TC02834

Appeal number: TC/2011/00955

Value Added Tax - Re-hearing of an appeal in relation to claimed under-declaration of turnover - Mitigation in relation to penalties - Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR. BENSON SUNDAY EYIN **Appellant**

-and-

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

TRIBUNAL: JUDGE HOWARD M. NOWLAN
CAROLINE DE ALBUQERQUE

Sitting in public at 45 Bedford Square in London on 6 August 2013

Mr. Benson Eyin in person

Mr. Bruce Robinson of HMRC on behalf of the Respondents

DECISION

Introduction

1. This Appeal was a re-hearing of an Appeal originally decided by Judge Malachy Cornwell-Kelly and Mrs. Sheila Cheesman on 20 January 2012. In that original hearing, three matters had been in contention. One concerned the VAT fuel scale charge in respect of vehicles, one concerned claimed under-declarations of turnover for VAT purposes, and the third concerned the degree of mitigation of penalties imposed by HMRC in respect of just two of the numerous VAT periods at issue in relation to the first two matters.

2. The decision of the First-tier Tribunal in the first hearing was in favour of HMRC on all three points.

3. When the Appellant sought leave to appeal to the Upper Tribunal, his application was refused by the First-tier Tribunal, and then refused by Judge Bishopp when dealt with on the papers. The Appellant, however, requested an oral hearing of his application to appeal to the Upper Tribunal, and that was heard by Judge Berner. Judge Berner's decisions on the first two issues were that there had been an error of law in relation to the fuel scale charge issue, and that the First-tier Tribunal had erred in relation to the second issue by having referred to the fact that letters by the Appellant's landlord had indicated that the Appellant's shop premises had been affected by water leakage from the roof, but the Tribunal had then failed to pursue the issue of whether water damage might have occasioned stock losses and explained the figures contained in the Appellant's numerous returns. Judge Berner also decided that the First-tier Tribunal had erred in dealing with the appeal in relation to the level of penalties because they had merely confirmed that they considered a factor of 40% reduction in the penalty on account of mitigating circumstances to be appropriate without then giving their reasons.

4. Judge Berner decided, however, that rather than allow the Appellant to appeal to the Upper Tribunal, it would be more appropriate for the Appeal to be remitted back to the First-tier Tribunal, and re-heard on all points.

5. By the time of the re-hearing before us, HMRC had conceded the first point in relation to the fuel scale charge, and the figures had been adjusted to remove any charge (and the element of the penalty) referable to the fuel scale charge issue. Accordingly we were required only to deal with the second and third points originally in contention. In relation to the more significant issue concerning the claimed under-declaration of standard-rated turnover, we were required to address all the points material to that dispute, but both parties concentrated predominantly on the issue that Judge Berner considered that the original Tribunal had failed to pursue, namely the issue of whether the claimed water damage to stock did indeed account for the low turnover and surprising low output liability for VAT purposes.

The facts

6. The Appellant was operating a shop in Penge in Kent, referred to as a "pound store". It did not follow from that description that all or indeed most of the goods were sold for £1. The nature of the shop was nevertheless that a great variety of very cheap goods were on sale. The trade had been conducted from various premises in

the period under review, to which we will refer below, and at the end of that period the trade had eventually been run down and had effectively ceased.

7. The dispute between the Appellant and HMRC commenced with a VAT repayment claim that the Appellant had made for his quarterly return period 6/10. In the course of considering that period, however, HMRC commenced enquiries into the periods from 9/06 to 3/10.

8. These enquiries resulted initially in adjustments to the figures for the 6/10 period and an assessment for the recovery of VAT allegedly owed and under-declared in the 3 ½ -year period. Aggregating all the figures in that period, the additional assessments were for £31,703, and the penalties, imposed in just two of the relevant periods, were £652. By the time HMRC had conceded that the Appellant's claims in relation to the fuel scale charge issue were correct, so that adjustments relevant to that matter were withdrawn, it followed that the adjustment to the 6/10 return was cancelled altogether, and the additional assessments for the periods from 9/06 to 3/10, and the related penalties, were marginally reduced to £30,174 and £633 respectively.

9. Aggregating the figures for all the VAT periods from 9/06 to 3/10, the Appellant's return of total sales (standard-rated and zero-rated) had been of sales of £298,443. That figure may have understated total sales, but at all times HMRC accepted that that figure was the correct figure of total sales. The Appellant had then contended that of those total sales, £200,170 had been received for sales of zero-rated items. No evidence accompanied this claim in relation to zero-rated sales and there was no documentary confirmation of the Appellant's claim that he had purchased in cash substantial quantities of books and children's clothes from a supplier who acquired them from some warehouse and provided no paperwork. In fact the only invoices produced in relation to purchases of zero-rated goods indicated that the aggregate price paid in all the periods for zero-rated goods had been £4,415.

