Appeal no: TC/2014/05699

Money Laundering Regulations - *Penalty imposed on estate agent for various infringements* - *Appeal against excessive penalty* - *Appeal allowed*

FIRST-TIER TRIBUNAL

TAX CHAMBER

JACKSON GRUNDY LIMITED

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: JUDGE HOWARD M. NOWLAN

CAROL DEBELL

Sitting in public at the Royal Courts of Justice in London on 24 to 26 February 2016

Alan Bates, counsel, on behalf of the Appellant

Peter Mantle, counsel, on behalf of the Respondents

DECISION

Introduction

1. This was not a tax appeal but an appeal in relation to the Appellant's claim that the penalty that had been imposed on it for various alleged breaches of the Money Laundering Regulations in the period April 2011 to April 2012 was excessive. The penalty was in fact imposed (along with penalties imposed on two other firms of estate agents) four days prior to the abolition of the Office of Fair Trading ("the OFT") on 31 March 2014. Thereafter enforcement of the Money Laundering Regulations, at least so far as estate agents were concerned, was entrusted to HMRC, as was any continuing dispute in relation to penalties initially imposed by the OFT.

2. After two reductions made in the proposed penalty prior to the final decision to impose a penalty, the penalty was imposed in the amount of £169,652. While the figures vary according to whether this level of penalty was compared with the after-tax profits of the Appellant for the same period or with the average profits in several periods around the relevant date, it is realistic to refer to the figures for the particular year in which the penalty was imposed, and in that period the penalty constituted approximately 45% of the Appellant's after tax profits. This was moreover at a time when the Appellant was battling against very difficult trading conditions, and when the effect of the penalty was thus particularly harsh.

3. Having had some concern that the proper course for us was to quash the penalty altogether, we announced our decision orally at the end of the hearing to the effect that the penalty should be reduced from £169,652 to £5,000. In short the reasons for this were that:

- taking the realistic conduct of the Appellant into account, and the onerous consequences to the Appellant resulting from the level of penalty imposed, the penalty was seriously disproportionate;
- the very mechanical policy adopted by the OFT for calculating the penalty could only generate a level of penalty that satisfied the requirement of the Regulations that it be "effective, proportionate and dissuasive" if the final step in the calculations designed to achieve that end was applied flexibly, and not, as in this case, said to be relevant only where there were "unusual circumstances";
- the level of penalty calculated under HMRC's own current guidelines in relation to identical circumstances would, at its very maximum, have been only about one quarter of the penalty imposed by the OFT, and very much less following the adjustments that we consider appropriate in the present case; and finally
- we consider it appropriate to pay regard to the apparent loss of business suffered by the Appellant, resulting from the website publication of the penalty imposed, being (and being mentioned to be) by far the highest penalty imposed on an estate agent for money laundering breaches, and to the other very material suffering and worry that the vastly excessive penalty has inflicted on the Appellant.

4. In short, we consider that the initial calculation of the penalty for failings that were more trivial than substantive (largely being related to record keeping and documentation) was wholly disproportionate and unjust. In addition to the penalty of £169,652 being many times the penalty calculated under the present HMRC guidelines, it was 17 times greater than any previous penalty imposed on an estate agent, even where there had been repeated failures

to register under the money laundering regime. Furthermore, in the light of the plea made on behalf of the Appellant (made shortly before the commencement of the hearing) that the Respondents should abandon their defence of the present Appeal, and accept the Appellant's offer to pay a penalty in settlement of £15,000, in order to save the still financially stretched Appellant from the very considerable costs of the Appeal, we consider that it was improper for the Respondents to continue their defence of the Appeal as they did.

The facts

5. In this section we will summarise the basic background facts and will defer summarising some of the evidence given during the hearing by Mr. Jackson until we deal with the practical application of the Money Laundering Regulations by the business in paragraphs 12 and 13 below and also until we record particular evidence in our Decision section, at paragraphs 34 to 38 below.

6. The Appellant is an estate agent with 10 offices, all in Northamptonshire and most, if not all, based in the villages in the county. Each of the offices has at all times been run by a manager. We were told that all, possibly bar two or three, of the managers had been in their present roles for at least 10 years, and that the business was fortunate and unusual for estate agents in that staff tended to remain in the business to a far greater extent than is apparently common for estate agents. We were also told that one at least of the managers who had been appointed within the last 10 years was previously an assistant in one of the offices, and thus familiar with the practices and traditions of the business.

7. Although at the time it was not compulsory for estate agents to comply with money laundering requirements, in 2004 the managing director, Mr. Jackson, who gave evidence before us, said that he had circulated a policy and instruction statement in relation to money laundering responsibilities, certainly to all the managers, and possibly also to the assistants.

