



TC02228

Appeal number: TC/2011/07933

INCOME TAX – Concurrent VAT Investigation – whether understated trading profits – whether accounting records accurate – whether recalculations using a business economics model accurate – whether penalties justified. Appeal dismissed.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

**MRS AGNES NELSON
t/a SANDVALE LICENSED GROCERS**

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S Respondents
REVENUE & CUSTOMS**

**TRIBUNAL: JUDGE W RUTHVEN GEMMELL, WS
IAN M P CONDIE, CA**

**Sitting in public at George House, 126 George Street, Edinburgh on 15 and
16 August 2012**

Mr William Watson for the Appellant

**Ms Ros Shields, instructed by the General Counsel and Solicitor to HM Revenue
and Customs, for the Respondents**

DECISION

Introduction

- 5 1. This is an Appeal by Mrs Agnes Nelson trading as Sandvale Licensed Grocers (“AN”) against further assessments and penalty determinations for the tax years 2004-2005 to 2008-2009 inclusive, issued by HM Customs and Revenue (“HMRC”). The total amount of tax and penalties appealed is £62,968.34.
- 10 2. HMRC state that the profits are understated and raised assessments based on the profits they believe were earned. The penalties were incurred for failing to take reasonable care in maintaining records and negligently submitting incorrect returns.
3. Evidence was given by AN, Miss Karenanne McCleneghen (“KMC”), an employee of William Watson & Co Accountants Limited (“WW”) and W H Cunningham (“WHC”) and Mr B Hadley (“BH”) both employees of HMRC.
- 15 4. The fundamental issue relates to whether the entries contained in AN’s self assessment returns were correct and supported by appropriate records or whether the findings and recalculations carried out by HMRC, using a business economics model, reflect more accurate figures. This matter extended over five years.

Legislation

20 **Taxes Management Act 1970**

Section 12B

Records to be kept for purposes of returns

- 25 [(1) Any person who may be required by a notice under section 8, 8A. ... or 12AA of this Act ... to make and deliver a return for a year of assessment or other period shall—
- (a) keep all such records as may be requisite for the purpose of enabling him to make and deliver a correct and complete return for the year or period;
- 30 and
- (b) preserve those records until the end of the relevant day, that is to say, the day mentioned in subsection (2) below or, where a return is required by a notice given on or before that day, whichever of that day and the following is the latest, namely—
- 35 (i) where enquiries into the return ... are made by an officer of the Board, the day on which, by virtue of section [28A(1) or 28B(1)] of this Act, those enquiries are ... completed; and

(ii) where no enquiries into the return ... are so made, the day on which such an officer no longer has power to make such enquiries]

(2) The day referred to in subsection (1) above is—

5 (a) in the case of a person carrying on a trade, profession or business alone or in partnership or a company, the fifth anniversary of the 31st January next following the year of assessment or (as the case may be) the sixth anniversary of the end of the period;

(b) [otherwise], the first anniversary of the 31st January next following the year of assessment ...

10 [or (in either case) such earlier day as may be specified in writing by the Commissioners for Her Majesty's Revenue and Customs (and different days may be specified for different cases)].

The Facts

15 5. AN has traded as Sandvale Licensed Grocers since 1 November 2000 in Airdrie in Lanarkshire. Photographs of the shop and its location and details of a number of other and often competing businesses, were shown on maps submitted to the Tribunal. AN had previously been in partnership with her mother for a number of years before she commenced as a sole trader.

20 6. In the tax year 2005-06, based on the accounts to 31 October 2005, the gross profit was 4.37% and in the previous four years had been 6.4%, 9.1%, 4.5% and 6%.

7. An enquiry was started by HMRC on 24 October 2007 and on the same date a letter was sent to Watson Macarthur & Co, AN's then tax advisers.

25 8. A Notice under Section 9A(1) of the Taxes Management Act 1970 was served requesting, amongst others, a copy of the full accounts of the business covering the year ended 31 October 2005 and asking whether a figure was needed to balance the accounts and, if so, how much and how this was treated. In addition, the tax advisers were asked to provide a full analysis of drawings from the business to show cash, cheques and other items and to show how the figure of sales was arrived at.

30 9. An issue was raised as to whether the letters were sent to the correct address but a further letter was sent to AN on 26 November 2007 asking for, amongst other information, the items referred to in the letter of 24 October 2007.

35 10. No response appears to have been received and a further letter was sent by HMRC on 22 January 2008 containing a final warning that following an initial penalty of £50, further penalties up to £150 for each day, would continue if the failure to comply with the notice continued, and which would take effect 14 days later.

