[2016] UKFTT 0408 (TC)

TC05162

Appeal number: TC/2014/6212

VAT –underdeclaration of sales by restaurant trader – penalty – appeal against assessment dismissed – appeal against penalty allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

Mr XUONG NGO **Appellant**

- and -

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

TRIBUNAL: Judge Peter Kempster
Mr Julian Sims FCA CTA

Sitting in public at Royal Courts of Justice, London on 28 April 2016

Mr Arif Malida (Chartered Accountant) for the Appellant

Mr Bernard Haley (HMRC Appeals Unit) for the Respondents

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DECISION

Background

1. At the relevant times Mr Ngo carried on business as the sole proprietor of a Vietnamese and Thai restaurant in southwest London called The Paddyfield. The business was registered for VAT and used the flat rate scheme (s 26B VATA 1994 refers).

2. On 22 May 2013 Ms O'Hara of HMRC undertook a compliance visit. Ms O'Hara was not satisfied with the record-keeping and wrote to Mr Ngo on 28 May 2013 explaining that, while his method of record-keeping was a matter of choice for himself, he must record each individual sale as it was made, and keep a daily record. Further, that if he used his till to record daily gross takings then the till must be maintained to produce daily consecutive "Z" readings, and use an audit roll as well as the receipt roll. She instructed him to retain all meal bills and notepad entries, and warned that a further examination would be conducted on the 06/13 period return.

3. On Thursday 20 June 2013 HMRC conducted a covert visit to make three test purchases and a customer count.

4. On 31 July 2013 Ms O'Hara made her further visit and uplifted certain records. Mr Ngo had not kept an audit roll in the till and stated that he did not know how to take Z readings from the till. On 6 August 2013 Ms O'Hara wrote to Mr Ngo repeating the instructions given in her previous letter.

5. On Wednesday 4 September 2013 HMRC conducted a second covert visit and again made three test purchases and a customer count.

6. On comparing the test visits with the business records, Ms O'Hara noted that none of the six test purchases had been recorded, and that the number of customers was under-reported (7 reported out of 21 on the first visit, and 10 reported out of 18 on the second visit). From this data Ms O'Hara estimated that sales were being underdeclared by 56%.

7. On 10 December 2013 Ms O'Hara wrote to Mr Ngo to inform him that she suspected serious inaccuracies, possibly involving deliberate dishonest conduct. On 24 March 2014 Ms O'Hara wrote to Mr Ngo to warn that a penalty was under consideration (sch 24 FA 2007 refers). On 16 April 2014 Mr Ngo applied for deregistration from VAT. On 19 May 2014 Ms O'Hara disclosed the results of the two test visits; set out her estimate of the 56% underdeclaration of sales; and gave a calculation of the additional VAT due for the periods 03/10 to 03/14 totalling £66,397.

8. There was correspondence between Ms O'Hara and Mr Ngo's new accountant (Mr Malida, who represented Mr Ngo at the hearing). Mr Malida made a number of points which are set out in his representations below. Ms O'Hara addressed those points but did not accept them.

9. A VAT assessment as per Ms O'Hara's figures was raised on 1 July 2014, and a penalty in the amount of £58,097.33 was notified on 7 August 2014.

10. Mr Ngo requested a formal internal review and this was given on 17 October 2014, reducing the VAT assessment to £55,868 and reducing the amount of the penalty to £36,628.37.

11. Mr Ngo appealed to the Tribunal on 13 November 2014 against both the (revised) assessment and the (revised) penalty.

Witness evidence

12. We took oral evidence from both Mr Ngo and Ms O'Hara.

13. Mr Ngo confirmed and adopted a witness statement dated 30 November 2015.

(1) The restaurant was small (34 covers) and run by himself and three staff. He got very tired and confused at busy times. He had made mistakes and some of his staff had been unreliable, but there were no deliberate errors.

(2) He had used a sales record sheet given him by his previous accountants, who had been unreliable. He would complete the sheet at the end of the evening or the next morning. Given HMRC's concerns over the record-keeping, he had bought a new till in August 2013. The old till had been very difficult to operate. He had been formally trained in the operation of the new till in September 2013.

