[2020] UKFTT 0015 (TC)

TC07521

Appeal number: TC/2015/07174

VAT – inaccurate prime records – amendment of prime records – whether assessment made to best judgment – partially – whether income tax assessments made in time – partially – penalties – whether behaviour deliberate – no – appeal partially upheld

FIRST-TIER TRIBUNAL
TAX CHAMBER

MRS BRENDA CRUTCHLEY **Appellant**
(trading as VICTORIA'S HAIR AND BEAUTY)

- and -

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

TRIBUNAL: JUDGE ANNE FAIRPO
MRS SHAMEEN AKHTAR

Sitting in public at Birmingham on 30 and 31 October 2018

Mr Everett, VAT consultant for the Appellant

Ms Hickey, presenting officer for the Respondents

DECISION

Introduction

1. This is an appeal against the following assessments and penalties:

   (1) a VAT assessment of £67,807 for the period 1 March 208 to 31 August 2015;

   (2) a VAT belated notification penalty for the period 1 March 2008 to 15 May 2014;

   (3) income tax assessments of £19,510 in aggregate for the tax years ending 5 April 2009 to 2013 (inclusive);

   (4) a direct tax penalty of £10,243.16 for the tax years ending 5 April 2009 to 2013 (inclusive) under Schedule 24, FA 2007.

Background

2. The appellant (Mrs Crutchley) has owned a hairdressing salon in Walsall in the West Midlands since 1983. She registered for VAT on 24 October 1998, with effect from 1 April 1999. She deregistered for VAT on 16 January 2008.

3. On 30 March 2011 a letter and questionnaire were sent to Mrs Crutchley on 30 March 2011 as it appeared to HMRC from Mrs Crutchley's self-assessment tax returns that she may have been continuing to trade in excess of the VAT threshold, with the following income figures reported:

   (1) for the tax year ending 5 April 2008: £78,663 (the VAT de-registration threshold in October 2007 was £62,000; the VAT registration limit was £64,000); and

   (2) for the tax year ending 5 April 2009: £69.481 ((the VAT de-registration threshold in October 2008 was £65,000; the VAT registration limit was £67,000)

4. The questionnaire was returned on 27 April 2011 with details of monthly turnover for the period April 2009 to March 2011. For the period April 2009 to March 2010, the turnover figure given was £54,707.27. As this was below the VAT threshold no further action was taken.

5. On 24 April 2013, HMRC sent a further questionnaire to Mrs Crutchley. This was returned on 14 May 2013 and showed turnover of £66,349 in the accounts for the year ended 31 October 2011 (below the VAT threshold at the time).

Turnover for the year ended 31 October 2012 was reported to be £68, 401 (also below the VAT threshold at the time).

6. At a meeting on 9 July 2013 between HMRC, Mrs Crutchley and her accountant (Mr Petty), Mrs Crutchley's decision to deregister was discussed. HMRC notes indicated that Mr Petty confirmed that he had advised Mrs Crutchley that she would need to re-register if her turnover remained (or increased) above the relevant VAT limits. The notes also indicated that Mr Petty accepted that Mrs Crutchley appeared to be trading above the registration and re-registration limits when the annual accounts were completed. The notes indicate that Mrs Crutchley stated that she took advice from Mr Petty.

7. At that same meeting, the HMRC officer recorded information from the Diary Book, which is the primary record of salon bookings. Data was recorded for clients booked on Saturday 23 July 2011, among other dates.

8. Following the meeting, on 17 July 2013, HMRC wrote to Mrs Crutchley with a copy of the notes of the meeting and asked her to produce trading figures with supporting evidence.

9. On 19 July 2013, HMRC opened an income tax self-assessment enquiry for the tax year ended 5 April 2013, under s9A TMA 1970.

10. On 5 November 2013, a further meeting was held between HMRC, Mrs Crutchley and Mr Petty. During this meeting the Diary Book was re-examined and the meeting notes indicated that entries for the date previously examined (23 July 2011) had been altered and customers had been removed from the diary. HMRC removed copies of records from the business premises, including diary pages, the Simplex D books used to record financial information, accountants working papers, and bank statements.

11. On 13 November 2013, HMRC sent copies of notes of the meeting to Mrs Crutchley with a letter which noted the following concerns:

    (1) The number of clients and treatments provided to those clients were not accurately recorded in the Diary Book;

    (2) The information in the Simplex D book was inaccurate as it was based on the Diary Book information;

    (3) Income received on Saturdays had been understated due to the deduction of wages before including the sales figure in the Simplex D book (so that wages were deducted twice);

    (4) Primary business records had been altered after those records had been challenged by HMRC, apparently in order to ensure that the diary agreed with the takings recorded in the Simplex D books.

12. The letter also advised that HMRC intended to compulsorily re-register Mrs Crutchley for VAT from 16 January 2008. A schedule with monthly estimates of turnover based on the business accounts was attached, indicating that Mrs Crutchley should not have deregistered for VAT in January 2008. The effective date of re-registration was changed on 24 June 2015 to 1 March 2008, following correspondence.

13. Correspondence between the parties continued, as Mrs Crutchley insisted that she had not recorded net figures, with Mrs Crutchley's advisers proposing calculations of turnover which were not accepted by HMRC.

14. On 9 January 2015 Mrs Crutchley's agent stated that she accepted that she had de-registered too early but disagreeing with the level of calculated income on which the assessment was based. He stated that Mrs Crutchley also denied knowingly falsifying her records by altering her diaries to hide additional income received.