11. On 19 February 2008, AN was sent a penalty notice for £50 and on 26 February 2008 WW sent the books and records to HMRC which were hand delivered to their Motherwell office.
- 5 12. An undated letter, but received by HMRC at an Edinburgh office, was received on 3 April 2008 enclosing lead schedules and, at that date, HMRC said that the only documents they had received were four quarterly folders enclosing till rolls, receipts, cash expenditure and sales listings, on a weekly basis, and cash and carry computer listings.
- 10 13. On 10 April 2008, a Section 97A(1)(b) Taxes Management Act 1970 Notice was served requiring further information and on the same date AN was sent a penalty notice for the period 28 February 2008 to 9 April 2008.
- 15 14. On 16 April 2008, WW lodged an appeal on the grounds that HMRC had a copy of the accounts and related lead schedules and bank statements. The Appeal was acknowledged by HMRC on 29 April 2008, and at the same time a note of the documents and information still outstanding was provided which included mention of a balancing figure allocated to sales of £15,480.
- 20 15. This letter requested the analysis of drawings which had not been provided, the cheque and pay-in book stubs and stated that business bank account statements had been received with the letter of 16 April 2008 and noted a balancing cash figure of £18,189.37 which had been treated as fully arising from standard rated sales and that 25% of sales were zero rated and should be reflected in the adjustments to sales.
16. HMRC sent mandates in order for them to contact AN's four main suppliers and a meeting was arranged between AN, WW and HMRC on 23 May 2008 but which then took place on 17 June 2008. WHC was present for HMRC.
- 25 17. At this meeting, private and personal information was given about AN, stating that she owned a house on which there was an endowment mortgage of £36,000; that it would be helpful if AN's husband, although not part of the enquiry, provided information and made reference to the house next door for which they were making payments to the neighbour.
- 30 18. It was stated that AN had received or retained legacies worth approximately £30,500. At least £18,000 of this amount was retained in cash in the house.
19. There was discussion of a holiday to America which was taken in July 2005. It had been booked a year before travelling with half the cost paid in cash and the remainder by credit card. AN's credit card had a limit of £2,000 to £2,500.
- 35 20. The licensing hours of Sandvale Licensed Grocers were 8am until 10pm but AN normally opened at 9am having passed Booker Cash & Carry on the way to collect supplies of cigarettes and small spirits. Bulk orders were placed on Wednesdays for delivery on Thursdays and all purchases were paid for in cash. Another cash and carry, Davidsons, was used for alcohol and confectionery and they held an account
40 which AN made payments towards every second day from takings.

21. Various members of AN's family helped in the shop on an unpaid basis and as there was limited storage space at the shop regular cash and carry visits were necessary. The most popular items sold were Mayfair, Richmond KS and Regal cigarettes, beer, bread, milk and ten pence crisps.
- 5 22. AN stated that chemist goods which were expensive to buy in had a mark up of 25% to 30% and alcohol had a mark-up of 8% to 10%. For Booker supplies, AN used the recommended retail price but Davidsons goods were often pre marked with a price at which the goods were sold.
- 10 23. Although there was competition in the area and prices were often changing, AN confirmed at the meeting that there had been no change to her pricing policy for the last ten years and that margins were approximately the same.
- 15 24. There had been a break in to the property which caused a great deal of damage and, in addition, there was also natural wastage through the expiry of sell by dates and there had been shoplifting. The shop had a Pay Point system and cash for this was kept separate from other sales and banked at least every second day. Pay Point's payments were paid to them by direct debit.
- 20 25. A physical count of cash was made each night and a daily record kept and weekly cash sheets were prepared at home once a month. AN said that all sales were put through, and cash placed in, the till; that she never withdrew business cash from the bank but took weekly drawings which ranged between £100 and £200 per week in cash. No record of drawings taken was kept. Approximately £7,600 was attributed to own goods taken from the shop and stock figures were estimated as no stock takes were carried out.
- 25 26. At the meeting WHC stated he had concerns over the £18,000 balancing figure because there was no record of drawings and was unhappy with the gross profit rate which he considered to be low, at less than 5%.
- 30 27. As he noted the pricing policy had not changed over the years, he, therefore, stated his intention to look at the current prices when he visited the shop with a view to comparing this with recent purchase prices. A note of this meeting was sent to WW requesting in writing any amendments. None were received.
- 35 28. A further request for information was made on 24 June 2008, to be received by 31 July 2008. It was not received and a Section 19A Notice was issued on 4 August 2008. On 19 September 2008, a further notice was sent having received no response to the 24 June 2008 letter and a penalty notice in respect of this was sent, followed on 21 October 2008, by a penalty determination for the year 2005-2006 for £50.
- 40 29. On 27 October 2008, WW responded to the letter of 24 June 2008 enclosing a means test which showed a positive balance at the year end, noting that although there was no statutory requirement to produce this data, it showed that drawings substantiated AN's lifestyle. WW advised that AN was unwilling to allow HMRC to

approach the suppliers to request the information because she was trading in difficult circumstances.

