

## **Lloyds TSB Group Plc v The Commissioners for HM Revenue & Customs (2005) Decision 19330**

**By Peter Mantle and Valentina Sloane  
First published by De Voil Indirect Tax Intelligence,  
Issue 115, December 2005**

A demand by the Commissioners for a bank's management accounts and for the documents used to prepare those accounts was reasonable and within the scope of the powers conferred on them pursuant to VATA 1994 Sch 11 para 7(2). Legal advice that a Notice of Demand under that provision is invalid is not a "reasonable excuse" for non-compliance, for the purposes of liability to a penalty under VATA 1994 s 69.

In a decision of 9 November 2005, the VAT & Duties Tribunal (Stephen Oliver QC, Chairman) has given a ruling on the scope of the Commissioners' powers to demand documents under VATA 1994 Sch 11 para 7(2), together with a ruling on the issue on what constitutes a "reasonable excuse" for failure to comply with such a demand.

VATA 1994 Sch 11 para 7(2) provides:

"Every person who is concerned (in whatever capacity) in the supply of goods or services in the course or furtherance of a business or to whom such a supply is made, ... shall –

(a) furnish to the Commissioners, within such time and in such form as they may reasonably require, such information relating to the goods or services or to the supply, ... as the Commissioners may reasonably specify; and

Monckton Chambers  
1 & 2 Raymond Buildings  
Gray's Inn  
London WC1R 5NR

Tel 020 7405 7211  
Fax 020 7405 2084  
DX LDE 257

chambers@monckton.com  
www.monckton.com

(b) upon demand made by an authorized person, produce or caused to be produced for inspection by that person –

(i) at the principal place of business of the person upon whom the demand is made or at such other place as the authorized person may reasonably require, and

(ii) at such time as the authorized person may reasonably require, any documents relating to the goods or services ...”.

Failure to comply with such a demand exposes the person on whom notice was served to a penalty under VATA 1994 s 69, although there is no liability to a penalty if the person satisfies the Commissioners or, on appeal, a tribunal, that there is a “reasonable excuse” for the failure.

There is surprisingly little jurisprudence on the scope of the powers conferred by Sch 11 para 7(2), or indeed on what constitutes a “reasonable excuse” for the purposes of s 69. The first and only other reported case in which these provisions were judicially considered in some detail was *Interleasing (2002) Decision 17819*, which largely concerned the meaning of the phrase “supply of goods or services in the course or furtherance of a business”. This case therefore provides welcome illumination of the scope of the Commissioners’ general powers to require information.

## **Factual background**

Lloyds TSB Group (“the Bank”) appealed against two decisions of the Commissioners. The first concerned the issue of a notice to produce documents (“the Notice of Demand”). The second (“the Penalty Letter”) notified the Bank that its failure to comply with the Notice of Demand had made it liable to a penalty of £5 a day up to a maximum of 100 days on which the failure continued.

The Bank made both taxable and exempt supplies and operated a special method of partial exemption. The Bank’s taxable supplies for which recovery of input tax was available included corporate finance and asset management services. These fell within what was referred to as the “service” category of the Bank’s activities. The Bank’s exempt activities for which no recovery of input tax on costs was available were its lending to customers. Both the service and the lending categories of supplies fell within what is sometimes referred to as the Bank’s “core” banking activities. The partial exemption special method, sometimes known as the core bank method, existed for the purpose of enabling the apportionment of residual input tax by reference to taxable and exempt outputs in each category.

As from 1 January 1996, Private Banking was first included in the core bank method. A letter from Customs to the Bank in 2002 sought to open discussion on the continued use of the service/lending method. Aspects of the method, the letter noted, appeared to be out of step with some of the Bank’s and there was a need to review whether the result of the special method was still “fair and reasonable”. The inclusion of the private bank’s taxable income within the “core bank” calculation improved—and in the Commissioners’ view, distorted—the “service” recovery rate to an extent that far exceeded the rate justified by the sector’s usage of input tax in making its taxable supplies.

Fruitless discussions between the parties culminated in a Notice of Demand, which required: (1) the originals or copies of the management accounts, or equivalent, for the Bank for a specified year; and (2) the originals or copies used to prepare the management accounts for that year and which related to the manner and the extent to which costs and income were allocated internally. The stated purpose of the Notice of Demand was to obtain the necessary information to enable the Commissioners to determine whether the Bank’s partial exemption special method produced a fair and reasonable attribution of input tax.

## Ruling on the Notice of Demand

The Bank challenged the Notice of Demand, emphasising the observation of Browne-Wilkinson VC in *EMI Records Ltd v Spillane* [1986] STC 374 at 379j:

“The Court looks jealously at such legislation and, if there is any ambiguity in the legislation, such ambiguity must be resolved in favour of existing legal rights, and particularly in favour of an individual’s freedom of personal or privacy.”

It was argued for the Bank that the Bank’s Monthly Management Report (“MMR”), which most closely answered the term “management accounts”, was not within Sch 11 para 7(2). The MMR had not been used for the purposes of the VAT returns or for the purposes of calculations under the then special method. While the MMR might admittedly provide a “better understanding” of the Bank’s business, it did not relate to a supply of goods or services. In addition, the Bank argued that the documents referred to in the second limb of the Notice of Demand were outside the scope of Sch 11 para 7(2): there were no documents used to prepare the MMR, only electronic data; this data is not used to allocate costs to Private Banking and not all of those costs bore VAT anyway.

