TC07943

VAT – assessment under s73 VATA – standard rated sales incorrectly recorded as zero rated – output tax under-declared - whether assessment made to best judgment – yes – whether assessment displaced by appellant – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/02103

BETWEEN

SUBWAY (STAINES CENTRAL) LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE NATSAI MANYARARA
SONIA GABLE JP

The hearing took place on 7 July 2020. With the consent of the parties, the form of the hearing was V (video) /Kinly/Tribunal video platform. A face to face hearing was not held because it was not in the public interest during the pandemic to hold a face to face hearing open to the public and it was in the public interest for the hearing to go ahead remotely, which by necessity meant it must be in private.

We heard Mr Kliment Gkinin, Director, for the Appellant and Mrs Rosemary James, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

Introduction

1. The Appellant appeals against an assessment of VAT covering the tax periods from 05/15 to 02/17 (inclusive) ('the Assessment'). The Assessment comprises of an additional £37,568.00 of output tax following the decision that the Appellant had previously under-declared output tax. The Assessment was issued on 9 July 2018, pursuant to s73(1) of the Value Added Tax Act 1994 (hereinafter referred to as 'VATA').

2. The Appellant is also appealing against an inaccuracy penalty ('the Penalty') charged pursuant to Sch 24 of the Finance Act 2007 ('Schedule 24'), in the amount of £6,198.02, relating to inaccuracies in the Appellant's VAT returns for the period identified above.

Background facts

3. The Appellant traded as a franchisee of Subway, based in Staines Central, with premises situated at 50 High Street, Staines-upon-Thames, Middlesex. Mr Kliment Gkinin was, at all material times, the Appellant's Director. The Appellant registered for VAT, with effect from 1 February 2015. The Appellant's VAT returns for the relevant period displayed 39% to 53% of standard-rated sales, which was considered to be significantly lower than that normally seen in Subway restaurants. Following consideration of the Appellant's VAT returns, the Appellant's case was passed on to Officer Ansell (HMRC), who then initiated a series of covert test purchases; the first of which was carried out on 28 February 2017, with a further three test purchases being carried out on 2 March 2017.

4. Following the four test purchases, Officer Ansell wrote to Mr Gkinin, on 10 April 2017, in order to schedule a VAT inspection meeting on 23 May 2017. On 18 May 2017, Mr Gkinin emailed HMRC to cancel the intended meeting. Officer Ansell subsequently left HMRC in June 2017 and the matter was passed on to Officer Knight. On 17 July 2017, Officer Knight wrote to Mr Gkinin to confirm that the meeting had been re-scheduled to take place on 1 August 2017.

5. On 1 August 2017, Officer Knight visited the agreed location of the VAT inspection, which was the offices of Cheshams Chartered Certified Accountants. Present at the meeting were Mr Gkinin, Mr Ashok Cheriyan (accountant) and Officer Knight. During the meeting, Mr Gkinin informed Officer Knight that when he purchased the franchise, he had discovered that it was not profitable. He had therefore sold the franchise in July 2017. It was agreed at the meeting that Officer Knight would carry out an invigilation at the former business.

6. On 14 August 2017, an invigilation exercise was carried out by Officer Knight. On 23 August 2017, Officer Knight wrote to Mr Gkinin with a proposed Assessment in the sum of £53,913.00, based on the results of the invigilation carried out.

7. On 4 July 2018, a penalty explanation letter and schedule were issued to the Appellant. The intention was to charge a penalty (based on carelessness) in the sum of £8,776,34. On 9 July 2018, a notice of assessment under s73(1) VATA for under-declared output tax for the accounting period 05/15 to 02/17 was issued by HMRC, in the sum of £53,190.00. The Assessment was calculated on a rate of supersession of declared sales of 75.94%. The Penalty was subsequently issued on 6 August 2018.

8. On 4 January 2019, the Assessment was reduced to £48,025.20 following identification of an error in the calculation, where a percentage of 79.5% had been applied, instead of 75.9%. Mr Gkinin then submitted an appeal against the Assessment and the Penalty on 22 January 2019. The appeal was treated as a review request, in light of the correspondence that had already been exchanged between Mr Gkinin and HMRC. A review acknowledgment letter was issued on 22 February 2019 and revised on 27 February 2019.

9. By a review conclusion dated 7 March 2019, the Assessment and the Penalty were varied as the true output tax figure due had been calculated on a VAT exclusive, as opposed to VAT inclusive, basis. The Assessment was therefore varied from £48,025.20 to £37,568.00.

10. On 1 April 2019, Mr Gkinin appealed to the Tribunal.

11. The Respondent's case can be summarised as follows:

(1) From the till receipts obtained during the four test purchases at the Appellant's business premises, HMRC established that staff members incorrectly charged supplies that should have been standard-rated as zero-rated. This would result in under-declared output tax. In all four instances, purchases were recorded as zero-rated, without asking the customer if they were eating in or taking away. One cold food purchase was consumed on the premises. This should have been recorded as standard-rated.

(2) The invigilation on 14 August 2017 was carried out by Officer Knight within one month of the sale of the Appellant's business and covered 131 sales. The invigilation exercise illustrated that 75.9% of sales should have been standard-rated.

(3) Having determined that the Appellant's business records could not be relied upon as accurate, and in the absence of an alternative calculation, a best judgment Assessment has been raised under s73(1) VATA, with the percentage of 75.9% standard-rated supplies applied.

(4) HMRC made an honest and genuine attempt to make a reasoned assessment of the VAT payable. HMRC are required to exercise their powers in such a way as to make a value judgment based on the material which is before them. The burden lies on the taxpayer to establish the correct amount of tax due. The Appellant's records could not be relied upon to show the correct level of standard-rated sales. Having gathered evidence through test purchases, it was reasonable to conclude that these incorrect transactions were not an isolated incident.

(5) The Penalty has correctly been calculated. Conditions 1 and 2 of Sch 24 are established. VAT returns including under-declared standard-rated sales were submitted. HMRC contend that these inaccuracies were 'careless'. A penalty of 30% of the Potential Lost Revenue ('PLR') is payable.

(6) The inaccuracies were discovered during further investigations carried out by HMRC. HMRC consider this to be a 'prompted' disclosure, within the meaning of paragraph 9 (2) (b) of Sch 24. The minimum penalty charged within para 10 of Sch 24 is 15%, for prompted disclosure. Full reductions have been given for 'helping' and 'giving' and a 20% reduction for the 'telling' element has been applied. This gives a total reduction of 90%. The penalty is therefore charged at 16.50% of the £37,568.00 PLR.

(7) Having considered the facts of the case, there are no special circumstances. The penalty assessment has been correctly made in accordance with paragraph 13 of Schedule 24.