30. At the Tribunal hearing the means test statement was discussed and it became clear that within the income total figure, the contributions from “Sandvale” was unclear. As AN stated that this was comprised of a private share of motor car expenses and “own goods”, there seemed to be no inclusion of the £200 per week which AN had admitted at the Tribunal hearing to taking out as cash drawings.

31. A large item of expenditure related to the American holiday at a cost of £6,500. As the credit card limit for AN was £2,500 it was unclear how this payment of £6,500, which was the total cost of the holiday, could be relevant to the year 2005 when half had been paid in cash in 2004 nor how the balance was paid by AN’s credit card.

32. It was established that the means statement was neither a cash statement nor a statement based on the accruals accounting concept but was instead a hybrid which made it difficult to understand but, on the face of it, it seemed that the income did not cover the amount of the expenditure and, accordingly, there was not a surplus balance but a negative one.

33. On 28 October 2008, HMRC wrote to WW stating they did not believe that AN’s records were robust; that they were incomplete because a figure in excess of £15,000 had been credited to sales to balance the accounts; no record had been maintained of AN’s drawings and that the gross profit rate returned, at less than 5%, was substantially lower than would be expected for the type of shop involved and below that which would be expected from the mark up rates indicated by AN. A request was made for three month’s worth of purchase invoices ending 31 July 2008 in order to carry out an exercise which WW considered to be a “fishing exercise”.

34. On the same day a letter was sent from WW appealing against the notice of 21 October on the grounds that AN was not in a “stable stress free relationship” as AN said she was in a state of fear and alarm in relation to HMRC obtaining information regarding her husband’s tax affairs, that her marriage was under great strain and that she had various personal health issues which precluded her from acting in a timeous manner.

35. On 30 October 2008, HMRC advised that they had not been aware of Mr and Mrs Nelson’s relationship problems and that, although the bank statements were one of the documents requested, there were a further six other items which remained outstanding. At the hearing it was acknowledged that in fact there were five items outstanding at the date.

36. On 4 November 2008, WW handed in a VAT folder covering the quarter to July 2008 to the Motherwell Tax Office. On 12 January 2009, WHC sent his calculations of the gross profit ratio based on the purchase invoices from May to July 2008 in conjunction with the prices obtained from a visit to the shop on 20 June 2008. HMRC felt that grocery items appeared to be sold at the

manufacturer's recommended retail price but that some could be sold at higher mark up rates providing an unweighted mark up of 37.8%, tobacco items providing a mark up of just over 7% and alcohol sales of 23.6%.

5 37. The purchase mix was ascertained at 39.49% for tobacco, 32.54% for alcohol and 27.97% for other sales. HMRC concluded that they were expecting an overall mark up of 21% or a gross percentage ratio of 17% - much higher than the 4.36%.

10 38. A Commissioners Hearing took place on 22 January 2009 in relation to a £50 fixed penalty. The appeal was dismissed by the Commissioners. After further correspondence, stencils were sent by HMRC on 9 March 2009 and further information requested.

15 39. At this stage, mention had been made of a theft in WW's letter of 6 March 2009. Further details of the theft were requested including the name of the employee concerned, the period employed, the period over which the thefts occurred, the amounts and how these were uncovered and further evidence in support by way of police reports, lawyers letters etc.

20 40. A meeting took place on 16 March 2009 between AN, Mr Findlay of WW and WHC at which the bank accounts' stencil could not be completed because AN could not remember her account number but the mandates for the suppliers were completed. No further information could be supplied regarding funds from and repaid to AN's mother.

25 41. AN said she had suffered a breakdown around February/March 2005 and had found it difficult to work in the shop for a period of 18 months. During this period she had had the help of a friend who became more involved in the shop during AN's illness. She basically ran the shop. AN indicated that she would do most of the ordering of the stock but the friend would also order more stock.

30 42. AN would not give HMRC details of the friend who had been stealing stock from the shop and it was estimated that approximately £10,000 worth of sales had been involved. AN would not involve the police because of her concern for the friend and her family and, in evidence, AN confirmed that the friend was in a responsible job that she would otherwise lose.

35 43. Neither the friend nor any member of the family received any payment for their help given in the shop and AN had only become aware of a problem when she was told by customers that stock was being removed and that sales were not being recorded through the till. AN also became suspicious when Davidsons' bills increased noticeably and AN discovered that the friend was adding orders on to AN's own stock orders and then stealing the goods.

44. WHC said that there was no corroboration of the thefts but AN said she would not supply any details.

40 45. Further discussion took place in relation to pricing policy and although AN stated that she would be able to give only limited information of the pricing policy in the

year because of her health problems and she was unsure if the prices had changed at all.