15. On 28 April 2015, income tax self-assessment assessments and determinations were issued under s29 TMA 1970 as follows:

    (1) Tax year ended 5 April 2009: £4,165.80

    (2) Tax year ended 5 April 2010: £3,383.40

    (3) Tax year ended 5 April 2011: £3,693.20

    (4) Tax year ended 5 April 2012: £4,304.00

16. A closure notice for the tax year ended 5 April 2013 was issued on 29 April 2015, for £3,964.40, under s28A(1) & (2) TMA 1970.

17. The aggregate liability for income tax was £19,510.80.

18. Associated penalties were issued on 8 June 2015 under Schedule 24, FA 2007. The penalty was categorized as deliberate but not concealed and prompted; penalty mitigation of 50% was given so that the total penalty percentage was 52.5%, with a total penalty of £10,234.16.

19. On 27 August 2015, HMRC issued a Notice of Penalty for belated notification of the liability to register for VAT. The VAT calculated was £76,003 and based on the period 1 March 2008 to 15 May 2014; the penalty was calculated as 15% of this amount, being £11,400. The VAT assessment on the basis that the income suppressed equated to the wages declared in the accounts.

20. On 7 October 2015 Mrs Crutchley submitted a VAT return for the period 1 March 2008 to 31 August 2015, showing output tax of £23,251.84 and net sales of £210,096. Mrs Crutchley had applied to use the flat rate scheme and so no input tax was shown.

21. On 9 October 2015 HMRC notified Mrs Crutchley and her agent that they had deregistered the business for VAT purposes with effect from 8 October 2015.

22. The VAT assessment and associated penalty and income tax assessments and associated penalties were appealed to this Tribunal in 2016.

23. Further correspondence as to the basis of the assessments continued with Mrs Crutchley's advisers providing further financial details and revised calculations; in March 2018, HMRC advised that they did not intend to alter the assessments.

Appellant's case

Evidence

24. Mrs Crutchley gave evidence by way of witness statement and in person at the hearing.

25. By way of background, she described how the salon operated at the relevant time:

    (1) Mrs Crutchley had owned the salon since 1983, although she had stopped working in the salon in 2006 and no longer had an active role in the day to day business. She continued to live above the salon. The staff in the salon took all bookings, as there was no receptionist, and they maintained the diary in the salon. Customers were 'ticked' in the diary when they arrived. A cancellation was marked with a 'c'.

    (2) Customers paid staff for the treatment; the staff would put the money in a drawer. Staff were also expected to complete tickets for each treatment, recording what was done, and put these in the drawer as well. The tickets were not always completed if staff were busy.

    (3) Mrs Crutchley would take the money and the tickets at the end of each day and she would deal with the bookkeeping in a Simplex D cash book. For each day she would tally the tickets and the takings and record the takings in the cash book. She did not keep the tickets after completing the cash book each day. She did not tally the takings or tickets against the salon diary.

    (4) The cash would be placed in an old make-up bag each day. On Saturday, she would pay the wages out of this cash. The remainder was banked in the business account. If there was a shortfall, for example if more customers had paid with cards, she would borrow from money from her husband to make up the wages payments.

    (5) The cash book entries recorded card takings, cash takings, and separately recorded income from the sale of hair straighteners and similar goods.

    (6) If she was on holiday, the staff would put the takings and tickets for each day into an envelope for her to update the cash book on her return. She would leave cheques for wages payments.

(7) Mrs Crutchley confirmed that she had never knowingly under-recorded takings.

(8) Mrs Crutchley's accountant would calculate the wages payments due to each staff member each week.

(9) Staff were paid on Saturday evenings. This is because they were paid in cash, and the week's takings were needed to make the payments. Payments were generally made after the cash book was completed so that Mrs Crutchley knew how much money she had. Even if staff were paid before she completed the cash book, the cash book was completed on the basis of the total takings.

(10) If there were insufficient funds to pay all of the wages (for example, when customers paid more often by card, Mrs Crutchley would borrow the balance needed from her husband. From around 2011-2012, she had started paying staff direct into their bank accounts as cards became more prevalent.

(11) The salon is a residential area which is not affluent and does not have a significant amount of passing trade. It was closed on Tuesdays. Prices are much lower than town centre salons as a result. Clients would complain if prices increased by 50p. Some long-standing clients would also get a reduced price and reduced prices were offered to pensioners for mid-week sessions.

26. Mrs Crutchley explained that she had been deregistered from VAT when one of her stylists left to set up her own mobile salon: it was expected that takings would be reduced as a result, as some customers would follow the stylist, and she had been advised to deregister by her accountant at the time. That accountant had continued to deal with her accounts and wage records and Mrs Crutchley had expected that he would advise her if she needed to reregister for VAT. He did not do so, even when completing annual accounts showing turnover above the registration threshold. Mrs Crutchley was not aware of the limits.

27. Mrs Crutchley confirmed that she had accepted that she should not have deregistered for VAT purposes.

28. Mrs Crutchley's evidence as to the HMRC visit in July 2013 was that she had become confused during the course of the visit as to what was expected of her, and the notes of the visit do not reflect what Mrs Crutchley believed to be the case. HMRC were claiming that she was paying wages before entering the takings into the cash book, which was not the case.

29. At the end of the meeting, Mrs Crutchley recalled that she was told that HMRC wanted all of the Saturday diary papers for the previous year and that she should "sort the figures out" so that the takings and the diary matched. Mrs Crutchley believed that this meant that she was required to tally up the diary with the cash book, as she knew that the cash book was accurate. She was not given specific

instructions as to what to do, and the only way she could tally up the diary and the takings was to change the diary.

