NCN: [2021] UKFTT 220 (TC)

TC08169

VAT, corporation tax and associated penalties – alleged suppression of takings by Chinese restaurant – on the facts, best judgment not used by HMRC – appeal allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal numbers: TC/2018/03657
TC/2018/06426
TC/2019/01334
TC/2019/01335

BETWEEN

KONG'S RESTAURANT LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE KEVIN POOLE
TERRY BAYLISS

The hearing took place on 19 and 20 April 2021. the form of the hearing was V (video), conducted using the Tribunal's own Video Hearing System. A face to face hearing was not held because of the restrictions caused by the Covid-19 pandemic. The documents to which we were referred comprised a pdf bundle of documents of 380 pages and a separate pdf bundle of authorities of 313 pages.

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.

Desmond Poon of SH88 Limited for the Appellant

Rebecca Arnold (VAT) and Paula O'Reilly (corporation tax), litigators of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. These appeals concerned assessments (and an amendment to a self-assessment):

   (1) for VAT totalling £61,314[1] (with associated penalty of £54,923) in respect of the period from 1 April 2014 to 4 July 2017; and

   (2) for corporation tax totalling £43,797.20 (with associated penalty of £39,417.48) in respect of the accounting periods ended 31 March 2015, 2016 & 2017,

all arising from supposed under-declaration of sales and profits by the Appellant, which carried on business as a Chinese restaurant and takeaway in Abergavenny.

THE EVIDENCE

Introduction

2. We received written witness statements and heard oral testimony from HMRC officers Daniel McKay, Beverley Bolton and David Morgan and from Cherry Kong and Geane Reyes (respectively the Director and Assistant Manager of the Appellant over the relevant period). We also received a bundle of documents.

3. We find the following facts.

Scope of evidence from HMRC

4. It is first important to record the scope of involvement of the three HMRC officers who gave evidence.

5. Officer McKay was the manager of officer Paul Williams, who actually led the VAT enquiry and issued the VAT and penalty assessments under appeal before he left HMRC around the end of July 2018. The VAT assessment was issued on 22 February 2018 and the penalty assessment was issued on 24 July 2018, both by officer Williams. Officer McKay's evidence was therefore limited to confirming his agreement with the basis on which the two assessments had been calculated by officer Williams (subject to one small adjustment which had been made following the statutory review of the VAT penalty assessment) and exhibiting various documents from HMRC's files. We had no evidence from officer Williams, beyond his written notes of visits which were included in the document bundle. Officer McKay sought to introduce new evidence at the hearing about previous events involving Mr Kong, but as this was not included in his written witness statement and the Appellant therefore had no warning to enable it to produce evidence in rebuttal, we excluded it.

6. The corporation tax enquiry only formally commenced in February 2018 and was initially handled by officer Lee Bramwell (who had also attended the unannounced visits in January and June 2017 referred to below), who left HMRC in May 2018. By that time, he had indicated the basis upon which he proposed to deal with the corporation tax liabilities of the Appellant for the accounting periods ended 31 March 2015 and 2016. Officer Bolton took over the matter in July 2018. Officer Bolton was responsible for completing the enquiries, and she included the accounting period to 31 March 2017 (which had not previously been addressed by officer Bramwell). In doing so, she simply relied on the outcome of the VAT enquiry, adding the same uplifts in respect of the supposed suppressed sales and purchases and then adjusting the taxable profits accordingly (without making any other amendments to the returned figures).

7. Officer Morgan had a very limited role in the enquiry, attending with officer Williams at the Appellant's premises to observe a delivery from the Appellant's supplier Total Asia Food

[1] The actual assessment gave the figure £61,134, but the individual elements of it added up to £61,314 and that is the figure stated in the statutory review letter.

Limited ("TAF") in January 2018 (some months after the Appellant ceased to trade, though the business itself was still being carried on but through a different company essentially run by the same people) and to attend at TAF's premises the following day with him and another HMRC officer to establish what records were held there concerning its supplies to the Appellant.

8. The documents in the bundle relating to the corporation tax enquiry were sketchy in the extreme and did not include any copies of the Appellant's returns for the three years in question or of the closure notice which appears to have closed the 2016 enquiry or the discovery assessments raised in respect of 2015 or 2017 (or any explanation of why an assessment was considered appropriate in respect of 2017 rather than a formal enquiry and closure notice).

Scope of evidence from the Appellant

9. Whilst Ms Kong gave evidence in her capacity as the former Director of the Appellant, and Mr Reyes as its former assistant manager, it was unfortunate that Mr Kong, who had described himself as the manager and had actually dealt with HMRC during their visits to the restaurant, did not give evidence. There was no evidence before us as to the reason for this omission, and we infer it was feared that his evidence, when tested in cross examination, might not assist the Appellant's case.

