[2018] UKFTT 0070 (TC)

TC06335

Appeal number: TC/2016/02326

VAT – whether turnover under-declared – assessment by HMRC on basis of capital introduced – whether correctly assessed to best judgment – no – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

THOMAS O'ROUKE T/A SOUTHGATES UK **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE FAIRPO
SONIA GABLE

Sitting in public at Norwich on 1 June 2017

Mr Simpson, accountant for the appellant

Mr Qureshi, presenting officer for the Respondents

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DECISION

Introduction

1. This is an appeal against an assessment for under-declared output VAT in the amount of £29,539 for VAT periods 06/11 to 09/14 inclusive, raised on 7 July 2015 under s73(1) VATA 1994.

Background

2. The appellant operates a business which sells second-hand vehicles and carries out repair work on vehicles.

3. The assessment was raised following a visit by the respondents (HMRC) to the appellant's premises on 5 November 2014, which was a follow up to an earlier visit in November 2011. HMRC also visited the appellant's accountants' premises on 18 November 2014.

4. HMRC examined the following records:

(1) Annual accounts workings 2011-2014

(2) On site appointments diary, with details of customers and when they are expected to arrive

(3) GB Prolite system used to produce sales invoices when work completed

(4) Sample purchases and sales invoices

(5) Sample job cards

(6) Second-hand margin scheme stock book, produced from job cards, purchase invoices and bank statements

(7) SAGE Line 50 back up

(8) Sample bank statements

(9) Detailed VAT records and supporting documents for VAT period 12/12

5. HMRC analysis of the documents highlighted the following areas of concern:

(1) Annual losses of £20,000 for 2011, £20,000 for 2012, £50,000 for 2013 and £74,000 for 2014.

(2) Financial year end figures described as capital introduced of £51,929 for FYE 31/7/11 and £35,000 for FYE 31/7/12, with no evidence to support capital introduced

(3) SAGE deficit figures which were described as covered by capital introduced of £50,757 for FYE 31/7/13 and £74,208 for FYE 31/8/14 (a 13 month period), with no evidence to support capital introduced

(4) Evidence that twelve cars had been purchased in VAT periods 03/14 and 06/14 but not recorded in the stock books or any VAT records. HMRC noted that grossed up over the period this predicted a shortfall of £11,536 in VAT

(5) Evidence of spare parts purchases in the VAT period 12/12 that could not be linked to any of the vehicles sold or on which repairs were undertaken

(6) Missing scrap sales, identified from bank statements and not declared for VAT purposes. HMRC noted that this gave rise to under-declared VAT of £480 for the periods 09/13 and 09/14 inclusive

(7) High levels of stock on hand of parts contradicting the appellant's statement that parts are only purchased when required, and increasing stock levels when the appellant had explained that parts were returned to the supplier if not required.

6. HMRC took the view that the losses were unsustainable and that it was not conceivable that someone would be able to continue to trade in these circumstances.

7. HMRC asked for an explanation of the discrepancies and evidence to support the capital introduction, which had been stated to be by way of mortgages and credit cards. As no substantive response to these requests had been received, an assessment was raised on 29 May 2015 for additional output VAT. The basis of the assessment was the "shortfall between declared sales and business costs indicating additional undeclared income". The assessment letter also refers to "car parts purchased that are not consistent with declared sales and unlikely to remain in stock on hand".

8. The appellant's accountant responded in October 2015, having obtained what records were available and brining the business records into line. The accountant provided HMRC with a review of the business from 1 April 2011 to 30 September 2014, showing an overall gross profit of 8.42% which the accountant described as "low but due to the circumstances … to be expected". The margin on vehicle sales was estimated to be 2.64%, with the margin on repairs being 12.7%. On the basis that estimates had been used, the accountant proposed an uplift on vehicle sales recorded to reflect a gross profit figure of 10%. The figures produced showed sales below the levels recorded in the VAT returns for the same period. The accountant confirmed that regular stock books and records were now being kept.

9. HMRC maintained their assessment. A formal review was requested on 30 December 2015. The review, on 17 March 2016, upheld the assessment. The appellant appealed to this tribunal on 22 April 2016, the delay in appealing being explained as being due to the appellant's illness. HMRC did not challenge the late appeal and so it was allowed to proceed.

Appellant's evidence and submissions

10. The appellant's accountant explained that there had been a number of problems with the business.

11. The business operated at the lower end of the second-hand market with very little mark-up on low selling prices. Due to a decline in business, the appellant's son had left in 2010 to work elsewhere and the appellant found it difficult to maintain the records whilst trying to keep the business going and deal with ill-health.

12. There had also been an ongoing problem with a spare parts supplier. Firstly, when parts were ordered it was not unusual to receive several variations on the same part. The unused parts were return unused to the supplier for credit. However, the staff at the supplier were paid bonuses which were based on targets for parts sold. Their performance against these targets was reduced by credits for returned parts and so were reluctant to process credits for parts returned. As the business needed to be able to access parts, the appellant had continued to pay for parts and tried to pursue credits for parts returned. The business was turning over approximately £1,000 per week, but he was being charged £800 per week for parts because he had to pay for all parts received and then try to pursue refunds for returns. Eventually the appellant stopped using this supplier. At the time he stopped using them, the supplier pursued the appellant for £6,000 as the balance left on account although this figure did not reflect the returns of parts which had been made.