30. Accordingly, Mrs Crutchley explained that she went through the salon diary and attempted to tally the Saturday entries with the takings in the cash book. She explained that there would often be discrepancies between the takings and diary because customers would not always have the treatment which they had originally booked, as they may change their minds before they arrive, or may not turn up at all. The diary was not always updated to reflect this, but she trusted most of her staff. The exceptions had been one former member of staff who had booked in 'invisible' clients in order to have less work to do, in 2009, and another, in 2012, who had stolen from other staff members and has not handed in all of the money she had received from clients.

31. At this point, HMRC noted that these points about the staff had not been put into the grounds of appeal.

32. Mrs Crutchley accepted that she had originally attempted to say that she hadn't changed the diary entries, as she did not want HMRC to think she was covering things up and thought this would be an admission that she had underdeclared her takings to HMRC, which she said that she had not done. She had altered the diaries because HMRC had told her to "sort the figures out".

33. Mrs Crutchley also explained that she had resisted the advice of various accountants to make an offer to settle the matter because she was not prepared to say that she had taken the money, as she had not done so.

Submissions

34. It was accepted that Mrs Crutchley should have re-registered for VAT in 2008 when it became clear that her takings had not declined as expected when the stylist left.

35. It was accepted that Mrs Crutchley's actions in amending the diary have made it difficult for HMRC to accept the accuracy of any of the business records. It was also accepted that in those circumstances, HMRC are entitled to make an assessment of VAT due on the basis of "best judgement" (VATA 1994, s73(1)). It was submitted, however, that the assessment had not been made on the basis of best judgement.

36. The case of *Van Boeckel* ([1981] STC 290) considered the meaning of the phrase "best judgment" and set out the following principles:

    (1) HMRC should not be required to do the work of the taxpayer;

    (2) HMRC must perform their function honestly and above-board;

    (3) HMRC should fairly consider all the material before them and on that material come to a decision which is reasonable and not arbitrary;

(4) There must be some material before HMRC on which they can base their judgement.

37. The principles were further developed in the case of *CA McCourtie* (LON/92/191) as follows:

(1) The facts should be objectively gathered and intelligently interpreted;

(2) The calculations should be arithmetically sound;

(3) Any sampling technique should be representative.

38. Mrs Crutchley was not inferring that the assessment lacked any form of judgment or was vindictive, but questioned the reasonableness of the approach, as there was an inconsistency of method and a refusal to take additional information into account. The arithmetical accuracy was also in question.

39. With regard to the inconsistency of method, two methodologies had been used by HMRC, as follows:

(1) For the period January 2008 to October 2012, the assessment was calculated on the basis of accounts turnover plus wages. This gave a wages:turnover ratio of between 3.1 and 3.49.

(2) For the period from November 2012, the assessment was calculated on the basis of a wages: turnover ratio of 2.9.

40. It was submitted that it appeared that Officer Burke had concluded at a very early stage of the investigation that the wages were being paid in cash before the daily takings were recorded and seemed to have refused to accept anything that does not produce a result in line with that conclusion.

41. Mrs Crutchley's agent had put forward alternative analyses of the information available, based on (for example) average income of £11.47 per half hour booking slot. On the basis of the information available, that analysis produced a turnover figure similar to that in the accounts. Even if all possible slots had been booked, on the basis of that average income the maximum possible turnover was less than the amount assessed by HMRC.

42. These alternative analyses had all been rejected by HMRC on the basis that the diary had been altered and so the information could not be relied upon.

43. At the original visit, the "discrepancies" identified amounted to £87, £152 and £35 on three Saturdays. Saturdays (and Fridays) were the busiest days of the week at the salon.

44. At that time (the accounting period ended October 2011), the weekly wage of the business was in excess of £600. The "discrepancies" found in no way reflect that weekly wage bill and it was submitted that to assess on that basis without further

evidence is unreasonable and lacks objectivity. Accordingly, it was submitted that the assessment for the period January 2008 to October 2012 was not made to best judgement.

45. The second methodology used wages:turnover ratio within a range considered appropriate by HMRC for the hairdressing industry. If the second methodology had been applied throughout, the method used would have been consistent throughout and would have produced an assessment approximately £12,000 lower than that issued.

46. It was submitted that, even so, this figure was too high as the ratio chosen failed to take into account the location of the salon and the type of customer base and, in particular, the low prices required in a low income area.

47. It was further submitted that there was no logical reason for using two different methodologies for the same type of error.

48. In addition, for the accounting periods ending October 2014 and October 2015, the assessments had been based on the wages figure for the period to October 2013 as, at the time of assessment, the 2014 and 2015 accounts had not been finalised. Those accounts have since been finalised and show a considerable lower wages figure. The accounts have been provided to HMRC but no amendment has been made to the assessment.

49. In correspondence dated 14 July 2017, Officer Burke calculated a turnover figure based on the diary sheet for 23 July 2011, which was considered to be the only reliable unaltered diary sheet. That turnover figure was £91,821.96 for the period ending October 2011. Although that contained a 4% markup for "unidentified sessions", the figure was considerably lower than the figure of £97,872 assessed for that year.

50. It was submitted that HMRC failed to use best judgment because they had not taken into account all relevant information and had failed to take material information into account because in summary:

    (1) The assessment was based on the premise of wages deducted from takings before the takings were recorded;

    (2) The discrepancies identified were based on booking details rather than actual supplies;

    (3) The discrepancies identified were not sufficient to warrant the size of the assessment;

    (4) The assessment contains two different methodologies to assess the same variance in different periods;

    (5) The assessment does not take into account additional information supplied to HMRC in the form of completed accounts for 2014 and 2015.