10. The HMRC officer dealing with the case, Mr. Robin Walker, who gave evidence before us, concluded that the remaining figures derived from the various returns were simply not credible if one assumed that approximately 2/3 rds of the Appellant's sales had, as claimed, been of zero-rated items. For the implicit result would then have been that, as the total VAT input tax in respect of standard-rated purchases (according to the invoices, and ignoring input tax in relation to rent and other overhead matters), had been £30,347, and the declared output tax in respect of the standard-rated supplies had been £12,383, occasioning significant repayment claims, these figures indicated that the standard-rated produce had been purchased for approximately £200,000 and it had been sold for £80,000. These figures derived simply from grossing up the VAT inputs and outputs just mentioned to arrive at VAT inclusive purchase and sale prices. Since the Appellant had claimed that his general mark-up on selling standard-rated product was in the region of 40%, and these claimed figures suggested that the standard-rated product must have been sold at colossal losses, Mr. Walker concluded that the figures were simply not credible.

11. The adjustment that Mr. Walker made was based on the proposition that there was no documentation to support the claim that £200,170 of the sales had been of zero-rated product, and no documentary support for the claim that large amounts of zero-rated stock had been purchased in cash without any documentation. The only figure on which any reliance could be placed was the figure of £4,415 paid for purchases of zero-rated product, for which purchase invoices were available. Assuming (generously, as he said) that the zero-rated items were sold at a 100%

margin, producing therefore sale consideration of £8,830 for the zero-rated stock, if one then deducted this amount from the total sales figure of £298,443, the result indicated that the sales proceeds for standard-rated stock would have been £289,613. This would have occasioned total output tax of £42,547, rather than the figure in the returns of £12,383, and an under-declaration of output tax of £30,174. This was accordingly the figure included in the assessments for the various periods in the period being reviewed, ignoring the further amounts in respect of the fuel scale charge matter.

12. The Appellant had volunteered another possible explanation for the extraordinary level of loss implicitly recorded on his version of the figures, which was that large amounts of stock had been lost or destroyed either by staff pilfering, accidental damage, or damage occasioned by a leaking roof in the premises in which at one time the business was conducted. The Appellant provided one or more letters of complaint about the leaking roof to the landlord of the relevant premises.

13. The outcome of the first appeal was that the Tribunal held that in the absence of any confirmatory evidence about the substantial cash purchases of zero-rated books and children's clothes, the Appellant's claim was dismissed. The Tribunal confirmed the calculations based on purchases and sales of zero-rated product at Mr. Walker's revised figures. The Tribunal then said that because the letter or letters to the landlord did not indicate any quantification of damage to stock on account of the claimed water leak in the roof, no adjustment would be made in respect of the Appellant's claims about stock losses through pilfering, accident and water damage.

14. By the time the matter came before Judge Berner, the Appellant had produced two items of further evidence. One was a letter from his solicitors to the landlord that not only complained about the water damage, but it appeared to establish that the terms of the lease rendered the landlord liable for the condition of the roof and the letter also drew attention to resultant stock losses. Secondly, the Appellant provided Judge Berner with a relatively detailed list of items that the Appellant claimed had been lost or destroyed, such that they had to be thrown away on account of water damage or breakages, largely occasioned by the need to move stock around as a result of the water damage. Some may have been lost through pilfering or by goods passing their "sell-by" date. We should make it clear that although the Appellant claimed that the lists had been compiled from note books that had been made up periodically, recording losses shortly after they arose, the lists themselves that were shown to Judge Berner, and to ourselves, had all been produced for the hearing before Judge Berner, and were not themselves contemporary documents.

15. Whilst Judge Berner remitted the matter to the First-tier Tribunal for a full re-hearing, this resulted largely from the fact that the First-tier Tribunal had originally made no enquiries about the water damage, had of course not seen the lists of damaged items that the Appellant had produced before Judge Berner, and so the significance of these figures dominated the debate between the parties before us.

The additional evidence

16. The Appellant produced 20 lists for various periods of different lengths (sometimes for one month, sometimes for several months) of goods that had been wholly written-off for one of the reasons already mentioned or because the goods had passed their "sell-by" date. Measured by their purchase price (their VAT-inclusive purchase price where the goods were standard-rated goods), the purchase price of the

goods written-off came to the total figure of £107,872.40. Damage from leaks in the roof were said to be the cause of some of the losses in the periods running from July 2006 to roughly the end of September 2007. In the five-month period from December 2006 to May 2007, the purchase price of goods written off in that period alone was £66,230.50.