8. We were told that it was the practice for Mr. Jackson and each of the office managers to meet every Monday in a pub to discuss business matters, and periodically (roughly every six weeks) the same individuals assembled in the main meeting room, perhaps in the administration office, for more structured discussions. We imagine that money laundering issues would rarely have been discussed at these sessions, largely because they would have been rare in the business of a village-based estate agent in Northamptonshire, but we have no doubt that if a manager had had concerns about the identity of a particular vendor, that would have been mentioned at one of these meetings, particularly to Mr. Jackson who was principally responsible for monitoring compliance with the Regulations.

9. At the date of the OFT compliance visit to the Appellant on 22 June 2012, the business had recently experienced very difficult trading conditions. The general downturn in the whole housing market, and thus in particular the profitability of the sales agency limb of the business, had led to roughly 45% of the employees being made redundant. The problems in relation in particular to the sales agency business had led to the firm's accountants recommending a reorganisation designed to merge the previously separate profitable lettings business, and a financial services business with that of the sales agency. This reorganisation, undertaken of course at an anyway difficult time for the business, took up much of Mr. Jackson's time and attention, and was then followed by a further reorganisation of the firm's administration activities. Prior to these changes, each office had dealt with its own administration. The plan was for most of the administrative functions to be dealt with at the

one administrative office, located behind the sales office in Duston, and also to arrange for much of the administration to be dealt with on computers. It is hardly surprising that these two reorganisations, and the regrettable redundancy of staff, were the dominant concern of the managing director at the time.

The responsibilities of estate agents in relation to the Money Laundering Regulations

10. Once they became obligatory, the Money Laundering Regulations made it clear that estate agents were one of the various bodies required to assist in combatting money laundering, investment in property being seen both as a major investment that fraudsters, criminals and terrorists might make with "dirty money", and also a possible method of transposing "dirty money" into "clean money" by distancing the proceeds of crime by first investing in real property and then later selling the property. Whilst it is easy to see why property search agents might need to be particularly astute to detect money laundering on the part of major property investors, for present purposes we are only concerned with the Appellant's activity as a sales agent. Mr. Jackson said that he found this odd, but we were nevertheless told that estate agents' business in relation to property letting was not covered by the Regulations and, insofar as penalties might be geared, for non-compliance with the Regulations, to the business turnover, turnover derived from the lettings business was to be excluded.

11. The Regulations identified various steps that had to be taken by businesses that were responsible for complying with the Regulations. These included the obligation to check the identity of clients and thereafter the need to continue to monitor their identity; the need to adopt and to circulate written policy statements in relation to money laundering procedures; the obligation to educate staff in relation to their responsibilities, and the need to keep records of identity checks in case at some later stage the police or other public bodies might need to obtain such information. We were also told that it was not open to estate agents to ignore the checks on dealing with potential sellers of properties merely because (at least in the Appellant's practice) solicitors were always engaged in relation to property sales and they would undertake similar checks. We were also told that new Regulations were introduced in 2007, making various changes and in particular adopting a more "risk-based" approach to the expected checks. We were told that the meaning of "risk-based" checks was rather in line with common sense, in other words the proposition that more checks should be undertaken when the circumstances were suspicious, and perhaps less attention given when the circumstances were known to be entirely innocent.

The practical steps adopted by the Appellant prior to the visit by an OFT officer to the Appellant on 22 June 2012

12. Mr. Jackson explained to us that since the Appellant had been a fairly long-established business and one largely based in small villages, it was commonplace for office managers to know a very high proportion (80% was the percentage figure mentioned) of potential vendors who instructed the Appellant. Many of those had used the Appellant's services in the past and were thus particularly well known.

13. Mr. Jackson also said that when a potential vendor approached the Appellant in relation to the possibility of using the Appellant's services in selling their house, the initial meeting with the potential client would always be undertaken by the office manager, and since one of the purposes of the meeting would be to establish the value of the property, that meeting

would virtually always be at the potential vendor's house. The dual significance of these facts was that the responsibility for establishing the true identity of the owner of the property would always be undertaken by the office manager, and since the meeting would be at the house, this would also give the manager, on looking around the house intelligently, a very good idea as to whether the seller was a manifestly honest and innocent seller or a possible fraudster or terrorist. The result of this was that when a very considerable majority of potential clients were going to be well known to the office managers anyway, the managers did not request to see gas bills, passports and driving licences of people who they already knew. Furthermore, since the office managers would invariably deal with the initial meetings, taking down more information, and contact details relevant to the intended sale etc there was less need for assistants later showing potential purchasers round the properties to be fully briefed in terms of written policy statements and formal education in relation to money laundering issues. The other more material departure from the strict obligations contained in the 2007 Regulations was that the Appellant did not keep copies of passport identification, driving licences and other identification information, in all cases where it had been considered necessary to examine such documents, in other words when the vendors were not already well known to the office manager. Mr. Jackson said that some such details were retained but we were not shown any examples. Mr. Jackson attributed the feature of not invariably retaining copies of such documents at least partly to the risk of retaining identity documents in offices, and the possibility of such information being used for identity theft if an office was broken into.