HMRC's case

51. Officer Burke provided a witness statement and gave oral evidence at the hearing, as follows:

52. At the first meeting between HMRC and Mrs Crutchley, on 9 July 2013, the salon diary was examined as it was the only record available to verify daily takings, since the tickets for appointments were not retained. Officer Burke would expect the diary to be 99% accurate as it was the only record against which declared takings could be verified.

53. The diary entries were marked as follows:

    (1) A tick or no mark indicated that the person had attended the appointment

    (2) A 'c' or 'x' indicated that the person had not attended the appointment.

54. The date of 24 April 2011 was examined and compared to declared takings. There was a difference between the income declared and that calculated from the diary entries. A further two dates, 23 July 2011 and 1 October 2011 (both Saturdays), were selected for review at this meeting. These dates also had significant differences between the diary information and the takings.

55. The summary differences for these three dates were:

    (1) 24 April 2011: diary - £305; Simplex D - £218. Difference - £87

    (2) 23 July 2011: diary - £571; Simplex D - £419. Difference - £152.00

    (3) 1 October 2011: diary - £364; Simplex D - £329. Difference - £35

56. At this meeting, Mrs Crutchley advised that she may have taken the wages out before recording the takings but it was not a regular occurrence, but then stated "I always do it that way".

57. The officer stated that she had advised Mrs Crutchley that it would appear that she had not been recording all of the income, and that this may be in direct relation to the wages being taken from income before recording the takings.

58. The officer advised Mrs Crutchley that she had three options:

    (1) Accept that wages had been deducted before takings were recorded, so that all wages would be added to the accounts figures already prepared; or

    (2) Quantify the actual income under-declared for each Saturday in a twelve-month period; or

    (3) Examine the full weeks diaries for the three Saturdays considered in the visit to calculate the full suppression for the full weeks and pro-rata the under declarations to establish a credible twelve month turnover.

59. Officer Burke also told Mrs Crutchley that she needed to sort it out but would never tell a trader to alter prime records. The officer noted that it was up to the trader to make sure records are correct.

60. The diaries were not taken at the first visit as Mrs Crutchley would need them to be able to sort things out.

61. After the follow up meeting, correspondence with Mrs Crutchley's agent indicated that an examination of the Saturday diaries for 2011 had shown discrepancies only on 24 April 2011 and 23 July 2011.

62. At the follow up meeting on 5 November 2013 the diary page for 23 July 2011 was re-examined and was found to be different to that originally seen at the first visit. Mrs Crutchley initially denied doing anything to the records but then later stated that she may have made some changes to the records, but only a few and not deliberately to evade tax. She then admitted that she had made the changes so that the diaries would tie in with the takings and that she had not had the money; it had been used to pay wages.

63. Officer Burke retained copies of the Saturday pages from the diaries and also the Simplex D books at the end of this visit.

64. Officer Burke stated that, in January 2014, Mrs Crutchley's agent asked whether HMRC would accept a suppression figure of £100-£150 per week. She and another officer examined the diary copies to review two Friday pages which had been copied with the Saturday pages. These two Fridays indicated suppression in excess of £150 as follows:

    (1) 19 October 2012: diary - £502; total income - £323.85. Difference - £178.15

    (2) 3 August 2012: diary - £505.50; total income - £322.64. Difference - £182.86.

65. Further Fridays were also examined and HMRC's schedule showed as follows:

    (1) 22 July 2011: diary - £487.50; Simplex D - £310. Difference - £177.50

    (2) 24 February 2012; diary - £601; Simplex D - £358.99. Difference - £242.01

    (3) 18 May 2012: diary – £636; Simplex D - £463. Difference - £173.00

66. Accordingly, the proposed suppression figure of £100-150 was rejected. In further correspondence, Mrs Crutchley's agent asked whether HMRC would accept a suppression figure of £250 per week based on a schedule prepared by him. This was also rejected because it was not considered that the offer had any basis.

67. Delays then occurred as a result of changes in Mrs Crutchley's agents; protective assessments were issued.

68. On 20 November 2014 a further meeting took place. Officer Burke stated in that meeting that she did not believe she could rely on any diary evidence for other periods due to the length of time that had passed, which would have allowed time for the diary entries to be changed.

69. Following correspondence over a period of years, and an alternative dispute resolution meeting, a further meeting was held on 6 April 2017. The diaries were examined again, and it appeared that Mrs Crutchley had altered the diaries further as the diary entries were different to those which had been analysed by the agent.

70. Officer Burke confirmed that two methods had been used to make the VAT assessments:

    (1) Firstly, for the period up to 2013, the declared turnover had been increased by wages paid. This was because Mrs Crutchley had advised HMRC that the Saturday girl at the salon was paid cash in hand. As it was not clear that she was on the books in any case, it was not fair to include her wages in the calculation as this would have increased the level of turnover. Officer Burke believed that the Saturday girl was paid approximately £25.

    (2) From 2013 onwards, turnover had been calculated using HMRC's industry wage:turnover ratio because the Saturday girl's wages were now clearly included in the wage figures. A ratio of 30% was used as normal for the salon.

71. Officer Burke confirmed that she had not checked whether the card:cash ratio declared in the Simplex D book was out of line with that which would be expected of a salon in that type of area. She considered that the age profile of customers would indicate a preference for paying in cash.

72. Officer Burke confirmed that the wages uplift of 2.9 used to make assessments for 2013-15 had been taken from HMRC guidance.

73. Officer Burke confirmed that the assessments based on turnover plus wages had not been tested against this guidance figure.