17. Since the majority of the losses arose in the period just mentioned, it is worth reproducing the table of losses incurred in that five-month period. It read as follows:

Description	**Quantity lost**	**Unit price**	**Total price**
Utensils	244	£6.99	£1,705.56
Hardware	456	£1.99	£907.44
Fabric	13,100	£0.85	£9,326.20
Confectionary and Drinks			£24,287.06
Mop buckets	388	£0.65	£252.20
Mop heads	4,060	£0.65	£2,939
Batteries	512	£0.55	£281.60
Toys	6,012	£0.68	£4,088.16
Radio	84	£15.99	£1,343.16
Fans	48	£17.99	£863.52
Heaters	84	£12.99	£1,091.16
Plantain chips			£49
Washing-up liquid	98	£0.65	£63.70
Washing powder			£296.40
Toilet rolls	124	£0.65	£80.60
China plates	2,592	£0.75	£1,944.0
Party wares		£0.65	£2,623.40
Brooms	144	£3.99	£574.56
Deodorant	98	£1.20	£117.60
TV aerials		£0.55	£158.40
Perfumes	560	£1.99	£1,114.40
Body cream	400	£1.99	£796.0
Matches	410	£0.45	£184.50
Washing line	172	£2.99	£514.28
Pegs	144	£0.65	£93.60

HMRC's analysis of the further information about total losses of stock

18. HMRC contended that, for VAT purposes, a distinction had to be made between theft of stock by staff, and failure to ring up the price received from customers on tills. There appeared to have been some indication that the pilfering often took the latter form. We attach little importance to this point, though we agree that, in principle, theft of actual stock would occasion no receipt by the trader of proceeds, and no output liability, whilst failure to ring up the price on tills would leave the VAT liability in respect of the stock actually sold to a customer unchanged. We had no basis for distinguishing between the two categories of loss or indeed the level of the significance of either, and so we attach little importance to these possible causes of losses.

19. The significant points made by HMRC in relation to the further information in relation to stock losses were that, since the Appellant's lists identified the type of

goods sold, and their related purchase prices, it was possible to calculate the resultant ratio of standard-rated goods lost to zero-rated goods lost. In a few of the later periods there was less detail, and so HMRC simply applied the ratios from the numerous earlier periods to those final periods, but otherwise, with one exception, it was simple to split the two categories of lost goods. Very roughly, of total losses of £110,000, measured in terms of purchase price, £90,000 involved losses of standard-rated items, whilst the remaining £20,000 involved losses of zero-rated items.

20. The one exception just mentioned arose because HMRC had treated "fabric" as simply material such as curtain linings and had assumed that fabric was standard rated. Were the fabric instead children's clothes, this would modify the ratio between standard-rated and zero-rated items, but would lead to a further observation that we mention below.

21. Having produced the above split between the losses of the two categories of goods, HMRC observed that on the basis of the Appellant's declared input tax in respect of standard-rated goods of £30,347, it followed that the aggregate VAT-inclusive purchase price of all the standard-rated goods purchased (both those lost and sold) would have been £188,000. It therefore followed that if standard-rated goods with a purchase price of £90,000 had been lost, the purchase price of goods that were actually sold would have been £188,000 minus £90,000, i.e. £98,000. Since however, the sale consideration received for the standard-rated goods, derived from the Appellant's own returns, was £71,500 (occasioning output VAT liability of £12,383 mentioned above), it followed that, in addition to suffering total write-offs in relation to a huge quantity of stock, even the stock sold was sold at a very considerable loss.

22. HMRC claimed that this was improbable, particularly when the Appellant had asserted that he sold standard-rated stock at a 40% mark-up, and so HMRC claimed that we should largely disregard this new evidence. They did, however, make three further points, all of which, HMRC claimed, rendered the figures even more curious.

23. First, HMRC claimed that the above calculation of losses (not particularly VAT but simply losses) understated the position in the respect that at the beginning of the periods under review, the Appellant would have held "opening stock". Since the trade had all but ceased by the end of the period, with remaining stock worth only £500, the feature that the true profit and loss would have been influenced by the stock sold in the period having included the opening stock, the resultant loss was actually greater than the implicit loss calculated at the end of paragraph 21 above (i.e. £98,000 minus £71.5000, or £26,500).

24. The Appellant indicated that there had been an opening stock valuation of £9,250 at the beginning of the periods under review, with the result that on HMRC's calculations the loss would have been more than £26,500.