12. The Appellant's grounds for appeal can be summarised as follows:

(1) HMRC never highlighted the errors on the receipts during the test purchases until five months after the test purchases. The Appellant should have been informed of the errors in time. There could have been a system error, or pure misunderstanding between HMRC and the Appellant's staff.

(2) The franchise was sold and HMRC conducted a check on the new business on 14 August 2017, for a couple of hours over lunch. Even if this kind of assessment is considered to be valid or fair, there are many issues with the way it was done.

(3) VAT estimates were done under a different company, with different management and staff. There were different offers on hot and cold food at the time (delivery platters for offices and vegetarian food).

(4) One day's invigilation is not representative.

(5) The Appellant sent an appeal and the appeal was never logged as a formal appeal but as a complaint. HMRC only corrected the errors in some of their calculations without addressing the Appellant's other points of concern.

Evidence and Submissions

13. At the commencement of the appeal hearing, Mrs James proceeded by opening HMRC's case, as set out in the Statement of Case. She cross-referred us to various documents included in the Documents Bundle and the Authorities Bundle.

Evidence

14. We then heard evidence from Officer Knight. In his oral evidence, he adopted the contents of his witness statement, dated 3 March 2020. In response to further questions in examination-in-chief from Mrs James, he stated the following:

(1) Paragraph eight of his witness statement refers to three test purchases when, in fact, there were four test purchases. At paragraph 20 of his witness statement, he refers to a percentage of 74.94% instead of 75.94%. Apart from this, there are no other amendments to be made to his witness statement.

(2) HMRC carried out two major exercises relating to Subway restaurants over the last ten years. They discovered that restaurants were not correctly recording VAT. This was established through invigilation exercises. Guidance was provided to staff by HMRC. He personally carried out invigilation exercises on ten restaurants and he was in contact with officers who were carrying out other invigilation exercises. In most cases, VAT was underpaid.

(3) There is a good deal of continuity between franchises as the franchiser has control. All supplies are approved and decided by the head office. The advertising and food are identical and the design is by authorised sub-contractors.

(4) In Subway restaurants, toasting is a major feature, if not the selling point. During invigilation, he found that toasted sandwiches were a major component of sales. He only came across a couple of restaurants where the taxable level of sales was lower, but the restaurants were in unusual areas.

(5) He concluded that special circumstances did not apply because Mr Gkinin has not made HMRC aware of any special circumstances, despite Mr Gkinin's personal issues at the time. Mr Gkinin did not make a strong enough case.

(6) There was no Personal Liability Notice ('PLN') on Mr Gkinin.

15. In response to questions for the purposes of clarification from the Tribunal, Officer Knight stated that invigilation exercises vary from premises to premises, to ensure that the least disruption is caused to the business. Officers will stand next to the till and see what is being sold. They will then retain a copy of the till receipt to see if the VAT liability is correct. The exercises take place at a busy time, such as lunch time. Some officers have worked at night. The Subway, Staines Central branch is a little cramped and he could not stand at the till. He did however take a copy of the sales invoice as a sale went through. The invigilation exercises are carried out with the knowledge and co-operation of staff.

16. Under cross-examination by Mr Gkinin, Office Knight stated the following:

(1) He was sitting at a table near the till during the invigilation exercise. There is a long counter with ingredients behind a counter. There are also ovens behind the counter. People queue up in front of the counter and make their orders. They order the ingredients they would like and then the sandwiches will be heated. The order is then put back on the counter and the customer goes to the till to pay and get their receipt.

(2) He made a note of who was ordering which sandwich and whether the sandwich was heated. It may be possible to lose track of which invoice relates to which sandwich, if it is busy.

(3) He is fairly experienced in invigilation exercises after ten years' experience.

(4) He did not ask the new owners of the restaurant if his invigilation caused disruption and he just carried out one day's invigilation. The new owners did not mind.

(5) He cannot discuss the tax affairs of other taxpayers.

17. There was no re-examination.

18. We then heard from Mr Gkinin. In his oral evidence, he adopted the contents of his letters/grounds of appeal. A large part of Mr Gkinin's cross-examination of Officer Knight comprised of statements, in which he stated the following:

(1) He has been informed by the new owners that Officer Knight was very polite during the invigilation exercise. He respects what HMRC need to do and he is not disputing that best judgment was applied. The invigilation was not however representative of taxable sales. Franchises have a choice as to the deals and products they promote.

(2) Customers prefer crisps, which are zero-rated. The majority of meal deals in Subway, Staines Central, were cold meal deals. There were rarely any hot meals. Toasting of sandwiches is time consuming. In Staines, many people are focused on their health and people purchased vegetarian meals. The majority of customers were also office staff, as offices were two to three minutes away. People who like to eat-in prefer to go to McDonald's, which is much bigger. There are limited breaks for people in retail.

(3) There were unannounced checks on 28 February 2017 and 2 March 2017. There are four receipts. He was only made aware of the issue five months later and he was unable to properly investigate what had happened during the visits. He is not sure if there were system failures or staff errors, as sales are recorded on the system for one month.

(4) There are discrepancies in the receipts included in the bundle. The issues are in relation to the number of people who were in the restaurant and the seating capacity in the restaurant.

(5) The call that took place between him and Mr Ansell (HMRC) is missing from the Documents Bundle. He explained to Mr Ansell that he had been dealing with personal problems. Mr Ansell told him that there were no issues but that HMRC just wanted to meet him to learn more about his business. He (Mr Gkinin) had to change the date for the meeting because he could not be in two places at the same time. He put the store up for sale because of the issues that he was dealing with.

(6) The person he purchased the business from had not been honest with him when he purchased the business. He had managed to increase the sales in two years. The main reason he sold the business was that he had moral concerns about how Subway was treating its staff. He did not sell the business on 26 July 2017. That date was simply when the sale was complete. He put the business up for sale in September 2016 and Subway delayed the transfer for six months.

(7) He provided evidence and tried to appeal three times. He supplied evidence of sales one week before and one week after the invigilation exercise. The taxable sales were 55% of sales. There were 67% of taxable sales on the day of the invigilation. The

assumptions being made by HMRC are not accurate. Even though the restaurant is on the High Street, there are different clientele. There are a lot of office staff who want cold sandwiches to take back to the office. There are also retail staff.

(8) Platter sales represented 80% of sales on some days, when the weather was bad, and there were few other customers. DHL was a major client in this regard and there were regular contracts. There would be three to four platters of sandwiches. Platters were prepared in the morning and delivered later in the day. He has emails about the contracts. Robert Taylor was communicating with companies on his behalf. Robert Taylor is no longer available. The other individual who was involved in the contracts is now in Australia.

(9) August is the busiest month as children are out of school. Taxable sales would therefore be slightly higher. There are a lot of families with children who will eat in.