5 46. On 26 March 2009 a note of this meeting was sent asking for intimation of any disagreements with its content. None were received. Further independent verification of AN's illness was requested. This was not received. WW stated that they were reticent in asking AN to obtain information from her GP regarding her health as it might cause her more distress "not to mention the costs incurred in such a request".

10 47. On 31 March 2009, WW stated that it was difficult to calculate the cost of the theft caused by a mixture of stock and cash that had been misappropriated but an explanation was made that the theft of two cartons of cigarettes a week for £50, groceries of £75 and cash of £125 would support the missing amount.

15 48. On 7 July 2009, HMRC wrote to WW stating that having reviewed the records from Davidsons the pattern of purchases, assuming an annualised figure for the period ended 31 October was correct and was very similar to the years ended 31 October 2007 and enclosed a revised sales analysis based on a sample for three months and calculated a mark up rate before wastage and theft of 17.5% and a gross profit margin of 14.88%.

20 49. On 15 July 2009, WW responded that he fundamentally disagreed with the calculation and said that the purchase figure for the year in question should have been reduced by £15,479 as opposed to sales being increased by this amount. Furthermore, WW stated that the period of trade taken for this exercise did not reflect profitability of the business during the year in question.

25 50. At this stage, an enquiry in to the VAT returns of Sandvale Licensed Grocers was issued and the books and records were received by HMRC on 26 February 2010. Consequently, BH of HMRC became involved and a further meeting took place on 11 May 2010 which was primarily to discuss VAT issues. Both WHC and BH were present as were WW and AN.

51. The note of this meeting was confirmed by BH in examination and cross examination.

30 52. Comments on the meeting note were sent by letter of 22 July 2010 by WW to BH and on 23 July 2010, WW wrote to HMRC stating that they believed the records to 31 October 2005 to be robust and that it was standard procedure, when dealing with single entry accounts preparation to deal with any cash differences, to credit sales if the balance is in credit and debit personal drawings if the balance is in debit. 35 Accordingly, there was no loss to HMRC.

40 53. BH gave evidence to say that he had visited Sandvale Licensed Grocers, primarily with a view to checking the till and that this had proved to be satisfactory as regards programming and that he had found nothing contentious. His major concern was that the till audit rolls had been kept for only three months and then destroyed and, on 28 July 2010, AN was reminded that she was required by law to keep these for six years.

54. On 21 October 2010, HMRC wrote to AN with a business model, which allowing for a 5% wastage rate in calculating the mark up rates used by HMRC, provided a gross profit ratio of 12.75% and an overall mark up of 14.61%. An explanation of the mark up rates was provided. This was then translated into a revised “profit build up account” for the year ended 31 October 2005 and resulted in an adjusted additional profit rounded to £32,000. This process was then applied to the other years including the tax year 2007-2008 which covered a 17 month period and resulted in additional profits for the tax year 2004-2005 of £30,000, 2005-2006 of £32,000, 2006-2007 of £32,000, 2007-2008 of £42,500 and 2008-2009 of £28,000. This produced additional duties of £47,697.15.

55. On 15 November 2010, having made complaints about the delay in receiving documents from HMRC, WW responded that the business model failed to take account of VAT on the sales margin, that there were no ghost sales and that HMRC were happy with the till system. Consequently, WW said that the business model contained fundamental errors.

56. On 16 November 2010, HMRC responded stating the business exercise marked up net of VAT purchases and, as such, arrived at a figure of sales net of VAT; that they accepted that no suppression of purchases had been found in respect of suppliers contacted and that this was not the basis of concerns over recorded sales and confirmed that the HMRC VAT visit, although happy with the till system, did not provide satisfaction that all sales had been fully recorded through the till.

57. An appeal was intimated on 17 November 2010.

58. The results of an independent review were issued by HMRC on 16 September 2011 and concluded that AN’s rate of gross profit was not credible and that HMRC’s compiled figures which calculated a gross profit in the region of 12.75% were correct; that AN’s records had not been based on a robust bookkeeping system and were, therefore, incomplete and her tax return was, therefore, incorrect.

59. The review was founded on AN’s statement that the business practice had not changed for ten years so, in the general presumption of continuity, WHC had used his findings to look at other returns and had based his adjustments on what he found.

60. KMC who had worked for WW for four years gave evidence setting out her duties and explaining how the VAT returns, till rolls and daily sheets were utilised.

61. One of these important sheets was entitled “Paid in Cash”. It became evident throughout the Hearing that these payments were not all cash because Davidsons Cash & Carry amounts appearing in the list were purchased by means of a credit account and that cash payments were made to Davidsons’ every other day from the till. These were itemised under the “Paid into Bank” part of the daily sheet.