The Tribunal rejected the Bank’s submissions and upheld the Notice of Demand. In the first place it was satisfied that the MMRs were fairly within the scope of the expression “management accounts or equivalent” and that they related to the supply of the Bank’s services. The Bank carried on business as a retail bank and as such made supplies of services. The MMRs covered and analysed elements such as sales, cash flow and profit forecasts. The MMRs might or might not, when actually inspected, provide information that would enable the Commissioners to determine whether the Bank’s partial exemption special method produced a fair and reasonable attribution of input tax. But, in the ordinary and unstrained meaning of the word, they and the information contained in them “related” to the Bank’s supplies. The Tribunal considered that there is no ambiguity in the expression “relate to”; it is an expression that has to be applied to the particular circumstances. Nor do the words “relate to” limit the category of information or documents to those, such as invoices, that are directly connected with the making of actual supplies.

Secondly, the Tribunal was satisfied that the specification by Customs of the management accounts or equivalent was “reasonable”. The operation of the partial exemption regime is under the care and management of Customs. It is Customs’ function to ensure that the partial exemption special method of the taxable person in question produces a fair and reasonable attribution of input tax to taxable, exempt and other supplies. In this case, the Commissioners saw as critical the question whether the Private Banking sector was part of the core bank for purposes of the method or whether the Private Banking sector should be treated as a separate and clearly defined business area for the purposes of making an attribution of input tax. Whether on the final analysis that was a correct approach, was beside the point. The point was that the Commissioners were reasonably specifying information that related to supplies of services by the Bank and they had fully stated their case for doing so in the correspondence with the Bank. The Tribunal observed further that: the Bank’s witness accepted that the partial exemption method was subject to regular review; it was three years since the last review and the Commissioners had made the Bank aware of their concerns; the Commissioners had offered assistance to the Bank for the purpose of obtaining the information. Those features reinforced the reasonableness of the request.

Turning to the second limb of the Notice, the Tribunal considered whether the documents demanded in the second limb were “any documents relating to the goods or services or to (their) supply”. The use of the words “any documents” indicated to the Tribunal that the power to issue Notices of Demand is not limited to particular types or categories of documents. If the contents of the MMR related to the supply of the Bank’s services, it had to follow that the documents used to prepare them did too. The Tribunal noted that the word “documents” had been used but considered it would be ludicrous to interpret the letter as confining the request to such hard copy as the Bank had in its possession or chose to print out but exclude the relevant information stored by the Bank in electronic form.

The final question on the Notice was whether the Commissioners had acted reasonably in demanding the documents in the second limb. The Bank argued that the description of documents in the second limb of the Notice of Demand related to a vast amount of information which might or might not relate to the Bank's supply of goods or services and that the requirement was vague and unspecific. The Tribunal rejected the Bank's submissions, taking the view that the wording of the Notice of Demand was sufficiently specific. It was fortified in this conclusion by the evidence of the Bank's witness who had accepted that information used to prepare the MMR was in electronic form and that this electronic data related to the manner in which costs were allocated.

### **Ruling on the Penalty Letter**

The Tribunal then turned to the Penalty Letter and considered whether the Bank had a "reasonable excuse" for the purposes of VATA 1994 s 69. The Bank contended that it had a reasonable excuse: the interpretation of the Notice of Demand was not, in their view, clear cut. The Bank's Senior Group VAT Manager, Mr Guest, had experience as a VAT officer and had always considered that a taxpayer might volunteer management accounts but could not be compelled to provide them. Moreover Mr Guest had reasonably concluded that the MMR contained nothing that specifically related to goods and services or indeed to the allocation of costs to Private Banking. Thus, it was argued, the Bank reasonably took the view that production of the MMR would not in fact assist Customs in their enquiries. Finally it was pointed out that the Bank had sought and obtained legal advice to the effect that the MMR was outside Sch 11 para 7(2).

In the Tribunal's view, none of the points taken by the Bank amounted to a reasonable excuse. They were all variations on the same theme, namely that the Notice of Demand was, for one reason or another, itself outside the scope of Sch 11 para 7(2). If a taxable person proposes to challenge a Notice of Demand the Act gives him the means of doing so. The fact that he may think that the Notice of Demand does not apply to him or that it places unreasonable demands on him or that the Commissioners are acting unreasonably are relevant in determining the validity of the demand. They do not, however, furnish the taxable person who chooses to ignore the demand with a reasonable excuse. The fact that the Bank took legal advice as to whether the MMR was within the scope of Sch 11 para 7(2) was also beside the point. If the advice was that the Notice of Demand was invalid to the extent requiring production of the MMR that point could have been followed up by a challenge by the statutory means, ie before the Tribunal, as the Bank had gone on to do.

The Tribunal did give some, albeit narrow, indication of what might constitute a reasonable excuse: it suggested that a reasonable excuse might be present where for some unforeseen or inescapable reason that bank had been unable to comply with the Notice of Demand. An example might have been a failure of that bank's computer system storing the electronic data required to satisfy the Notice of Demand.

**For more information on Peter Mantle and Valentina Sloane, please contact the Clerks on 020 7405 7211 or consult the 'Find a Barrister' Section on [www.monckton.com](http://www.monckton.com).**