13. As he was unable to pay this amount, and unable to defend the ensuing court case, they had obtained judgment against him. He had had to borrow money to meet the county court judgment, to avoid the bailiffs' action. The appellant had had to pay subsequent suppliers in cash to obtain parts as it took a while to be able to get credit again as a result of the judgment being on his record.

14. With regard to the twelve car purchases in 03/14 and 06/14, the appellant had purchased vehicles at auction for a third party who did not have an account needed to participate in auctions. The arrangement had been that the appellant would purchase the cars on behalf of the third party and then sell them on behalf of the third party, the commission for the appellant agreed being 50% of the profit on sale. The third party repaid the appellant for the purchases but took the cars before they could be sold. The appellant had not purchased the vehicles on his own behalf and was providing a service, for which he was not paid, rather than buying and selling goods on his own behalf. In fact, as he had carried out some minor repair work on some cars for which he was also not paid, the appellant had lost money on the transactions.

15. The accountant explained that the 'capital introduced' transactions were SAGE transactions to 'true up' the accounts and zero out losses for the relevant financial years. They were not intended to reflect payments of capital in the bank statements and should be regarded as the opposite of drawings: expenses of the business met by the appellant personally. As a result, the amounts could not be proven by entries in the business' bank statements.

16. The accountant could not explain why his analysis of the records of the business produced sales figures lower than those in the VAT returns submitted.

17. The appellant also explained his personal financial position: he was £16,000 in arrears on rent on the business premises (details were provided at the tribunal hearing)

and had a repossession order on his house which was currently suspended as he attempted to pay down arrears. He had purchased his house from the council for £28,000 some years ago. In order to support the business and to have funds to live on, he had remortgaged the house such that the mortgage on the house was now £101,000. Copies of mortgage statements had been provided to HMRC, although the representative for HMRC was not aware of seeing these and neither were they in the bundle. The appellant had taken out a number of loans totalling approximately £10,000 (details provided at the tribunal hearing) in order to have funds available.

18. The appellant explained that he had a reasonably tough reputation in the area and, as a result of this reputation, the appellant did not believe that he could get a job in another garage and did not want to go on the dole. He considered that his only option was to try to carry on with this business, although he was barely managing to live week to week. His wife had gone to work for the first time, in a supermarket, to help to pay bills. They had not taken a holiday for over six years, and the appellant had not drawn any wage from the business for over three years. He did not have the kind of lifestyle that would reflect the type of money that HMRC had indicated with their assessment.

19. For the appellant it was submitted that HMRC had not considered all of the evidence and that the appellant's accountants' analysis should be preferred.

HMRC evidence and submissions

20. HMRC submitted that the records of the business were not consistent and were incomplete, so that it was not possible to reconcile the VAT returns with the underlying records and invoices.

21. With regard to the cars purchased and to be sold on commission for a third party, HMRC submitted that these should not be regarded as contributing to loss figures as the appellant had stated that he had not lost any money on the purchases.

22. With regard to the problems with the parts supplier, HMRC noted that the annual accounts had shown stock on hand increasing, and any returns should have been reflected in the accounts. It was also submitted that the only figure which should be accepted for returns is £6,000 as that was the amount for which a county court judgment was obtained, and that such an amount did not justify the loss levels in the accounts.

23. The officer had raised the assessment on the figures available from the accounts of the appellant as other figures could not be confirmed and cross-referenced. Evidence had not been provided to support the narrative as to the debts of the company: no mortgage statements or credit card statements, for example, had been provided. Accordingly, in the absence of any such records and evidence, HMRC had taken the "capital introduced" and "deficits" figures from the SAGE records as being sales amounts under-declared.

24. Following the principles in the case of *Van Boeckel v Customs and Excise Commissioners* [1981] STC 290, in the absence of records giving a true picture of the VAT declared and claimed, it was submitted that HMRC had correctly relied upon the annual accounts as the basis of their assessment. In the absence of proper records and, as the output tax declared on the VAT returns was greater than the amounts analysed by the appellant's accountant, it was submitted that the amounts set out in the assessment had been correctly assessed to best judgement and that the appellant had not shown that an alternative amount of tax was correctly payable.

Relevant law

25. Section 73(1) of the Value Added Tax Act provides:

> "Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him."

Discussion

26. We considered the appellant's evidence and found him to be a credible witness. We do, however, agree with his assessment that his "paperwork is terrible".

27. We agree with HMRC's submission that the cars purchased on behalf of a third party should not be regarded as contributing to the losses but, equally, neither can they be considered to be evidence of suppression of sales.

