[2021] UKFTT 0203 (TC)

TC08153

VALUE ADDED TAX – whether sales under-declared – whether VAT assessments made to best judgment – yes – whether assessments correct – no – appeals allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/01874
TC/2018/01875
TC/2019/03603
TC/2019/03605

BETWEEN

HUSEYIN ACAR (TRADING AS FEZ MANGAL)
AND
HILL CATERING LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE VICTORIA NICHOLL
MS JANE SHILLAKER

The hearing took place on 30 March 2021. With the consent of the parties, the form of the hearing was V (video). A face-to-face hearing was not held because the Covid pandemic and it was considered that the case was suitable for a remote hearing. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public. The documents to which we were referred are two electronic bundles in relation to the VAT assessments, an Authorities bundle and the parties' skeleton arguments and appendices.

Mr Edward Waldegrave, counsel, instructed by A. Zorba & Co Accountants, for the Appellants

Ms Esther Hickey, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. The Appellants (together referred to as Mr Acar where relevant) have operated the Fez Mangal Turkish/Mediterranean restaurant in Ladbroke Grove since 2008.

2. The Respondents ("HMRC") concluded from their compliance checks in 2015 that the restaurant's takings had been under-declared by the Appellants for some years. HMRC issued VAT assessments in 2016, and then income tax and corporation tax discovery assessments and closure notices some two years later in 2018 and 2019. Together with penalties, the assessments amount to just under £610,000.

3. These are appeals by the Appellants against the assessments made by HMRC on the grounds that there has been no suppression of takings, or that HMRC's calculations are not correct.

PRELIMINARY ISSUES

4. The appeals to the Tribunal were notified late because the Appellants applied to use the alternative dispute resolution procedure and had not understood that it was also necessary to file their appeals with the Tribunal. The Tribunal considered the reasons for the delay, the effect on the parties, and the fact that HMRC have not objected to the late notification, and decided to give permission for the late appeal.

5. On the day before the hearing HMRC made an application for partial withdrawal of its case in accordance with rule 17(1)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application advised that "following a review of the Appellants' skeleton argument and having considered their own position again in relation to the discovery assessments, closure notices and penalties issued to the Appellants", HMRC no longer wished to defend the direct tax decisions.

6. The Tribunal confirmed that following HMRC's withdrawal in respect of the appeals against the discovery assessments, closure notices and penalties, those appeals are allowed. The procedural history and grounds of appeal against these direct tax assessments and penalties are not referred to further in this decision, but paragraphs 57 and 58 below confirm that those appeals are allowed.

7. The Tribunal is grateful to Mr Waldegrave for his well-prepared skeleton argument and to Ms Hickey for HMRC's constructive response.

BACKGROUND AND FINDINGS OF FACT

8. We made the following findings of fact from the evidence in the Tribunal's bundles and the witness evidence of Mr Acar and HMRC officer Carole Esson. Officer Esson was working in HMRC's restaurant taskforce at the relevant times.

9. The restaurant was founded by Mr Acar as a sole trader in 2008. When Mr Acar purchased the business, it was operating as a kebab shop. Mr Acar is the restaurant's head chef, and he manages the business. He is at the restaurant on most days.

10. On 1 March 2013 Mr Acar transferred the business to Hill Catering Limited. Mr Acar is the sole shareholder and director of Hill Catering Limited.

11. It is accepted that Mr Acar's intention throughout his ownership of the business has been to conduct it successfully and properly. He has gradually upgraded the restaurant and his returns show that the turnover has increased from £130 per day when he bought the business in 2008, to over £6,000 per day by 2020. This is in part due to improvements over the years to increase the number of tables indoors and on the pavement outdoors. Mr Acar's evidence is

that over the period in question the restaurant's takings have grown by an average of 12.5% each quarter. The increase over the 12 months to the invigilation period was about 50%. Mr Acar has built up a successful business with local, tourist and celebrity customers, and the turnover shows strong year on year growth.

12. On 20 March 2015 Officer Esson opened a compliance check into the takings for the Fez Mangal restaurant. Officer Esson first visited the premises on 26 March 2015 with her manager. They interviewed Mr Acar and he told the officers about the number of covers indoors and outdoors, staff, records, variations in the business, including the busiest times of the week and year, and the approximate cash to card split.