(10) He met Officer Knight at his accountant's office (Cheshams CCA) but that accountant was not representing him. The first company that represented him were De Bono & Hamilton Forensic Accountants Ltd. They told him that a day's invigilation was not representative.

(11) He no longer has access to Subway systems to get any further information. No-one asked him if he had any problems with continuing with the invigilation. The new owners were not asked if Officer Knight caused any disruption to their business. HMRC were not keen on carrying out a further invigilation exercise with the new owner.

19. In addition, Mr Gkinin stated the following:

(1) The invigilation in the *Golden Cube Limited v HMRC* [2018] UKFTT 488 (TC) (Judge Cannan) case was over three days. The invigilation in his appeal was only one day. HMRC have not taken into account when the toasting machine may have been broken.

(2) He had major issues with the till system and he had to purchase a new till. The screen kept freezing.

(3) The system tells you what you need to order and things have to be recorded accurately. Staff ordered stock three times a week and everything is done automatically by the system.

(4) The issue is the way the invigilation was conducted. If he had been aware that there were any issues in advance, he would have made sure that he was on site at the time of the invigilation. He had only been told that Mr Ansell had wanted to introduce himself.

(5) Taxable sales were about 35% to 40% when he purchased the business. This increased to 50% to 55% over time.

(6) He is suffering from anxiety because of all of these issues.

20. Under cross-examination by Mrs James, Mr Gkinin stated the following:

(1) He is aware that HMRC's position is that three out of the four test purchases made by HMRC in February and March 2017 incorrectly recorded the sales as zero-rated. He agrees that toasted food and eat-in meals should be standard rated.

(2) He does not have any evidence to show that, at times, some of the sales comprised of food platters. He cannot provide any evidence because he no longer has access to the till system at Subway.

(3) The high street in Staines was not an average high street. A lot of teenagers used to loiter around after 5pm and some of his staff were attacked. People did not generally go to the high street. There was also a lot of traffic in the area. He used to be part of the membership of the council. There was a Business Improvement Development where businesses would pay a fee to bring events to the high street. On Wednesdays and Saturdays, there was a market. This was unlike Uxbridge, where there was a constant flow of people from the station. If it was cloudy in Staines, the high street would be deserted.

(4) Lunch time was the busiest time in the restaurant and they could not cope with queues when he ran the restaurant. They tried not to use the toaster and promoted cold food. He does not have any evidence to show what different deals are being provided by the new owners of Subway, Staines Central.

(5) He accepts that the report provided to HMRC as part of the invigilation exercise would have been available when he was running the Staines branch. He has not provided any other reports because he does not have access to the system as this information is stored in the cloud. You can only access this when you are running a franchise.

(6) The taxable sales he has calculated are different from those provided for the invigilation. He believes there were 66% of taxable sales.

(7) His staff were aware of the importance of recording accurate sales. If the system fails, it would be important to enter the information accurately.

(8) He accepts that toasted and non-toasted items use the same ingredients.

21. The last witness to give evidence was Mr Daniel Dimov (Appellant's Duty Manager). In his oral evidence, he adopted the contents of his undated witness statement as being true and accurate. He added the following:

(1) He is currently a delivery driver for DPD. At the time of the test purchases, he was a manager at Subway, Staines. He started working at Subway in November 2015 and he stopped working there in about July 2017.

(2) He worked five days a week (sometimes six days) and he was on site from 11am until closing. Unless he was serving customers, his duties involved ensuring that staff were doing their job properly. He was also involved in training staff.

(3) Quite often there were problems with the toaster and the only option would be to put food in the microwave. Most customers did not like this option as bread would become soggy. On one occasion, the toaster was not working for two days and they were mostly serving cold food.

(4) They sold a large number of salads on a daily basis.

22. Under cross-examination by Mrs James, Mr Dimov stated the following:

(1) As far as he knows, cold sandwiches and salads are not taxable.

(2) Cold food is not taxable although crisps are taxable. Potato crisps may be subject to VAT but they served different types of crisps, like corn crisps, in Staines.

(3) Bottled drinks like water, Coca-Cola and iced tea are probably standard-dated, as are toasted sandwiches.

(4) The only thing that is always served hot is meat balls (in response to Mrs James' indication that his witness statement suggests that he is not sure which items are subject to VAT and which items are not).

(5) He did not mention the toaster breaking down before because he has only just remembered this. It did not just breakdown once. On one occasion it broke down for four to five days.

23. There was no re-examination and no further witnesses were called.

Closing submissions

24. In her closing submissions, Mrs James stated the following (in summary):

(1) Of the four receipts from the test purchases, three contained errors. Hot food and eat-in meals were incorrectly stated to be zero-rated. They should have been standard-rated, in line with Group 1 of Sch 8 VATA. The Appellant has therefore under-declared output tax.

(2) By the time it was possible to meet the Appellant to carry out an invigilation exercise, the Appellant had sold the franchise and it was no longer possible to carry out an invigilation of the Appellant's business. It was therefore agreed that there would be an invigilation of the new business, within one month of the business being sold. Franchises are consistent as the franchiser retains control. There is no evidence to suggest that the business practices had changed in relation to operation or customer demographic.

(3) The Appellant's business records are not accurate and the VAT returns are not correct. HMRC therefore raised assessments under s73 VATA. In the absence of any alternative evidence, best judgment has been applied consistently with s73 VATA. A percentage of 75.9% was established through the invigilation exercise carried out. The principles established in case law have been applied. The Assessment is reasonable and not arbitrary.

(4) The burden is on the Appellant to show that the Assessment is excessive. Any evidence the Appellant could have provided in relation to the food offers being made in the new business would have been available when the Appellant was running the business. The Appellant has cited case law to say that one day's invigilation is not

representative. The Appellant's appeal can be distinguished from the case law relied on. In the case the Appellant has specifically relied on, HMRC had not provided any evidence to show that the VAT returns were incorrect.

(5) The Penalty has been charged as a result of the Appellant's failure to take reasonable care. There is no allegation of deliberateness. The percentage PLR is 30% for careless action. PLR is defined in para 5 of Sch 24. The inaccuracies were discovered during investigations and therefore this was prompted disclosure. Some assistance was provided by the Appellant and the Penalty applied was therefore 16.5% of the PLR. Officer Knight considered all the circumstances of the case and no special circumstances were found to exist. The Appellant's business has ceased trading and therefore the Penalty cannot be suspended. The Penalty was correctly calculated.

25. In closing and in reply, Mr Gkinin stated the following (in summary):

(1) He is basing his appeal on the *Golden Cube* case. The situation there is identical to his situation. The invigilation exercise is not representative.

