[2018] UKFTT 543 (TC)

TC06712

Appeal number: TC/2017/00512

VAT – civil penalty for dishonesty – evidence required – whether dishonesty established – yes – whether assessments to best judgment – yes

FIRST-TIER TRIBUNAL
TAX CHAMBER

DERBYSHIRE MOTORS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE FAIRPO
JOHN ADRAIN

Sitting in public at Manchester on 26 February 2018

Mr Gibbon of Nigel Gibbon & Co, for the Appellant

Mr Sellers, presenting officer for the Respondents

DECISION

Introduction

1. This is an appeal against:

(1) assessments for VAT issued on 11 August 2016 and amended on 25 November 2016 in the amount of £15,663.12 (following amendment) made under s73 Value Added Tax Act (VATA) 1994 for the VAT periods 12/03 to 12/08; and

(2) a civil penalty for dishonesty dated 12 December 2016 in the amount of £7,831 made under s60 VATA 1994 for the VAT periods 12/03 to 12/08.

2. The assessments and penalty have been issued on the basis that the appellant declared taxable services supplied to customers as being MOTs, which are outside the scope of VAT.

Appellant's case

Evidence

3. Mr Derbyshire, director and owner of the appellant, provided a witness statement and gave evidence at the hearing.

4. He confirmed that he had not misstated repair sales as MOT sales prior to January 2009, although he accepted that he had done so from January 2009.

5. His witness statement explained that, by the end of 2008, because of the credit crunch and the poor economic climate it was very difficult to invoice sufficient work for the business to survive. In oral evidence, he said that the business had always struggled but that it was more difficult than normal in January 2009, although he could not say specifically why this was the case. In earlier years he had put money into the business personally to support it, but that he ran out of funds in 2009.

6. His concern was for his two employees and the effect on their families if he had to make them redundant. He decided to start to treat some repair work as MOT tests for VAT purposes in order to improve the cash position of the business. He started to do this in early 2009 but accepted for the purposes of this appeal that it started on 1 January 2009.

7. Mr Derbyshire noted that he had thought that some of HMRC's figures as to the number of MOTs carried out were incorrect, although he now accepted that they were correct. Whilst he had thought the figures were incorrect, they did not affect the mark up assessment in relation to other sales and so he considered that there was no need to rectify the position. He stated that he had paperwork to show that figured were not correct and that, if he had thought it necessary, he would have given the information to HMRC.

Evidence of percentage of MOT sales

8. There was a substantial amount of discussion as to the number of MOTs carried out in 2012 and earlier years, with the appellant providing an analysis of figures taken from the VOSA database being provided and compared to turnover for various years to show that the number of MOTs had not changed substantially, in contrast to HMRC's evidence. It was eventually established that the value of the MOT sales recorded on VOSA and comparing this to turnover, using the appellant's estimates of average fees for trade and non-trade fees, amounted to approximately 52% of accounts turnover for the year ended 31 March 2012.

9. The appellant submitted that an analysis of actual MOT sales compared to turnover for 2007-2011 was relatively consistent with the percentage calculated for 2012, being approximately 50%. Accordingly, as HMRC had stated that VAT-declared MOT sales were between 50% and 70% of sales between 2003 and 2009, then it was submitted that it cannot be said that years for which MOT sales represented 50% of turnover were cogent evidence of dishonest conduct.

Dishonesty

10. For the appellant, it was submitted that the burden of proof in respect of the civil penalty is with HMRC, and that the standard of proof is the balance of probabilities. It was submitted that, per Lord Hoffman in *Rehman* [2002] 1 All ER 122 at para 55,

> Cogent evidence is generally required to satisfy a civil tribunal that person has been fraudulent or behaved in some other reprehensible manner

11. It was submitted that HMRC have concluded that the appellant was dishonest prior to January 2009 because he has admitted dishonest conduct from January 2009 onwards. They had also argued that there were similarities within the appellant's accounting records from 30/09 onwards compared to 12/03 to 12/08 which justify the assumption that, if he was dishonest in the later periods, he must have been dishonest in the earlier periods.

12. It was submitted that this was at best assumption and not "cogent evidence" of dishonesty. As there was no direct evidence of any dishonest conduct, HMRC have failed on the balance of probabilities to show that the appellant was dishonest and so the assessments were made out of time.

Best judgement

13. It was submitted that HMRC had not used best judgement because the amounts assessed were based on material relating to years other than those under assessment. In particular, it was submitted that the tests in *Van Boeckel* [1981] STC 290 required that HMRC base assessments on "material" in relation to that particular period and that, as they had not done so, the assessments were not made to best judgement.

