[2018] UKFTT 349 (TC)

TC06564

Appeal number: TC/2016/01554
TC/2016/01888

VAT and Income Tax – assessments, closure notices and penalties arising from alleged under-declarations of sales and profits – second undisclosed purchase account with supplier not included in the appellant's accounts or business records – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

YEW KAI LEE **Appellant**

-and-

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

TRIBUNAL: **JUDGE KEVIN POOLE**
RAYNA DEAN FCA

Sitting in public in Centre City Tower, Birmingham on 22-23 May 2018

P H Yeung, Solicitor for the Appellant

Pat Roberts, Presenting Officer of HM Revenue and Customs for the Respondents

DECISION

Introduction

1. This appeal concerns VAT, income tax and class 4 NI contributions (and associated penalties) arising from alleged under-declaration of sales by the appellant in relation to his Chinese takeaway restaurant.

The facts

2. We received a bundle of documents and heard oral evidence from the appellant (through an interpreter) and from HMRC Officers Stuart Clarkson (a specialist VAT officer on an HMRC Task Force team since 2013) and Alison Matthews (a specialist income tax officer on an HMRC Task Force team).

3. HMRC had also lodged witness statements made by Officers Karen Maybin and Alan Herbert of HMRC. Officer Maybin had been the main investigating officer on the VAT enquiry and Officer Herbert had also had an important role. The appellant applied at the outset of the hearing for those witness statements to be excluded, on the grounds that the respective witnesses were not present for cross examination on their witness statements. HMRC had indicated that they would not be attending, as they were "no longer with the department", but wished the Tribunal still to admit their respective witness statements in evidence. On 18 October 2017 the Tribunal had issued case management directions, including a direction in the following terms:

> "**6. Witness attendance at hearing:** At the hearing any party seeking to rely on a witness statement may call that witness to answer supplemental questions (but the statement shall be taken as read) and must call that witness to be available for cross-examination by the other party (unless notified in advance by the other party that the evidence of the witness is not in dispute)."

4. In the light of this, we confirmed at the hearing that the witness statements of Officers Maybin and Herbert would not be admitted in evidence. We adjourned the hearing briefly to enable HMRC to consider their position. After a short adjournment, Ms Roberts confirmed HMRC still considered there was sufficient evidence in the documentary bundles, combined with the oral testimony of Officers Clarkson and Matthews, to support their case and accordingly we continued with the hearing on that basis.

5. We find the following facts.

6. From 1 July 2008, the appellant carried on business as a sole proprietor, running the Chinese takeaway restaurant known as "Full River" in Acle, near Norwich. He used the flat rate VAT accounting scheme.

7. HMRC carried out a test purchase exercise in August 2013, as a result of which they became suspicious that the appellant's business records were incomplete. As appears from a later letter from HMRC to the appellant's accountants, to which a

detailed reply was sent, HMRC followed up the test purchase exercise with a visit to the business premises on 15 October 2013.

8. On 8 January 2014 HMRC wrote to the appellant to request a meeting, explaining that they had reason to believe that under-declarations of VAT had occurred, possibly as a result of dishonest conduct. They proposed a meeting at their offices in Norwich on 21 January 2014. The appellant's accountants replied by letter dated 14 January 2014, stating that the appellant had told them he "has a medical condition and suffers from Depressive and Anxiety Disorder." As a result, it was more appropriate for the matter to be dealt with by correspondence rather than have a meeting.

9. In a letter dated 24 January 2014 to the appellant's accountants, HMRC indicated that they held information suggesting that the true amount of VAT had not been declared because of conduct involving dishonesty. They confirmed that the period under enquiry was from 1 July 2008 to 31 December 2013, and involved suspected suppression of sales. They invited the appellant to make a full disclosure of any irregularities, and said they would be investigating the matter either with or without the appellant's co-operation but that lack of co-operation would be reflected in any subsequent penalty if conduct involving dishonesty was established.

10. By letter dated 6 March 2014, the appellant's representatives confirmed to HMRC that to the best of the appellant's knowledge and belief there were no irregularities in his business records. They invited HMRC to disclose such details as they had in order to enable the appellant to provide an explanation.