74. Officer Thomas, who issued the direct tax assessments, also provided a witness statement and gave oral evidence.

75. In summary, his evidence was that the direct tax assessments were based on the VAT assessment figures.

76. The penalty was issued on the basis that he considered that the behaviour that had led to errors on the return was deliberate. He had come to this conclusion from the notes of the meeting in July 2013, which he considered showed that Mrs Crutchley knew that the figures that were submitted on her tax returns were incorrect.

77. He had considered whether special circumstances might apply but concluded that they did not.

HMRC submissions

Income tax assessments – discovery

78. HMRC submitted that the income on Mrs Crutchley's self-assessment tax returns had been understated and that this understatement had been brought about deliberately such that HMRC were entitled to raise assessments for earlier years.

79. It was submitted that (as applicable to this appeal) s29 Taxes Management Act 1970 allowed HMRC to raise assessments where they have made a discovery that tax has been underassessed, and that such discovery had been made when the discrepancies between the diary and the cash book were identified. It was submitted that, on the basis of presumption of continuity, the same errors would have occurred in earlier years as well.

80. Under s36(1) TMA 1970, HMRC may raise assessments in respect of a loss of tax up to six years after the end of the tax year to which the assessment relates where the loss of tax has been brought about carelessly. Under s36(1A), HMRC have a further extended time limit of twenty years to raise an assessment where the loss of tax has been brought about deliberately.

81. HMRC submitted that the behaviour which led to the loss of tax was deliberate on the basis that wages were deducted from takings before the takings were recorded, and that the prime records (the diary) had been altered.

82. Accordingly, HMRC submitted that the income tax assessments had been properly issued. It was accepted that, as the income tax assessments were based on the VAT assessments, if the Tribunal were to require any changes to the VAT assessments then the income tax assessments would be similarly amended.

Direct tax penalties

83. It was submitted that the penalties had been reasonably calculated and fairly applied in consideration of the deliberate alternation of prime records and the provision of amended/altered records to HMRC. 25% mitigation had been given as Mrs Crutchley attended meetings and provided access to records. HMRC accepted that the amount of the penalty would have to be amended if the VAT assessments were altered.

VAT – best judgement

84. HMRC agreed that the VAT assessments had to meet the 'best judgement' criteria and that case law had determined that this meant that HMRC must take any necessary action and produce a result that is deemed to be reasonable and not arbitrary. Best judgement was not the 'best result' or 'most favourable conclusion' but instead a reasonable process by which an assessment is

successfully reached. The cases of *Van Boeckel* ([1981] STC 290) and *Queenspice* ([2010] UKUT 111) were quoted in support of this.

85. HMRC submitted that the prime records of the business were flawed, as comparison of the diaries with the Simplex D cash book at a meeting in July 2013 indicated that there had been significant suppression of income on the Saturday entries reviewed. At a second meeting, Mrs Crutchley admitted that she had altered the diary after that meeting in July 2013, so that it would tally up with the Simplex D book, but stated that this was not done to evade tax.

86. Accordingly, HMRC submitted that the diary and takings records of the business were not reliable and could not be used as the basis of an assessment. HMRC had therefore used the wages figure to calculate the amount of income underdeclared to the best of their judgement. For years up to and including 2013, the wages figure was added to turnover. For 2014 and 2015, HMRC's industry ratio of wages to turnover was used. It was submitted that these assessments were made to best judgement on the basis of the information available at the time.

VAT belated notification penalty

87. HMRC submitted that the belated notification penalty was appropriate because Mrs Crutchley did not re-register for VAT when her turnover was above the VAT threshold.

Discussion

88. The issues to be decided in this case are as follows:

(1) Whether the VAT assessment was based upon best judgment and reasonable calculations;

(2) Whether the VAT belated notification penalty was reasonably calculated and fairly applied;

(3) Whether the income tax assessments and determinations were reasonably calculated;

(4) Whether the income tax penalties were reasonably calculated and fairly applied.

89. Point (3) follows in this case from point (1), and no submissions as to the calculation of the income tax assessments beyond that were made by either party.

90. In addition to the oral evidence and witness statements, a substantial number of documents were provided in the bundles provided to the tribunal.

Findings of fact

91. Considering the evidence, we find that:

(1) The output figure declared in Mrs Crutchley's VAT return for the period March 2008 to August 2015 is incorrect as it is substantially below the turnover declared in the accounts and no explanation was given for the difference.

(2) The information in the diary for Mrs Crutchley's business cannot be relied upon to support the turnover declared in the accounts for the business either because:

(a) in the case of specific dates in 2011 and 2012 which were examined as set out below, there is a discrepancy between the information in the diary and the declared takings for which no clear explanation has been given;

(b) Mrs Crutchley has admitted that she altered other information in the diary following the meeting with HMRC in July 2013.

(3) The only record available to assess whether the takings declared as turnover in the accounts are accurate is therefore, the diary entry for 23 July 2011 which was noted by HMRC during their July 2013 visit. The information in this entry does not match the takings recorded for that day in the business' Simplex D cashbook.

Whether VAT assessment to best judgment

92. 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."

93. The VAT return submitted on Mrs Crutchley's behalf in November 2015 stated that the total outputs of the business for the period March 2008 to August amounted to £210,096. The accounts turnover for this period was in excess of £500,000. There was clearly a substantial discrepancy between the VAT return output figure and the accounts turnover. No explanation for this was provided to us and so we consider, as it appears from a comparison with the accounts that the return was incomplete or inaccurate, that HMRC were entitled to assess the amount of VAT due to the best of their judgement. As set out below, we also consider that Mrs Crutchley failed to keep documents required to enable the returns to be verified.