The visit by Sarah Bailey, an OFT officer, to the Appellant's premises to monitor money laundering procedures on 22 June 2012

14. This visit, a one and a half hour visit and the only visit ever made to the Appellant by an OFT officer, led regrettably to some considerable misunderstandings and was the visit that led eventually to the imposition of the penalty. The fault for the misunderstandings was not entirely the fault of the officer in that Mr. Jackson had failed to obtain, in readiness for the visit, the documents that the officer had asked Mr. Jackson to locate. Mr. Jackson's failure to produce such documents was in turn based on the clear impression created by the officer's prior emails, all of which indicated that the purpose of the visit was to enable the OFT to give further information, education and suggestions as to how the Appellant might improve its money laundering practices. Mr. Jackson had therefore not realised that it was considered crucial for him to have assembled the various requested papers.

15. To illustrate the reason why Mr. Jackson assumed, very understandably, that the purpose of the proposed meeting was one of assistance, two paragraphs in an email of 18 May 2012 made the following points:

> *"I would like to make an appointment with you for the purposes of ensuring your business is complying with anti-money laundering legislation.*
>
> ……
>
> *Our aim is to work with you by giving advice on any failings we discover under the Money Laundering Regulations 2007 and agreeing timescales for the rectification of those issues."*

16. Much the same point was made in a follow up email of 28 May which said:

> *"The purpose of the visit is to determine the company's level of compliance with the Regulations and to give advice and guidance, if required, in respect of its AML regime."*

17. We accept that the OFT officer had also said that she expected to see various documents, including a policy statement adopted by the firm in relation to compliance with the Regulations, written training instructions issued to managers and employees and client files so that she could see the records of identity checks that had been taken. Mr. Jackson had been unable to locate a copy of the anyway somewhat out of date policy and training document that had been prepared and circulated to managers in 2004 (the failure to locate it possibly being referable to the fact that the computer server had gone down); he had also not obtained numerous client files, but when asked to do so simply went to the adjacent sales office and picked up five client files. None of these recorded any detail of how the relevant manager had verified the identity of the seller. We were not specifically told during the hearing whether the five files that Mr. Jackson had picked up at random happened to be files relating to a vendor well known to the manager of the sales office who was not available to join the discussion at the time, though that was certainly possible. Had that not been so, and had passport, driving licence and utility bill evidence been seen, it is also entirely possible that once those documents had been checked and found to occasion no concern, they might very well not have been retained.

18. While Mr. Jackson did indeed learn of the more documented procedures that the Appellant was expected to introduce, and those procedures were indeed largely introduced immediately, Mr. Jackson still assumed that the meeting had been a meeting principally designed to request that the Appellant made the changes suggested, and he expected there to be a follow-up meeting in which an OFT officer would come and check whether the requested changes had been made.

19. The OFT produced a report of the visit. It was not a verbatim report of the conversation and it was not initially shown to Mr. Jackson. It did, however, form the basis of the OFT conclusion that there had been "significant and widespread" failings in the Appellant's observance of the Money Laundering Regulations and without there having been any further meeting or indeed direct conversation with Mr. Jackson, or any communication with any of the office managers of the Appellant, in December 2013 the OFT sent the Appellant, as they were required to do prior to actually imposing a penalty, a formal notification that the OFT intended to impose a penalty on the Appellant of £200,000.

20. At this stage Mr. Jackson obviously understood that his assumption that the meeting approximately 18 months earlier had been designed solely as a training meeting had been wrong. In the December notification of the proposed penalty the Appellant was given 14 days in which to make representations to the effect that the proposed penalty was inappropriate, and on a request for further time to prepare a representation that request was granted.

21. The Appellant then sent the OFT comprehensive representations drafted by its solicitors indicating why it was considered that the penalty was excessive. It was conceded that there had been failings, and the Appellant even conceded that it would accept a penalty of £20,000. It was strongly argued, however, that it was inappropriate for the penalty fine to be 17 times greater than any earlier fine imposed on estate agents, particularly when earlier fines had been imposed for repeated failures, following warnings, to register under the Regulations at

all. It was stressed that the Appellant never dealt with conveyancing so that whenever the Appellant had been instructed on a sale, solicitors would be engaged, and mortgage lenders would often be involved either in relation to repayments or further advances for a new property purchase. Considerable reliance was thus placed on the fact that these other parties, also subject to the Money Laundering Regulations, and moreover directly dealing with money movements on behalf of the vendors, would also be undertaking the relevant checks. The representations also stressed the business difficulties that the Appellant had suffered, and the disruption that resulted from the reorganisation of its business strands and its administration, and the degree to which Mr. Jackson had had to focus much of his attention on those essential matters. It also stressed that it was the practice for the directors to derive much of what effectively constituted remuneration for work by taking only nominal salaries and thereafter taking dividends out of the profits of the business such that a penalty, constituting a very significant proportion of the profits, was going to cause considerable hardship to the directors.

