TC02166

Appeal number: TC/2010/07801

VAT – assessment of VAT on undeclared business income – whether deposits into bank account evidence of undeclared income – held yes – whether underdeclaration of turnover in some years evidence of underdeclaration of turnover in earlier years – held yes - whether assessments made to best judgment – held yes – whether VAT loss as result of dishonest evasion of VAT by Appellant – held yes - whether assessments made under extended time limits in time – held yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PETER LORD
t/a PML BUILDING SERVICES **Appellant**

- and -

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

TRIBUNAL: JUDGE GREG SINFIELD
MRS RUTH WATTS DAVIES MHCIMA FCIPD

Sitting in public in London on 28 June 2012

Peter Lord in person

Colin Strudwick of HM Revenue and Customs for the Respondents

DECISION

Introduction

1. Peter Lord carries on business supplying and installing heating and ventilation systems. He registered for VAT as a sole proprietor, trading as PML Building Services, with effect from 1 March 2001. Following an audit visit on 25 November 2008, HM Revenue and Customs ("HMRC") discovered that deposits into Mr Lord's bank account between November 2005 and July 2008 showed that the turnover of the business was greater than declared on Mr Lord's VAT returns. HMRC concluded that Mr Lord had not accounted for VAT that he was required to account for and assessed him for VAT of £77,599.94 for the periods 08/01 to 08/08 and interest of £7,586.05.

2. The assessment was made on 27 November 2009 and covered periods which were outside the normal four (previously three) year time limit in section 77(1) Value Added Tax Act 1994 ("VATA"). In relation to earlier periods, HMRC relied on the extended 20 year time limit in section 77(4) which is set out below. In order to use the 20 year time limit, HMRC must show that the loss of VAT was brought about by Mr Lord dishonestly evading VAT.

3. Mr Lord now appeals against the assessment. Mr Lord makes three points against the assessment which boil down to a submission that the assessment, or part of it, was not made to HMRC's best judgment as required by section 73(1) VATA. The three points are:

> (1) the amount of the assessment was made up and without substance;
>
> (2) the method of calculation did not reflect reality; and
>
> (3) the assessment made no allowance for input tax on additional supplies assessed.

In addition, we must consider whether, in relation to the periods outside the normal time limits, HMRC have established that Mr Lord dishonestly evaded VAT.

4. For the reasons set out below, we have found that the assessment was made to the best judgment of HMRC and, in relation to periods 08/01 – 02/06, that Mr Lord dishonestly evaded VAT. Accordingly, our decision is that Mr Lord's appeal is dismissed.

Legislation

5. The power to assess amounts of VAT is contained in sections 73 and 77 VATA. Section 73(1) states:

> "Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may

assess the amount of VAT due from him to the best of their judgment and notify it to him."

6. The time limits within which an assessment under section 73(1) must be made are set out in section 73(6), which provides:

> "An assessment under subsection (1), (2) or (3) above of an amount of VAT due for any prescribed accounting period must be made within the time limits provided for in section 77 and shall not be made after the later of the following -
>
> (a) 2 years after the end of the prescribed accounting period; or
>
> (b) one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge …"

The assessment was made on 27 November 2009 which was within one year of HMRC receiving Mr Lord's bank statements which were provided at different times after they were first requested on 1 December 2008. The time limits for making an assessment under section 73(6) are subject to the overriding time limits in section 77.

7. Section 77(1)(a) currently provides:

> "Subject to the following provisions of this section, an assessment under section 73 … shall not be made
>
> (a) more than 4 years after the end of the prescribed accounting period …"

8. The four year time limit replaced the former three year limit with effect from 1 April 2009. The amendment was made by paragraph 34 of Schedule 39 Finance Act 2008 which was brought into force by article 2(2) of the Finance Act 2008, Schedule 39 (Appointed Day, Transitional Provision and Savings) Order 2009 (SI 2009/403). Article 4 of the 2009 Order provides that the changes do not apply to prescribed accounting periods ending on or before 31 March 2006. That means that the assessment made on 27 November 2009 was within the section 77(1) time limit only in respect of periods 05/06 – 08/08.