94. Various submissions were made for Mrs Crutchley as to whether the assessment was made to best judgement. We have discussed most of these in more detail below, but comment on one point here as we consider that it relates more to the question of whether HMRC can raise an assessment at all rather than whether the assessment is made to best judgment.

95. The submission was that the assessment was not made to best judgment because "the discrepancies are based on booking details rather than actual supplies". It was submitted that the booking details did not always record what was actually supplied because customers may change their minds or not attend at all, and so it was not reasonable to base the assessment on such booking details.

96. In our view, the fact that the discrepancies were identified by comparing booking details with turnover does not mean that the assessment was not made to best judgment. The assessments were not calculated on the basis of those discrepancies; the methodologies actually used are discussed below.

97. As the tickets which were completed with details of work done were destroyed, and the evidence given makes it clear that the diary is not a reliable source of information, we find that there are no records against which the accuracy of the VAT return can be verified and it is therefore not possible to verify what supplies were actually made by the business. As noted in the legislation set out above, where a taxpayer fails to keep records so that returns cannot be verified, HMRC may assess the amount of VAT due to best judgement.

98. The question for us is, therefore, whether the assessment was made to best judgement.

99. 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)

100. 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."

101. 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.

102. 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))

103. The VAT assessment for the period March 2008 to August 2015 (inclusive) was prepared using two methodologies, as follows:

(1) March 2008 – October 2012: the assessment was produced by adding together the wages and turnover in the accounts for the business.

(2) November 2012 to August 2015: the assessment was produced by multiplying wages by 2.9, a figure taken from HMRC guidance as to the expected wages:turnover ratio for hairdressing salons.

104. We have considered these two periods in reverse chronological order.

November 2012 to August 2015

105. The explanation given for the use of this methodology was that HMRC believed that, from October 2012, the full wages of the business had been included in the accounts and so it was appropriate to use the industry ratio to establish the turnover of the business.

106. The decision in *Van Boeckel* requires that "there is some material on which the Commissioners can reasonably act"; in *Rahman*, the requirement is that the assessment is in effect a "spurious estimate or guess in which all elements of judgment are missing"; or is "wholly unreasonable".

107. For the period November 2012 to July 2013, we consider that it was reasonable for HMRC to make an assessment on the basis of an industry ratio of wages to turnover as, prior to the HMRC visit, there were unexplained discrepancies between the diary and the takings. Although the diary and cash book were not compared for the period in the accounting period from November 2012 prior to the visit, no indication was given by or on behalf of Mrs Crutchley that anything had changed in the business in that period that might have made a difference on a comparison of those documents.

108. It was not suggested in evidence by either party that the wages figure for this period was not accurate.

109. The industry ratio selected was 2.9. Officer Burke's evidence was that this was taken from guidance. No evidence was provided as to whether this was a single figure or whether there was a range of acceptable ratios. For Mrs Crutchley, it was submitted that this ratio did not take into account the location of the salon and the nature of the clientele, and it was submitted that this would tend to a turnover lower in comparison to wages than could be achieved in (for example) a city centre salon or a more affluent area.

110. In correspondence dated 26 November 2015, Officer Burke states that as the diary had been used to establish suppression of takings, there was no need to take into account the location of the salon. Whilst this might be relevant to the other methodology used for earlier periods (set out below), it is clearly not the case for the period from November 2012 onwards, where the wages to turnover ratio was used to make the assessment.

111. This suggests that the figure of 2.9 may not properly reflect the wages to turnover ratio appropriate for this type of salon. In the absence of any information as to the ratio range and effect of location on that range, we cannot determine whether the assessment for the period of November 2012 to July 2013 is in fact reasonable.

112. For the period August 2013 to August 2015, the assessment was produced on the basis of the 2013 figures as no accounts were produced for these years until January 2018.

113. On behalf of Mrs Crutchley it was submitted that HMRC should have amended the assessments on the basis of the wages figures in these accounts once they had been produced. No clear explanation was provided by HMRC as to why they had not done so.

114. For Mrs Crutchley, it was submitted that an alternative calculation should be used, based on information retrieved from the diaries. As set out below, we do not consider that the diary information can be relied upon and so do not consider that such calculation should be used to displace the methodology adopted by HMRC of assessing on the basis of an industry ratio of wages to turnover.

115. **We direct that the assessment for the period November 2012 to August 2015 should be reviewed by HMRC to take into account the evidence as to the location and nature of the clientele in order to assess whether the ratio used for the assessment for this period should be reduced below 2.9.**

116. The appellant argued that HMRC had not taken into account the information provided as to wages for the 2014 and 2015 accounting periods; no explanation was provided by HMRC as to why this had not been done and so we direct further that the assessments should be reviewed by HMRC to consider whether to take into account this revised information.

March 2008 – October 2012

117. For the period March 2008 to October 2012, the assessment was arrived at by adding the wages of the business to the turnover of the business. HMRC submitted that this methodology was reasonable, on the basis that Mrs Crutchely had stated in their meetings that she took the wages out of the Saturday takings before recording them and that she had attempted to hide this by changing the diary. It was also submitted that the assessment should not be made on the basis of wages alone because HMRC believed that during this period payments were made to a Saturday girl which were not included in the accounts figures for wages.

118. Mrs Crutchley denied that she paid the wages prior to recording takings. Her evidence was that she had altered the diary because she knew that the takings were correct and that, as HMRC wanted the diary and the takings to match, the only way to achieve this was to alter the diary.

119. We consider that Mrs Crutchley was a credible witness, and consider that she was confused by what she had been asked to do by HMRC. We note that the meeting notes kept by HMRC do not record verbatim responses in relation to the question of whether the wages were paid from the Saturday takings and it is possible that there was some confusion between them as to what was said or intended.