(2) The invigilation was done over three hours, as opposed to three days. The only other evidence is the unannounced checks, where three receipts were found to be inaccurate. He does not know if this was down to a system failure or human error.

(3) He was not given the opportunity to investigate further. He was only told about the problems five months after the unannounced checks.

(4) He is not disputing that the best judgment was applied but the invigilation was only over three hours.

(5) He does not agree that three receipts can be representative of VAT over a three-year period.

26. At the conclusion of the appeal hearing, we reserved our decision, which we now give with reasons.

Discussion

27. This is an appeal by the Appellant against an assessment of VAT ('the Assessment') made by HMRC, in the sum of £37,568.00, following the decision that the Appellant had under-declared output tax during the period 05/15 to 02/17 (inclusive) ('the relevant period'). The Assessment was made following an invigilation exercise in which HMRC concluded that the Appellant had been incorrectly classifying standard-rated food supplies as zero-rated. In summary, standard-rated sales (subject to VAT at 20%) comprise of food consumed on the premises (eat-in), as well as hot takeaway food. Zero-rated sales comprise of cold food. The issue raised in this appeal is whether the Assessment made by HMRC was made to the best of judgment. The relevant statutory provision is s73(1) VATA.

28. The Appellant also appeals against an inaccuracy penalty ('the Penalty') in the sum of £6,198.02.

29. The burden is on the taxpayer to establish the correct amount of tax due. This is evident from the case *Commissioners of Customs and Excise v Pegasus Birds Ltd* [2004] STC 1509; [2004] EWCA Civ 1015, where Carnwath LJ said this:

> "[14] Generally, the burden lies on the taxpayer to establish the correct amount of tax due:
>
> 'The element of guess-work and the almost unavoidable inaccuracy in a properly made best of judgment assessment, as the cases have established, do not serve to displace the validity of the assessments, which are *prima facie* right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessments right or more nearly right.'

30. HMRC are required to demonstrate that the Penalty is due and that it is correctly charged. The standard of proof is the civil standard; that of a balance of probabilities.

31. We have derived considerable benefit from hearing the oral evidence given in this appeal. We have further had the benefit of considering all of the documents submitted in support of the appeal, which included a comprehensive collection of correspondence and other documentation relating to the Assessment and the Penalty. Having considered all of the documentary and oral evidence cumulatively, we make the following findings of fact:

32. The parties are in agreement about the background chronology, albeit that they differ in view as to the conclusions we should reach as a result. The Appellant's VAT returns for the relevant period displayed 39% to 53% of standard-rated sales, which was considered to be significantly lower than that normally seen in Subway restaurants by HMRC. Following consideration of the Appellant's VAT returns, a series of covert test purchases was initiated; the first of which was carried out on 28 February 2017, with a further three test purchases being carried out on 2 March 2017.

33. The receipts relating to the test purchases were accompanied by notes setting out the actual orders made by the officers who took part in the test purchases. We have had the benefit of seeing the receipts and accompanying notes. Mrs James further helpfully explained the date format on each of the receipts. There is no suggestion that the receipts cannot be relied on, save that Mr Gkinin's position is that there are inconsistencies in relation to the number of customers who were present and the amount of seating available in the restaurant, which we will consider later. We are however satisfied that we can place reliance on the receipts as adequately reflecting the sales that were made during the test purchases. We are further satisfied that the accompanying notes are reliable.

34. During the test purchase on 28 February 2017, the relevant officer ordered a toasted sandwich. His note records that he was not asked whether he would be eating-in. The relevant receipt however showed that the order was put through as a zero-rated sale. A further three test purchases then took place on 2 March 2017. The receipts relating to these sales show that sales were put through as being zero-rated sales. The accompanying notes however show that on all three of the test purchases on 2 March 2017, the relevant officers were not asked whether they would be eating-in or taking away, despite the fact that all three sales were to eat-in. In one of the sales on 2 March 2017, the relevant officer asked for a toasted sandwich, which was also recorded as a zero-rated sale.

35. A VAT inspection meeting was then scheduled. On 1 August 2017, Officer Knight, who gave evidence before us, visited the agreed location of the VAT inspection, which took place at the offices of Cheshams Chartered Certified Accountants. Present at the meeting were Mr Gkinin, Mr Ashok Cheriyan (accountant) and Officer Knight. We have seen the notes relating to the meeting that was held on that occasion and the accuracy of the notes has not been called into question by Mr Gkinin. During the meeting, Mr Gkinin informed Officer Knight that when he purchased the franchise, he had discovered that it was not profitable. He had therefore sold the franchise in July 2017. At the appeal hearing, Mr Gkinin clarified that the sale was completed on 26 July 2017 but that he had put the franchise up for sale much earlier and Subway had delayed the transfer. It was agreed at the meeting that Officer Knight would carry out an invigilation at the former business. The purpose of the invigilation was to enable HMRC to get an indication of the correct level of standard-rated sales.

36. On 14 August 2017, an invigilation exercise was carried out by Officer Knight. We will return to consider the invigilation exercise in greater detail later. On 23 August 2017, Officer Knight wrote to Mr Gkinin with a proposed Assessment in the sum of £53,913.00, based on the results of the invigilation carried out. On 4 July 2018, a penalty explanation letter and schedule were issued to the Appellant. The intention was to charge a penalty (based on carelessness) in the sum of £8,776,34. On 9 July 2018, a notice of assessment under s73(1) VATA for under-declared output tax for the accounting period 05/15 to 02/17 was issued in the sum of £53,190.00. The Assessment was calculated on a rate of supersession of declared sales of 75.94%. The Penalty was subsequently issued on 6 August 2018.

37. On 4 January 2019, the Assessment was reduced to £48,025.20 following identification of an error in the calculation, where a percentage of 79.5% had been applied, instead of 75.9%. Mr Gkinin then submitted an appeal against the Assessment and the Penalty on 22 January 2019. The appeal was treated as a review request, in light of the correspondence that had already been exchanged between Mr Gkinin and HMRC. A review acknowledgment letter was issued on 22 February 2019 and revised on 27 February 2019.

38. By a review conclusion dated 7 March 2019, the Assessment and Penalty were varied as the true output tax figure due had been calculated on a VAT exclusive, as opposed to VAT inclusive, basis.