11. HMRC then sent a letter dated 24 March 2014, setting out the information they had gleaned from the visit in October 2013, at which a friend of the appellant had acted as interpreter for him. The accountants then sent a detailed response dated 22 May 2014, in which they set out seven items of "amended information" which they said were required to the information set out in HMRC's letter dated 24 March 2014. This was after the appellant had (according to their letter dated 4 April 2014) arranged a meeting with his interpreter friend who had attended at the original meeting in October 2013 in order to go through the details of HMRC's letter dated 24 March 2014. We infer that the information in the 24 March 2014 letter which was not challenged by the appellant through his accountants was accordingly accepted by him as accurate.

12. In their response dated 23 June 2014, having noted that the accountants' letter dated 22 May 2014 did not seek to amend the statement in HMRC's earlier letter that "you are satisfied that your VAT returns rendered between 1 July 2008 and 31 December 2013 accurately reflect your business activities", HMRC set out the two items which they considered to amount to evidence of understated sales:

- "HMRC conducted covert observations and made test purchases at Full River, Acle. None of our test purchases have been included in your clients records.
- An analysis of containers purchased supports HMRC's contention that the takings have been understated."

13. The letter went on to say that, by reference to an "average price per container" derived from "the meal tickets produced", and the number of containers purchased over a 12 month period, HMRC considered that 33% of the actual takings had not been declared. There were some further details to the calculation, but these are not relevant for present purposes.

14. In a detailed response dated 19 September 2014, the appellant's accountants took issue with HMRC's calculation of the average value per container (which they placed at £6.07, rather than HMRC's £6.60). They also argued that according to the appellant, approximately 5% of the containers would be wasted or spoilt, others would be used for staff meals, storage of ingredients, and they enclosed to a credit note issued by the appellant's main supplier (referred to in this decision as "X Limited") for 1500 containers which had not been taken into account in HMRC's calculations. They calculated that on this basis, sales would be under-declared by 2.68%.

15. In response, HMRC made a request (confirmed by email dated 3 October 2014) for copies of all the sales invoices and credit notes issued to the appellant by his supplier X Limited from October 2012 to September 2013.

16. After examining all the material obtained, HMRC wrote to the appellant's accountants on 6 February 2015. This long letter focused on details around calculation of average value per container and non-chargeable containers, but it also referred to a conversation with X Limited about the credit note. They had provided an explanation for its issue, and confirmed the purchase invoice to which it related, being an invoice number 383651 dated 27 August 2013. HMRC would therefore have given credit for these containers, but for the fact that there was no trace of the related purchase invoice in the appellant's business records.

17. By letter dated 10 March 2015, the appellant's accountants responded. They continued to dispute HMRC's calculation of the average value per container and proposed a compromise figure on container wastage and usage for staff meals. They had also been in contact with X Limited, and claimed to have established that there was no order of 27 August 2013 to which the credit note could relate, but there was an invoice dated 27 August 2014 with the invoice number 383651 (of which they supplied a copy). They argued therefore that HMRC should reduce the number of containers purchased during the relevant period by 1,500.

18. HMRC were not satisfied by this explanation. They arranged to visit X Limited. That visit took place in April 2015. Officer Clarkson attended. In his witness statement, he said this:

> "I attended a visit to [X Limited] with Karen Maybin in April 2015. I can confirm that as a result of information obtained on the visit it was established that Yew Lee held two purchase accounts for his business Full River, one named and one unnamed. I can also verify that only the purchases from the named account appeared in the business records of Full River."