The law, the OFT interim penalty policy for the calculation of penalties, referred to as the "IPP", the basis of calculation of the penalty actually imposed on 26 March 2014 in the amount of £169,652, the basis of calculating penalties later adopted by HMRC and the jurisdiction of the Tribunal in this case

The relevant law

22. The only guidance given in the Regulations in relation to the calculation of penalties for infringement of the Money Laundering Regulations is that the penalty should be of an amount considered "appropriate" by the designated authority (initially the OFT), and then "appropriate" is expressly defined to mean "effective, proportionate and dissuasive".

The IPP adopted by the OFT

23. In order to achieve some consistency in calculating penalties, the OFT published a policy document referred to as the IPP, and sought representations in relation to its approach.

24. The IPP generated a calculation in accordance with four steps.

25. Step one was to take the turnover of the party alleged to be in default. In some cases (in other words in cases involving other entities than estate agents) the turnover calculation referred only to the "at risk" turnover of the alleged defaulter) but in the case of estate agents the turnover figure referred to the entire gross turnover, excluding just turnover derived from letting activities. It was in this regard that the penalty came down from £200,000 to the figure of £169,652 because the higher penalty had failed to exclude the lettings turnover by mistake.

26. Step two then calculated the penalty initially by taking one of four percentages of gross turnover, the four percentages being 15%, 10%, 5% and 0%. There was no reference to it being appropriate for a case to fall midway between any of those identified percentages. The allocation to a particular percentage figure resulted from there being various descriptions of conduct that resulted in each of the figures being the appropriate percentage of turnover to take. Accordingly the 15% figure was said to be appropriate in the most serious cases, with the conduct that attracted the 15% of turnover being said to include the direct involvement of the business itself in money laundering, terrorist financing or other financial crime, and conduct designed intentionally to facilitate breaches of the Regulations. The descriptions of

the conduct that should attract the 10% of turnover, as the starting point for the calculation of the penalty, varied quite widely. One referred to the business being involved in threats of, or actual violence or abuse to consumers, the making of significant profits by the business as a result of the breaches and breaches causing significant loss or risk of loss to individual consumers. Naturally none of these were pertinent so far as the Appellant was concerned, though it was suggested that the Appellant fell within two other descriptions of conduct that attracted the 10% of turnover calculation, namely "breaches committed deliberately or recklessly" and cases where senior management were aware of, or should have been aware of the breaches. Needless to say the 5% category was said to apply to less serious breaches, and some of the descriptions of conduct that attracted this percentage figure aptly described the Appellant's situation.

27. The third step in the penalty calculation allowed the OFT to increase or reduce penalties where there were either mitigating or aggravating circumstances. Mitigating factors were said to be co-operation of the business with the OFT after breaches had been identified and the fact that remedial action had been taken.

28. The fourth step directly raised the issue of whether the penalty initially calculated under the first three steps was appropriate. In other words it had to be judged to be "effective, proportionate and dissuasive".

The application of the IPP in the present case

29. Sally Johnson, ("Ms. Johnson") was the OFT officer who dealt with the calculation of the penalty imposed on 26 March 2014, and she was the Respondents' only witness in the hearing before us. Having appropriately adjusted the turnover to exclude the irrelevant lettings turnover, she then applied the 10% figure to the turnover, conceded a 10% reduction under step three for co-operation, and then failed to make any adjustment to the calculated figure under step four. She said, not that this factor was mentioned in the policy itself, that she considered that step four was of principal relevance "in relation to unusual circumstances" and that there were no unusual circumstances in the Appellant's case.

The HMRC approach to the appropriate calculation of penalties

30. HMRC had been responsible for the enforcement of the Money Laundering Regulations in relation to some categories of professionals to whom they related from well before the date on which, with the abolition of the OFT, HMRC were given the responsibility for enforcement of the Regulations on estate agents. HMRC had therefore adopted a policy for calculating penalties for infringements before the date when the penalties were actually imposed in this case, and the same policies have been applied in the case of estate agents since 1 April 2014. Although HMRC also became responsible on 1 April 2014 for dealing with later disputes in relation to penalties imposed by the OFT, in this case HMRC obviously thought it appropriate to oppose the Appellant's appeal for a very considerable reduction in the penalty imposed by the OFT, by continuing to defend the penalty originally imposed without regard to the indisputable fact that the penalty would have been much lower had the HMRC guidelines applied at the time, or had the penalty been reduced to match the figure applicable under HMRC's current guidelines.

