TC06947

Appeal number: TC/2016/07217

VALUE ADDED TAX – retail scheme – assessment – undeclared output tax – penalties – deliberate suppression of takings – established for two accounting periods – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

CHAUHAN **Appellant**
t/a
ONE STOP SHOP

- and -

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

TRIBUNAL: JUDGE JONATHAN CANNAN
MR TONY HENNESSEY FCA

Sitting in public in Manchester on 16 October 2018

Mr Hitesh Patel of Bohemia Chartered Certified Accountants for the Appellant

Mr Gareth Hilton of HM Revenue and Customs for the Respondents

DECISION

Introduction

1. The appellant is a partnership of 3 brothers, Mr Nilesh Chauhan, Mr Hasmukh Chauhan and Mr Shantilal Chauhan. The partnership operates a small retail convenience store in Chorley under the name One Stop Shop. The appeal is against assessments to VAT for accounting periods 01/11, 07/14 and 10/14 and against penalties in respect of accounting periods 01/11 to 10/14. The amount of VAT in dispute is £12,277 and the penalties in dispute are £11,550.

2. The issues which arise for determination are as follows:

   (1) whether the appellant understated the amount of output tax for which it was required to account, and

   (2) if so, whether it do so deliberately or carelessly.

3. There are further assessments to VAT for accounting periods 04/11 to 10/14 which are not in dispute. Those assessments total £13,264 and to that extent only, the appellant accepts that output tax was understated in the returns for those periods. However, it says that responsibility for those understatements rests with the partnership's former accountants and that no penalties should be imposed. In relation to the assessments and penalties in dispute the appellant contends that there has been no understatement of output tax.

4. The burden is on the appellant to satisfy us on the evidence that the assessments to VAT are excessive. In relation to the penalties the burden is on the respondents ("HMRC") to satisfy us on the evidence that the appellant deliberately or carelessly understated its liability to account for output tax.

5. We heard evidence from 3 witnesses on behalf of HMRC. Ms Jennifer Hindle, the officer who made the assessments and notified the penalties and Mr Gareth Thomas and Ms Johanna Wood, both specialist officers who obtained and analysed electronic data from the appellant's electronic point of sale ("EPOS") till system. On behalf of the appellant we heard evidence from Mr Hitesh Patel of Bohemia Chartered Certified Accountants, who represented the appellant at the hearing before us, and from Mr Nilesh Chauhan ("Mr Chauhan") who is one of the partners.

6. All witnesses made witness statements, gave oral evidence and were cross examined. Based on that evidence and on the documentary evidence before us we make the findings of fact set out below. First, we say a little about accounting for VAT using retail schemes, and in particular Direct Calculation Scheme 1.

Direct Calculation Scheme 1

7. The operation of VAT can pose practical problems for retailers, in particular ascertaining the output tax due where a retailer has sales at different rates of VAT. The Value Added Tax Act 1994 makes provision for retailers in certain circumstances to use one of a number of methods set out in a notice published by HMRC, known as

retail schemes. The retail scheme which the appellant intended to use for all accounting periods under consideration is known as Direct Calculation Scheme 1 ("DCS1"). It is governed by *Notice 727/5 Retail Schemes: How to Work the Direct Calculation Schemes*, which in part has the force of law. DCS1 involves calculating the expected selling price of goods at one or more rates of VAT in order to establish the proportion of daily gross takings on which output tax is due. Direct Calculation Scheme 2 is the same as DCS1 but involves an annual stock adjustment.

8. DCS1 requires a retailer to calculate the expected selling price of "minority goods", which are the goods at the rate of tax which forms the smallest proportion of retail sales. If zero rated goods are the minority goods, the retailer calculates the expected selling price of zero rated goods and deducts this from the daily gross takings. This gives a figure for standard rated sales and the VAT fraction is applied to that figure to give the output tax liability on those sales. The retailer is required to keep a record of its daily gross takings and any working papers used to calculate the output tax liability.