(3) He had put forward a number of reasons why HMRC's calculations were wrong but HMRC refused to change their view. He felt bullied by Ms O'Hara.

14. Ms O'Hara confirmed and adopted a witness statement dated 13 November 2015.

(1) The covert visits had been on different days of the week, and did not include a weekend or public holiday (when the restaurant might be busier). The declared turnover of the business had been fairly consistent over the period assessed.

(2) In estimating the underdeclared turnover the six test purchases by the officers had been ignored. Out of 39 observed customers only 17 had been recorded, suggesting an underdeclaration of 56%. On the basis of the information available, that represented her best judgement of the extent of the underdeclarations. The business used the flat rate scheme and so there was a simple adjustment of gross figures required to produce the estimated understated VAT.

(3) She had considered and addressed all the points put forward in correspondence by Mr Ngo and Mr Malida but decided her method of adjustment of the gross takings would automatically take into account matters such as price list changes, seasonal differences, and mix of takeaways and sit-downs.

(4) She considered the underdeclarations were deliberate. She had given clear instructions as to record-keeping of sales but those had been ignored. Two of the test purchases received itemised bills carrying a till record number but were not declared, which pointed to manipulation of the till receipts.

(5) In relation to mitigation of the penalty:

(a) No reduction had been given for "telling" as there had not been a full disclosure of suppression of takings. HMRC had requested a meeting with Mr Ngo and Mr Malida but this had not been possible.

(b) A reduction of 10% (out of possible 40%) had been given for "helping", because Mr Ngo had been co-operative in earlier meetings.

(c) A reduction of 15% (out of possible 30%) had been given for "giving", because there had been partial co-operation.

(6) In response to questions in cross-examination by Mr Malida: The results of the covert visits were not disclosed earlier in the investigation because of the risk of amendment of business records. She had made clear in writing that HMRC had serious concerns about the takings. When it was apparent that no meeting was forthcoming then she had revealed the covert visit results.

Appellant's case

15. For Mr Ngo Mr Malida submitted as follows.

16. HMRC had relied heavily on the results of two visits. That was not a satisfactory sampling technique and could not result in figures that were to HMRC's best judgment. The observations of the visits had not been disclosed to the taxpayer until May 2014, by which time Ms O'Hara had already made up her mind about the matter.

17. There were further faults in HMRC's methodology. All these had been described in detail in correspondence (together with alternative calculations) but had not been adjusted by Ms O'Hara.

(1) At the time of the visits around 38% of orders were for takeaways but the proportion for earlier times had been significantly less. This was because in June 2012 a new takeaway delivery service (MyDeliveryCab) had been introduced which successfully increased takeaway sales.

(2) There were seasonal variations in trade. The visits were in June and September which were busier months than, say, March and December.

(3) The business ran occasional special offers which, as evidenced by customer letters, brought in significant increased trade. Offers had been running at the times of both visits, as had been noted by the officers.

(4) No account had been taken of menu price increases over time.

18. The reduction to the assessment made by the HMRC review officer showed that later quarters were accepted by HMRC as not being understated, and pointed to the excessive nature of the adjustments to the earlier periods.

19. Mr Ngo had purchased a new till and taken training on it, which was evidence of his willingness to present proper records. It appeared that errors had been made but these were in the nature of carelessness, not deliberate understatement.

20. Mr Ngo had been keen to co-operate with HMRC. Significant quantities of information had been provided. A meeting had been offered on the basis of an agenda being given in advance but that had not been produced.

Respondents' case

21. For HMRC Mr Haley submitted as follows.

22. HMRC had conducted two visits, both showing significant underdeclarations of turnover. That provided the evidence for HMRC's best judgement assessments. The declared turnover had been fairly consistent from quarter to quarter. The business used the flat rate method and so Ms O'Hara's 56% adjustment to gross takings would result in the correct estimate of underdeclared VAT. That method also took care of any changes due to price list changes, special offers, seasonal differences, and mix of takeaway and seated meals. Ms O'Hara had been correct to reject Mr Malida's proposed amendments.

23. The penalty had been carefully considered by both Ms O'Hara and by the review officer, who had reduced it. The underdeclarations were deliberate and systematic. Some mitigation had been given at an appropriate level.