Penalty mitigation

14. It was submitted that, in any case, insufficient reduction was made in the level of the penalty to reflect the appellant's co-operation in this enquiry. HMRC allowed only a 50% reduction, although they allowed an 80% reduction for the wrongdoing [penalty imposed for 03/09 onwards. It was submitted that the same reduction should apply for earlier years.

HMRC's case

Evidence

15. For HMRC, Officer Laura-Marie Pearce provided a witness statement and gave evidence in person at the hearing, as follows:

(1) During a visit to the appellant on 4 March 2014, one of the checks carried out was to trace purchases showing specific vehicle registration numbers shown on the purchase invoice through to a sales invoice. For the seven registrations checked, no corresponding sales invoices could be found.

(2) Records for the years ending 31 March 2012 and 31 March 2013 were taken for more detailed analysis. The analysis showed that, of 135 purchases relating to a specific car registration during 31 March 2012, only 29 corresponding sales invoices were available.

(3) At a subsequent meeting on 31 July 2014, this was put to Mr Derbyshire and he checked his diaries for a number of the registrations but could not locate sales. He could not explain how this had happened, but was sure no sales were missing. On request, he provided diaries for 2011 and 2012 to check against the analysis.

(4) The diaries showed numerous entries each day in excess of sales declared. Several entries in the diary showed amounts to pay "for cash or + VAT", which was considered to show that the appellant would not declare the sale for VAT if cash was paid.

(5) At a further meeting on 11 March 2015, Mr Derbyshire was asked about the discrepancies. He admitted that he did do some work and, if they did not require an invoice, he put all of the work on one invoice which stated that it was for MOTs for fictitious garages. He admitted that VAT had been understated.

(6) In a letter dated 23 June 2015, the appellant was asked to provide a full disclosure of errors, and was advised that if this was not provided, best judgement assessments would be issued.

(7) On 8 July 2015, a letter was received from the appellant without a full disclosure but providing some information as to the amount of the discrepancy between the MOT tests amount and the MOT tests actually carried out.

(8) On 7 September 2015, HMRC replied by letter to say that the information could not be accepted as it would not be enough to cover the repairs and servicing for purchases information available, and that it did not match the explanation for the fictitious MOT invoices. The letter provided proposed

assessment figures for the year ended 31 March 2012, based on marking up purchases without a sales invoice at the same percentage as those purchases for which sales invoices could be identified. The letter also advised that assessments would be considered for up to 20 years as the errors were deliberate.

(9) On 12 February 2016, in a meeting with Mr Derbyshire, the appellant provided revised proposals excluding some amounts for tools and oil that would be kept in stock. Mr Derbyshire said that he had only understated VAT for the year then under consideration, the year ended 31 March 2012. He was advised that HMRC had looked at figures provided for 2013 which showed the same issues. Following this, Mr Derbyshire accepted that he had understated VAT for 2013 as well.

(10) The appellant was asked what the earliest year was for which records were available: this was 2009. The same errors, with invoices to fictitious garages, were evident from the sales day books for January 2009 onwards.

(11) The appellant has now accepted that he understated VAT from January 2009 onwards.

(12) On 22 July 2016, a letter was issued by HMRC with revised figures, with confirmation that assessments would be made back to 2003. This was decided upon as the percentage of MOT sales compared to standard rated sales declared on VAT returns appeared to increase after the last VAT visit in January 2004 from 35-40% to over 60% of sales for the following years, each year being around 50% to 60%, with some being higher.

(13) For example, the value of MOT sales initially declared in the VAT return for 03/12 represented 59.9% of total sales; for 09/11 it was 63.44% of sales; and 80% of sales for 12/11. Once adjusted to follow the assessment figures for the year 31 March 2012, the value of MOT sales put forward by the appellant in a letter of 22 August 2016 represented 40% of the VAT-inclusive total for all sales.

(14) The figure for total sales was established by calculating the value of actual MOT sales (as evidenced from VOSA information and the appellant's estimate of fees charged), and adding to this evidenced sales and an amount representing other sales on the basis of a markup on purchases, as it was clear that not all sales had been invoiced. It was submitted that the appellant had not disputed the markup in his letter of 22 August 2016 when he had provided some amended figures to HMRC.

(15) The presumption of continuity therefore indicated that there had been overstatements of MOT sales in the VAT returns throughout.

16. It was put to Officer Pearce that it would have been more appropriate to deduct the amount for evidenced MOT sales from the total sales, rather than using a markup on parts to recalculate the amount. Officer Pearce replied that it was clear that sales had not been invoiced and so it was not appropriate to do this.

17. It was put to Officer Pearce that the evidence of uninvoiced sales in the letter of 7 September 2015 had been established from very short periods of time – a nine day period and a ten day period. She explained that these were examples of missing sales between two invoices, and that the appellant had not disputed the examples nor the overall markup.