19. In evidence, he expanded on this statement, though no copy of his contemporaneous note of the meeting appeared in the bundle. At X Limited, the director had talked through the process of orders. He showed the officers delivery lists, which had a named account, followed by an unnamed account with different account numbers. He was asked whether he considered it strange that customers should be allowed two separate accounts in this way. He said they had checked and satisfied themselves that they were fulfilling their VAT obligations; and if they did not allow customers to operate in this way, they would lose business to other suppliers who would. He did not consider it to be any of his business why customers wanted two accounts in this way. So far as X Limited were concerned, the two accounts were linked through the customer address – and our bundle included a copy of a page extracted from X Limited's address list showing, under "Customer name", the entry "183 Lee/mrs Tang", which Officer Clarkson said they were told referred to the appellant's unnamed second account with X Limited. There were a number of other customer details on the same page, about half of which included a three-digit number under the same "Contact name" heading.

20. The officers obtained details of the purchases made by the appellant on the second unnamed account from November 2013 to January 2015 and compared them to the purchases during the same period on the named account. They extracted only the standard rated purchases (which were considered to represent containers). The VAT on the disclosed purchases over the period totalled £599.63 and the VAT on the undisclosed purchases totalled £383.72. HMRC said this indicated that only 61.3% of the containers purchased were reflected in the appellant's records (which they rounded up to 62%).

21. This led to HMRC deciding to do some further covert test purchases, followed by an unannounced cash-up check. This was done on 15 May 2015. There were a number of officers involved, but only Officer Clarkson gave evidence about it. He confirmed he had made a test purchase during the course of the evening, but he had not been involved in the later cash-up check. Included in our bundle however was a copy of the cash-up sheet signed by the appellant on the evening, which we accept as correct. This showed that the amount of cash in the till was found to be £2,114; after deduction of the opening float claimed by the appellant (£203, compared to the usual £100 or so which had been previously referred to), the gross takings for the day were shown as £1,911. It was also agreed that all the test purchases made by the officers during the course of the evening were shown in the records, and all the £20 notes which they had used were present in the till.

22. On 1 June 2015, the appellant's accountants wrote to HMRC to inform them that the appellant had ceased to trade on 23 May 2015, having transferred the business as a going concern to a Mr Kok Yong Goh on that date.

23. On 2 October 2015, HMRC wrote again to the appellant's accountants. After summarising the factual history as HMRC saw it, the letter explained that some of the appellant's contentions about the use of containers had been accepted following the test purchase exercise, which reduced the average value per container to £6.41. In the light of the figures referred to at [20] above, however, and the observed use of 19 containers

for non-sale purposes at the 15 May 2015 visit (for which HMRC were prepared to allow a "wastage/non-sale use" rate of 19 containers per day), HMRC calculated a suppression rate of 51.71% of total sales, requiring an uplift of 107.1% to the reported sales to arrive at HMRC's best judgment estimate of actual sales.

24. In reaching that decision, HMRC had taken into account that the gross takings recorded for 15 May 2015 (a Friday) were recorded as £1,802.60 after deducting the test purchases made by the undercover officers. This compared to an average reported Friday daily gross takings figure of £694.48 over the period from 8 July 2011 to 8 May 2015, and a standard deviation in those takings figures of £249.28. The only Friday on which a higher gross takings figure had been recorded was 27 March 2015, when England were playing Lithuania at Wembley.

25. HMRC performed the calculation by simply uplifting the VAT payable figure reported in the appellant's various VAT returns by 107.1%. For the aggregate periods from 1 July 2008 up to and including 09/11 (i.e. the three month VAT accounting period ended 30 September 2011), the uplift amounted to £46,483; for the following nine VAT accounting periods (i.e. 12/11 up to 12/13 inclusive) the respective uplifts totalled £37,438. The total amount of VAT assessed was therefore £83,921. Notice of an assessment in this amount was sent to the appellant on 14 October 2015.

26. On 14 October 2015, HMRC also wrote to the appellant notifying him of their intention to charge a civil evasion penalty under section 60 Value Added Tax Act 1994 ("VATA") in respect of VAT accounting periods 09/08 (in the sum of £2,871) and 12/08 (in the sum of £2,685). These sums were calculated at 90% of the underpaid VAT in respect of the two periods assessed by HMRC; they had allowed 10% mitigation in respect of the appellant's co-operation during the enquiry. The total civil evasion penalty assessed was therefore £5,556.