Consideration and Conclusions

24. We consider first the appeal against the VAT assessment and then the appeal against the penalty.

Appeal against VAT Assessment

25. We are satisfied that HMRC applied a reasonable methodology to estimate the understatements of turnover, and that the resulting figures represent their best judgement of the under-assessed VAT.

26. What "best judgment" means in this context (ie s 73 VATA 1994) was the subject of guidance first by Woolf J in *Van Boeckel v CEC* [1981] STC 290 and later by Carnwath J in *Rahman (t/a Khayam Restaurant) v CEC* [1998] STC 826. In *Van Boeckel* Woolf J pointed out (at 292):

> "Clearly [HMRC] must perform that function [of exercising their powers in such a way that they make a value judgment on the material which is before them] honestly and bona fide. It would be a misuse of that power if the commissioners were to decide on a figure which they

> knew was, or thought was, in excess of the amount which could possibly be payable, and then leave it to the taxpayer to seek, on appeal, to reduce that assessment.'"

The further guidance offered by Carnwath J in *Rahman* was (at 835):

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

27. HMRC conducted two test visits which both revealed significant under-recording of sales assessed by the number of orders seen and recorded. Mr Ngo had previously been advised to keep more accurate records. There was nothing exceptional about the trading conditions on the dates of those visits – they were both midweek days in different months and revealed sizeable shortfalls. It was reasonable for HMRC to take the 56% underdeclarations at the visits as being their best estimate for the period of trading. We are satisfied that the information and arguments provided by Mr Malida after the issue of the assessment were fully considered by HMRC and resulted in reductions for the final two quarters but otherwise were judged not to warrant any adjustment to the assessment.

28. We do not accept the objections to the methodology raised by the Appellant. HMRC took the reported sales for each quarter, applied an uplift to correct the 56% underdeclaration, and then applied the flat rate scheme percentage to arrive at the understated VAT. We find that the methodology applied by HMRC would not have been distorted by lower menu prices in earlier periods (the lower prices were reflected in the reported sales that were uplifted); nor by special offers and complimentary items (the reported sales were uplifted); nor by fewer takeaways in earlier periods (ditto); nor by seasonal variations (ditto). We have carefully considered the alternative methods put forward by Mr Malida but find they have no evidential basis to displace HMRC's best judgment estimates.

29. Accordingly, we uphold the VAT assessment in the revised amount of £55,868.00.

Appeal against Penalty

30. HMRC have raised penalties on the basis that (i) for VAT periods 6/10 to 3/13 the inaccuracies were deliberate but not concealed; and (ii) for VAT periods 6/13 to 9/13 the inaccuracies were deliberate and concealed. HMRC's reasons are given on pages 8-9 of the review letter dated 17 October 2014.

31. We agree with HMRC that the inaccuracies were deliberate; we do not accept that the inaccuracies were due merely to carelessness. However, on the matter of concealment, we consider there was no concealment (within the meaning of sch 24 FA 2007) for all periods. We agree with HMRC that disclosure was prompted. Thus the standard penalty before any mitigation for quality of disclosure was 70%, with a minimum after any mitigation of 35% (para 10 sch 24 FA 2007).

32. We have considered carefully the mitigation allowed by HMRC pursuant to para 9 sch 24. We agree with HMRC that no mitigation is due for "telling". However, having reviewed all the correspondence between the parties, we consider that the appropriate mitigation for "helping" and "giving" should be 20% of the discretionary penalty in each case (rather than the 10% and 15% respectively allowed by HMRC). That reduces the penalty to 56% of the VAT assessment (ie 35% plus (60% x 35%)), being a penalty of £31,286.08. Accordingly, we allow in part the appeal against the penalty so as to reduce the penalty to £31,286.08.

Decision

33. The Tribunal decided that (a) the appeal against the VAT assessment is DISMISSED; and (b) the appeal against the penalty is ALLOWED IN PART so as to reduce the amount of the penalty to £31,286.08.

34. This document replaces the summary decision issued to the parties on 26 May 2016 and 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.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 10 JUNE 2016