Dishonesty

18. HMRC submitted that the appellant has admitted that he made an active decision to dishonestly record taxable sales as MOTs in order to avoid accounting to HMRC for the VAT that was properly due.

19. HMRC submitted that, as the action is dishonest, the time limit for the assessment is governed by s77(4) and s77(4A) VATA 1994 and so the appropriate time limit for assessment is twenty years, and the appellant's submission that the assessments are out of time is incorrect.

20. HMRC further submitted that the appellant is incorrect in his contention that HMRC are required to show that sales were underdeclared for the periods under appeal. Instead, HMRC contend that the burden of proof lies with the appellant to prove that sales were not underdeclared.

21. HMRC submit that, on the balance of probabilities, it is more likely than not that the appellant underdeclared sales throughout the whole period, rather than deciding to do so in the first period for which records have been retained.

Best judgment

22. HMRC submitted that the appellant's contention that the assessments are not made to the best of their judgement is incorrect, and that the approach taken is that set out in the decision of Woolf J in *Van Boeckel* [1981] STC 290 which they submitted has. together with other case law, set out the following three tests that need to be considered:

> (1) the figure should be reasonable, in that it is not excessive, unrealistic or a spurious estimate or guess in which all elements of judgement are missing; and
>
> (2) the figure was reached honestly, not dishonestly or vindictively or capriciously; and
>
> (3) there was some material before HMRC on which the figure could be based

23. HMRC submitted that the tests were met as follows:

> (1) the amount under appeal is reasonable and realistic: it had been calculating using average figures for the period 03/09 to 03/15 which were then extrapolated to the earlier periods.

(2) The figure had been reached honestly, without malice or capriciousness, as it is calculated using recognised methodologies to provide a fair and reasonable estimate in the absence of documentary evidence.

(3) The figure was based on evidence and documentation available for the later periods.

24. The appellant was not required to have kept records for the periods under appeal and did not do so. In the absence of such records, HMRC had made the assessments using their best judgement.

25. HMRC submitted that the appellant had misunderstood the tests in *Van Boeckel*: if the requirement of the legislation was that, in order to come to a best judgement assessment for a specific period, HMRC must have "material" in relation to that particular period it would make the provisions of s73 redundant. It was submitted that the purpose and intention of s73 is to allow HMRC to come to a reasonable estimation of a liability where the evidence of that liability has been lost, destroyed or otherwise made unavailable.

26. HMRC submitted that the methodology used is reasonable as it is more likely than not that the appellant had carried on the dishonest behaviour throughout the entire period and did not simply begin these actions at the point that it was required to retain its records. HMRC submitted that the burden of proof was on the appellant to show that the assessment was wrong and also to positively show what corrections should be made in order to make the assessments more accurate.

Penalty mitigation

27. HMRC submitted that 50% has been allowed in mitigation to recognise that he appellant provided records and eventually admitted the deliberate understatement of sales for later periods.

28. HMRC submitted that this was an appropriate and reasonable reflection of the assistance given by the appellant and the seriousness of the actions taken that lead to the penalty in the first instance.

Discussion

Dishonesty – whether established at all

29. Although HMRC made some submissions as to the nature of dishonesty, we note that the appellant has not disputed that he has undertaken dishonest behaviour, he has disputed only when the dishonest behaviour started. Accordingly, we find that it is agreed that the deliberate misdeclaration of taxable repair supplies as MOT sales outside the scope of VAT is dishonest behaviour.

Ability to raise assessments

30. HMRC submitted that, as the action is dishonest, the time limit for the assessment is governed by s77(4) and s77(4A) VATA 1994 and so the appropriate time limit for assessment is twenty years. HMRC further submitted that the appellant is incorrect in his contention that HMRC are required to show that sales were underdeclared for the periods under appeal.

31. We find that s77(4) and s77(4A) provide a time limit for assessment of twenty years in a case involving a loss of VAT brought about deliberately by a taxpayer.

32. We consider, therefore, that the burden of proof is on HMRC to show that the appellant acted deliberately to bring about a loss of VAT for each of the periods under appeal. If HMRC can establish that, then they would be entitled to assess the appellant in respect of the loss of VAT, using best judgment. The burden of proof would then be on the appellant to show that the amount of the assessment is incorrect.

Dishonesty – whether dishonesty prior to 2009

33. We considered Mr Derbyshire's evidence as to when he had begun to misdeclare taxable supplies as MOTs outside the scope of VAT in his VAT returns.

34. Mr Derbyshire stated that the business had always struggled and that he had had to put money into the business to keep it going; what had changed in early 2009 was that he had run out of money with which to support the business and that things were more difficult than normal. He said that he could produce further information but did not in fact produce any further evidence to support his statement.