39. The Assessment was therefore varied from £48,025.20 to £37,568.00, as follows:

VAT Period	**Initial Assessment incorrect percentage of 79.5%**	**Revised Assessment using 75.9%**	**Revised Assessment Amount (following statutory review)**
05/15	£1,780.00	£1,541.81	£1,144.00
08/15	£7,216.00	£6,490.31	£5,054.00
11/15	£5,978.00	£5,383.53	£4,199.00
02/16	£6,012.00	£5,326.16	£4,070.00
05/16	£7,100.00	£6,429.36	£5,047.00
08/16	£8,677.00	£7,905.41	£6,251.00
11/16	£8,827.00	£8,048.97	£6,371.00
02/17	£7,600.00	£6,899.65	£5,432.00
TOTAL	**£53,190.00**	**£48,025.20**	**£37,568.00**

40. The Penalty was also varied from £8,776.34 to £6,198.72, as follows:

VAT Period	**Potential lost Revenue (PLR)**	**Penalty (Charged at 16.50% rounded down)**
05/15	£1,144.00	£188.00
08/15	£5,054.00	£833.00
11/15	£4,199.00	£692.00
02/16	£4,070.00	£671.00
05/16	£5,047.00	£832.00
08/16	£6,251.00	£1,031.00
11/16	£6,371.00	£1,051.00
02/17	£5,432.00	£896.00
TOTAL	**£37,568.00**	**£6,194.00**

41. There was no PLN on Mr Gkinin.

42. In determining whether the burden of proof has been discharged, the Tribunal is required to consider the totality of the evidence. We proceed by considering the basis of the Assessment, initially limiting ourselves to the information before HMRC at the time that the Assessment was made.

VAT Assessment: Best Judgment

43. The power given to HMRC under statute (s73 VATA) is to make an assessment to their best judgment on such information as is available. Case law has established that this allows for a margin of error, as opposed to an educated guess. An assessment requires to be made to best judgment in the sense that it has to be prepared in good faith. This must be balanced against the well-established rule that the primary obligation is on the taxpayer to make a return himself and HMRC are not required to do the work for the taxpayer.

44. The meaning of the phrase "to the best of their judgment" has been the subject of some adjudication. The starting point to the sphere of litigation that has arisen are the principles enunciated in the case of *Van Broeckel v Customs and Excise Commissioners* [1981] STC 290, where the classic test was laid down by Woolf J (as he then was), at page 292, as follows:

> "…… 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."

45. He added this, at page 296:

> "If they do make investigations then they have got to take into account material disclosed by those investigations.

46. Woolf J drew three conclusions in relation to the obligation that is upon HMRC. Firstly, there must be some material before HMRC on which they can base their judgment. Secondly, HMRC are not required to do the work for the taxpayer in order to form a conclusion as to the amount of tax due. Thirdly, HMRC are required to exercise their powers in such a way that they make a value judgment on the material which is before them.

47. Lord Justice Carnwath cited the same passages in *Rahman v Customs and Excise Commissioners* [1998] STC 826. At page 835, he said this:

> "……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 has been reached 'dishonestly or

vindictively or capriciously'; or is a 'spurious estimate or guess in which all elements of judgment is 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."

48. The test to be applied in interpreting s73(1) VATA is now adequately set out in *Pegasus Birds Ltd*. At [38], Lord Justice Carnwath provided the following guidance:

"38. In the light of the above discussion, I would make four points by way of guidance to the tribunal when faced with 'best of their judgment' arguments in future cases:

(i)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.

(ii)Where the taxpayer seeks to challenge the assessment as a whole on 'best of their judgment' grounds, it is essential that the grounds are clearly and fully stated before the hearing begins.

(iii)In particular the tribunal should insist at the outset that any allegation of dishonesty or other wrongdoing against those acting for the commissioners should be stated unequivocally; that the allegation and the basis for it should be fully particularised; and that it is responded to in writing by the commissioners. The tribunal should not in any circumstances allow cross-examination of the Customs officers concerned, until that is done.

(iv)There may be a few cases where a 'best of their judgment' challenge can be dealt with shortly as a preliminary issue. However, unless it is clear that time will be saved thereby, the better course is likely to be to allow the hearing to proceed on the issue of amount, and leave any submissions on failure of best of their judgment, and its consequences, to be dealt with at the end of the hearing."

49. The threshold for making a "best judgment" assessment is therefore a low one. The correct test is whether there has been an honest and genuine attempt to make a reasoned assessment: see *Pegasus Birds Ltd*, at [22] (per Carnwath LJ). This does not translate to meaning that whether an assessment could be said to be "wholly unreasonable" is irrelevant to determining that question: see *Pegasus Birds Ltd*, at [77] (per Chadwick LJ). HMRC only need to consider the information before them in a fair way and come to a decision which is reasonable (and not arbitrary) as to the amount of tax due.

Q. Was the Assessment reasonable and carried out to the best of judgment?

50. Officer Knight, who conducted the invigilation exercise and issued the Assessment in this appeal, gave evidence before us. We find that Officer Knight gave evidence in a clear and straightforward manner, without equivocation, and we are satisfied that he was a truthful witness. His evidence included a summary of his experience in carrying out a number of invigilation exercises of the nature carried out in this appeal. Officer Knight has worked as an Assurance Officer for the Customer Compliance Team at HMRC since 2003. Officer Knight further provided detail about the events leading up to the invigilation, as well as the events on the day of the invigilation itself. Based on his experience and the level of consistent detail included both in his written and oral evidence, we are satisfied that Officer Knight was experienced in the invigilation exercise that he conducted on behalf of HMRC in this appeal.

51. The Assessment followed a day's invigilation on 14 August 2017. Mr Gkinin had sold the franchise by the time of the invigilation exercise and it was agreed that the invigilation would take place at the new business. As part of his evidence, Officer Knight referred to the continuity that exists between Subway franchises as a direct result of the level of control exercised by the franchiser. We find that the invigilation exercise took place within one month of the sale of Mr Gkinin's business, with Mr Gkinin's consent and with the cooperation of the current owner of the franchise. We are satisfied that continuity does exist between franchises. We accept that Subway franchises are rigidly controlled by the franchiser. Such control extends to fittings and fixtures, marketing, pricing and suppliers. Mr Gkinin did not seek to gainsay this, albeit that he made reference to various offers that would have applied at the time that he ran the franchise, which he suggested may be different from those offered by the current franchisee. Mr Gkinin did not however provide any evidence of the offers available when he ran the franchise or those that are offered by the current franchisee.

52. The invigilation exercise itself involved Officer Knight attending the premises to observe the operation of the till and to record details of individual sales transactions. Officer Knight proceeded on the basis that eat-in sales and take-away sales of hot food were standard-rated, as were sales of bottled water. That is consistent with Group 1, Sch 8 VATA (zero-rating of food), which provides that supplies in the course of catering are standard-rated and which defines 'in the course of catering' as including any supply of food for consumption on the premises, as well as any supply of hot food, wherever consumed. A total of 131 sales were made during the invigilation and each sale was recorded on an invigilation sheet, which we have had the benefit of seeing. Each sales receipt was given a unique identifying number. There was also a record of the time the sale was made, whether the food was toasted or eaten-in, the gross value and whether VAT was correctly applied. The sales from the invigilation were then entered into a spreadsheet, which has also been included amongst the documents that we have had sight of.