25. HMRC then indicated that all their calculations of input VAT related solely to that referable to stock purchases, such that VAT in respect of the VAT-inclusive rent that the Appellant paid, and in respect of other overhead items, had been ignored. So too of course had those items been ignored in calculating the net losses. £26,500 was merely the implicit gross loss, before deducting any staff costs, rent, electricity etc.

26. HMRC's final observation was that if, as he claimed, the Appellant indicated that the lost fabric did in fact constitute children's clothes, then it would follow that

the amount to be deducted from the VAT-inclusive purchase price of all the standard-rated stock would itself be reduced (by the price paid for the children's clothes), so that with a higher aggregate purchase price of standard-rated stock that was sold, and an unchanged sale consideration of £71,500, the loss would again be increased.

27. In short, HMRC claimed that by undertaking some calculations entirely using the figures provided by the Appellant, the business was said to be trading on a highly improbable basis, particularly in light of the Appellant's own claim about a 40% profit margin.

Our decision on the accuracy of the Appellant's returns, and in particular the significance of the evidence produced about the stock losses

28. We will deal first with the issue of whether or not we accept the Appellant's new evidence at face value.

29. We do not.

30. We endorse all the criticisms made in relation to it by HMRC that we have just summarised. Those calculations appear to indicate that the claims about the stock losses still leave the Appellant claiming that it sold standard-rated stock at a 40% mark-up but simultaneously seeming to realise an approximately equivalent gross loss, and therefore something simply fails to add up.

31. There are the following rather simpler observations to make in relation to the loss claims.

32. Their sheer scale (illustrated by the quantities of stock said to have been lost in the period mentioned in paragraph 17 above) is highly improbable. Beyond the matter of sheer scale, it is extremely difficult to imagine how some of the claimed losses occurred. For instance, in the period for which we gave the figures, it was claimed that in excess of 2,500 china plates had been wholly lost. China plates could hardly suffer damage from water leakage from the roof, and when we asked how this damage occurred, the Appellant said that the water damage would have necessitated the plates being moved and they would have been accidentally broken. Breaking a few plates is credible, but breaking 2,500 is inconceivable. Water damage appears in the same period to have damaged many other items that would appear fairly impervious to water damage. Utensils and hardware, mop buckets, mop heads, washing-up liquid, deodorants, TV aerials, washing lines and pegs would all sound to be difficult to destroy by water damage or accident. Nevertheless 388 plastic mop buckets were said to have been destroyed, and 4,060 mop heads were damaged, in addition to another 720 in roughly the previous one-month period. We were told by the Appellant that the colour of the mop heads changed when they were wet, though it seemed difficult to believe that nearly 5,000 had been affected in this way, quite apart from the fact that they would obviously get wet when eventually used. We were told that the TV aerials that had been broken were not roof aerials but set-top aerials that had plastic bases, but again the notion that approximately 300 such aerials had all been dropped and their plastic bases damaged seemed incredible.

33. We were also surprised at the huge quantities of many items of stock held. The figures given in paragraph 17 above related admittedly to the period when the losses were at their worst, but it seems curious that such large quantities of many of

the items detailed in that list were held in stock in just a 5-month period, particularly for a store with a claimed turnover of all goods in a 3 ½-year period of only £298,443.

34. HMRC made the point that they had been unable to reconcile invoices of purchases with the figures of losses. We attach little importance to this claim because this point was not demonstrated to us in any detail. We certainly observed, however, when we referred on a completely random basis to the purchase invoices that were amongst the documents, that we found that stock purchases were often in small numbers. For instance on 3 January 2007, two halogen heaters were purchased at £5.75 each, and four packs of mugs (seemingly with six in each pack) were also purchase for £4.70. On 4 January we note that one further halogen heater was purchased, and that one pack of safety matches (containing it seems 12 boxes) was purchased. Yet 84 heaters and 410 boxes of matches were said to have been destroyed.

35. We reach the conclusion that there are so many manifest doubts in relation to these claimed losses that we cannot rely on them at all. Quite apart from all the obvious points that we have now listed, it also seems highly curious that the Appellant made little of the point about stock losses in the original hearing. We accept that he referred to water damage, and water damage in the context of losing stock, but if the various causes of stock losses occasioned total write-offs of stock that had cost £110,000, i.e. a vast percentage when the gross turnover, at a claimed 40% margin over the same 3 ½ - year period, was just below £300,000, it is decidedly odd that little reference was made to this in the original hearing.