9. The time limit in section 77(1) is extended by section 77(4) which was also amended with effect from 1 April 2009 but, again, only in relation to prescribed accounting periods ending after 31 March 2006. For periods ending on or before that date, section 77(4) provided that if VAT had been lost as a result of conduct falling within section 60(1) (which provided for a penalty for dishonest evasion of VAT) an assessment may be made as if the reference to three years in section 77(1) were a reference to 20 years. The effect of section 77(4) is that HMRC are only entitled to assess Mr Lord in relation to periods 08/01 – 02/06 if they can show that Mr Lord evaded VAT and his conduct involved dishonesty (whether or not it is such as to give rise to criminal liability).

Burden of proof

10. In relation to the assessment for the normal time limit periods (periods 05/06 – 08/08), the burden of proof is on Mr Lord to show that the assessments were not made to HMRC's best judgment or were incorrect in some other way. In relation to extended time limit periods (periods 08/01 – 02/06), the burden of proof is on HMRC to show that Mr Lord dishonestly evaded VAT.

Evidence

11. We were provided with a bundle of documents. A witness statement was produced by Mr Raymond Harris, an officer of HMRC, who also gave evidence. Mr Lord did not produce a witness statement but we read his letter to HMRC in response to Mr Harris's witness statement. Mr Lord also gave oral evidence and was cross-examined. On the basis of the documents and witness evidence we find the facts to be as set out below.

Facts

12. Mr Lord is a heating and ventilation engineer. He registered for VAT with effect from 1 March 2001. On 25 November 2008, Mr Harris visited Mr Lord at his home to carry out a VAT assurance visit.

13. Mr Harris was aware that Mr Lord was in receipt of regular VAT refunds in the VAT periods before period 08/08 and that in some periods he had submitted nil returns. Mr Harris produced a schedule of Mr Lord's VAT returns, which was not disputed, for the periods 05/03 – 05/08. The schedule showed that Mr Lord made nine claims for VAT refunds, for amounts between £123 and £3,602; ten payments of VAT of amounts between £24 and £735; and two nil returns. Although no VAT return had been submitted for the period 08/08, Mr Lord sent HMRC a cheque for £2,207 for the period after Mr Harris had arranged the VAT assurance visit.

14. At the visit, Mr Harris asked to see Mr Lord's VAT account and Mr Lord told him that he never listed his outputs and inputs for his VAT return. Mr Lord explained that he did not keep ledgers or other records for his business. He said that he just gave invoices and receipts to his accountant at the end of each year. No annual accounts were produced to HMRC or the Tribunal. Mr Lord told Mr Harris that he had no VAT records available except for the period June to August 2008. Mr Lord said that the earlier records had been destroyed due to a leak in the roof of his garage where they were stored.

15. In his evidence, Mr Lord said that he kept records from his business in his house until he had too many files when he put them in a plastic box in his garage. He said that the garage roof was damaged and rainwater had soaked all his receipts. Mr Lord stated that it was only the invoices for purchases that were damaged and the invoices for his sales were kept inside the house and were not damaged. Mr Lord did not provide any explanation why, if that were so, the sales invoices were not produced to HMRC. In cross-examination, Mr Strudwick, for HMRC, referred Mr Lord to a letter, dated 29 October 2007, which he had sent to HMRC. That letter stated that his

receipts had been destroyed by water leaking through a roof which is why he had not submitted a VAT return. The letter stated that the roof had been repaired. Mr Lord accepted that it looked like the leak had been fixed by late October 2007 and that, therefore, the records for the period from October 2007 to May 2008 could not have been destroyed by the leak in the garage roof. Mr Lord said that whatever was not in his garage would have been produced to Mr Harris. We do not accept Mr Lord's explanation of why he did not produce records to HMRC. Even if there was a leak in his garage roof, it is clear that it had been repaired by the end of October 2007 and it seems that only purchase invoices were affected. We find that Mr Lord either did not retain any VAT records or deliberately chose not to produce them to HMRC.