9. Retailers using DCS1 may use the estimated selling price of "majority goods" if it is more straightforward for them to do so. For example, newsagents may find it easier to use expected selling prices for the sale of newspapers and magazines because there will be fewer purchase records compared to minority standard rated sales of tobacco and confectionery.

10. Where a trader uses a retail scheme there is no need to rely on any VAT calculation which may be done by a till system. The till may simply be used to record the daily gross takings.

Findings of Fact

11. The appellant trades from shop premises which were purchased about 27 years ago. The shop became a Londis convenience store about 15 years ago. In 2011 there was a refit at the shop. Until 2014 the shop opening hours were Monday – Saturday 8am to 10pm and Sunday 9am to 10pm. In or about 2014 the shop started to sell newspapers and from then on it opened an hour earlier each day.

12. Since about 2011 the appellant has operated an EPOS till system using a bar code scanner. When an item is scanned the till records the retail price of the item and allocates the transaction to one of a number of "departments", such as tobacco, sweets, groceries or beers. In order to do this the relevant information about each product on sale must be scanned into the till system software. The software operated by the till is known as the "back office".

13. Mr Chauhan stated and we accept that he uses the EPOS till because he is required to do so by Londis. He is not a technical person and on occasion he has difficulties using the till, as do the appellant's staff. For example, if an item does not scan properly he overrides the till and makes a manual entry. Pricing mistakes can also be made, for example prices input into the back office might not reflect special offers, in which case the transaction is corrected on the till and the price is entered manually. Void sales might be recorded where, for example, a customer pays by credit card but the card is declined.

14. First thing each morning Mr Chauhan reconciles the takings for the previous day to the till record for that day and then prints off a z reading showing the daily gross takings. Daily gross takings figures from the till records are used to carry out the DCS1 calculations for each VAT accounting period.

15. The appellant uses the services of an accountant to prepare and submit VAT returns, year-end accounts and self-assessment returns. This includes preparing DCS1 calculations to be used in the VAT returns. At all material times until October 2016 the appellant used the services of Mr Jayant Shah, accountant. HMRC's enquiry started in 2013 and Mr Chauhan told us that by October 2016 he had lost faith in Mr Shah. He said that he was concerned at the way Mr Shah was dealing with HMRC's enquiries and considered that the DCS1 calculations submitted by Mr Shah on behalf of the appellant "grossly misrepresented" the appellant's business.

16. Ms Hindle made an unannounced visit to the appellant's premises on 25 January 2013 and subsequently arranged to check the appellant's books and records at the offices of Mr Shah in Huddersfield. Ms Hindle identified what she considered to be a large number of corrections being put through the till and pointed these out to Mr Shah in a letter dated 4 July 2013. She also considered that the average transaction values for tobacco, beer, wines and spirits were very low. Ms Hindle arranged a further visit to the appellant's premises on 18 June 2014.

17. At the visit on 18 June 2014 Ms Hindle met with Mr Chauhan. Mr Chauhan agreed in future to keep a record of corrections entered into the till.

18. On 29 July 2014 Mr Thomas made an unannounced visit to the appellant's premises in order to interrogate the EPOS till system. He was accompanied by Ms Hindle and another officer. Mr Chauhan and a staff member were present at the premises. Mr Thomas obtained sales data for a 60 day period between 31 May 2014 and 29 July 2014. He identified what he regarded as a number of unusual "refund/negative" value transactions being processed at the very start of each day, before the shop opened. The till description for these items was "Faulty". The transactions were almost all rounded to the nearest pound and of amounts up to £1,000. There were 295 such transactions and the total value was £30,950.34.

19. Mr Thomas acknowledged and we accept that incorrect information may be mistakenly inputted into the till back office. He also acknowledged and we accept that sales may be recorded in the till manually without scanning, and that mistakes could be made with manual entries.