62. In addition to the Pay Point system, it was explained that during the period of the assessments under Appeal, a lottery machine was installed which had a beneficial effect on sales.

5 63. Evidence was led in relation to a report on gross margin prepared by WW stating “since the client records all sales from the ‘z total’ on the till, if we secure the purchase invoices then we can report the gross margin achieved. If we accept that there will be no material movement in stock held then the results are easily conclusive”.

10 64. The report used the sample period 1 November to 21 November 2010 and referred to a listing of 811 sales detailing every purchase invoice that was presented in the period, with each item attributed a net and a gross price and, where appropriate the “flashed” price, ie the price printed on the side of the packaging to be paid for by the retail customer. All costs of sales and overhead items were included in the spreadsheet.

65. Accompanying this was a further spreadsheet “GM1” being a listing of 665 sales which had been reviewed by AN to confirm the actual price achieved but excluding overhead items and cleaning.

15 66. The GM1 sales report showed the sales for the same period with the gross margin percentage mark up on the selling price. A GM2 report showed the overall gross margin percentage.

20 67. At the Tribunal hearing there was considerable discussion about the GM1 report which produced a gross profit margin of 9.94%. A further examination by the Tribunal of the figures in this document showed that the total of the column headed ‘Profit’ of £150.90 should be reduced by £11.50 in respect of the cost of blue recycled carrier bags, which were not and never were intended to be items for resale.

68. WW accepted the validity of excluding the aforementioned item and the effect of this exclusion resulted in a gross profit margin of approximately 10.7% .

25 69. An analysis of the GM2 document, to confirm the percentage profit, set out a figure for sales from which was deducted a figure for purchases, but these in turn had been increased by adding 8% to the cost of purchases to represent wastage. The level of 8% which had been provided by AN. WW believed this was a robust and correct calculation of a percentage of stock going off or past its expiry date or shoplifted, and
30 produced a gross profit percentage of 9.50%.

70. The Tribunal questioned why the wastages had been added to the purchases as the purchases were already fully stated. The effect of adding estimated wastage to the purchases had the effect of underestimating the gross profit margin. Also, following through the calculation of the purchases figures, there seemed to be no account taken
35 of the own goods which had been admitted by AN were taken on a regular basis. If, as WW had stated, there was no stock movement, the cost of goods sold was accordingly overstated.

40 71. The Tribunal concluded that this was not a reliable piece of evidence and WW stated that notwithstanding that there may be some variances on the accounting treatment, the basic position was that there had been considerable theft from the

business and a break in and WW maintained that the prices used were valid because the client had sat in on the exercise.

5 72. On cross examination, HMRC said that the exercise carried out in 2010 contained stock items that were not for sale on 17 June 2008 which is the date the prices had been used in order to recreate the 2006 prices based on the assertion by AN that the pricing policy had not changed.

73. AN gave evidence and pointed out that having been trading for over 32 years and having had two VAT visits, there had been no request to change anything and no penalties had been payable.

10 74. AN was asked by WW if she or her family had the means to pay £47,697 demanded by HMRC to which AN replied that she did not and that if she had to pay she would lose everything. AN stated the investigation had been going for six years and had caused her much distress. Reference was made to the meeting of 17 June and AN confirmed that her mortgage was still £36,000 and that she had endowment shortfalls with policies with the Bank of Ireland and Standard Life.

15 75. AN also stated that no close family members could help as her son was insolvent, that no other family members were holding funds that could help and that AN had “no other funds”; that the value of the stock in the shop was between £8,000 and £12,000 and that the lease to the local council for the shop premises came to an end in the current year, 2012.

76. When questioned by the Tribunal as to the payments made to the neighbour in relation to the house adjoining AN’s house, it was subsequently ascertained that AN owned the adjoining house and it was mortgage free.

25 77. AN stated that she had suffered from stress, marital breakdown and was receiving medication, primarily sleeping pills, painkillers and anti-inflammatory drugs and that her relationship with her husband had deteriorated as they were arguing over money.

78. AN said she did not wish to report the friend who had allegedly stolen £10,000 worth of cash or stock. This individual was named at the hearing but AN could not remember when she started working.

30 79. AN described the considerable competition from many grocery and licensed premises in the vicinity, the refurbishment of competitors’ premises using family money, the options of her shop as regard passing motor vehicle trade and visiting ice cream vans. AN considered that, although having regular customers, pricing was key to retaining their business.

35 80. WHC gave evidence and confirmed his concerns about the cash adjustment and the level of profitability. He had concerns about the amounts of cash, at least £18,000 retained in AN’s house; the lack of any record of drawings; that the procedures followed were standard for recreating a profit margin and an adjusted figure of profits.