16. During the visit on 25 November 2008, Mr Harris looked at the invoices for the current period (11/08) and added up the outputs and inputs. Mr Harris established that Mr Lord was liable to account for output tax of £10,757 less credit for input tax of £834.

17. Following the visit, Mr Harris asked Mr Lord to provide bank statements for the period December 2007 to May 2008 for the account used by Mr Lord for his business receipts. Mr Lord said that he only had one account which he used for both business and personal banking and provided the bank statements requested and others for the period December 2005 to 30 November 2008 which were asked for subsequently.

18. A further meeting between Mr Harris and Mr Lord took place on 29 September 2009. At that meeting, Mr Harris informed Mr Lord that his analysis of the bank statements showed that the deposits during the period 26 September 2005 to 15 October 2008 exceeded declarations on the VAT returns by £204,238. Mr Harris produced a schedule of deposits and payments from the bank statements that showed all payments into the bank account. Mr Lord could not identify all the deposits but identified some amounts as relating to a loan and an inheritance which Mr Harris later excluded. Mr Harris prepared a note of the meeting which Mr Lord signed. The note states that Mr Harris asked Mr Lord if the underdeclaration of income was due to dishonesty. The note records Mr Lord as saying that it could be said that he had been dishonest but he had not intended to be but that he had got into a mess with his paperwork. The note also states that Mr Lord accepted that most of the amounts paid into the account were business income even though he could not identify the individual deposits. Mr Lord accepted that he owed VAT of £30,418.44 for the period 26 September 2005 to 15 October 2008. Mr Lord claimed that some of the deposits were loans and that documents had been provided to support that. Mr Harris said that the documents related to loans made before September 2005 but agreed to exclude any non-business deposits where documentation could be supplied. No such further documentation was supplied.

19. Mr Lord's evidence was that not all the deposits shown on the bank statements related to his business. He said he had a single bank account for both business and personal expenses and income. He did not produce any new evidence of levels of business income during the period covered by the assessment or of amounts of non-business income. Mr Lord said that some of the deposits shown on the bank statements were loans, some deposits related to an inheritance and some related to the

sale of his car. Mr Lord pointed to specific deposits as not being business income. He said that a deposit on 19 November 2005 of £2,500 was not money for a job as that would not be a round sum. He said that a further payment on 11 January 2006 was a personal cheque and a payment on 20 January 2006 of £1,586 was an inheritance from an uncle. Mr Lord also referred to a loan from someone called Tony of £6,000 and a repayment on 13 June 2008 by cheque of £8,300. There was nothing on the bank statements to indicate that the deposits, which were all made by cheque, were from particular payers or related to specific purposes such as a loan. We do not consider that Mr Lord has established that, on the balance of probabilities, the payments into the accounts were not income related to his business.

20. Mr Harris issued the VAT assessment for £77,581, plus interest, made on 27 November 2009 to Mr Lord on 8 December 2009. Mr Harris calculated the assessment for 12 periods (11/05 – 08/08) using the unexplained deposits shown on the bank statements. Mr Harris then calculated the average amount underdeclared per period and used it to assess Mr Lord for £2,675 for each of the previous 17 periods (08/01 - 08/05). Mr Harris said that he used an averaging method to determine the amount of the assessment for the earlier periods because that was the only information available to him. HMRC did not have bank statements for the earlier periods.