31. The basis of the calculation of penalties, as applied by HMRC, started with a fixed penalty of £5,000. That was then increased to reflect how many relevant transactions the party in default had undertaken in the period being reviewed, i.e. a one-year period in this

case. The Appellant had acted for vendors in the relevant period for approximately 830 clients, which figure potentially increased the penalty by £10,000. This figure derived from various different (and escalating) additional penalties being added to the £5,000, the additional amounts increasing as the number of client instructions in the period increased. There was then a rather involved method of dealing with how many different failings the defaulter in question had been responsible for. Some technically distinct failings were aggregated and all counted as just one default in calculating the penalty. Others were treated as distinct. In the present case, it appeared that there had been defaults in three separate categories, which thus meant that the penalty initially calculated at £15,000 (i.e. £5,000 plus £10,000) was multiplied by three and put at £45,000. There was then a 50% reduction in the penalty, had the particular defaulter neither been given a training session or meeting, nor a warning following a meeting. Neither had been given in this case, so that the maximum penalty calculated under the strict rules adopted by HMRC would have been £22,500 (i.e. half of £45,000). These were the strict rules but the policy then acknowledged that in order to satisfy the continuing obligations that the penalty should be "effective, proportionate and dissuasive", any of the figures calculated under the above steps could be varied or indeed a wholly different approach might be adopted on the basis that it would be more suitable.

Our jurisdiction

32. Both parties accepted that we had a very wide jurisdiction in this case. We could determine all the facts for ourselves, regardless of whether they had been appreciated when the penalty was originally imposed. We could reduce or quash the penalty, and could certainly calculate the penalty that we thought appropriate by commencing the calculation afresh. We did not in other words have to review the original decision or challenge the approach adopted by the OFT in calculating the original penalty. We could simply start again.

33. There was also discussion as to whether we considered the IPP to have been unlawful. We do not intend to consider that topic. It seems to us that it was perfectly lawful for the OFT to devise a method of calculating penalties, and particularly if one of the steps enabled mechanically-calculated figures to be adjusted to generate a penalty that met the key three requirements of "effectiveness, proportionality and dissuasiveness", it is difficult, or indeed impossible, to mount a claim that the IPP was simply unlawful. This is not to say, however, that we have no criticisms to make both of the formal steps in the IPP, and in particular of the calculations adopted in the present case. We will outline some criticisms of both. Since, however, the policy is no longer in force and since we can calculate our own penalty figure, solely constrained by the requirement that it should be "effective, proportionate and dissuasive", criticisms of the IPP and the way in which it was applied in this case are fairly secondary.

Our decision

Our factual findings

34. In reaching our decision, we start with Mr. Jackson's evidence and our own findings of fact in relation to the level of compliance with the Regulations by the Appellant prior to the 22 June 2012 visit.

35. We consider that Mr. Jackson was an honest and impressive witness. He said that he spent a considerable amount of time familiarising himself with statements and policy documents that emanated from the various estate agents' professional bodies that would naturally refer to the obligations under the Money Laundering Regulations, and he said that he always endeavoured to ensure that the Appellant's business was conducted in a professional way, and with a high degree of integrity. We accept this claim.

36. Although little had been made of this point in the representations that were sent to the OFT that we referred to in paragraph 21 above, we do accept his evidence that all of the Appellant's office managers were aware of their money laundering responsibilities. They will very likely not have demanded proof of identity from intending clients who they considered that they already knew, which is perhaps hardly surprising, albeit not strictly in conformity with the Regulations. Mr. Jackson said that when potential clients were not known to the office managers they would have sought proof of identity though they did not always keep copies of passport identification, driving licences and utility bills. This was either thought unnecessary, in ignorance, or in the days when the administration was undertaken on paper and in files, Mr. Jackson said that they were also concerned about theft of documents that could lead to identity theft. He also said that while employees would have had some knowledge of their responsibilities under the relevant Regulations, virtually the entire burden of complying with the obligations fell on the office managers because it was the office managers who invariably conducted the first meeting with potential clients, that meeting almost always being at the potential client's house, since the office manager would need to value the house and suggest selling prices.

37. We consider that a fair but short summary of the degree of compliance on the part of the Appellant prior to the visit on 22 June 2012 was that if compliance was to be judged simply from documentation, it is not surprising that the OFT officer considered the level of compliance to have been bad. Although there may have been some recording and retention of identity checks, this was certainly not the norm, and no checks would have been undertaken when office managers already knew the potential clients. Mr. Jackson had not updated the policy document originally circulated in 2004, and so had not reflected any of the changes introduced by the 2007 Regulations. Furthermore it took a considerable time for the Appellant to locate a copy of the 2004 document and to send it to the OFT. Most of the training had been undertaken in discussions with office managers, and there were no formal training documents for staff. If, however, the question is whether the failings were more technical than substantive, we consider on the basis of Mr. Jackson's evidence that they were. We believe that when potential clients were not known to the office managers that identity checks had been undertaken, and we also accept that when the officer managers visited the houses of potential clients they would have been using their intelligence to detect whether the potential clients looked manifestly honest or possibly dubious. Particular attention would have been given to the situation when potential vendors were absent or out of the country.