HISTORY OF THE ENQUIRIES

VAT

Outline facts

10. Officer Williams, accompanied by officer Bramwell and officer Cath Jones, made an unannounced visit to the Appellant late in the evening of Friday, 27 January 2017. Mr Kong was there and identified himself as the manager and partner of the owner. He provided the officers with the meal slips for that evening divided into four sections representing takeaway meals purchased by cash/card and restaurant meals purchased by cash/card. Upon examination, according to the notes of the visit prepared by officers Williams and Bramwell, these showed the day's sales as comprising:

(1) Takeaway meals bought with cash: £426.35.

(2) Takeaway meals bought by card: £544.90.

(3) Restaurant meals bought with cash: £449.10.

(4) Restaurant meals bought by card: £396.70.

11. The total sales for the day were therefore shown on the meal tickets as £1,817.05 (£875.45 in cash and £941.60 by card). Mr Kong advised that trading in January had generally been down on the previous year, though that Friday was busier than previous Fridays. No reason for this is recorded in the notes of the meeting, but subsequently it was pointed out that 27 January 2017 was Chinese New Year's Eve, when there would have been some kind of promotion running to generate extra business.

12. After the last customer had left, a cashing up exercise was carried out. The card sales were transacted through a PDQ machine which linked directly to the Appellant's business bank account. A report from the PDQ machine showed total card sales for the day of £1,003.60 (compared to the officers' calculated figure from the meal tickets of £941.60, an excess of £62) and the cash in the till, after adding back some small cash expenses paid out, came to £1,049.96 (compared to cash receipts recorded on the till of £1,048.40 and cash meal tickets totalling £875.45). Thus the total receipts, based on the PDQ report and the cash in the till, came to £2,053.56, compared to the £1,817.05 figure derived from the meal tickets, a difference of £236.51 (if the cash reported as logged by the till were used instead of the cash actually counted, the difference was reduced to £234.95). The total cash received and logged through

the till was £172.95 more than would have been expected based on the meal tickets, and the total card receipts were £62 more than would have been expected based on the meal tickets. No explanation appears to have been sought or offered in relation to these differences.

13. Mr Kong explained that the meal slips for card transactions were retained but those for cash transactions were destroyed at the end of each day as the cash sales were all keyed through the till, which therefore contained a report of them; a report was produced to them to show the detail included in it, but no copy of that report was before us in evidence, nor was there any evidence as to the level of detail it contained. The till was a Softabacus EPOS till.

14. Elsewhere in the bundle of documents before us was an undated and untitled two-page listing showing a breakdown of "eat in" amounts and "eat out" amounts, each broken down into cash and card elements. The document itself was not explained and did not appear in any particular context which clarified its origin. Its "eat out" totals for both cash and card did however match the meal ticket figures included in the meeting notes of the 27 January 2017 visit, so we infer the listing shows a breakdown of the meal tickets examined by the officers on that evening. What is not explained is that the "eat in" totals shown in that list total £1,055.75 (compared to the figure of £845.80 derived from the meeting notes), broken down as to £458.70 in card sales (compared to the figure of £396.70 contained in the meeting notes) and £597.05 in cash sales (compared to the figure of £449.10 in the meeting notes). The meeting notes recorded that the HMRC officers took away with them the various till reports that had been printed for them and the original meal tickets, but no copies of either of them were included in our bundle, even though HMRC's list of documents stated that they would be relying on "Copy Meal Bills and Analysis". This confusion and lack of primary evidence adds to a general impression of slight carelessness with which the whole case has been conducted by HMRC.

15. At the 27 January 2017 visit, Mr Kong also identified the Appellant's suppliers as "Global, Total Asia, Philip Jones and L & K Wines".

16. It appears nothing further happened until Friday 30 June 2017, when another unannounced visit took place at the end of the evening. Again, officers Williams and Bramwell attended, accompanied this time by an officer Huw Blacker.

17. A similar cashing up exercise was carried out, and office Blacker also downloaded the data from the till. A review of the meal slips for the evening provided the following totals:

(1) Takeaway meals bought with cash: £449.10.

(2) Takeaway meals bought by card: £752.05.

(3) Restaurant meals bought with cash: £196.20.

(4) Restaurant meals bought by card: £326.85.

18. The total sales for the day were therefore shown on the meal tickets as £1,724.20. A report from the PDQ machine showed total card sales for the day of £1,078.90 and the cash in the till came to £651.00 (after deducting the float of £150 which Mr Kong said had been there at the start of the evening). Thus the total receipts, based on the PDQ report and the cash in the till, came to £1,729.90, compared to the £1,724.20 figure derived from the meal tickets, a difference of £5.70.[2]

19. Mr Kong again confirmed that the main suppliers to the business were Global Foods, Total Asia and Philip Jones (there was no mention in the notes of L & K Wines). Mr

[2] Officer Bramwell used a cash figure of £660.60 rather than £651 in his eventual calculations, we infer on the basis of the cash total logged on the EPOS till.

Bramwell's note records that Mr Kong told them that "deliveries were mainly on a Tuesday from the main supplier Global".

20. It appears that shortly after this visit, the Appellant's business was transferred to another legal entity and the Appellant therefore ceased to trade on 3 July 2017.