81. He stated there was no evidence that the friend had ever worked in the shop; there was no corroborating evidence that the friend had stolen from the shop and expressed considerable surprise that the matter had not been reported to the police.

5 82. WHC conceded that the amount of wastage in a licensed grocers business with this mix of sales would be difficult to quantify exactly but felt that 5% was a fair estimation and stated that 40% of the purchases being cigarettes and alcohol attracted very little wastage.

10 83. WW referred to what he believed were the errors contained in WHC's letter of 6 June, being items listed but not analysed, where no dates were ordered and that there was no indication of how the gross profit percentage was achieved.

84. In response, WHC stated that he did not accept that there were major errors in the spreadsheet and it was, in any event, amended but provided no material difference in result; that he had carried out a 12 months exercise after WW had complained that a three month exercise was an insufficiently long period for the sample.

15 85. WHC was asked to confirm the prices shown in the photographs produced by AN but WHC stated he did not know when the pictures were taken and that although the prices were higher than the ones he had used he was confident that the prices used in 2008 were correct.

20 86. The Tribunal questioned WHC as to whether he had asked if there were any unrecorded expenses and he responded that he had asked this but not specifically about casual wages because he had been told that no monies had been paid.

87. WHC stated that the drawings analysis showed no cash drawings and, at the meetings with AN, confirmation had been received that these ranged from zero to £200 per week for which there was no record.

25 88. BH gave evidence to the reason for the VAT enquiry and what took place as a result of that enquiry which primarily was related to a two hour visit asking basic questions and checking the till for programming.

30 89. It was stated that, as the issues discovered by HMRC in relation to the income tax enquiry related to carelessness and negligence, any reclaim of VAT was out of time in terms of the VAT regulations.

90. Throughout AN's evidence, WW made reference to a number of external publications, being those produced by an information provider, CCH, such as "the grocery trade", "factors affecting ratios" and "wastage".

35 91. Reference was also made to an HMRC publication which set out the basic records that are required to be kept including a list of all sales and other income, a list of expenditure including day to day expenses and equipment, a separate list for petty cash expenditure of relevance, a record of goods taken for personal use and payments to the business for these and back up documents for all the above.

5 92. During the hearing it was suggested that no balance sheets had been drawn up but on the second day of the hearing a balance sheet was produced for AN to 31 October 2006 showing the opening balances as at 30 October 2005. It was accepted this was only a snapshot but the Tribunal had a number of concerns relating to this.

10 93. The opening figure of trade creditors which it was ascertained related to the Davidsons Cash & Carry seemed very similar to the closing figure, 12 months later and, indeed, was slightly higher and, consequently, the Tribunal were unclear as to where the increased totals, as a result of the theft, were reflected in these figures, particularly the opening figure. WW said that the total had fluctuated throughout the year.

15 94. It was also unclear why the item "Pay Point creditor" was contained within current assets and WW suggested that this was an error and that it should have been offset against the VAT liability but the relationship as to why this offset should take place remained unclear.

95. WW accepted that the balance sheet might be incorrect.

AN's Submissions

20 96. AN says that income and expenditure are different from capital and referred to the great emphasis put on unrecorded drawings by HMRC; that as drawings are not allowed for tax relief there is no need to show them on tax returns and that drawings are not a capital transaction and as there can be an abuse of the tax system, the only way to stop it is to have bank reconciliations, test check the z readings from till rolls for the whole year and carry out a cash reconciliation for the year in the accounts.

25 97. AN says that if it is assumed that all sales are on weekly cash sheets and cash expenses have been paid out and bankings confirmed to the amounts lodged in the bank then any cash balance in credit would suggest suppressed sales and any cash balance in debit would suggest drawings taken by the client.

30 98. AN says that the amount of drawings was confirmed by the client at various meetings including goods taken for own consumption. On a strict basis, if these had been put through the business accounts as purchases it would have secured relief which was not due.

99. AN says the term "uplift to sales" can be emotive and that, if you reconcile a balance sheet, you should have some comfort that all items on the balance sheet will be reflected through an income expenditure account or a profit and loss account.

35 100. AN says she offered to take part in a mediation exercise with HMRC in relation to a pilot scheme, went to all the meetings and produced a means test although there was no statutory requirement to do so.

101. AN says she had mental health issues which were a significant factor and that advantage was taken of her by her friend during a vulnerable period in her life and that the resulting gross profit which was low was explained by the theft.

5 102. AN says that the HMRC business economics exercises were refuted more than three times with comparisons to actual prices and to photographs of stock; that the extensive evidence, the CCH documents and confirmation the shop is not a high performing shop and in an area with challenging and difficult trading conditions are relevant.