38. We consider that the visiting officer's judgment on and after 22 June 2012 was rather clouded by failings of recording and documentation, and that insufficient attention was given to the fact that in reality the Appellant's conduct would have been most unlikely to allow a fraudster to proceed unchecked, at least in the cases where none of the more formal procedures would have identified anything anyway.

The calculation of the penalty, the observations in relation to the IPP in general and the observations in relation to how it was applied in this case

39. Turning now to the calculation of the penalty, we do first criticise the OFT for having made just the one visit, for not having spoken to a single office manager, and for being ready to impose a highly significant fine on the basis of inadequate information.

40. In relation to the IPP, we do not particularly criticise the starting point in the calculation for having been the gross turnover. The percentage of turnover that eventually constitutes net profit will of course vary wildly from business to business, and when the pain of a penalty will be particularly serious where the penalty constitutes a high proportion of net profit, the eventual imposition of the penalty must take this into account. However, it would plainly be impossible to commence any calculation of penalty from a net profit figure since this would be unworkable in the case of a loss-making business, and particularly such a business with really serious money laundering failings.

41. There are numerous fair criticisms of step two in the IPP principles. Fixed percentages of turnover geared to described failings will impact very differently with different ratios of profit to turnover. The description of conduct that fell within each of the four percentage categories varied quite considerably. For instance, threats of, and actual violence (though slightly difficult to visualise in the context of failures to enforce the Money Laundering Regulations) and situations in which the defaulting party had profited from its lax enforcement of the rules both seemed infinitely more serious than other conduct that similarly resulted in 10% of turnover being seen as an appropriate starting point. It seemed curious that the conduct that attracted the 15% figure would often be highly fraudulent, though deserving it seems of only a penalty half again as serious as that for the less serious categories of conduct that attracted the 10% penalty.

42. The step dealing with aggravating and mitigating circumstances was perfectly reasonable, though everything would of course depend on how it was applied. It seemed odd that the only examples of mitigating circumstances related to co-operation with the OFT and subsequent improvement of practices, and nothing referred to the circumstances relevant at the time the earlier conduct had been reviewed.

43. The final step, that for adjusting the calculations to ensure that the penalty was "effective, proportionate and dissuasive", was technically impossible to criticise, though of course again everything would depend on how it was actually applied in practice.

44. Turning now to the actual application of the IPP in the present case, we have more to criticise. We consider that the 5% multiplier would have been more appropriate than the 10% multiplier. Insofar as the 10% figure was chosen because the Appellant's breaches of the Regulations had been said to be "deliberate or reckless", we consider that neither such description is appropriate. We consider that Ms. Johnson's claim that the Appellant's conduct fell plainly within the 10% category and was "at the higher end of that classification" was simply wrong.

45. We note that in considering mitigation, no attention was paid to the problems that the business had been suffering; no reference was made to the administrative changes and the switch to administration largely being dealt with centrally and on the computer; no regard was paid to the way in which the profits of the business directly generated the broad equivalent of quite modest salaries or profit shares to the directors, and it was not even appreciated that the failings of the Appellant were more technical than really substantive. Nobody had spoken to a single office manager and nobody appeared to have appreciated that

in the case of most sales the office managers knew the intending vendors and undertook identity checks when they did not know them. The failings related almost entirely to the absence of policy and training documents, and the failure to record and retain the details of identity checks in all cases. The OFT never suggested that a single fraudster or intending terrorist had slipped through the net, and we would have been astonished (not of course that this could be confirmed with certainty) had this in fact occurred. We did consider the reduction geared to mitigating circumstances, particularly when Mr. Jackson's main focus was on saving the business in a very difficult period of trading, to have been wholly inadequate.

46. Our main criticism relates, however, to the way in which Ms. Johnson decided, without any direction in the IPP to do so, to assume that step four was only designed to modify the earlier mechanical calculations where there were "unusual circumstances". She eventually conceded in a question from us that the rigid principles of the first three steps would only lead to the imposition of reliable and proportionate penalties if step four was applied in a flexible manner. By that we mean that at the very least the officer considering the application of what might be "effective, proportionate and dissuasive" could hardly consider a penalty on a relatively small firm of then struggling estate agents to be proportionate when it represented roughly half of the firm's net profits, and profits largely destined to satisfy the ordinary and fairly modest remuneration expectations of the directors. Furthermore, when the failings were in fact more failures of recording, rather than substantive failings likely to enable fraudsters and terrorists to invest in real property in Northamptonshire villages and to slip through the net of protection, the feature that the penalty was 17 times higher than any earlier penalty imposed on a firm of estate agents seems to us to have been outrageous.