36. As we have said, this matter was referred back to the First-tier Tribunal on the basis that we would undertake a full re-hearing. Whilst little attention was paid to the original claim about the sale of zero-rated stock for £200,070, and the substantial cash purchases of zero-rated stock with no related documentation, the figures produced to us in relation to the loss claims do appear to have some bearing on the ratio of standard-rated to zero-rated goods sold.

37. We first acknowledge, having found that all the evidence about the loss claims is totally unreliable, that it is doubtful whether we should use the self-same figures in order to make other calculations. It is often necessary to calculate turnover by taking the reliable figures for one period and by then applying them, or applying them with sensible adjustments, in order to make calculations for other periods where there are either no figures, or where the figures are manifestly unreliable. It is obviously far less satisfactory to base any calculations on figures that are themselves highly doubtful.

38. Notwithstanding that observation, it is the case that if the split suggested by the Appellant between the losses of standard-rated and zero-rated items in the ratio of 90 to 20 is anywhere near correct, this does have a bearing on the calculations originally advanced by the Appellant, and those substituted by HMRC in relation to the same ratios. In other words, the ratio of 90 to 20 appears to undermine the Appellant's original claim that £200,170 of sales out of £298,443 total sales were sales of zero-rated product. There may indeed be a case for saying that the zero-rated goods mentioned in paragraph 17 (i.e. books, plantain chips and possibly children's clothes) would have been more susceptible to water damage than many of the standard-rated items and this would make the Appellant's original £200,170 sale figure for sales of zero-rated product even more doubtful. Simultaneously, however, the loss claim ratios cast some doubt on the figure substituted by HMRC, namely sales of only

£8,830 of zero-rated product, i.e. approximately 3% of the gross sales figure that HMRC has accepted.

39. But for two facts we would have been inclined to leave HMRC's assessment unchanged for the same reason as the earlier Tribunal left it undisturbed, namely that there was absolutely no documentation confirming the purchase of any part of the claimed purchase of books and children's clothing from the supplier that insisted on receiving cash and provided no documentation. That approach resulted of course in the sale price for zero-rated stock being left at HMRC's figure of only £8,830.

40. We both believed, however, that it was likely that the Appellant had purchased some zero-rated stock for cash and without receiving any documentation. Subject to the unreliability of the entire loss claims, this would at least explain how it happened that zero-rated stock with a purchase price of £20,000 was said to be the subject of the total write-offs. We also note that some evidence was given before the earlier Tribunal of the various ways in which the Appellant claimed to have funded those cash purchases. None of this evidence was decisive, but explanations were offered as to how the Appellant generated the cash to make the cash purchases.

41. Whilst, thus, we acknowledge that it is unsatisfactory to derive material calculations from highly doubtful figures, we consider that the assessments made by HMRC should be adjusted such that the deduction from the total sales figure to be made in respect of sales of zero-rated items should be taken to be 2/11ths (i.e. the ratio of 20 to 90) of the total sales of £298,443, and that the output liability in respect of the remaining sales should be based on that ratio. No adjustment should be made, should it be asserted by the Appellant that the ratio should be adjusted to reflect the true nature of the loss of fabric. This is because there was no evidence as to the nature of the fabric, and in any event we are using the ratio of 20 to 90 as an extremely rough guide.

42. The Appellant's appeal in relation to the assessments should accordingly be allowed in small part in order to make the adjustment just indicated.

The penalty issue

43. There is no need for us to address the issue of why penalties were only imposed for under-declarations in just two out of many VAT periods. The appeal simply raises the issue of whether the penalties that were imposed for those two periods were calculated correctly.

44. We confirm firstly (not that the Appellant claimed that he had a reasonable excuse) that the Appellant had no reasonable excuse for the under-declarations of taxable turnover.

45. We next confirm that we consider that HMRC approached the matter of reducing the penalties to reflect mitigating circumstances in a fair and reasonable manner, or rather in fact in a generous manner. No reduction was conceded for voluntary disclosure because there had plainly been no such voluntary disclosure. All the adjustments resulted from enquiries that HMRC themselves made.

46. Beyond that, we note that HMRC conceded a 40% reduction of penalties to reflect 10% for helping HMRC to understand the facts, and 30% for giving access to records. Since much of the information given appears to have been unconfirmed by

documents, and the very decision that we have eventually reached is based on reliance on figures that cannot be corroborated by documentary evidence, we consider that the percentage reductions that HMRC has conceded were certainly fair, if not generous.

47. The penalties will of course be reduced automatically because the decision given in paragraphs 41 and 42 above will reduce the assessments, and thus the penalties, but we dismiss the appeal in relation to the calculation of the penalties, and so no further adjustment will be made to the penalties.

Right of Appeal

48. 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.

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 14 August 2013