13. At the hearing Mr Acar explained that the split between restaurant and takeaway business, and the level of business, can both vary according to the time of year, the day of the week and the weather. It is always busier when the weather is good. In summer it is generally quieter as people are away on holidays, but the business picks up business from tourists. In September business picks up as people return from holidays, and often want to eat outside or buy a takeaway to avoid cooking in the rush of the new school term. Daily takings can fluctuate widely, but Fridays and Saturdays are the busiest days, and Monday and Tuesday are the quietest days. At the hearing Mr Acar maintained that Wednesdays are more than average, but this is not borne out by the figures that his accountant produced for 21 days in March and April 2015.

14. Throughout HMRC's compliance check the business was using a computerised till system. Mr Acar had understood that the system retained information entered in the till, and there was therefore no system for retaining and storing till rolls. Mr Acar told Officer Esson when she visited that the system recorded the meal bills. He believed that the till system had a hard drive that contained the information required and both he, and his tax agent, told Officer Esson that technical advice was being sought to reprint the till rolls. Mr Acar then established after the invigilation days that the system had not been upgraded to retain the daily gross takings information required to be retained for VAT purposes. The information that was retained throughout is the monthly Z report. This itemises every product sold by category, but not by customer.

15. Mr Acar explained that the waiting staff take orders at the tables on paper, and that they are entered into the till system at the till or using a handheld screen. The paper order is handed to the chef. At the end of each day the paper orders are reconciled with the till by Mr Acar or one of his managers and then disposed of. Mr Acar prepares his figures for the business VAT returns using the Z reports.

16. Mr Acar explained at the hearing that all cash paid by customers goes through the till. He takes all the cash left in the till home at night. He uses the cash to pay some staff and suppliers. He only banks cash if the bank balance is getting too low. There is a single business bank account.

17. Following the visit on 26 March 2015 Officer Esson wrote to Mr Acar on 23 April 2015 advising that the business must retain the paper records. The letter also asked Mr Acar to supply 14 days' records of trading. Officer Esson highlighted that the business could zero rate a percentage of its sales, as none of their supplies had been zero rated. Officer Esson told the Tribunal that following the first meeting and receipt of the spreadsheet from Mr Acar's tax representative, she was also concerned whether cash was being correctly recorded in the business and whether there was an explanation for the number of void transactions.

18. Mr Acar's accountants responded to Officer Esson's letter by sending records of the daily gross takings for 21 days in March – April 2015. The information provided confirmed Officer Esson's decision that it would be necessary to carry out an invigilation of the business.

Following further correspondence, Officer Esson arranged to invigilate the business on Wednesday 2 September and Friday 11 September 2015. Her decision was based on the information provided by Mr Acar when he was interviewed on 26 March 2015, and the information provided by his accountant for 21 days' trading. This suggested that Wednesdays are quieter days in the week and Fridays are busy days. It is standard practice to base compliance checks in small businesses on data from two days that are chosen to reflect both busy and quieter trading days.

19. The weather was dry and warm on the invigilation days. Officer Esson attended at the start of each day's invigilation but was not there at the end of each day when her officers supervised the cash up. Officer Esson noted that the cash to card proportion was higher than Mr Acar's estimate when they met in March. It was also noted that there was a slight shortfall (c£35) in the amount of cash in the till compared to the Z report. This was attributed to human error in giving too much change.

20. Mr Acar's tax representative filed VAT returns for the 08/15 period after HMRC's invigilation days. Whereas the turnover of well over £3,000 on both invigilation days was the highest daily turnover to date at that time, the period to 11/15 return included days with turnover in excess of this figure. Officer Esson suggested that the higher figures for turnover after the invigilation days reflected the fact that the business owner was aware of the outcome of the invigilation by the time that the return was filed. We accept Mr Acar's explanation that there has been a steady increase in the business' turnover from 2013 to date, and that the figures reflected the Z reports for the periods after the invigilation days.

21. Officer Esson referred the matter to her direct tax colleagues in October and November 2015, but she did not speak with Mr Acar or his tax representative following the invigilation days until September 2016. This was because she was away on secondment. As the secondment was not expected to last for long, this matter was not handed over to a colleague. It was in fact a year before Officer Esson returned to her Fez Mangal compliance file in September 2016. By this time Officer Esson was facing an approaching deadline for the issue of the assessments. She contacted Mr Acar's representative to apologise for the long delay and then issued the assessments based on her best judgments without waiting for a response or information from Mr Acar or his representative.