53. The average proportion of standard-rated sales to gross sales over the day of invigilation was 75.94%. The methodology applied in making the Assessment has been adequately explained to us. Officer Knight worked out the percentage of sales that were subject to VAT by adding up the total VAT amount. He then calculating the total VAT that

would apply if there had been VAT on all sales. This was done by taking the net amount and multiplying it by 20%. Officer Knight then analysed the results from the invigilation exercise and ascertained that the proportion of standard-rated sales during the invigilation exercise was much higher than that shown in the Appellant's VAT returns for the relevant period. We acknowledge that Officer Knight's initial calculation of turnover and the findings of under-declarations had applied the wrong percentage (i.e. 79.5% instead of 75.9%). This was however rectified on review and Officer Knight candidly conceded this initial error in his evidence. The Assessment was amended on review to reflect this.

54. We were cross-referred to the different documents, which provided clear detail about the methodology underlying the Assessment. Having considered the evidence that was available, together with the methodology underlying the Assessment, we are satisfied that Officer Knight adopted a fair and balanced approach, resulting in a reasonable estimate of the true level of turnover. We find that Officer Knight's direct experience provided the necessary skills for the exercise that he carried out. By his own oral evidence, Mr Gkinin did not dispute that the Assessment was made to best judgment. He nevertheless relies on sales reports for the week preceding the invigilation and the day of the invigilation, which he contends show that the Assessment is excessive. We shall return to consider this later when considering whether the Appellant has discharged the burden of proof to show that the Assessment is excessive.

55. The Assessment was followed by two letters of complaint from the Appellant's then representatives, De Bono & Hamilton Forensic Accountants Ltd. The letters of complaint related to Officer Knight's personal conduct. We find that whilst a complaint was made against Officer Knight by Mr Gkinin's previous representatives, De Bono & Hamilton Forensic Accountants Ltd, this does not sit well with the evidence given by Mr Gkinin in these proceedings. By his own oral evidence, Mr Gkinin lucidly stated that Officer Knight had proceeded in good faith throughout the invigilation exercise. Mr Gkinin however also suggested that Officer Knight had informed him that he had proceeded with the Assessment because a complaint had been made against him by De Bono & Hamilton. He added that he had recorded his conversation with Officer Knight in this regard. We find that this allegation against Officer Knight does not however sit well with the Appellant's earlier reference to Officer Knight's benevolent conduct. We further find that this allegation is unsupported by any evidence.

56. In relation to any allegation that there was bad faith on Officer Knight's part, we find that any recording that Mr Gkinin may have made during a conversation with Officer Knight was not lawfully obtained. Indeed, Mr Gkinin could not say whether he had informed Officer Knight that he would be recording the conversation prior to the conversation taking place. Mr Gkinin, rightly in our view, has not sought to provide a copy of any such recording, which we would not have admitted in the absence of a clear indication that the conversation was to be recorded before the conversation took place. We find that there is no evidence upon which to base a finding that there was any bad faith on Officer Knight's part and there is therefore no evidence upon which to base a finding that there was an improper motive behind this Assessment. We have found that by his own oral evidence, the Appellant stated that he is not disputing that the Assessment was carried out to best judgment.

57. Having considered all of the evidence, we are satisfied that the Assessment and the methodology underlying it were reasonable and based upon all of the information that was available to HMRC at the material time.

Q. Has the Appellant discharged the burden of proof to show that the Assessment was excessive?

58. It is trite law that in an appeal against an assessment to tax, the burden is on the Appellant to show that the sums charged to tax by the assessment are excessive. This was confirmed by Mustill LJ in *Brady (Inspector of Taxes) v Group Lotus Car Companies plc* [1987] STC 635, at 642, as follows:

> "The starting point is an ordinary appeal before the [Tribunal]. Here, however unacceptable the idea may be to the ordinary member of the public, it has been clear law binding on this court for sixty years that an inspector of taxes has only to raise an assessment to impose on the taxpayer the burden of proving that it is wrong: *Haythornwaite & Sons Ltd v Kelly (Inspector of Taxes)* (1927) 11 TC 657"

59. An assessment to best judgment may be shown to be inaccurate because later evidence from the Appellant shows a more accurate picture. It is not enough for the Appellant to show that the Assessment did not reach the standard required of a reasonably competent officer. The Appellant must satisfy the Tribunal that the Assessment was *"wholly unreasonable"*. This means that the Assessment must be shown to be outside of the parameters of what could have been reasonable if all the material before HMRC had been fairly considered. Case law has established that if the officer making an assessment uses, or relies on, incorrect or flawed material provided by another officer, that must be relevant to his exercise of best judgment on behalf of HMRC. The primary obligation is however on the taxpayer to make a return himself, hence HMRC are not required to do the work of the taxpayer for the taxpayer.

60. Although Mr Gkinin has unequivocally stated in oral evidence that he does not dispute that best judgment was applied by HMRC, he nevertheless challenges the invigilation broadly on the basis that one day's invigilation is not representative. Having heard the evidence as to the invigilation carried out by Officer Knight, together with the supporting documentary evidence, we find a number of facts to be established.

61. We find that the starting point and the trigger to the invigilation exercise conducted on 14 August 2017 were the initial test purchases that were carried out on 28 February 2017 and 2 March 2017. The test purchases were against the backdrop of the information that had come to HMRC's attention concerning Subway franchises generally, where output tax was shown to have been under-declared. During the test purchases on 28 February 2017 and 2 March

2017, anomalies were identified between the purchases actually made and the sales shown on the corresponding receipts. We find that apart from challenging the seating capacity and customer presence in the franchise on the dates of the test purchases, Mr Gkinin does not challenge the record of the sales reflected in the receipts. We have had sight of the receipts and the corresponding notes relating to the test purchases. We have found that we can place reliance on the notes as representing an accurate and reliable record of the orders placed. The incontrovertible fact is that the receipts from the dates of the test purchases do not show any standard-rated sales, despite some of the officers eating-in and at least one officer asking for a toasted sandwich.

62. The following arguments were advanced on behalf of the Appellant in support of the principal submission that the Assessment is excessive:

63. Firstly, Mr Gkinin submits that the errors identified in the test purchases that preceded the Assessment may be due to staff or system errors. Whilst this is not directly relevant to the invigilation exercise itself, we have treated this statement as a submission that errors may have contributed to incorrect output tax being declared. We find however that the reference to staff errors does not sit well with Mr Gkinin's oral evidence that the system tells you what order needs to be made and it is therefore reasonable to conclude that this would leave very little room for staff error. In relation to system errors, we find that Mr Gkinin has not provided any evidence to substantiate the claim that there were problems with the till system during the period that the Assessment relates to as that is the relevant period in this appeal. We acknowledge that there has been a lapse in time and the business has changed hands, however we find that the only reference that had been made to the till system in the past was in relation to the screen freezing and not to incorrect orders being made by default. We therefore do not accept that staff or system errors can displace the Assessment.