21. There appears to have been further correspondence between HMRC and the Appellant's accountants in which daily journals from the till were provided. None of this material was included in our bundle. An analysis of this information caused officer Williams to write to the Appellant's accountants on 4 October 2017, expressing concern at the number of cancellations and voids which were recorded. He sent a spreadsheet showing a summary of this information for the period from 26 March to 2 July 2017 and requested his "thoughts" on the matter. In the same email, officer Williams confirmed that he wished to send off requests for information to "the main suppliers i.e. Global Foods and Total Asia". He asked if there were any other suppliers which the business used on a regular basis. In response, it was said that the Appellant wished to resolve the concerns about voids and cancellations by direct contact, and that any 3rd party requests should be sent direct to the Appellant. No copy of any further correspondence on either matter was included in the evidence before us, except for an explanation of the difference between "voids" and "cancels" obtained from the suppliers of the till in the following terms which was passed on to HMRC in March 2018:

> "Cancels Before Sales" means exactly as it says, it keeps track of all deletions due to entry errors during the data entry process before orders are committed (sent to the kitchen/payments were made). In contrast, a deletion after an order is committed is marked as "Voids After Sale".

22. Officer Williams was clearly interested in establishing whether the Appellant was including all its purchases in its accounting records. On 9 November 2017, HMRC sent a third party request to TAF. There was no copy of that request or the response to it in the evidence before us, but it apparently requested all delivery notes, delivery schedules and sales invoices issued to the Appellant from 1 April 2016 to 30 June 2017. On 12 December 2017, HMRC apparently received "some purchase invoices" from TAF relating to the Appellant. In evidence, officer McKay confirmed that HMRC had written to "other suppliers" of the Appellant but had not received any response and had not taken the matter any further with them.

23. On Monday 29 January 2018 officers Paul Williams and David Morgan made an unannounced visit to observe an anticipated delivery from TAF to the successor business to the Appellant in Abergavenny. Mr Kong received the delivery. When asked to produce the paperwork relating to the delivery, Mr Kong had produced a single invoice/delivery note addressed to the Appellant's successor in business, recording a purchase of £601.09. Mr Kong confirmed that this invoice had not yet been paid. He also confirmed that he had not received any other invoices with the delivery that had just been received, and had not paid the delivery driver any cash, nor did he intend to do so.

24. The following day, 30 January 2018, the same officers attended at the premises of TAF, accompanied by another officer from HMRC's Systems and Data Compliance Team. They obtained data from the TAF computer system showing that on the previous day, in addition to the invoice which had previously been shown to them by Mr Kong, TAF had delivered other goods to a value of £202.93 at the same Route and Drop number, but which were subject to a separate cash invoice made out to "Cash444" rather than to a named customer. A pattern of similar "dual delivering" could be seen which involved three separate dates prior to the Appellant's cessation of business as well as a great many subsequent dates.

25. On 10 April, 29 May and 26 June 2017, normal deliveries to the Appellant and associated deliveries on invoices addressed to "Cash23", "Cash28" and "Cash28" at the same Route and Drop numbers respectively had been made, as follows:

Delivery date	Invoice to Appellant	Cash invoice
10 April 2017	£226.30	£115.95
29 May 2017	£294.56	£162.93
26 June 2017	£360.54	£224.63

26. The IT system of TAF was quite antiquated and whilst they had been allowed access to download what they wanted, it had been a time consuming process. Although Global Foods was a far larger business (turnover in the region of £150 million compared to TAF's £5 million, according to officer Morgan), they had not pursued things further with them because although Global Foods had been identified to them by Mr Kong as the Appellant's main supplier, the evidence of suppression of purchases which they had obtained from TAF appeared sufficient to support their conclusion, essentially derived from the two visits to the Appellant, that it was under-declaring sales.

27. Finally, as to the volume of voids and cancellations, HMRC had prepared a schedule listing the takings, voids and cancellations separately for each business day from 26 March to 2 July 2017. This showed that such occurrences were taking place every day, and in respect of significant amounts. Even on the date of the second HMRC visit to the restaurant (30 June 2017), the schedule shows £2.95 of "voids" and £166.30 of "cancellations" (on a day when the recorded takings shown by the till were £1,739.50). Over the entire period, reported takings were £78,479.62, the value of "voids" was £1,983.70 and the value of "cancellations" was £8,465.24. According to the calculations on this schedule, the aggregate of £10,448.94 of voids and cancellations, if added back to the reported takings of £78,479.62, would produce total takings of £88,928.56, of which the voids and cancellations represented 11.75%.