22. Officer Esson calculated the amounts assessed by taking the figures for the 2nd and 11th September 2015 to calculate the assumed turnover of the business in the reference period, treating every Sunday to Thursday as Wednesday 2nd September, and treating every Friday and Saturday as Friday 11 September 2015. Officer Esson's calculations took account of the zero-rated percentage of supplies by reference to the zero-rated sales on the two invigilation days in her calculations. An entry in HMRC's records in November 2015 suggests that no merchant acquirer data was located to assist HMRC with their calculations.

23. The reference period chosen by Officer Esson was the three-month period immediately prior to the invigilation, 1 June 2015 to 31 August 2015. This reflects what Officer Esson explained to be standard practice as HMRC consider that the period that includes the invigilation day could be affected by the trader's knowledge of the outcome of the invigilation. Officer Esson recognised that the reference period included July and August when many customers may be away and that Mr Acar had told her that July and August are 20-25% quieter, but her response is that the figures for the 08/15 period are higher, and therefore more favourable to the trader, than those for 05/15.

24. The next step in Officer Esson's calculations was to deduct the declared takings for the reference period from her calculation of the assumed takings to calculate what she considers to be the amount of the takings that had been suppressed. The suppression rate calculated by

Officer Esson was 37.88%. The suppression rate was then applied to increase the takings that Officer Esson considered had been under-declared throughout the periods from 1 July 2012 until 31 May 2016. The resulting takings were then reduced by 4.03% to reflect the percentage of zero-rated sales on the invigilation days, and this produced the assumed takings. The assumed takings were divided by six to calculate the amount of the assumed VAT, and the VAT declared was deducted from this figure to determine the amounts of the assessments.

25. Officer Esson used the method outlined above to calculate the assumed takings and under-declared VAT for the periods of Mr Acar's ownership from 09/12 and through all of Hill Catering Limited's ownership until 05/16. This meant that the assessments covered more than two VAT periods after the invigilation date. Officer Esson's evidence is that she assessed the periods back to 2012 and up to 31 May 2016 as she considers that the under reporting went back to that time, and that the amounts reported after the invigilation days had fallen rather than continue to rise as might be expected. She considers that this might have been due to the fact that the assessments were not issued until September 2016. Officer Esson also told the Tribunal that she does not consider that HMRC's first visit to discuss the business compliance with Mr Acar in March 2015 affected the under-declaration of takings or his standard rating of 100% of supplies.

26. On 9 September 2016 Officer Esson issued VAT assessments in respect of the VAT periods when Mr Acar owned the business and twelve VAT periods following the transfer of ownership to Hill Catering Limited as follows:

VAT Assessments Period Issued	Person	Amount	Date
1 July 2012 – 28 February 2013	Mr Acar	£12,968.00	9 September 2016 Revised 3 October 2018
1 March 2013 – 31 May 2016	Hill Catering Ltd	£122,726.00	9 September 2016 Revised 3 October 2018
Total		£135,694.00	

27. On 27 September 2016 Mr Acar and Hill Catering Limited wrote to HMRC to appeal against the assessments.

28. On 4 October 2016 Officer Esson met with Mr Acar and his tax representative and took them through how she had calculated the amount of the under declared output tax. The penalty factsheets were handed to Mr Acar to read. Following the meeting Mr Acar's representative provided Officer Esson with Z report readings for various dates and a copy of planning permission obtained in 2011 and invoices for improvements works carried out in 2013.

29. On 2 March 2018 Mr Acar and Hill Catering Limited filed appeals to the Tribunal against the VAT assessments. The hardship application made was granted.

30. The parties agreed to meet for an alternative dispute resolution meeting. During the course of the meeting on 19 June 2018 Mr Acar explained that the restaurant is always closed on the Sunday and Monday of the Notting Hill carnival. HMRC agreed to amend its calculations to reflect the days on which the restaurant was closed. This reduced the suppression percentage to 34.493% and this was then applied to all periods. HMRC issued revised VAT assessments on 3 October 2018 as noted above.

31. On 4 October 2018 HMRC filed its statement of case. HMRC cancelled the VAT penalties that had been issued on the same date.