64. Furthermore, despite Mr Gkinin's reference to the possibility of staff errors and system errors, this was not something that was referred to by Mr Dimov in his written evidence. Mr Dimov was a manager at Subway, Staines Central, at the relevant time. Mr Dimov's oral evidence was that he was at the store for most of the week and he added that he was involved in training and would often be on the shop floor. It is therefore odd that he did not identify any possible staff or system errors in his written evidence.

65. Even if we were to accept that there may have been staff or system errors that contributed to the findings during the test purchases, we find that these would not assist the Appellant's case concerning the Assessment as the previous VAT returns for the relevant period would still be inaccurate based on the findings of the invigilation and that is the relevant issue in this appeal. We further find that staff or system errors, if substantiated, would only have been relevant to any reduction in the Penalty, if there had been early disclosure of such errors. We find however that the Appellant cannot have it both ways by saying, in one breath, that there may have been staff or system errors and, in another, that HMRC's invigilation is not representative.

66. Returning to the till receipts and accompanying notes from the test purchases, secondly, Mr Gkinin submits that there were discrepancies in the notes that accompanied the till

receipts from the test purchases on 28 February 2017 and 3 March 2017. We have however found that any inaccuracies or inconsistencies identified by Mr Gkinin only related to the number of customers who were within the restaurant/seating capacity and not to the record of the sales made, as shown in the receipts. We have found that we can place reliance on the receipts and accompanying notes. We find that no taxable sales were recorded in the receipts, despite the orders placed by the officers during the test purchases.

67. Thirdly, Mr Gkinin submits that HMRC delayed in bringing his attention to any problems with the VAT returns. Whilst Mr Gkinin's position is that HMRC waited five months to bring any concerns arising from the test purchases to his attention, and further, that Officer Ansell had said he simply wanted to discuss the business, we find that the letter dated 10 April 2017 inviting Mr Gkinin to attend a VAT inspection meeting clearly set out that the purpose of the meeting was to check the company's VAT returns and records for the period 02/15 to 02/17. This letter pre-dated the completion of the sale of the business in July 2017 and was just over a month after the last test purchase on 2 March 2017. We therefore find that ample time was provided to gather any evidence to shed further light on any issues that may have affected the Appellant's VAT position, such as staff and system errors.

68. Fourthly, and most importantly, Mr Gkinin submits that the invigilation is not representative. This is the main crux of the Appellant's appeal before us. In further amplification of this point, Mr Gkinin relies on the case of *Golden Cube*. In *Golden Cube Limited*, the invigilation exercise took place over a three-day period. There, Judge Cannan found that three days' invigilation was not representative but this was because there was no other reasonable explanation for the percentage in the invigilation in that appeal being different. The VAT status in *Golden Cube* was shown to be incorrectly recorded at the till. Furthermore, HMRC did not assert any positive case as to why the standard-rated sales might be understated and therefore no alternative evidence had been provided.

69. Having considered the evidence in the appeal before us, we find that the *Golden Cube* case does little more for the Appellant than to set out the application of the principle that the burden of proof is on the taxpayer to show that the assessments are incorrect and does not assist the Appellant any further than this.

70. Whilst reference was made in evidence to problems with the toaster affecting hot food sales, this issue was something that was only introduced during the appeal hearing and is one that is remarkably similar to the situation that occurred in *Golden Cube*. Furthermore, the issue concerning the toaster is at odds with the previous reasons given for the low number of taxable sales. The Appellant's case up to that point had been that office and retail workers made up most of the clientele and that they preferred to take sandwiches away with them, thus affecting the level of taxable sales. We cannot therefore place any reliance on this late claim. We find that even if there had been problems with the toaster, by Mr Dimov's own oral evidence, this happened infrequently so that this should not have had a bearing on the ratio of standard-rated sales.

71. In support of the appeal, Mr Gkinin and Mr Dimov have referred to platter deliveries, which were said sometimes to have represented 80% of daily sales. We have not, however, been provided with any evidence to substantiate this. A high percentage of platter deliveries may, arguably, have brought down the percentage of taxable sales, if substantiated by evidence. Mr Gkinin's explanation for the lack of any documentary evidence was that the people who were involved in arranging the platter deliveries are no longer available. We find that whilst these people may no longer be available, Mr Gkinin did however state in oral evidence that there were contracts with clients such as DHL. He further referred to emails leading up to the contracts. These emails and contracts have not been provided. We find that it would have been an obvious and relatively simple matter to produce the emails, or indeed any contracts, which Mr Gkinin, as Director, could, and should, have had a record of. Overall, the oral evidence relating to platter deliveries was vague and often contradictory.

72. On the issue of which offers are available at Subway franchises, Mr Gkinin has also raised the issue of different offers being available during the relevant period, as opposed to the offers currently available at the new franchisee's business. Mr Gkinin has not, however, provided any evidence of any discount offers, vouchers or promotions that would adequately explain the low-level of standard-rated sales during the relevant period. We find that there is no reason why it would not have been in Mr Gkinin's power to provide such evidence as this would have formed part of the VAT records that he would have kept and would, once again, have been an obvious and relatively straightforward matter. We find that there is no evidence before us upon which to base a finding that the new business was substantially different to the Appellant's business.

73. In relation to Mr Gkinin's argument that August is the busiest period, thus explaining the higher percentage of taxable sales on the day of the invigilation, we find that this does not however sit well with his evidence that office workers and retail staff purchasing their lunch on most other occasions made up the highest percentage of the clientele. We find that if there is a constant flow of office staff on a daily basis, the level of sales would not dip significantly during other periods in the year given that offices and retailers are open and staffed throughout the year. Whilst Mr Gkinin also adds that office workers preferred cold sandwiches to heated meals, the evidence we heard from Mr Dimov showed that there was little understanding of what is to be classified as a zero-rated sale.