120. In addition, we consider that HMRC's position following their meetings that staff had been paid from Saturday takings prior to those takings being recorded is not sustainable. No evidence has been provided to suggest that the business had sufficient takings on a Saturday to pay the weekly wages of approximately £600 at all, let alone a shortfall of that order. Indeed, HMRC's note of meeting shows the following (this information was recorded before any alteration of the diary):

    (1) 24/4/2011: bookings of £305;

    (2) 23/7/11: bookings of £571;

    (3) 1/10/11: bookings of £364.

121. Even if the position is that wages were paid from overall takings before these were recorded for each day, a letter of 13 November 2013 from HMRC to Mrs Crutchley also contained the following summary of an analysis of Friday entries:

    (1) 7 January 2011: diary - £340; Simplex D - £250. Difference - £90. Staff working: 2

    (2) 10 June 2011: diary - £366; Simplex D - £306. Difference - £50 (*sic*). Staff working: 2

    (3) 22 July 2013 (*sic* – from the other records, this appears to have been 2011): diary - £556. Simplex D - £310. Difference - £246. Staff working: 3

We note that in a letter from HMRC dated 18 February 2014, the diary information for this date was stated to show work done of £487.50.

(4) 28 October 2011: diary – £370. Simplex D - £303. Difference - £67. Staff working: 2

(5) 24 February 2012: diary - £666; Simplex D - £358.99. Difference - £307. Staff working: 3

(6) 18 May 2012: diary - £661; Simplex D - £463. Difference - £198. Staff working: 3

122. In our view, the discrepancies do not clearly indicate weekly wages are being suppressed from the overall takings either, particularly as it was not disputed that Friday and Saturday would have the highest takings for the week.

123. We note that HMRC did not test whether the turnover achieved using this methodology (adding wages to accounts turnover) was in line with that which would be expected from a salon of this nature, using the industry ratio wages to turnover which they used for the later period, as set out above.

124. Reviewing the information available, the methodology produces a level of assessed turnover which is rather more than 2.9 times the wages (the ratio used for the later period), giving a result of between 3.1 and 3.5.

125. Considering the case law set out earlier in relation to best judgement, we find that HMRC have taken into account all of the information made available to them – in particular, the industry ratio of wages to turnover and also the information as to payments to the Saturday girl. Officer Burke's evidence is that she believed that the Saturday girl was paid £25 a week. This was disputed by Mrs Crutchley, who said that the Saturday girl was a relative and was paid a smaller amount. No explanation was given by HMRC as to why it was not, for example, appropriate to add the Saturday girl wages to the accounts wages and assess on the basis of the industry ratio as for the later period.

126. In addition, HMRC do not appear to have considered whether it was credible from the information which they had recorded that turnover was suppressed by the full amount of the wages paid. As set out above, the information gathered does not seem to us to be not consistent with suppression of £600 per week.

127. We note the case law on best judgment and particularly the finding in *Van Boeckel* that HMRC should "fairly consider all the material before them and on that material, come to a decision which is reasonable and not arbitrary" and in *Rahman* that the judgement is "wholly unreasonable". We do not consider that HMRC have taken fairly considered all of the material before them and, as a result, their decision to use wages and turnover as a methodology for assessment of this period whilst using the industry ratio of wages to turnover for the subsequent period is unreasonable in the *Rahman* sense.

128. For the reasons set out earlier, we do not consider that the diary-based calculations submitted as an alternative for Mrs Crutchley are appropriate as the diary information cannot be relied upon.

129. **We direct that the assessment for the period March 2008 to October 2012 should be calculated on the same basis as that used for the period November 2012 to August 2015 – that is, applying the same industry ratio of wages to turnover to the wages paid to staff, including amounts paid to the Saturday girl, in this period.**

130. As noted above, we do not have enough information to be able to determine what the appropriate industry ratio is and have directed that HMRC should consider whether the ratio of 2.9 used for November 2012 to August 2015 should be reduced; the same ratio should be used in calculating this earlier period as well.

Direct tax assessments

131. HMRC submitted that they were entitled to make discovery assessments under s29 Taxes Management Act (TMA) 1970 (as applicable to the years in question), as the finding of the discrepancies between the diary and the cash book in 2013 amounted to a discovery that income which should have been assessed had not been so assessed, and that this had been brought about carelessly or deliberately by Mrs Crutchley or by someone acting on her behalf.

132. Although the error was established in 2012/13, HMRC submitted that the assessments for earlier years had been raised on the basis of presumption of continuity, that the same error had occurred in such earlier years. The assessments were made on 28 April 2015 (for the tax years 2008/9 to 2011/12) and 29 April 2015 (for the tax year 2012/13).

133. Under s36(1) TMA 1970 an assessment may be made up to six years after the end of the relevant tax year where there has been a loss of tax brought about carelessly by the taxpayer. For the tax years 2009/10 to 2012/13, the assessments were made within this time period.

134. For the 2008/9 tax year, the six year period under s36(1) expired on 5 April 2015 and so an assessment cannot be made under s36(1) TMA 1970.

135. HMRC submitted, instead that the assessment for 2008/9 was in time under s36(1A)(a) TMA 1970, which applies where the loss of tax is brought about deliberately by the taxpayer.

136. Officer Thomas' evidence is that he considered that the behaviour which led to the loss of tax was deliberate on the basis of Officer Burke's notes of the meeting held in July 2013.

