature of the wording, there is an element of subjectivity because the "reasonableness" has to be determined in the context of the relevant circumstances, and not by some higher standard based on a hypothetical corporate group. Further, one should have regard not only to the size, nature and complexity of the group's affairs, but also to facts relating to the SAO's situation and his ability to operate the tax function and whether that ability was hampered by constraints outside his control.

One needs to be clear, however, whether an individual's conduct amounts to taking reasonable steps on the one hand, or failing to take reasonable steps but having a reasonable excuse for doing so. Both routes avoid a penalty, but the way you get there is different. For example, another way of looking at Mr Thathiah's situation might have been to say that the failure to carry out selective testing was a failure to take reasonable steps. But given the resources at his disposal, he had a reasonable excuse for that failure. It is pertinent to note that in the legislation, it is expressly provided that an insufficiency of funds is not a reasonable excuse unless attributable to events outside the SAO's control. Mr Thathiah's inability to expand the internal accounting function was a constraint outside his control and could be viewed as a reasonable excuse.

While the result of either approach is the same i.e. no penalty, there is a fundamental difference in onus. It is for HMRC to show that reasonable steps have not been taken, but if they succeed, then it is for the taxpayer to show he has a reasonable excuse. HMRC approached the case on the footing that reasonable steps had not been taken, so it was up to the taxpayer to show he had a reasonable excuse. But the Tribunal took the view that HMRC had failed in discharging their onus, so there was no need to consider whether there was a reasonable excuse. The Judge did, however, comment that the insufficiency of resources might have been sufficient to show a reasonable excuse, had that point been a live one.

The Tribunal were clearly concerned with how Mr Thathiah had been treated by HMRC and made some further observations:

- The taxpayer's treatment at the 2015 meeting was unfortunate, as was the fact that he was not given sufficient detail of the allegations against him until a late stage in the appeal. The Tribunal described this treatment as "unfair", and one might speculate as to whether aspects of HMRC's decision-making process might not have been subject to judicial review. Happily for Mr Thathiah (at least thus far as it is not known whether HMRC have asked for leave to appeal), this route was unnecessary, but certainly some of HMRC's conduct was questionable;

- HMRC failed to make sufficient allowance for the fact that the taxpayer was unrepresented;

- HMRC's evidence and arguments failed to draw any distinction between different sizes of partly exempt financial services businesses; it was critical to have a look at the actual circumstances, and not to apply some sort of industry gold standard for measuring reasonable steps;

- HMRC focussed too much on whether the taxpayer had a "reasonable excuse" for his actions without fully considering whether they had discharged their onus of showing no reasonable steps.

The Tribunal's approach confirms that, from the SAO's viewpoint, the better strategy with HMRC is to challenge the assertion that reasonable steps were not taken, rather than to accept that and then rely upon a reasonable excuse to get off the hook. This of course presupposes that the SAO has good evidence of appropriate behaviour to back his position. It is particularly important to get the approach right as it is possible for one person to view a pattern of behaviour as a reasonable step, but for another to see it as an unreasonable step for which there may be a reasonable excuse. The problem with the latter is a practical one: once HMRC have discharged their onus and the SAO's conduct found to be wanting, justifying that conduct becomes much harder.

It is not known whether the case will go on appeal. From HMRC's viewpoint, it may not be advantageous to take it further given the strong findings of fact made by the Tribunal in favour of the taxpayer. It cannot also be in their interests to advertise further their behaviour when it has come under criticism by the Tribunal. The implications of HMRC pursuing a SAO of a group after he has left his employment are also problematic. It is clearly unsatisfactory for such an individual to be under investigation for inappropriate conduct in the past and for him also to be told that he cannot see the basis of the investigation because of taxpayer confidentiality. Mr Thathiah was caught between a rock and a hard place since his former employer also offered no help. If HMRC decide to take action against other individuals who have left their SAO-related employment, they clearly need to find a satisfactory way of treating such individuals even-handedly. It would not be surprising for other taxpayers in this situation to act without professional representation since the pecuniary amounts at stake are small. But this makes it even more critical for HMRC to be constructive in their dealings with the taxpayer.

If the decision becomes final without further appeal, it may not have precedent value, but it will be a helpful reminder that it is important not to put the "reasonable excuse" cart before the "reasonable steps" horse. It is also important for HMRC to be reasonable.

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