21. Mr Lord said that Mr Harris's projection using average figures was unreasonable as no month or quarter is the same. His evidence was that the business would not be very active in some months, when he was mostly quoting for jobs, and then other months would be very busy. He said that his business was one of highs and lows. Mr Lord also contended that Mr Harrison's figures did not take input tax into account. Mr Lord said that he would often work in an area where he would incur input tax e.g. to buy in a boiler or other equipment. Further, he said that most of the labour that he engaged was VAT registered and therefore he would have paid VAT to his subcontractors. Mr Lord explained that he did not have any employees and all his subcontractors (or 80 or 90% of them) were VAT registered. He said that those invoices had all been destroyed in the flood as a result of the damage to his garage roof. Mr Lord suggested that many of the debits shown on his bank statements were, in fact, payments to his subcontractors.

22. Mr Harris said that he did not give any allowance for input tax because it appeared from the repayment returns and the low value of the payment returns that Mr Lord had recovered input tax over the years but not accounted for all the output tax due. Mr Harris said he had concluded that Mr Lord had been dishonest because the returns for periods 08/08 and 11/08 showed reasonable amounts of VAT due that were in excess of amounts declared on earlier returns. The previous returns which were nil or repayment returns did not seem reasonable and made Mr Harris suspicious. Mr Lord said that he had been a project manager for company during the period May to July 2008. That was the reason why his returns for 11/08 and 02/09 were larger than the earlier returns because he was charging output tax but had no purchases on which to claim input tax.

Discussion - ordinary time limit periods

23. As explained above, the burden of proof is on Mr Lord to show that the assessment for periods 05/06 – 08/08 were not made to HMRC's best judgment or were incorrect in some other way. We find that Mr Lord has not satisfied us that the assessments were not correct. We accept Mr Harris's evidence and, in particular, his analysis of the bank statements and his note of the meeting on 29 September 2009. Mr Lord's records were, on his own evidence, incomplete at best. Mr Harris excluded amounts, such as the inheritance and loan, which could be shown by reference to third party documentation not to be business income. Mr Lord has not produced any evidence to show that the other deposits included in the assessments were not payments for supplies by the business. Mr Lord accepted in the meeting on 29 September 2009 that the deposits were mostly from business income. Before us, Mr Lord's complaint about the assessments generally was that Mr Harris had used averaging in respect of the periods 08/01 – 08/05 (ie not the ordinary time limits assessments) which was unrealistic. In our view, Mr Lord impliedly accepted that the assessments based on the bank statements were correct with the exception of a few points. However, these were not substantiated by any independent evidence. The assessment for the periods covered by the ordinary time limits was based on the bank statements so Mr Lord's criticisms that they were not made to best judgment because they used averaging did not apply to the assessment. We dismiss Mr Lord's appeal in relation to the assessment in so far as it relates to periods 05/06 – 08/08.

Discussion - extended time limit periods

24. As explained above, the burden of proof is on HMRC to show in relation to periods 08/01 – 02/06 that Mr Lord evaded VAT and that his conduct involved dishonesty (whether or not it is such as to give rise to criminal liability). If that is established then the burden of proof reverts to Mr Lord to establish, if he can, that the assessment for those periods was not made to HMRC's best judgment or was incorrect in some other way.

25. In *Stuttard and another (t/a de Wynns Coffee House v Customs and Excise* [2000] STC 342, Carnwath J, as he then was, said at page 348.

> "Dishonesty is an ordinary English word, and in most cases it is a straightforward jury question whether there has been dishonesty."

A little later, Carnwath J said "what the tribunal had to do, looking at the facts overall, was to decide whether they showed a dishonest course of conduct." We have applied the ordinary meaning of dishonesty to the facts overall and reached the conclusion that HMRC have established, on the balance of probabilities, that Mr Lord dishonestly evaded VAT for the following reasons.

26. In our view, the bank accounts (discussed above) clearly show that Mr Lord had substantial amounts of income which was not declared on his VAT returns. Mr Lord did not suggest that he had any other sources of regular income apart from his business. We conclude that the deposits shown on the bank statements were (except

for the inheritance and loan which Mr Harris excluded) income of Mr Lord's business which was not declared on his VAT returns. We do not accept that Mr Lord had simply got into a mess with his paperwork (see below). Mr Lord only operated one bank account and it follows that he must have known that the amounts deposited in it were greater than the amounts that he was entering on his VAT return.