20. Mr Chauhan's explanation in evidence was that every morning when he opened the shop he would count the cash and compare it to the till readings. Where necessary he would adjust the till before doing the z reading. For example, if there was £1,000 in cash but the till record showed takings of £800 he would correct the till. This might arise where Paypoint or lottery scratch card transactions were not entered into the till. If there was less cash than the till record showed he would deduct the difference from the till because "more had been tilled-in than should have been". Adjustments would generally be rounded up or down to the nearest pound. He did not recognise the till description of "Faulty" but accepted that these were "item corrections" he had put

through the till. Mr Chauhan had no explanation as to why there were 295 such corrections being made over a 60 day period.

21. On 16 September 2014 Ms Wood made an unannounced visit to the appellant's premises in order to interrogate the EPOS till system further. She was accompanied by Mr Thomas and Mr Chauhan was present. Ms Wood obtained sales data for the period between 30 July 2014 and 15 September 2014. She recorded the following matters in a report of the visit dated 26 September 2014:

(1) The till records showed four deductions totalling £298 at the very start of trading on 31 July 2014 described as "Faulty". After 31 July 2014 there were no adjustments at the start of the day.

(2) The average daily gross takings recorded by the till in the data extracted for both visits was broadly the same, approximately £1,700 per day. However, Ms Wood identified that the average number of transactions in the period looked at by Mr Thomas was 488 per day compared to 429 per day in the period for which she had obtained sales data. Based on an average transaction value of £3.66 she estimated that there was a potential understatement of declared turnover of £10,101.

(3) Ms Wood identified that there was a large item correction of £5,050 on 29 August 2014 and four large "void sales" totalling £3,779 in the period she was looking at. There was no earlier entry which these were correcting. Apart from these entries, the majority of item corrections were for lower values where the entry could be seen to correct an earlier entry in the till.

22. Ms Wood's evidence was limited to what she had recorded in her report. The underlying data was not in evidence because of a problem with the server on which she had saved the data. However, we are satisfied that the appellant was given a USB stick at the time of the visit which would have had the same data on it. The appellant therefore had an opportunity to challenge the matters which Ms Wood had noted in her evidence. Mr Chauhan stated that he had given the USB stick to Mr Shah, but there was no reason why the appellant should not have asked the Tribunal to direct Mr Shah to produce that evidence. We are satisfied that Ms Wood's report is an accurate summary of the till data which she extracted.

23. Mr Chauhan's evidence was that after July 2014 he stopped making early morning corrections to the till. He said that he was told by Mr Shah that he should not make such corrections because it was "not right".

24. Mr Chauhan suggested that the item correction of £5,050 might have been an incorrect entry for an item which was priced at £5.50. When it was put to him that there was no earlier entry which might have been corrected he could offer no explanation for the item, despite the fact that he had previously agreed to keep a record of item corrections. Mr Chauhan told us that he asked staff making a correction to print a receipt off for him to collect the next morning and attach to the z reading. He said that he gave these to Mr Shah but they have not been produced in evidence. Mr Chauhan said that this was because he could not get hold of Mr Shah. Again, there is no reason the appellant should not have asked for a direction for the production of that evidence.

25. We would not expect Mr Chauhan to recall several years later why a particular item correction might have been generated, even if he himself had made the entry. However, he was not able to offer any plausible explanation as to what might have caused the item correction of £5,050, or the void sales of £3,779.

26. Mr Chauhan denied that the appellant had deliberately suppressed its takings. In particular he denied that the reduction in the average number of transactions identified by Ms Wood was because not all sales were being entered into the till. He suggested that it was because the shop had two competitors nearby together with a large Asda superstore. One competitor came under new ownership in late 2012 and started to sell beers. The other shop had been an empty unit until it reopened in 2013 and the Asda superstore opened at some time in 2014. We were invited to find that the reduction in the number of daily transactions was caused by increased competition.

27. Ms Hindle carried out a weighted mark-up exercise by reference to the purchase price and selling price of various standard rated product lines sold by the appellant in eight categories of goods in January 2013. She agreed with Mr Chauhan that January 2013 was a representative period. The categories included beers, wines and tobacco. She obtained purchase prices from the appellant's purchase invoices and obtained selling prices during her visits to the premises. Ms Hindle calculated a weighted mark up on sales of standard rated goods of 25.41%. This compared to a mark-up on standard rated sales based on declared takings for accounting periods 10/11 to 01/13 of between -0.135% to 8.95%.