RELEVANT LAW

32. The assessments were issued in accordance with section 73 VATA 1994 (VATA):

> "**Section 73 Failure to make returns etc**
>
> (1) 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."

33. The time limit for making an assessment is four years from the end of the prescribed accounting period as set out in section 77 VATA:

> "**Section 77 Assessments: time limits and supplementary assessments**
>
> (1) Subject to the following provisions of this section, an assessment under section 73. . . or 76, shall not be made -
>
> (a) more than [4 years] after the end of the prescribed accounting period or importation . . . concerned, or
>
> (b) in the case of an assessment under section 76 of an amount due by way of a penalty which is not among those referred to in subsection (3) of that section, [4 years] after the event giving rise to the penalty."

34. Section 83(1) VATA provides that an appeal may be made to the Tribunal against:

> "(p) an assessment -
>
> (i) under section 73(1) or (2) in respect of a period for which the appellant has made a return under this Act; or
>
> (ii) under [subsections (7), (7A) or (7B)] of that section; . . .
>
> (iii) . . .
>
> or the amount of such an assessment;"

35. The Tribunal was referred to the guidance provided in the decisions of the High Court in *Van Boeckel v. Customs and Excise Commissioners* [1981] STC 290 (*Van Boeckel*) and the Court of Appeal in *Customs and Excise Commissioners v. Pegasus Birds Limited* [2004] STC 1509 (*Pegasus*).

36. The burden of proof is on the Appellants to show that the assessment should be set aside or reduced.

SUMMARY OF THE SUBMISSIONS

37. Mr Waldegrave submissions on behalf of Mr Acar are that there was no suppression of Fez Mangal's takings and that the assessments should be cancelled.

38. If the Tribunal is not persuaded that there was no suppression, Mr Waldegrave submits that the assessments should be reduced to reflect the issues identified with the method of calculation. These concern the choice of the invigilation days, the choice of the reference period and the assumption that the suppression continued for some 9 months after the invigilation.

39. Mr Waldegrave was clear that the Appellants do not suggest that the assessments were not made in Officer Esson's best judgment based on the information available to her at the relevant time.

40. Ms Hickey's submissions on behalf of HMRC are that Mr Acar has under-declared the VAT output tax for the business in the relevant periods. The assessments issued were made in Officer Esson's best judgment at that time. HMRC do not suggest that Mr Acar has not been honest, but that the absence of retained records means that he cannot produce accurate returns.

41. Following Officer Esson's cross-examination Ms Hickey advised the Tribunal that HMRC accept that the assessments for the VAT periods ended 02/16 and 05/16 should be set aside.

DELIBERATIONS

42. We considered the questions for determination in this appeal on the basis of the application of the relevant law to our findings of fact on the evidence. The questions are whether the assessments were validly issued to the best of HMRC's judgment, whether takings were under-declared, and if so, whether the assessments are for the correct amount.

43. The Court of Appeal in *Pegasus* set out the following clear guidance for tribunals when faced with 'best of their judgment' arguments (Lord Carnwath at para [38]):

> "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."

Best judgment

44. The Appellants in this appeal accept that Officer Esson's assessments were to the best of her judgment in accordance with the requirements of section 73(1) VATA.

45. We note for completeness in this respect that that we considered whether setting the reference period over July and August was a mistake given that HMRC recognised that these were quieter months, but we were satisfied with Officer Esson's clear and reasonable explanation of why she chose this reference period.

46. We considered the guidance provided by Woolf J in *Van Boeckel* and found that HMRC had exercised their powers "in such a way that they [made] a value judgment on the material which [was] before them. Clearly they must perform that function honestly and bona fide" as Officer Esson's exercise of HMRC's has proven to be. The VAT assessments were validly issued.

What is the correct amount of tax?