10 103. AN says that the records are robust which is evidenced by HMRC's acceptance that they have never once found a z total not in agreement with the daily sheets and that the VAT inspection of the till found nothing contentious; that z totals and slips are time sensitive; and questions where the £32,000 is, if it has been received.

15 104. AN says that the friend's stealing appears "risky" but said that the friend was dismissed, that the gross profit margin was reduced and that there was, at the time, no CCTV evidence, that all statements have been made to the best of her ability and honestly under oath and says the assessments are not robust because they are excessive and, accordingly, that the Appeal should be allowed.

HMRC's Submissions

20 105. HMRC say that the records are incomplete; that the limited records that were produced provide no information for the amounts of own goods, the amount of cash drawings, creditors, opening and closing stock and, accordingly, it was necessary for a cash balancing figure to be introduced.

25 106. HMRC say that AN received commission from Pay Point but that there were no records of the income and the same applied to the ancillary services provided by AN, although HMRC concede these amounts may be at a small level.

30 107. HMRC refer to the requirements under the Taxes Management Act for record keeping and although the reference at Section 12B of the Taxes Management Act 1970 does not provide actual detailed guidance, it does say at paragraph 1(a) "keep all such records as may be requisite for the purpose of enabling the tax payer to make and deliver a correct and complete return for the year or period". HMRC say the word "all" means all and refer to the requirement to keep records for the six year period which was also disregarded in relation to the till rolls so that had HMRC wanted to see these, they could not have done so.

35 108. HMRC say that, based on the incomplete records, they had to carry out an exercise to test the accuracy of the returns. This was done for three months and then having being told this was insufficient, for twelve months.

109. HMRC say that their business model exercise is robust based on AN's statement that there had been no material changes in pricing policy over the last ten years. As the data for the initial year under enquiry was unavailable, data at 2008 and relying on

the statement was sufficient and WHC had visited the shop to take a note of the prices.

110. Notes of the minutes of the meetings were sent but no amendments were made or received.

5 111. An alternative dispute resolution pilot exercise took place on 20 June 2011 but no agreement was reached.

112. A comparison took place of the margins and data used by the HMRC and by WW/AN for tobacco products and all the other categories of product which showed marked differences in every respect. HMRC said that no explanation on contemporary evidence had been produced to substantiate WW's 2010 mark up rates.

113. HMRC say the onus of proof lies with AN; that there is no corroboration of the theft and no analysis of what was stolen and so it was not clear whether it was goods or cash stolen or, if both, nor in what proportions.

15 114. HMRC say that AN was given every opportunity to produce further information but did not do so.

115. HMRC say that the assessments should be upheld.

Penalties

116. HMRC say that the penalties are appropriate.

20 117. The penalties for the years 2004-2005 to 2007-2008 were raised under Section 95 of the Taxes Management Act 1970 and under Section 24 of the Finance Act 2007 for the year 2008-2009.

25 118. HMRC say that, whereas a higher penalty would be applicable for the earlier years, the level should be consistent and that the penalty loading of 30% was reasonable under the new rules for 2008-2009. They, therefore, applied 30% to all years because there had been no disclosure and a lack of cooperation and delays.

119. The total penalties on tax amount to £14,307 on tax due of £48,661.34.

120. AN says the penalties are excessive.

Reasons for the Decision

30 121. The Tribunal were mindful and sympathetic to AN's health and marital problems and to the difficult and competitive trading conditions in which her business operated in Airdrie.

122. The starting point was that once HMRC had initiated their investigation and, particularly in the absence of till rolls, all of which require to be kept for a period of

six years in terms of the Taxes Statutes, it, of necessity, became necessary for HMRC to satisfy their enquiries by other means.

5 123. The reasons for the enquiry was because HMRC ascertained that there was a shortfall in cash which had been credited to sales and they questioned the accuracy of the sales records.

124. HMRC could find no record of drawings other than adjustments made for own goods taken from the shop and the private use of a motor vehicle and AN had indicated that between zero and £200 per week was taken from cash. HMRC were also concerned that the returned gross margin was very low.

10 125. As a result of the lack of actual records, the accounts initially for the year ended 31 October 2005 had to be recalculated and reasonable assumptions used.

15 126. Based on AN's assurances, HMRC based mark up figures on a review of costs, manufacturer's recommended retail prices and actual shop prices at June 2008 and purchase costs based on a review of products bought in the year ended 31 October 2005.

127. WW, on AN's behalf, noted that there were some discrepancies in these business models and objected to a three month sample recommending that a 12 month sample would be more representative. This was carried out and provided a simple average mark up of 14.6% and a gross profit ratio of 12.7%.

20 128. It is clear that subsequent work carried out in relation to the Appeal used prices at 2010 and there was an element in both models of some purchases being available in 2008 but not in 2010 and vice versa.