HMRC's decisions

28. It appears officer Williams was supplied at some point with more detailed daily takings figures, from which he calculated an average Friday takings figure for the period 6 January to 30 June 2017 of £1,309. No copy of the correspondence supplying those figures appeared in our bundle. Officer Williams compared the takings for the two Fridays of the visits with this average, which resulted in the conclusion that the average reported takings fell approximately 36% short of the 27 January 2017 figure and 24% short of the 30 June 2016 figure. He considered there was sufficient evidence before him to support a conclusion that the Appellant was, on average, suppressing 30% of its actual sales (suppressing a similar volume of purchases in order to make the gross margin appear adequate). Its excessive use of the "void" and "cancel" feature on the till supported him in this conclusion, as did a roughly comparable suppression of purchases appearing from the TAF invoices. By grossing up the reported takings of £858,408 in respect of the total period from 1 April 2014 to 30 June 2017 to take account of this supposed suppression, he concluded that the Appellant's true turnover over that period (inclusive of VAT) was £1,226,297 (i.e. an increase of £367,889) and accordingly (applying a VAT rate of 20%), he considered the Appellant to be liable for VAT totalling £61,314 allocated across the various VAT accounting periods between those two dates.

29. As officer McKay emphasised to us, HMRC were defending this assessment (and the associated corporation tax calculations) primarily on the basis of the suppression of takings which were supposedly revealed as a result of the visits in January and June 2017. The

evidence of suppression of purchases and the high level of voids and cancellations on the till merely confirmed their view that suppression was taking place.

30. Officer Williams issued an assessment (and an explanatory letter setting out the basis of its calculation, summarised above) on 22 February 2018. This was confirmed, following a statutory review, on 29 May 2018.

Corporation tax

Outline facts

31. As mentioned above, officer Bramwell took part in the two visits to the restaurant, and initially dealt with the corporation tax side of the enquiry. No steps were taken to investigate the PAYE position, though HMRC were provided with the names of 9 employees on their first visit (all of whom were on duty that night) and there do not appear to have been any RTI returns by the Appellant in respect of any employees; indeed officer McKay indicated that one likely use of the cash said to have been retained by suppressing sales might have been to pay employees.

32. On 16 February 2018, less than a week before the VAT assessment was issued, officer Bramwell wrote to the Appellant formally opening enquiries into the Appellant's corporation tax returns for the two years ended 31 March 2015 and 2016. In an accompanying letter (headed "Check of the company's tax position for the accounting period ended 31 March 2015 and 31 March 2016), he explained the basis upon which he intended to calculate the company's liability. Oddly, the stated basis was as follows:

> Following a number of visits to the business premises throughout the enquiry, it has been established that purchases made by you were understated by approximately 30%. It is therefore reasonable to assume that subsequent sales were also understated by this value.

33. Officer Bramwell went on to set out the detail of the calculations he was proposing in respect of the two years. He intended to increase the "cost of goods" figure for each year by 30%, then apply the actual mark-up rate declared in each year's accounts to arrive at an adjusted turnover figure. No other adjustments would be made. The net result was an increase in the corporation tax liability of £12,007 for 2015 (from £84 to £12,091) and an increase of £13,516.60 for 2016 (from £4,055 to £17,567).

34. In the same letter (in which the two years 2015 and 2016 were confused more than once), officer Bramwell went on to say this:

> … I intend to close my enquiry for the years stated above by amending the return for the year ended 31 March 2016 to reflect the adjustments noted.
>
> I also intend to raise further assessments for the year ended 31 March 2015.

35. It seems that officer Bramwell then left HMRC before taking any further action. It would appear likely that what he intended to say in this letter was that he proposed to amend the tax returns for the 2015 and 2016 years by closing his open enquiries into those two years, and he intended to take further action in relation to the 2017 year.

HMRC's decisions

36. Officer Bolton took the case over in July 2018. She reviewed officer Bramwell's letter dated 16 February 2018, the evidence on which the uplifts had been calculated, and agreed with the method used. In her witness statement, she went on to say "I raised CT assessments for the accounts years ended 31 March 2015 and 31 March 2016 based on the suppression rate of 30%...", on the basis set out in the 16 February 2018 letter. She went on to say "I also issued an enquiry closure notice for the accounts year ended 31 March 2016 on 5 July 2018… In

addition I also raised an assessment on 5 July 2018 for additions on the subsequent year, accounts year ended 31 March 2017 also based on the suppression rate of 30%."

37. No copy of any closure notice or notice of assessment was included in our bundle. All that was included was:

(1) in relation to the year ended 31 March 2015, a screenshot dated 4 January 2021 from the COTAX system recording the making of an assessment on 4 July 2018 (issued on 5 July 2018), with a note "Discovery assessment raised based on additional sales identified during enquiry", and stating "Amount Stoodover" as £12,090.97 and "Tax Paid for AP" as £84.23, together with a scanned copy of a page from a ring binder of documents headed "Display Assessment", which appeared to record the making and issue of the same assessment whilst setting out a tax calculation based on "trading profit" of £60,455 and ending with a line "Net tax payable" of £12,091.00;