The Respondents' counsel's reliance on the ECJ decision in Louloudakis v. Elliniko Dimosio [2001]ECR 1-5547 ("Louloudakis") and the Upper Tribunal's decision in HMRC v. Trinity Mirror plc [2015] UKUT 421 ("Trinity Mirror")

47. The proposition for which the Respondents' counsel referred to the cases of *Louloudakis* and *Trinity Mirror* was that when an appellant was endeavouring to ensure that a penalty was reduced because it was claimed to be disproportionate, the Appellant had to go further than to establish that a penalty was simply excessive. The Appellant had to establish the further point that the excessive nature of the penalty would actually lead to a risk of undermining the Treaty freedom at stake in the particular case.

48. In the *Louloudakis* case, the appellant and his wife had major connections with both Italy and Greece. They lived in both, had business in both and strong and realistic connections with both countries. The appellant apparently took three vehicles, an old and small Iveco van, an old Fiesta and a BMW, all registered in Italy, to Greece. He would have been exempt from registration taxes in Greece had his case been clear and had he been able to establish that the imports were temporary and that the vehicles were to be returned to Italy, but he was apparently unable to establish that. He thus suffered penalties in amounts considerably exceeding the value of the vehicles, the Greek government claiming that the penalties had to be draconian because there needed to be a strong deterrence feature in the level of penalties because it was relatively difficult to identify situations where vehicles had been improperly imported and registration taxes avoided. The critical point in the *Louloudakis* case was that the ECJ held that in considering whether the penalties were disproportionate, that would be the case, and arguably might only be the case, if the excessive level of the penalties *"became an obstacle to the freedoms enshrined in the Treaty"*. The

freedom in issue in this case was of course that of free movement so that the conclusion was that if the penalties were so excessive that they jeopardised the Treaty principle of free movement between Member States, then they were to be struck down as disproportionate.

49. Before considering the significance of this authority, and the related decision of the Upper Tribunal in *Trinity Mirror*, a case where the level of a default surcharge penalty was challenged on the ground that it was disproportionate, we must commence by saying that both cases are irrelevant in the present circumstances. Both the *Louloudakis* and the *Trinity Mirror* cases had similar facts in the respect that in each case the provision under which the penalty was imposed was a provision that proceeded in a mechanical manner, and the provision itself made no reference to proportionality. The aim of the appellants in both cases was of course to establish that the strict calculations could be undermined and the penalties struck out or reduced when they infringed the general European principle of proportionality. For present purposes the crucial point is that this present Appeal is not one where statutory provisions have prescribed a mathematical method of calculating penalties, whereupon the aim is to strike down that mathematical calculation in reliance on the general European principle of proportionality. The very reverse is the position in this case. There is no mathematical or other strict method of calculating the penalty, since the only direction in the Regulations is that the penalty must be "effective, proportionate and dissuasive". Proportionality results from the very direction that the penalty must indeed be proportionate.

50. There is a second reason why the reference to an excessive penalty jeopardising one of the fundamental European Treaty principles cannot be relevant in this case, and this is that were it relevant it would appear to undermine the whole direction that penalties should be "proportionate". This is because, in contrast to the situation in *Louloudakis*, it is pertinent to note in this present situation that if a penalty could only be struck down or reduced on the ground that it was disproportionate, **if the excessive level of the penalty led to the risk of some European Treaty freedom being undermined,** it is difficult to see that this point could ever be established in the present situation, and therefore the ability to reduce a penalty to ensure that it was "proportionate" as that notion is generally understood, would in fact be undermined. This is for the simple reason that while excessive penalties might be considered to be unjust and quite unnecessary to achieve the other requirements of being "effective and dissuasive", it is difficult to see what Treaty freedom or principle would be put at risk by the penalties being excessive. Excessive penalties would simply be unjust and not required to meet the other two requirements, but their only effect would be to enhance the observance of the Money Laundering Regulations, and thereby to counteract crime, fraud and terrorism. Insofar as it might be suggested that the principle put at risk by excessive penalties would be the unjustified interference with individuals' right to their possessions, then we say that, as an alternative approach, the threat to their effective remuneration by the imposition of excessive penalties would involve a breach of the individuals' right to possession of their property.

51. For present purposes, however, our conclusion is simply that any principle to be derived from *Louloudakis* is irrelevant to the fact that in this case the penalty needs, according to the terms of the Regulations, to be proportionate. "Proportionate" means that it is must be appropriate, having regard to the gravity of the default, and the resultant disadvantage and suffering on the part of the defaulter following the imposition of the penalty, and having regard also to the feature that the penalty must be effective and dissuasive.