25 129. The Tribunal had more confidence in the 2008 figures which were prepared against a background of an initial enquiry as against the 2010 figures which were much later and at a time when there was an increasingly protracted dispute.

130. The Tribunal also took into account the analysis and discussion of AN's computation GM2 which, when the adjustment for wastage is corrected, produced a much higher gross margin percentage than was reflected in the assessment.

30 131. The Tribunal concluded that the document GM1 was not robust in proving that the gross profit margin was 9.94% and, in any event, was significantly higher than the recorded figures for AN throughout four prior years.

35 132. The Tribunal noted that there was no record and some doubt in HMRC's mind that the friend who allegedly stole the goods ever existed and, if so, was ever employed and no evidence was given to the Tribunal, other than a name about the employee who was a friend of AN's sister and appeared to be "to all intents and purposes running the shop" which was open for nearly 13 hours a day, seven days a week for no remuneration whatsoever, a circumstance which is by no means commonplace.

133. The Tribunal also shared HMRC's lack of understanding as to why the thefts were not reported to the police. Even if that had resulted in no action being taken it would have provided corroboration that the events had taken place and the sentiment expressed by AN that the individual concerned might have lost her job, which was a job working with quite possibly vulnerable people, lacked credibility.

134. The Tribunal were similarly not persuaded by AN's credibility in relation to her direct assertion that she had no funds to pay any tax demand when, following the Tribunal's enquiry, it transpired she owned the house adjoining her own.

135. In answer to the assertion that money was being taken from the business which was required to fund AN's lifestyle, WW prepared a means test and this was a principal piece of evidence in his discussion with HMRC to the extent that their suspicions were unfounded. The Tribunal, again, had difficulties in giving a great deal of weight to this evidence.

136. It appeared to ignore cash drawings on the income side and, amongst other issues on the expenditure side, included the full costs of a holiday to the United States of America, which, in evidence, it had been said had been paid half in cash when the holiday was booked one year before (ie July 2004) and the remainder paid for by a credit card which seemed unlikely, given that the limit of AN's credit card was only £2,500.

137. It was unclear whether the statement purported to be one of actual cash received and cash paid as regards income and expenditure or whether, as was suggested by WW, some element of accruals and a prepayment in relation to the US holiday had been taken into account by WW.

138. In relation to the GM2 document, WW suggested that the Tribunal should ignore this document but it had been founded on and it seemed to have reached its gross percentage profit conclusion on the unsound basis of increasing purchases by an estimated wastage percentage.

139. The Tribunal also had difficulty in accepting the robustness of the information contained within the 31 October 2006 balance sheet and WW accepted that there were errors in the balance sheet which in the Tribunal's view were in part due to insufficient records being available.

140. WW, on AN's behalf, argued that the HMRC guidance and other information available in relation to grocery businesses restricted the amount of information that was required to be retained, that stock takes were not necessary and set out his basis for justifying the reason why the cash shortfall was credited to sales.

141. The Tribunal understood that full and extensive accounting records may not be required in practice but were of the view that the choice of which records to keep or not to keep had to be seen in the context of the requirement under the Taxes Management Act to "keep all such records as may be requisite for the purposes of enabling the taxpayer to make and deliver a correct and complete return for the year or period".

142. The Tribunal's view was that all requisite records had not been retained and specifically till rolls and that, in the circumstances, HMRC were justified in making their enquiries and using the process they chose.

5 143. In conclusion, the Tribunal considered the methodology and basis of HMRC's assessment was fair and reasonable.

144. The onus is on the taxpayer to prove why the assessments raised by HMRC are incorrect by putting forward sufficient evidence. Taking all the factors into account, the Tribunal were not satisfied with the weight of the evidence to overturn HMRC's assessments and, accordingly, this element of the Appeal is refused.

10 145. The next issue the Tribunal considered was the penalties and the efforts made to use the alternative dispute resolution mechanism and then the independent internal HMRC review process. AN had, in addition, attended all the interviews she was requested to attend.

15 146. There had clearly been issues of delay and incorrectly addressed correspondence by HMRC but overlying the whole of this dispute between AN and HMRC was a series of repeated requests for information which HMRC were entitled in statute to request but which were not complied with.

20 147. In addition, when the issues of AN's health were raised and a discovery of the theft took place, HMRC required independent verification of these matters which the Tribunal believe could have been simply achieved.

148. The Tribunal noted the abatement considered by HMRC and their decision to charge penalties at the rate of 30% when for part of the period this could have been much higher and, accordingly, uphold the level of penalties.

149. This aspect of the Appeal is also refused.

25 150. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision 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
30 "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

35 **W RUTHVEN GEMMELL, WS**
TRIBUNAL JUDGE

RELEASE DATE: 29 August 2012