74. Mr Dimov gave evidence and adopted the contents of his witness statement as being true and accurate. The importance of Mr Dimov's evidence is that Mr Gkinin's own evidence is that he did not know anything about the food industry and therefore left it to existing staff members. In his written evidence, Mr Gkinin says this:

> *"I did not know anything about the food business and asked the existing staff members to take control over the store as I could not manage it and my intention was to put it up for sale."*

75. The above statement is included in the letter dated 2 August 2018, from Mr Gkinin to HMRC.

76. In his witness statement, Mr Dimov stated, *inter alia*, that the average taxable sales were 50% of the sales, excluding crisps, sandwiches and cold drinks. He added that some items like cold sandwiches, cold drinks, salad sales and 98% of crisps were zero-rated. When it was put to him that crisps were not zero-rated, he referred to corn chips being sold instead. He accepted that meatballs are heated and that these would be standard-rated. Having had the benefit of hearing Mr Dimov giving evidence, we find that Mr Dimov did not appear to be able to distinguish between standard-rated food and zero-rated food. We therefore find that we are unable to place any reliance on the accuracy of his evidence. We accept however that there has been a lapse of time since Mr Dimov was managing the franchise. We find it would however be reasonable to expect him to have a proper understanding of the distinction between sales that are taxable and those that are not given his involvement in training staff and management.

77. Mr Gkinin challenges the figure of 75.9% from the day of the invigilation by the production of a report from the week prior to the invigilation exercise and from the day of the invigilation. We find that the report produced by Mr Dimov uses the same methodology applied by HMRC and is, equally, higher than the figures shown in the Appellant's VAT returns over the relevant period, which only showed between 39% to 53% of taxable sales. We find that Mr Gkinin's own analysis misses the point that output tax had been under-declared for the relevant period. Mr Gkinin did not suggest that HMRC's categorisation of the business's supplies or interpretation of the law was incorrect. By Mr Gkinin's own evidence, there had been a progressive increase in taxable sales after he took over the business, which he described as not having been profitable when he purchased it. We have further found that the evidence concerning taxable sales on behalf of the Appellant was unreliable. In view of the overall findings above, we hold that there is no evidence before us upon which to base a finding that the Assessment was excessive.

78. In *Buttigieg t/a the Cottage Café* (6 June 2008), the VAT and Duties Tribunal held, at [75], that an assessment was made to the best of judgment despite the calculation being based on a single day's invigilation and being applied to a three-year period. A similar conclusion was reached by Dyson J in *Akbar and Ors (trading as Mumtaz Paan House) v Customs and Excise Commissioners* [2000] STC 237, at p.249. We are satisfied that HMRC are not required to carry out exhaustive investigations.

79. The Assessment issued by HMRC and the methodology underlying it was reasonable and had been calculated to the best of judgment on the information available. We find that there has been no other competing evidence of sufficient cogency to displace the Assessment.

80. Accordingly, we uphold the Assessment.

Schedule 24: Inaccuracy penalties

81. A Penalty was issued under paragraph 1 of Sch 24, on 6 August 2018, on the basis of the inaccuracies contained in the Appellant's VAT returns. The amount of under-declared output tax in this appeal is £37,568.00 (the PLR) and the Penalty charged is £6,198.02. The Appellant appeals against the Penalty. On an appeal against the amount of a penalty, the Tribunal may either (a) affirm HMRC's decision, or (b) substitute the decision for another decision that HMRC had the power to make. In this appeal, there is no suggestion that the inaccuracy in the VAT returns was deliberate. The burden of proof rests on HMRC to show that the inaccuracies occurred as a result of the Appellant's careless behaviour.

Degree of culpability

82. As HMRC accept that there is no evidence to suggest deliberateness on the Appellant's part, HMRC have therefore reduced the penalty to the lowest amount permitted by law. In these circumstances, a penalty applies if the inaccuracy in the relevant document is due to a failure on the part of the taxpayer (or other person giving the document) to take reasonable care. The standard by which this falls to be considered is that of a prudent and reasonable taxpayer in the position of the taxpayer in question. Paragraph 4 of Sch 24 sets out the standard amounts of penalties. Paragraph 4(1)(a) imposes a penalty for careless action of 30% of the PLR. Careless is defined by para (3)(1)(a) of Sch 24.

83. We accept that Conditions 1 and 2 of Sch 24 are satisfied because a VAT return is a document listed in Sch 24 and the VAT returns included under-declared output tax, as a result of careless behaviour. The PLR is by reference to the Assessment and amounts to £37,568.00. We find that the taking of reasonable care would have included the early identification of any problems that would have affected the identification of sales as either standard-rated or zero-rated (i.e. system errors) and would have included the Appellant not overlooking the need to exercise prudence in this regard.

84. The penalty regime recognises that there can be a degree of culpability that Parliament has determined should be penalised. Paragraph 10 provides that where a person who would otherwise be liable to a 30% penalty has made a 'prompted' disclosure, HMRC shall reduce the 30% to a percentage not lower than 15%, which reflects the quality of the disclosure. "Quality" includes timing, nature and extent. Therefore, no reduction on account of disclosure can take the penalty below 15%.

85. The penalty in this appeal was levied at 16.50% of the PLR. HMRC reduced the amount of the penalty on the ground that there had been some co-operation by the Appellant in determining the true tax liability. Full reduction has therefore been given for "helping", "giving" and "telling". On the basis that the inaccuracy was careless, we find that the basic calculation of the Penalty was correct. The correct rate of 30% had been applied and this has been properly reduced for prompted disclosure. 16.50% of £37,568.00 PLR is £6,194.00.

Special Circumstances

86. A minimum penalty can be further reduced, or mitigated, in special circumstances, as provided by para 11, if HMRC think it right because of such circumstances. HMRC have considered the Appellant's appeal and the conclusion reached is that no special circumstances apply. The only circumstance raised by Mr Gkinin is that relating to the unfortunate family illness. There is no evidence before us upon which to base a finding that any family circumstances that resulted in the VAT inspection meeting having to be cancelled once pertained to the relevant period in its entirety. The Appellant had been able to continue to operate as a franchise throughout the relevant period and the fact that VAT returns were submitted strongly suggests that the business continued to operate. Therefore, we find that any family circumstances did not stop Mr Gkinin from continuing to run the business.

87. We do not consider that HMRC's decision in this case (set out in the Statement of Case) is flawed. Therefore, we have no power to interfere with HMRC's decision not to reduce the penalties imposed upon the Appellant. If HMRC find that no special circumstances apply, the Tribunal can only rely on paragraph 11 if HMRC's decision in this regard is flawed on judicial review principles only. That is a high test.

Suspension of the Penalty

88. HMRC further have the power to suspend all, or part, of a penalty for careless inaccuracy, but only if this would help a person to avoid becoming liable to similar such penalties. The power to suspend a penalty must be considered in the context of influencing future behaviour and it is not applicable as a general mitigation of the Penalty. In this appeal, the Appellant has since sold the business and therefore the Penalty has not been suspended.

89. Having considered all of the evidence cumulatively, we find that the Appellant is liable to the Penalty that has been charged and we are satisfied that the amount of the Penalty is correct.

90. Accordingly, we therefore also uphold the Penalty.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

91. 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.

NATSAI MANYARARA
TRIBUNAL JUDGE

RELEASE DATE: 13 NOVEMBER 2020