(2) in relation to the year ended 31 March 2016, a screenshot dated 4 January 2021 from the COTAX system headed "Display Assessment", recording the making of an assessment on 4 July 2018 (issued on 5 July 2018) with a note "Closure notice issued and profit revised based on additions identified during enquiry", and stating "Amount Stoodover" as "13,512.40 and "Tax Paid for AP" as £4,055.20, together with a scanned page in similar format to the above which, in spite of being headed "Display Assessment", appeared to record the making of a "Closure Notice with Rev Amdt" made on 4 July 2018 and issued on 5 July 2018; as above, this document set out a tax calculation based on "trading profit" of £87,821, ending with a "Net tax payable" line of (in this case) £17,567.60;

(3) in relation to the year ended 31 March 2017, a screenshot dated 4 January 2021 from the COTAX system recording the making of an assessment on 4 July 2018 (issued on 5 July 2018), with a note "Assessment raised based on additional sales identified during enquiry", and stating "Amount Stoodover" as £14,138.60 and "Tax Paid for AP" as £3,787.60, together with a scanned copy of a page from a ring binder of documents headed "Display Assessment", which appeared to record the making and issue of the same assessment as a discovery assessment whilst setting out a tax calculation based on "trading profit" of £70,693 and ending with a line "Net tax payable" of £14,138.60.

38. It appears therefore that, notwithstanding the open enquiry into the 2015 return, rather than issue a closure notice and amend the Appellant's return in the usual way, officer Bolton issued a discovery assessment of some kind; in relation to the 2016 return, it appears that she issued a closure notice and amended the Appellant's self-assessment; and in relation to the 2017 return (for which the enquiry window was still open), she issued a discovery assessment.

39. In a statutory review letter issued on 4 October 2018, HMRC confirmed the two assessments and the amendment to the Appellant's self-assessment effected by the closure notice. The amounts confirmed were £12,091 (for 2014-15), £17,567.60 (for 2015-16) and £14, 138.60 (for 2016-17), totalling £43,797.20. It became apparent on a close examination of the documents following the hearing that these figures represent the total adjusted corporation tax HMRC considered to be due in respect of the three years, and did not take account of the payments actually made by the Appellant (based on the returns it had submitted) of £84.23, £4,055.20 and £3,787.60.

Penalties

VAT

40. Officer Williams wrote to the Appellant on 16 May 2018, indicating the penalties which he proposed to charge in respect of the VAT liabilities. He had reached the view that there

were inaccuracies in the Appellant's VAT returns which were deliberate and concealed, and whose disclosure was prompted by HMRC's enquiries. This meant that the penalty range should be between 50% and 100% of the potential lost revenue. Within that range, mitigation of 0% was allowed for "telling", 5% for "helping" and 15% for "giving access to records". As a result, the final penalty loading he applied was 90%. Based on potential lost revenue of £61,314, this resulted in a proposed penalty of £55,182.60. He eventually issued a notice of penalty assessment in that amount on 24 July 2018. Ultimately the penalty was upheld on principle on statutory review, but in the reduced amount of £54,923 because the reviewing officer noted that a small part of the penalty appeared to have been imposed in respect of a day after the Appellant had ceased to trade.

Corporation tax

41. The corporation tax penalty procedure followed a similar path. Following the basic approach adopted for the VAT penalties, on 8 August 2018 a notice of intended penalty was issued to the Appellant, explaining that HMRC intended to impose penalties at the rate of 90% of the potential lost revenue reflected in the corporation tax assessments and closure notice previously issued. The potential lost revenue figures on which it was based were those reflected in the assessments/amendment referred to at [39] above. On any basis, therefore, the proposed penalty should be reduced to reflect this error.

42. By a statutory review conclusion letter dated 25 February 2019, HMRC confirmed the corporation tax penalties in the amounts set out in the penalty assessment.

THE APPELLANT'S EVIDENCE

43. As identified above, Mr Kong did not give evidence. The evidence from Ms Kong and Ms Reyes bore mainly on the question of the cash purchase invoices and the problems with the till, as neither of them was present at any of the visits to the restaurant.

44. Mrs Kong and Ms Reyes gave evidence that the items listed on the "cash" invoices included in the bundle were bought on behalf of members of staff, their families or the local ethnic community, up to 40 in number, and that some of those items were not even included in the menu of the Appellant. We accept that there might have been some purchases of this nature (for example, frozen banana leaves, which we accept were not used in the restaurant, but were an integral part of her own Filipino cuisine), but we do not accept that it explains the majority of the items – for example we do not find it credible that the restaurant should, in relation to <u>each</u> of the three deliveries on 10 April, 29 May and 26 June 2017 have required the following items (which are shown on the respective invoices for those three deliveries):

	Invoiced to Appellant (for restaurant)	Cash (for onward supply)
Square cut meaty ribs	20kg	10kg
Chicken breast fillet	30kg	15kg
Eggs	180	180

45. In the absence of further corroboration, we therefore reject Ms Kong's evidence to the extent she attempted to explain the cash invoice purchases as being <u>fully</u> referrable to purchases for friends and family. There is clearly sufficient here to make the objective reader suspicious, and to require further investigation. But none was carried out, as HMRC considered this to be mere corroboration of the clear view they had formed on the basis of their "average takings" calculations. An obvious next step would have been to form a clear picture of the actual supplies (including any by way of separate cash accounts) from all the Appellant's known suppliers, including its named "main supplier" Global Foods, for a reasonable period leading

up to the Appellant's cessation of business in comparison to the Appellant's declared purchases, but this was not done.