28. The mark up exercise carried out by Ms Hindle was not intended to replicate Direct Calculation Scheme 1. She was concerned at the low level of mark up the appellant was achieving on standard rated goods having used DCS1. She calculated the mark up on the standard rated goods which were the majority of goods sold, whereas DCS1 requires the trader to do the calculation by reference to the minority goods sold, which in this case would be zero rated goods. We are satisfied that Ms Hindle was entitled to do so. DCS1 is applied using the true figure for daily gross takings. Ms Hindle was concerned about the standard rated mark-up suggested by the appellant's DCS1 calculations and that the appellant might not be declaring all its takings. Further, the appellant had not provided Mr Shah's DCS1 working papers which the appellant was required to maintain.

29. Ms Hindle considered that the till interrogations and her weighted mark-up exercise were evidence of suppression of takings by the appellant. She sought to quantify the level of suppression and sent a pre-assessment letter to the appellant dated 29 January 2015. The appellant was invited to provide comments on her findings and calculations. No comments were received and assessments were issued on 27 February 2015 for period 01/11 and on 5 May 2015 for periods 04/11 to 10/14.

30. Ms Hindle applied the weighted mark up of 25.41% to the standard rated purchases in the year-ended 31 January 2013. On this basis she estimated that the appellant had sales of £473,015 for that year against declared sales of £394,932. She concluded that there were undeclared sales of £78,083 equating to undeclared output tax of £3,904 per quarter which she assessed for periods 01/11 to 04/14. The assessment for period 07/14 was based in part on the mark up exercise but mainly on till corrections identified by Mr Thomas. Similarly, the assessment for period 10/14

was based in part on the mark up exercise but mainly on the reduction in the number of daily transactions and the large correction and void sales identified by Ms Wood.

31. In making assessments by reference to the weighted mark-up exercise, Ms Hindle did not take into account stock movements over the period of the assessments. It does not appear that there was evidence as to stock levels from which she could take stock movements into account. We note that DCS1 does not require any stock adjustment.

32. The assessments were confirmed in a review dated 5 July 2016 and the appellant lodged a notice of appeal with the Tribunal on 1 December 2016.

33. The assessments for periods 04/11 to 10/14 were subsequently reduced following a reference to Alternative Dispute Resolution ("ADR") after the appeal had been submitted. As a result of the ADR procedure, both parties agreed the output tax on standard rated goods for periods 04/11 to 10/14. This was based on the recorded daily gross takings and did not take into account alleged manipulation of the till record for periods 07/14 and 10/14. No agreement was reached in relation to period 01/11 and as such HMRC seek to maintain the assessment for that accounting period. HMRC also maintain those parts of the assessments for periods 07/14 and 10/14 which are based on what HMRC allege was manipulation of the EPOS till. The original assessments, the reduced assessments following ADR and the amounts presently in dispute are as follows:

VAT Period	**Original Assessments* £**	**Reduced Assessments £**	**Amount in Dispute £**
01/11	3,904	3,904	3,904
04/11	3,904	0	
07/11	3,904	801	
10/11	3,904	441	
01/12	3,904	360	
04/12	3,904	2,491	
07/12	3,904	876	
10/12	3,904	747	
01/13	3,904	2,234	
04/13	3,904	469	
07/13	3,904	1,082	
10/13	3,904	553	
01/14	3,904	1,961	
04/14	3,904	42	
07/14	6,460	5,489	5,158
10/14	5,146	4,091	3,215
Total:	**66,262**	**£ 25,541**	**£ 12,227**

* The figures for the original assessments for some of the periods were not clear from the evidence before us, but both parties agreed the amount of the reduced assessments of £25,541 and the sums in dispute of £12,227.