28. With regard to HMRC's submission that the problems with parts are not supported by the fact that the accounts show stock on hand increasing, and that returns should have been reflected in the accounts, we note that it is not possible to conclude from an increase in stock on hand that there was no such problem with the supplier. Further, we consider that an increase in stock on hand could support the view that parts received were not being used in repairs and may also reflect the fact that credit notes had not been received. We do not agree that the returned parts should be regarded as amounting only to £6,000 on the basis that this was the amount for which a county court judgment was obtained: that judgment shows only that an amount of £6,000 was considered to be due to the supplier.

Decision

29. The meaning of 'best judgment' is agreed to be set out in *Van Boeckel v Customs and Excise Commissioners* [1981] STC 290:

> "What the words 'best of their judgment' envisage, in my view, is that the Commissioners will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due. As

long as there is some material on which the Commissioners can reasonably act then they are not required to carry out investigations which may or may not result in further material being placed before them" (at p 292)

30. Further guidance was given in Carnwath J in *Rahman (t/a Khayam Restaurant) v CEC* [1998] STC 826 (at 835):

> "… there are dangers in taking Woolf J's analysis of the concept of "best judgment" out of context … the tribunal should not treat an assessment as invalid merely because it disagrees as to how the judgment should have been exercised. A much stronger finding is required; for example, that the assessment had been reached "dishonestly or vindictively or capriciously"; or is "spurious estimate or guess in which all elements of judgment are missing"; or is "wholly unreasonable". In substance those tests are indistinguishable from the familiar *Wednesbury* principles (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223). Short of such a finding, there is no justification for setting aside the assessment."

31. In effect, in exercising best judgment an HMRC officer is simply required not to be arbitrary or to guess, he must not act from wrong motives, and he is required not to act wholly unreasonably. But he is not required to be as right as it is possible to be.

32. The position was also confirmed in in *Customs and Excise Commissioners v Pegasus Birds Ltd* [2004] EWCA Civ 1015 which then cautioned against allowing an appeal routinely to become an investigation of the *bona fides* or rationality of the "best of judgment" assessment made by Customs:

> "The tribunal should remember that its primary task is to find the correct amount of tax, so far as possible on the material properly available to it, the burden resting on the taxpayer. In all but very exceptional cases, that should be the focus of the hearing, and the Tribunal should not allow it to be diverted into an attack on the Commissioners' exercise of judgment at the time of the assessment." (para 38(i))

33. HMRC's assessment was based on one set of figures: those described as being "capital introduced" or "deficits" in the SAGE accounts. The assessment has proceeded on the assumption that these figures must in their entirety be under-declared sales and, in effect, refute the possibility that the appellant made any losses in the relevant periods.

34. HMRC's evidence is that there were large cash withdrawals which might have represented purchases of vehicles, but no details of how much such withdrawals amounted to were given and so no consideration was given as to whether the amounts withdrawn on a pro rata basis would support the 'capital introduced'/'deficits' amounts being treated entirely as under-declared sales.

35. Similarly, HMRC stated that the parts purchases did not match to sales declared but gave no details of the amount of such parts purchases, and so they also did not

indicate whether those purchases would support the 'capital introduced'/'deficits' amounts being treated entirely as under-declared sales.

36. Although we accept that HMRC were working with limited information we find that they considered only one aspect of that information and did not demonstrate whether that one aspect was supported by other information which they stated that they had in their possession. Whilst it is not up to HMRC to carry out exhaustive investigations in order to establish upon which to base an accurate assessment, they should not ignore material in their possession in determining whether their assessment is reasonable.

37. We find, therefore that HMRC's assessment was not made to best judgment; HMRC selected a particular entry from each of the accounts on which to base their assessment and did not use other material in their possession to confirm whether or not it was reasonable to base the assessment on that accounts entry.

38. We have borne in mind the caution in *Pegasus Birds* but consider that, in this case, HMRC have simply guessed that the losses in the accounts must be under-declared sales. Whilst some element of guess-work is inevitable in assessments, we consider that HMRC must, in exercising best judgment, use any other information available to them to consider whether that information supports that element of guess-work. They have not done so in this case and for the reasons set out above, the assessments to VAT are not to best judgement and so cannot stand as they are.

39. As far as possible, our primary task is to find the correct amount of tax on the material available. However, we cannot determine whether the assessment should be quashed altogether or be assessed for a different amount as we were simply not provided with sufficient information even to determine whether there was any element of under-declaration, as submitted by HMRC, or of over-declaration, as apparently indicated by the appellant's accountants' analysis.

40. We direct that the VAT assessments should be reviewed by HMRC to take into account the appellant's evidence as to his mortgage and other debts, together with evidence already held by HMRC and any evidence from the appellant's accountant as to the methodology used to produce their figures.

41. If HMRC consider, in the light of such evidence, that assessments are still required then the VAT assessment should be recomputed taking into account such information and, to the extent still needed, best judgement. In the absence of agreement between the parties as to any revised VAT assessments, then the matter should be brought back before this Tribunal for determination.

42. 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

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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ANNE FAIRPO
TRIBUNAL JUDGE

RELEASE DATE: 10 FEBRUARY 2018

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