46. As to the difficulties with the till, we accept that the till was complicated and the support given by the supplier was extremely limited. We also accept that it was used a great deal by staff whose only training was given by Ms Kong or Ms Reyes, after Ms Kong had attended one proper demonstration from the suppliers. The staff were often only temporary and not particularly adept, for some this was their first job and generally they were not fast learners, especially when under pressure. It was very easy to touch the wrong place on the touchscreen, which could mean having to cancel a transaction and start again. Remote support from the suppliers in Bristol would mean having to disconnect the telephone, which was not viable. If customers wanted to split a bill and pay part in cash and part by card, that would mean the whole bill would need to be cancelled and re-entered in two parts. Ultimately, because the errors could all be corrected and did not affect the final outcome in terms of the takings recorded on the till, not much attention was paid to them. It was no surprise that on one day picked by HMRC, there were 57 errors in 60 orders. We therefore do not consider the level of voids and cancellations, without more, to provide any material evidence of irregularities which would support HMRC's view that there had been long term systematic suppression of takings, partly or wholly disguised through the voids and cancellations shown on the till, noting that even if every void or cancellation considered by HMRC had in fact concealed a fraudulent suppression of takings, it would still only have amounted to approximately one third of the level of suppression claimed by HMRC.

THE ISSUES

47. In broad terms, the Appellant argued that:

(1) the cash-up exercises were flawed and could not be relied on as a basis for imposing the very large liabilities in issue in the appeals;

(2) the goods ordered on the cash sales invoices were for the personal consumption of the staff, their families and friends and were paid for by them, and the evidence relevant to the Appellant on this issue extended to just three invoices;

(3) the high level of voids and cancellations on the Appellant's till were easily explainable because it was such a complicated EPOS till which the poorly paid, inexperienced and badly qualified staff of the Appellant made repeated mistakes on.

48. Accordingly, it was said, the assessments could not be regarded as having been made to HMRC's best judgment. No attempt had been made to consider the means of the Appellant's Director or her partner, to confirm details of any suppressed purchases from any of the Appellant's other suppliers or the unreasonableness of the conclusions which HMC had reached given the size, location and profile of the Appellant's business in its local context.

49. As regards the calculations based on the cash-up exercises, it was said to be entirely unreasonable to extrapolate from two special Fridays (Chinese New Year's Eve and a midsummer payday) that the Appellant had been underdeclaring its takings on a consistent basis over three years.

50. HMRC argued, in outline, that the conclusions reached were soundly based in evidence and passed the "best judgment" test. The suppression of sales from the evidence gleaned at the two evening visits was clear, and the evidence of the second undeclared purchase account and high level of voids and cancellations on the till provided further evidence that supported their view that suppression had taken place. There was no need to enquire any further than they had in order to satisfy the "best judgment" requirement, whereupon the burden shifted to the

Appellant to demonstrate that HMRC's figures were wrong, a burden which the Appellant had, they submitted, failed to discharge.

THE LAW

51. It is clear that there is a two stage process to be followed in considering a VAT assessment raised by HMRC in cases such as this. First, it must be established whether the assessment was made "to the best of their judgment". The burden lies on the taxpayer to establish that it was not. If that hurdle is passed, the burden then lies on the taxpayer to demonstrate that the assessment raised by HMRC is excessive. As Woolf J said in *Van Boeckel v Customs & Excise Commissioners* [1981] STC 290 on the question of "best judgment",

> The contentions on behalf of the taxpayer in this case can be summarised by saying that on the facts before the tribunal it is clear, so it is contended, that the assessment in question was not valid because the commissioners had taken insufficient steps to ascertain the amount of tax due before making the assessment. Therefore it is important to come to a conclusion as to what are the obligations placed on the commissioners in order properly to come to a view as to the amount of tax due, to the best of their judgment. As to this, the very use of the word 'judgment' makes it clear that the commissioners are required to exercise their powers in such a way that they make a value judgment on the material which is before them. Clearly they must perform that function 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 to leave it to the taxpayer to seek, on appeal, to reduce that assessment.
>
> Secondly, clearly there must be some material before the commissioners on which they can base their judgment. If there is no material at all it would be impossible to form a judgment as to what tax is due.
>
> Thirdly, it should be recognised, particularly bearing in mind the primary obligation, to which I have made reference, of the taxpayer to make a return himself, that the commissioners should not be required to do the work of the taxpayer in order to form a conclusion as to the amount of tax which, to the best of their judgment, is due. In the very nature of things frequently the relevant information will be readily available to the taxpayer, but it will be very difficult for the commissioners to obtain that information without carrying out exhaustive investigations. In my view, the use of the words 'best of their judgment' does not envisage the burden being placed on the commissioners of carrying out exhaustive investigations. What the words 'best of their judgment' envisage, in my view, is that the commissioners will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due. As long as there is some material on which the commissioners can reasonably act then they are not required to carry out investigations which may or may not result in further material being placed before them.