34. The differences between the original assessments and the reduced assessments arise because HMRC accepted the appellant's DCS1 calculations for periods 04/11 to 10/14 subject to alleged till manipulation in 07/14 and 10/14. No calculation was provided for period 01/11 so the whole of the assessment remains in dispute. The amounts in dispute for periods 07/14 and 10/14 relate solely to alleged manipulation of the EPOS till said to have been identified during the unannounced visits to interrogate the till.

35. In relation to period 01/11, Mr Patel acknowledged that he could not produce any calculation for a reduced assessment because Mr Shah did not hand over any records for that period. In his evidence Mr Chauhan did not seek to justify the low level of mark up on standard rated sales based on the declared figures. He accepted that the declared figures prepared by Mr Shah were wrong.

36. Mr Patel carried out his own DCS1 calculations using the expected selling prices of zero rated goods which were the minority goods in the appellant's business. We understand that his calculations give a mark-up on standard rated goods of between 9% and 14%, but in any event his calculations were accepted by HMRC in the ADR, subject to additions to daily gross takings referable to alleged till manipulation.

37. Mr Patel submitted that the appellant's previous accountant, Mr Shah had produced incorrect DCS1 calculations. However, he submitted that the daily gross takings figures provided by the EPOS till were reliable, and had been accepted by HMRC in agreeing Mr Patel's figures for the purposes of ADR. HMRC had also accepted Mr Patel's mark-up calculations for his DCS1 calculations. He submitted that HMRC's assessments for 01/11 and in part for 07//14 and 10/14 were not based on DCS1 because they calculated the expected selling prices of majority goods.

38. We have already found that HMRC were entitled to make assessments for 01/11, 07/14 and 10/14 based on the very low mark up on standard rated goods. For the purpose of quantifying the amount of the underdeclaration they were entitled to use their estimated mark up of 25.41%. The appellant has not put forward any alternative calculation for period 01/11. In the circumstances we confirm the assessment for period 01/11.

39. Mr Hilton invited us to find that the understatement of output tax in all accounting periods was deliberate, but not concealed. It seems to us that the evidence of suppression relates only to periods 07/14 and 10/14. There is no evidence of deliberate manipulation of the till in earlier periods. We accept Mr Patel's evidence that he was able to calculate what HMRC regarded as a fair estimate of output tax for the earlier periods based on the appellant's records which he obtained from Mr Shah. On balance we are satisfied that the understatement of output tax which has been assessed for the earlier periods was because of errors on the part of Mr Shah in carrying out the DCS1 calculations. There was no evidence that Mr Shah was involved in deliberately understating the appellant's output tax liability.

40. The position is different in relation to periods 07/14 and 10/14. Here we are satisfied that there was deliberate manipulation of the till by Mr Chauhan.

41. The evidence as to the level of item corrections on the till in period 07/14 demands an explanation. Mr Chauhan has offered no credible explanation as to why there were so many corrections. Nor did Mr Chauhan explain what he did differently in the period after 31 July 2014 to account for differences between the daily takings and the till record. We find that the likely explanation is that Mr Chauhan was deliberately manipulating the till to reduce the appellant's liability for VAT. It was a clumsy and blunt way to understate the appellant's true liability but in the absence of any credible explanation we are driven to that conclusion.

42. We are not satisfied that the reduction in daily transactions after 31 July 2014 is explained by increased competition. It is notable that in period 10/14 the average daily takings remained the same as in period 07/14 despite a significant reduction in the number of daily transactions. We are satisfied that after 31 July 2014 Mr Chauhan changed the way in which he understated the appellant's output tax. Instead of making item corrections first thing in the morning, he ensured that certain transactions were not recorded in the till record of daily gross takings. He also put a large one-off item correction of £5,050 through the till to reduce the recorded sales and four large void sales in order to reduce the level of daily gross takings.

43. Mr Patel submitted that there was no evidence of purchases to support the alleged understated turnover. We take that submission into account, so far as it goes. We were not presented with any margin analysis to suggest that the level of purchases in these periods would not support the level of sales alleged by HMRC, and in any event there could still be off-record purchases.