Whether behaviour deliberate or careless

137. HMRC submitted that Mrs Crutchley had acted deliberately to suppress takings in order to keep declared turnover below the VAT threshold, and that this had been done by paying wages from takings before declaring the takings.

138. As set out above, we do not consider that the evidence supports the conclusion that turnover was suppressed by the payment of wages from takings. We also note that the contention that turnover was suppressed to keep it below the VAT threshold is not supported by the evidence as the declared turnover for 2008/9 was above the VAT threshold.

139. The burden of proof is on HMRC to show that the behaviour which led to the loss of tax was deliberate; there are clear discrepancies between the diary and the takings and we agree that the diary cannot be relied upon to verify the turnover of the business, but we do not consider that HMRC has established that these discrepancies and any loss of tax were deliberately brought about by Mrs Crutchley.

140. Some of the discrepancies noted, for example, are relatively small and could have arisen as a result of two cancelled appointments for colour which were not properly recorded. Mrs Crutchley noted that one member of staff had been dismissed because they were entering fictitious bookings in the diary in order to have free time; another had been dismissed for stealing from the business and other staff members. It was indicated that these were both in 2012, and so cannot entirely explain the differences. Mrs Crutchley stated that she otherwise trusted her staff.

141. We do not consider that the subsequent alteration of the diary is evidence of deliberate suppression of takings as we prefer Mrs Crutchley's evidence that she was confused as to what was required of her and, as she believed that her takings figures were correct, believed that she matching up the records as required.

142. Considering all of the evidence, we do not consider that HMRC have discharged the burden of proof on them and have not established that Mrs Crutchley deliberately brought about a loss of tax.

143. We do consider, however, that Mrs Crutchley's behaviour with regard to record keeping and hence to making declarations for tax purposes was careless: in particular, no accurate record of supplies was kept against which it would be possible to verify that takings were accurate.

144. Accordingly, as we consider that there was careless behaviour, the extended time limits in s36(1) TMA 1970 apply and we find that the income tax assessments for 2009/10 to 2012/13 were properly issued. The income tax assessment for 2008/9 was not raised within the six year time limit, and we find that the extended time limit in s36(1A) TMA 1970 does not apply as the behaviour leading to the loss of tax was not deliberate, so that that assessment was not properly issued.

Amounts of assessments

145. Both parties accepted that the direct tax assessments should follow the VAT assessments; HMRC agreed that the assessments would have to be recalculated if the VAT assessments were varied by the Tribunal.

146. As stated above, we have directed that the VAT assessments should be revised for the earlier period and reconsidered for the later period. As agreed by HMRC, the properly issued direct tax assessments are to be amended to follow the revision and reconsideration.

Belated notification penalty

147. Mrs Crutchley accepted that she should have re-registered for VAT and did not dispute that a belated notification penalty was appropriate. The amount of such penalty will need to be reviewed by HMRC when the VAT assessments have been reconsidered and revised.

Direct tax penalty

148. As the income tax assessment for 2008/9 was not raised in time, the penalty for that tax year is not validly raised.

149. For the penalties for the 2009/10 to 2012/13 tax years, we agree with the 25% mitigation figure but, as set out above, we do not consider that Mrs Crutchley's behaviour was deliberate. Accordingly, we consider that the direct tax assessment penalty should be recalculated on the basis of prompted, not deliberate, behaviour and to reflect the revised income tax assessment following the revision and reconsideration of the VAT assessments.

Decision

150. In summary, it was agreed that Mrs Crutchley should have re-registered for VAT in 2008. The VAT return submitted by Mrs Crutchley in 2015 was clearly incorrect as the turnover in that return was substantially lower than that declared for income tax purposes for the relevant periods.

151. Although we do not consider that there was deliberate suppression of takings by Mrs Crutchley in the diary and cash books considered in this matter, we consider that the prime records of the business cannot be relied upon to verify the turnover of the business for VAT purposes. HMRC are therefore entitled to make an assessment for VAT purposes and both parties agreed that the income tax assessments would follow from the VAT assessment.

152. As to the amounts of such assessments and the associated penalties, we find as follows:

(1) The VAT assessment for the period November 2012 to August 2015 is made to best judgement as to the methodology used but direct that HMRC should reconsider whether the appropriate ratio should be less than 2.9 in light of the location and situation of the salon, and the assessments should be reviewed to consider the accounts information provided as to wages for the 2014 and 2015 accounting periods;

(2) The VAT assessment for the period March 2008 to October 2012 is not made to best judgement as it does not properly take into account material available to HMRC and the reason given for the use of a different methodology when there had not been a material change in the business is not supported by the material available. HMRC are directed to remake he assessment using the same methodology as for the period in November 2012 to August 2015, subject to the direction above.

(3) The VAT belated notification penalty should be amended as necessary to reflect the amendments to the assessments as directed above.

(4) The direct tax assessment for the 2008/9 year was made out of time as the behaviour leading to any loss of tax for that year was not deliberate.

(5) The direct tax assessments for 2009/10 to 2012/13 were made in time and the amount of such assessments should be amended to reflect the amendments to the VAT assessments.

(6) The direct tax penalty for 2008/9 is not valid as the assessment was made out of time. The penalties for 2009/10 to 2012/13 should be reduced to reflect the fact that the relevant behaviour was careless, not deliberate, and the amount should be amended to reflect the amendments to the amount of the assessments directed above.

153. The appeal therefore succeeds in respect of the question of exercise of best judgement; as to the 2008/9 income tax assessment; and partially as to the penalties in respect of direct tax. The appeal is dismissed in all other respects.

154. 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.

ANNE FAIRPO
TRIBUNAL JUDGE

RELEASE DATE: 8 JANUARY 2020