52. We acknowledge that by ceasing to trade, the Appellant prevented HMRC from carrying out investigations into the conduct of its business after 3 July 2017, but this did not prevent further investigations in relation to the pre-cessation period.

53. In *Rahman (T/A Khayam Restaurant Co)* [1988] All ER (D) 265, Carnwath J said this about the above passage:

> If I am right in my interpretation of Van Boeckel, it is only in a very exceptional case that an assessment will be upset because of a failure by the

> Commissioners to exercise best judgment. In the normal case the important issue will be the amount of the assessment.

54. The *Rahman* saga continued, and in *Rahman (trading as Khayam Restaurant) v Customs & Excise Commissioners (No 2)* [2003] STC 150, [2002] EWCA Civ 1881, Chadwick J said this in the course of his judgment (at [32]), when considering an argument that the adjustments made by the Tribunal to the original assessments were so great (reducing them to less than half their original amount) that the Commissioners could not have been exercising "best judgment" in making the original assessments:

> But non sequitur: on a true analysis all that can be said is that the fact that, on considering the same material, the tribunal has reached a figure for the VAT payable which differs from that assessed by the commissioners requires some explanation. The explanation may be that the tribunal, applying its own judgment to the same underlying material at the second, or 'quantum', stage of the appeal, has made different assumptions—say, as to food/drink ratios, wastage or pilferage—from those made by the commissioners. As Woolf J pointed out in Van Boeckel ([1981] STC 290 at 297), that does not lead to the conclusion that the assumptions made by the commissioners were unreasonable; nor that they were outside the margin of discretion inherent in the exercise of judgment in these cases. Or the explanation may be that the tribunal is satisfied that the commissioners have made a mistake—that they have misunderstood or misinterpreted the material which was before them, adopted a wrong methodology or, more simply, made a miscalculation in computing the amount of VAT payable from their own figures. In such cases—of which the present is one—the relevant question is whether the mistake is consistent with an honest and genuine attempt to make a reasoned assessment of the VAT payable; or is of such a nature that it compels the conclusion that no officer seeking to exercise best judgment could have made it. Or there may be no explanation; in which case the proper inference may be that the assessment was, indeed arbitrary.

55. He went on, at the end of his judgment, to give the following guidance:

> **The approach which tribunals should adopt on appeals under s 83(p) of the 1994 Act**
>
> [42] In the final paragraph of his judgment in Rahman (No 1) [1998] STC 826 at 840 Carnwath J drew attention to the dangers of 'an over-rigid adherence to the two-stage approach'. He said:
>
> > 'I do not wish to diminish in any way from the importance of guidance given by Woolf J [in the Van Boeckel case] to Customs officers as to how to exercise their best judgment when making assessments. However, when the matter comes to the tribunal, it will be rare that the assessment can justifiably be rejected altogether on the ground of a failure to follow that guidance. The principal concern of the tribunal should be to ensure that the amount of the assessment is fair, taking account not only the commissioners' judgment but any points raised before them by the appellant.'
>
> I respectfully agree with those observations.
>
> [43] It is inherent in the structure of the legislation that a taxpayer can challenge, on an appeal under s 83(p) of the 1994 Act, both the fact that an assessment under s 73(1) of the 1994 Act has been made and the amount of that assessment. There will be cases where the power to make an assessment ought not to have been exercised; because the pre-conditions to the exercise of the power (failure to make returns; failure to keep documents or afford

> facilities for verification; incomplete or inaccurate returns) were not satisfied. I suspect that those cases will be rare; but the tribunal can address them if and when they arise. There will also be cases where it is apparent on the face of the material before the tribunal that the power to assess has not been exercised in accordance with the 'best judgment' requirement; for example, where the commissioners have not taken into account information which was made available to them by the taxpayer before the assessment was made, or can put forward no basis upon which the assessment can be supported. Again, I suspect that those cases will be rare.
>
> [44] In the usual case the tribunal will have the material before it from which it can see why the commissioners made the assessment which they did; and may have further material which was not available to the commissioners when the assessment was made. In such cases, as it seems to me, a tribunal would be well advised to concentrate on the question 'what amount of tax is properly due from the taxpayer?' taking the material before it as a whole and applying its own judgment. If that leads to the conclusion that the amount of tax properly due is close to the amount of the assessment, the tribunal may well take the view that it would be a sterile exercise to consider whether the commissioners exercised best judgment in making their assessment. The tribunal has power 'on an appeal against a decision with respect to any of the matters mentioned in section 83(p) [of the 1994 Act]' to give a direction specifying the correct amount of the tax due; and where such a direction is given the assessment has effect as an assessment of the amount specified in the direction (see s 84(5) of the 1994 Act).
>
> [45] It is in cases where the amount of tax found by the tribunal to be properly due is substantially different from the amount assessed by the commissioners that the tribunal may think it appropriate to investigate why there is that difference; and to seek an explanation. That investigation may—but, often (as in the present case) will not—lead to the conclusion that the commissioners did not exercise best judgment in making their assessment. The tribunal may take the view, in such cases, that the proper course is to discharge the assessment. But even in cases of that nature, as it seems to me, the tribunal could choose to give a direction specifying the correct amount—with the consequence that the assessment would have effect pursuant to s 84(5) of the 1994 Act. It could not be criticised for doing so. The underlying purpose of the legislative provisions is to ensure that the taxable person accounts for the correct amount of tax.