27. The two periods (08/08 and 11/08) around the time of the visit by Mr Harris show a very different pattern of trading to that shown on returns for earlier periods. Mr Harris was able to calculate VAT due for period 11/08 because he had the sales and purchase invoices. Our view is that the evidence clearly shows that Mr Lord had a level of business during those two periods which was higher than that reported in the VAT returns for previous periods. Mr Lord did not offer any convincing explanation as to why the level of output should be so different just in the periods when he was under scrutiny by HMRC.

28. We accept the note of the meeting on 29 September 2009, signed by Mr Lord, as evidence that Mr Lord accepted that it could be said that he had been dishonest but he had not intended to be but that he had got into a mess with his paperwork. We do not believe Mr Lord's excuse about being in a mess with his paperwork or his explanation why no invoices or business records for earlier periods were available. It is clear that the leaking garage roof had been repaired by late October 2007 and, in any event, the records stored in the garage related only to purchases. Our view is that Mr Lord deliberately either did not retain or withheld the records of his sales. The leaking roof was no explanation for the deposits into Mr Lord's bank account over a sustained period of time not being reflected in his VAT returns. In our view, the only credible explanation is that Mr Lord deliberately chose not to declare all the income received by the business. We find that such conduct was dishonest.

29. That does not conclude the appeal in relation to the assessment in so far as it relates to the extended time limit periods. In relation to the extended time limit periods, Mr Lord's main point was that Mr Harris had averaged out years in order to calculate the assessment and did not give any credit for input tax.

30. The approach that HMRC must take in making an assessment to the best of their judgment was set out by Woolf J in *Van Boeckel v Customs and Excise Commissioners* [1981] STC 290 at 292:

> "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."

31. Mr Lord said that Mr Harris's projection using average figures was unreasonable as no month or quarter is the same. In some periods, he would invoice a lot and in some only a little and this was not reflected in the averaged amounts assessed. We do not accept this undermines Mr Harris's method of calculating the assessment. The averaging method is not exact but should produce a result that, over time, smoothes out the peaks and troughs of Mr Lord's business but still reflects the level of trading. Mr Harris used an averaging method to determine the amount of the assessment for the earlier periods because that was the only information available to him. Faced with no records or material from which he could be reconstructed, we do not see what else Mr Harris could have done. Mr Harris did not even have bank statements for the earliest periods. In the circumstances, there was evidence, as we have found, of dishonest evasion of VAT by Mr Lord in the periods covered by the bank statements. Further the VAT returns for periods pre-dating the bank statements showed that Mr Lord had accounted for a lower level of VAT than seemed reasonable from the analysis of the bank statements and from the VAT amounts for periods 08/08 and 11/08.

32. In relation to Mr Lord's objection that Mr Harris had not given any credit for input tax, we note that Woolf J in *Van Boeckel* said that it was not for HMRC to do the work of the taxpayer. Mr Lord did not provide Mr Harris (or the Tribunal) with any evidence to substantiate claims to input tax for the extended time limit periods. In any event, the returns for the periods 05/03 – 02/06 show that Mr Lord made regular repayment returns (including claims for repayments of £3,602 and £1,871) while making only small payment returns (the highest being £735). The one verified period (11/08) showed a substantially larger net payment than earlier returns. We accept Mr

Harris's view that Mr Lord was more assiduous in recovering input tax than he was in accounting for output tax.

33. We conclude that the assessment relating to the extended time limit periods was made to the best of HMRC's judgment in the circumstances.

Decision

34. In the light of all the evidence and for the reasons given above, our decision is that Mr Lord's appeal is dismissed.

35. 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.

GREG SINFIELD
TRIBUNAL JUDGE

RELEASE DATE: 3 August 2012