35. In oral evidence, however, he was unable to say exactly when he started other than that it was during 2009, or to describe anything in particular which prompted the decision to under-declare VAT. We found it surprising that the appellant does not have a clearer recollection of what drove him to make such a decision.

36. Figures provided by the appellant in his witness statement show business turnover of:

(1) £95,752 for the year ended 31 March 2007;

(2) £88,208 for the year ended 31 March 2008;

(3) £86,550 for the year ended 31 March 2009;

(4) £93,728 for the year ended 31 March 2010;

(5) £81, 399 for the year ended 31 March 2011;

(6) £76,854 for the year ended 31 March 2012

37. We consider that, contrary to the appellant's evidence, these figures do not indicate that things were more difficult than normal in early 2009 as there is no substantial difference between the turnover to 31 March 2008 compared to the turnover to 31 March 2009. Indeed, the amount stated for the year to 31 March 2010

(that is to say, the year starting on 1 April 2009) shows an increase of over £5-7,000 in turnover compared to 2008 and 2009.

Evidence of the MOT sales percentage

38. The appellant submitted that, based on accounts turnover for 2012 and VOSA figures for MOTs, MOTs should be regarded as being 52% of sales for 2012 and that this was consistent with years back to 2007. Given that figure, the appellant submitted that HMRC's evidence that MOTs amounted to between 50% and 70% of sales from the VAT returns did not amount to cogent evidence of dishonest conduct as to any year prior to 2009.

39. We note the appellant's submissions but also note HMRCs evidence that the level of MOT sales were around 60% prior to 2009. If approximately 52% is the average level of returns, then such returns would clearly be evidence of misdeclaration of sales as MOT invoices.

40. We further note that the appellant's evidence as to the level of MOT sales is inconsistent: in his letter to HMRC on 22 August 2016, he stated that MOT sales amounted to £34,735.80 for 2012, based on a list which he provided. In the hearing, he accepted that they amounted to £40,260 for that period, on the basis of VOSA figures and the appellant's estimate of fees for trade and non-trade MOTs.

41. Given the inconsistencies in the appellant's evidence, we are not convinced that the appellant has established that HMRC's analysis of MOT sales percentages in the VAT returns for the periods prior to 2009 cannot indicate that there was an under-declaration of VAT in those periods.

42. We note that the appellant initially admitted only to dishonest conduct in 2012 when faced with evidence, and then admitted to similar conduct in 2013 when faced with evidence, and then admitted to similar conduct from 2009 onwards when faced with evidence. For years for which he has no records, he maintains that there was no dishonest conduct.

43. We have considered the appellant's submissions with regard to the need for "cogent evidence" in *Rehman* but we consider that "cogent evidence" can include behaviour and similar facts.

44. In this case, we find that the appellant has consistently sought to deny dishonest conduct until faced with documentary evidence. We also find that the reasons given as to why he began to under-declare sales for VAT in early 2009 are not supported by the evidence available to us.

45. Accordingly we find that, on the balance of probabilities, the appellant's dishonest behaviour began with the 12/03 VAT period and continued thereafter. As dishonest behaviour is, clearly, the deliberate bringing about of a loss of VAT we find therefore that the assessments were raised in time as they were raised within the twenty year time limit.

Best judgement

46. No submissions were made in the hearing on the question of whether best judgement was used in making the assessments, but the appellant's grounds of appeal included the submission that HMRC have no material on which they can act for periods prior to 03/09 and that the assessments have therefore not been made on using best judgement, as *Van Boeckel* [1981] STC 290 requires that "some material" is required for HMRC to reasonably act. As this was in the grounds of appeal, was not withdrawn, and HMRC addressed the point, we have considered it.

47. We agree with HMRC that the decision in *Van Boeckel* does not mean that "material" is required for the specific period for which an assessment is made: we consider that HMRC can, where necessary, undertake an assessment with best judgement by extrapolating from material available for other periods.

48. The appellant has not otherwise disputed the methodology used by HMRC to make the assessments and we find that the assessments were made to best judgement.

Penalty mitigation

49. As we have found that the appellant's dishonest behaviour applied from the 12/03 VAT period onwards, we also find, accordingly, that the civil penalty under s60 VATA 1994 applies.

50. The appellant submitted that the penalty mitigation for the periods under appeal should be the same as that allowed for the periods 03/09 onwards. We consider that there is a material difference between the penalty for 03/09 onwards and that for earlier periods, as the appellant admitted dishonest conduct for the 03/09 periods onwards but has not done so for the earlier periods. We do not consider that there is any reason to disturb the amount given by HMRC in mitigation for the penalty for 12/03 to 12/08.

Decision

51. The appeal is dismissed and the assessments and penalty are confirmed.

52. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ANNE FAIRPO
TRIBUNAL JUDGE

RELEASE DATE: 11 SEPTEMBER 2018