56. Thus it is clear that if the taxpayer argues that a VAT assessment should be overturned completely on the basis that it was not made to the best of HMRC's judgment, the burden lies on him to establish that fact. This is a difficult burden to discharge, but examples of situations in which it might be possible to do so would include those where HMRC have disregarded evidence advanced by the taxpayer or can put forward no basis upon which the assessment can be supported. We consider that cannot be regarded as an exhaustive list of the situations in which HMRC cannot be said to have exercised best judgment: Chadwick LJ did not suggest that it was, and it must clearly be the case that an assessment based on sound and understandable arithmetic but entirely unsustainable assumptions could not be regarded as made "to the best of their judgment" simply because no evidence advanced by the taxpayer had been ignored and the arithmetic underlying the assessment was entirely robust.

DISCUSSION

57. HMRC's case depends on the assumption that if the takings on the two particular Fridays in January and June 2017 selected by them for their visits exceeded the average reported Friday takings during the first six months of 2017, that amounted to clear evidence of suppression of

takings on the other 24 Fridays (and indeed for the previous two and a half years), sufficient to satisfy the *Van Boeckel* requirement for best judgment, without any but the sketchiest further evidence. We find that assumption to be unreasonable on the evidence before us in this case. HMRC attended at the end of the day's trading in each case. At the June visit, the report from the cash register and the card machine tallied with the meal tickets they were shown and with the cash in the till almost exactly. At the January visit, the meal tickets gave a figure some £235 less than the card machine and logged cash register receipts but no explanation was sought in relation to this discrepancy. The electronic records (cash register and card machine) gave takings figures that were higher, not lower, than the totals of the meal tickets, hardly consistent with an organised attempt to conceal sales in a situation where HMRC were obviously going to be interrogating the till.

58. The assumption that HMRC made was that the higher than average level of sales seen on the two visit nights must have been due to suppression of the average on the other 24 Fridays, not simply due to better than average trading on those two nights, even though the takings on the two nights in question, being 24% and 36% respectively below the average, showed large fluctuations between themselves. The arbitrariness of this assumption can be illustrated by simply selecting two other Fridays, for example one week before each of the two Fridays actually chosen. The reported takings for 20 January 2017 were £1,201.05 and for 23 June they were £1,066.50. Both these figures are well below the overall average calculated for the period by HMRC, accordingly if the visits had taken place on those evenings HMRC would either have to claim that the takings for those evenings were understated or they would have to accept that the Appellant had simply suffered two trading nights which were worse than the overall average. The point here is that in the absence of coherent evidence pointing one way or the other, any excess above the average can be attributable just as validly to simple random fluctuation as to systemic suppression of the takings for the rest of the year in order to reduce the average.

59. On the evidence before us, HMRC simply assumed the worst and sought subsequently to justify that approach by reference to evidence of just three cash purchases from one of a number of known suppliers (and not even the main one) and numerous voids and cancellations on the Appellant's till – including cancellations totalling £166.30 on the night of the June 2017 visit, representing on its own nearly 10% of the takings for that evening – which they do not appear to have investigated at all.

60. Therefore, notwithstanding that (a) HMRC did not disregard any material evidence put to them by the Appellant, and (b) that the calculations by which HMRC arrived at their assessments are (subject to some minor errors and inconsistencies) comprehensible and arithmetically robust, we therefore consider this to be one of those "rare" cases referred to in *Rahman (No. 2)*, in which the Appellant can discharge the burden of showing that HMRC did not exercise their best judgment in reaching the assessment.

61. Our conclusion in this regard is reinforced by considering how we might approach the task of quantifying the correct amount of tax if we were to find that the original assessment was made to the best of HMRC's judgment. Given our view of the entirely inadequate basis of HMRC's calculations and the paucity of other relevant evidence before us, we can see no way in which we could approach that task sensibly.

62. Since the corporation tax assessments (and amendment to the Appellant's self-assessment) stand on the same foundation, and both parties argued the case on the basis that the two sets of liabilities stood or fell together, we consider that those liabilities must be discharged also, essentially for the same reasons.

63. It also follows that, in the absence of any established "potential lost revenue", the penalties must also be discharged.

64. The appeal is therefore ALLOWED in full.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

65. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 21 JUNE 2021