47. The primary task for the Tribunal is therefore to find the correct amount of tax as made clear by Lord Carnwath (see para 43 above). We also noted the earlier confirmation by Woolf J in *Van Boeckel* that it is open to the Tribunal to reduce the amount of tax due even though it concludes that assessment was made to HMRC's best judgment:

> "Quite clearly that was a view which the tribunal could properly come to; but the fact that they came to that conclusion as to the amount of the assessment and rejected the view of the commissioners to that extent does not mean that the validity of the assessment was called into question. What the tribunal was doing when they decided to reduce the assessment was making a decision on the material before them as to the proper amount of tax in fact due. It was quite

> open to the tribunal, on the balance of probabilities, to come to the conclusion…"

48. Our starting point is to determine whether there was any suppression of takings. As noted in paragraph 11, we accept that Mr Acar's intention throughout his ownership of the business has been to conduct it successfully and properly. He put a till system in place that he believed met his obligations to retain records, and the returns were prepared using the Z reports for the business, both before and after the invigilation. We agree with Mr Waldegrave that it is not feasible that the figures in the Z reports were reverse engineered, but Mr Acar did not retain the records required for VAT purposes to allow him to check the figures and his use of cash may have contributed to errors not being picked up. He also failed to apply the zero rate when applicable to sales. We conclude that the failure to keep adequate records, and relying on information that his till system was not set up to provide, has resulted in it being more likely than not that errors were made.

49. We went on to consider what the proper amount of the assessments should be, relying on our findings of fact from the evidence put to us.

50. First, we accept Mr Acar's evidence that the Appellants' takings have grown by an average of 12.5% each quarter over the relevant periods. The increase over the 12 months to the invigilation period was about 50%.

51. Second, we find HMRC's position inconsistent as regards the effect of the invigilation: on one hand we were told that the quarter ending 11/15 quarter could not be used as the reference period because Mr Acar knew the outcome of the invigilation days; on the other hand we were told that the assessments were made for the periods ending 11/15, 02/16 and 05/16 because the behaviour had not changed. Mr Waldegrave submits that HMRC applied the suppression rate until an arbitrary cut-off date of 31 May 2016, and that the assessments for post-invigilation VAT periods would not have been made if the best judgment decision had been made in early September. We agree and, given the inconsistency in HMRC's position in relation to the post-invigilation periods, we welcomed Ms Hickey's concession that HMRC will withdraw the assessments for the 02/16 and 05/16 periods. We consider that this conclusion should also be applied to the 11/15 period as Mr Acar was aware of the outcome of the invigilation.

52. Third, we accept that the reference period included the quieter months of July and August. Mr Waldegrave submits that the discrepancy between the assumed and returned takings would fall to 16% if the reference period were to be 11/15. He also submits that this reduced discrepancy can be explained by the quarterly growth of the business. We did not adopt this approach as we accept Officer Esson's reason for using 08/15 as the reference period, but we recognise that an adjustment should be made to reflect the quarterly growth in takings of an average of 12.5%.

53. Fourth, we accept that daily takings can fluctuate widely. The choice of invigilation days was fair given the records provided for daily takings in March and April 2015.

54. We noted the comments made about the cash to card proportions but do not consider that they were relevant to the calculations as HMRC did not rely on merchant acquirer data. We also consider that the small discrepancy between the cash in the tills and invigilated amounts are not relevant to the calculations that should be based on the recorded takings rather than cash. No explanation was provided for the voids in the records.

55. We conclude for the reasons set out above that the Appellants have established that the VAT assessments should be reduced as follows:

(i) The assessments for the 11/15, 02/16 and 05/16 periods are set aside;

(ii) The assessments for the earlier periods should be revised by HMRC on the basis of applying a lower uplift percentage to the turnover declared for each period. The percentage to be applied to the earlier periods should be calculated by increasing the declared turnover for the reference period by 12.5% to reflect the quarterly growth in sales. Based on the schedule of revised calculations provided by Officer Esson with her letter dated 3 October 2018, this reduces the uplift to be applied to 19.5%.

DECISION

56. The appeals against the VAT assessments listed in paragraph 26 above are allowed in part:

(i) The VAT assessments for the periods 11/15, 02/16 and 05/16 are set aside; and

(ii) The VAT assessments for the period 01/07/201 – 28/02/2013 for Mr Acar and for the period 01/03/2013 – 31/08/15 for Hill Catering Limited are reduced by the amount calculated in accordance with the direction in paragraph 55 above.

57. The appeal against the income tax and penalty assessments issued on 25 January 2019 and 23 October 2019 to Mr Acar in respect of the tax years 2012-13 is allowed.

58. The appeal against the corporation tax discovery assessments, closure notices and penalties issued to Hill Catering Limited on 18 December 2018 and 27 December 2018 is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

59. 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.

VICTORIA NICHOLL
TRIBUNAL JUDGE

RELEASE DATE: 04/06/2021