44. Based on the evidence before us we find that Mr Shah incorrectly calculated the output tax for period 01/11 and that it was understated by £3,904. Mr Shah also incorrectly calculated the output tax for periods 04/11 to 10/14. On the balance of probabilities, the output tax for periods 04/11 to 04/14 was the reduced assessments in the table described above. Those sums were not disputed. There were errors in the appellant's DCS1 calculations of £331 and £876 for periods 07/14 and 10/14 respectively which are also not in dispute. We also find that the appellant's takings for 07/14 and 10/14 were deliberately understated so as to reduce the output tax for those periods by £5,158 and £3,215 respectively.

The Penalty

45. We were told that the penalty in dispute amounts to £11,550. This has been calculated by reference to the reduced assessments at the rate of 49%, although it does not appear that there is any penalty included in this amount for period 01/14. In relation to the assessments in dispute and the reduced assessments which are not in dispute, the appellant maintains that there has been no deliberate or careless understatement of output tax. There is no issue as to the amount of reduction given for disclosure by the appellant in the course of the enquiry. We were also told that an additional 5% reduction for further disclosure has been given but not yet actioned by HMRC. We assume this relates to the appellant's engagement in the ADR process.

46. The assessments arising from the mark up exercise carried out by Ms Hindle for period 01/11 and by Mr Patel for periods 04/11 to 10/14 amounted to £17,168. Save for 01/11 those assessments are not in dispute. Ms Hindle acknowledged that Mr Chauhan had always been accommodating and pleasant during the course of the enquiry. She said that the previous accountant Mr Shah had initially been helpful but in the latter part of the enquiry he had been difficult to deal with. Ms Hindle was asked where she believed the fault was for the failure to declare output tax calculated by reference to the mark up exercises. She candidly accepted that she could not really comment and that it would depend on what information the appellant had given to Mr Shah to prepare the VAT returns.

47. Mr Patel told us and we accept that he made his calculation of the mark up for periods 04/11 to 10/14 on the basis of material he had obtained from Mr Shah. We infer that Mr Shah was given the material by Mr Chauhan, and that the reduced assessments were what Mr Shah ought to have calculated based on the material Mr Chauhan had given him. Apart from the sums in dispute relating to the till manipulations, we are satisfied that the incorrect declarations in all accounting periods were the fault of Mr Shah.

48. Based on our findings of fact and for the reasons set out above we are satisfied that the understatement of output tax in periods 07/14 and 10/14 arising from adjustments to the till including the reduction in the number of transactions in period 10/14 was deliberate.

49. We find that the understatement of output tax in periods 01/11 to 04/14 was not deliberate but arose because of Mr Shah's failure to properly carry out the DCS1 calculation. The same applies to part of the assessments for 07/14 and 10/14 amounting to £331 and £876 respectively.

50. A penalty would also be payable if the understatement arose as a result of carelessness on the part of the appellant. It was not part of HMRC's case that if the understatement was not deliberate then it was careless on the part of the appellant. Hence, it was not put to Mr Chauhan that he ought to have realised that the VAT in these periods had been understated in Mr Shah's calculations. In those circumstances we are not satisfied that the appellant was careless in failing to realise that Mr Shah's calculations were incorrect and resulted in an understatement of the appellant's VAT liability.

Conclusion

51. For the reasons given above we allow the appeal in part. The effect of this decision is as follows:

(1) The appeal against the assessment for period 01/11 is dismissed.

(2) The appeal against the penalties in respect of periods 01/11 to 04/14 is allowed.

(3) The appeal against penalties on assessments of £331 and £876 for 07/14 and 10/14 respectively arising from incorrect DCS1 calculations is allowed

(4) The appeal against the assessments of £5,158 and £3,215 for periods 07/14 and 10/14 respectively arising from manipulation of the till is dismissed.

(5) The appeal against penalties of £2,527 and £1,575 for periods 07/14 and 10/14 arising from manipulation of the till is dismissed. We note and record that HMRC intend to provide a further reduction of 5% on the rate at which those penalties have been charged.

52. 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.

TRIBUNAL JUDGE
JONATHAN CANNAN

RELEASE DATE: 28 JANUARY 2019