52. In view of the fact that we have concluded that the *Louloudakis* case is of no relevance in the present situation we will ignore the further issue of whether that case merely decides that jeopardising Treaty freedoms is something that can be, and should be, taken into account when considering whether a penalty is disproportionate, or whether alternatively such a conclusion in relation to Treaty freedoms is an absolute pre-requisite to striking down a penalty as being disproportionate where at least the aim is to strike down rigidly calculated penalties by reference to the European principle of proportionality. We also observe that, while the inference to be drawn from the Upper Tribunal's decision in *Trinity Mirror* may be that it is virtually impossible to strike down a default surcharge penalty on grounds of dis-proportionality, it is difficult to see that that conclusion itself derived from any conclusion that the seriousness of the provision was jeopardising some Treaty principle. The imposition of the penalty on the defaulter could hardly jeopardise the neutrality of the VAT system, since the penalty constituted a penalty and certainly not VAT. The severity of the penalty did not in other words impose more VAT or "stranded VAT". Insofar as the default surcharge provisions are designed to ensure that suppliers duly pay their VAT liabilities and do not default, it is difficult to see why the excessive nature of the surcharge penalties might in some way jeopardise that principle of neutrality. The more extreme the penalty, the more likely it would seem to be that it would achieve its object of ensuring compliance with the due and timely payment of VAT, however unfair that might be considered to be. It seems at the very least, therefore, that the *Trinity Mirror* case was one where the feature of putting Treaty freedoms in jeopardy was less obvious than in the *Louloudakis* case in which it was understandable that there was some tension between excessive penalties and the basic principle of freedom of movement.

The current HMRC guidelines

53. Our conclusion that the penalty be reduced to £5,000 is based, to a considerable extent, on the current HMRC guidelines, applied however in a slightly modified fashion by us.

54. We consider it to be unduly harsh on the Appellant to add £10,000 to the basic penalty of £5,000 simply because the Appellant was instructed on roughly 830 occasions during the material period. When a very considerable majority of the instructions will have involved acting for people well known to the Appellant's office managers, where money laundering considerations will in reality have been irrelevant, we consider that it would be excessive to add the full £10,000 to the basic £5,000. In the reverse direction, however, although there might technically have been defaults of three categories in the present case, we consider that in reality the failing was all to do with absent documentation. That encompasses the fact that there was no up-to-date policy statement, there were no training instructions issued to all employees, and no records were maintained of identification information when it was obtained. We consider it to be realistic to treat those failings as one composite failing. Making two adjustments to the HMRC guidelines, therefore, we will in fact add the £10,000 to the basic £5,000, but will not then multiply the resultant total of £15,000 by three. We will, however, then apply the 50% reduction, resulting from the fact that in this case there was neither a training session, nor a warning meeting. That produces a figure of £7,500. We then pay regard to Mr. Jackson's evidence when he said that when the outrageous penalty was publicised on the OFT website, this was publicised in the local press and several clients withdrew their instructions. Mr. Jackson also said that when the business entered a period in which its competitors were seeing increased sales and increased instructions, for a period the Appellant's instructions were falling. Mr. Jackson attributed both these problems (the

withdrawal of existing instructions and the fall in business) to the bad publicity that the Appellant suffered as a result of the imposition of the outrageous penalty imposed on it, and doubtless the way in which this would have been recorded in the local press. We are only reducing the penalty that we have so far calculated at £7,500 by £2,500 to reflect the damage to the Appellant's business and we have a lingering concern that we should have gone further. We accordingly say, and we said orally at the end of the hearing, that the penalty should be £5,000.

55. We also record that we consider that it was improper for the Respondents to have persisted in defending the OFT level of penalty and to have rejected the Appellant's suggestion that the Respondents should accept a penalty offer of £15,000, and settle the case, so avoiding the costs of litigation. We have not considered the professional costs incurred by the Appellant in fixing the level of penalty, since this is a case in which we can only award the Appellant their costs if they establish unreasonable conduct. We understand that the Appellant will be making a written application for costs on that basis and that the Respondents will have an opportunity to oppose it. Our present tentative conclusion is that it would be wrong to take the professional costs into account, as a back-door manner of effectively granting the Appellant its cost, by further reducing the penalty, as fixed by us. We doubt, in any event, whether the level of penalty would enable the claimed costs to be fully recovered. We confirm however that that approach in relation to the calculation of the penalty is one that the parties (particularly of course the Appellant) may wish to submit further representations upon, and we also clearly indicated to both parties that each would have an opportunity to make representations in relation to a wasted costs order.

56. We conclude by saying that we consider that the Appellant has suffered a very considerable injustice in this case. The worry that Mr. Jackson will have suffered as a result of the imposition of the excessive penalty, the embarrassment that he may have felt viz a viz his fellow directors and office managers, as the person in the business principally responsible for attending to the Appellant's money laundering responsibilities, and the resultant freezing or reductions of remuneration that all have suffered will all have imposed a heavy burden on Mr. Jackson. We greatly regret this.

Right of Appeal

57. This document contains full findings of fact and the reasons for our decision in relation to each appeal. Any party dissatisfied with the decision relevant to it 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.

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 9 MARCH 2016