27. On 5 November 2015, HMRC wrote to the appellant notifying him of their intention to charge penalties under schedule 24 Finance Act 2007 in respect of VAT accounting periods 03/09 to 12/13 inclusive. They regarded the inaccuracies in his returns as deliberate and concealed, meaning that the available penalty range was 50% to 100% of the potential lost revenue. Within that range, they considered mitigation of 5% was due for "helping", on the basis that there had been a limited attempt to assist in quantifying the irregularity, but the appellant had provided untruthful information about the usage of containers and bags; they also considered 20% mitigation was due for "giving", on the basis that the appellant had produced the business records used to produce his VAT returns, and access was allowed to business records and the till at the unannounced cash-up, though suppressed purchase invoices had not been produced. This meant an aggregate mitigation of 25% of the range between 100% and 50%, i.e. penalties totalling 87.5% of the potential lost revenue. A notice of penalty assessment dated 7 December 2015 was subsequently issued to the appellant imposing the penalties envisaged in this letter, which totalled £68,027.70.

28. On 6 November 2015, HMRC (Officer Matthews) issued the following:

(1) A notice of further assessment for income tax and class 4 NI contributions in respect of the tax year 2009-10 totalling £21,447.15;

(2) A notice of further assessment for income tax and class 4 NI contributions in respect of the tax year 2010-11 totalling £26,569;

(3) A notice of further assessment for income tax and class 4 NI contributions in respect of the tax year 2011-12 totalling £34,310.71;

(4) A notice of further assessment for income tax and class 4 NI contributions in respect of the tax year 2012-13 totalling £28,443.56;

In each case, Officer Matthews had calculated the amount of the assessment by uplifting the appellant's turnover and cost of sales by 107%, making no adjustment to any of the other expenses.

29. On 12 November 2015, HMRC issued notices of their intention to enquire into the whole of the Appellant's self-assessment returns for the tax years 2013-14 and 2014-15 and, on the same date, issued closure notices making amendments to the appellant's self-assessment returns for those years, calculated in the same way. This resulted in additional income tax and class 4 NI contributions of £28,925.32 for 2013-14 and £37,014.11 for 2014-15.

30. On the same day, they issued a letter warning the appellant of their intention to impose penalties for inaccuracies in the relevant returns pursuant to schedule 24 Finance Act 2007. Applying the same proposed mitigation of 12.5% as for the VAT penalties, they indicated their intention of imposing penalties totalling £154,620.30 in respect of the potential lost revenue represented by the various assessments and amendments referred to above. This was followed up by a notice of penalty assessment dated 14 December 2015 in that amount.

31. The above assessments and amendments ultimately formed the basis of the appeal, following their confirmation in statutory reviews issued on 29 January 2016 (in relation to the VAT matters) and 10 March 2016 (in relation to the income tax and Class 4 NIC matters).

The issues

32. In his skeleton argument lodged before the hearing, Mr Yeung raised two "Preliminary Issues". The first of these related to the admission of the witness statements of Officers Maybin (who had run the VAT enquiry) and Herbert (who had performed the "cash-up" check on 15 May 2015 referred to above). The second related to the question of whether HMRC were out of time to raise any or all of the assessments under appeal.

33. We dealt with the first of these issues, as set out at [4] above, by excluding the witness statements of Officers Maybin and Herbert.

34. As to the second, Mr Yeung did not persist with it to any significant extent at the hearing, and in our view he was correct not to do so. His skeleton argument appeared to centre around section 77(6) VATA, claiming that the relevant evidence came to HMRC's knowledge as a result of the initial test purchases made on 15 August 2013, thus requiring any assessment to be made before 16 August 2014. We are quite satisfied that in relation to the VAT enquiry, the relevant evidence did not come to HMRC's knowledge until, at the earliest, the meeting with X Limited in April 2015 and accordingly the assessments were made within the relevant time limit. As to the income tax/class 4 NIC assessments, he argued that at least the 2009-10 and 2010-11 assessments were invalid, as they were issued outside the "normal" four year time limit. He acknowledged that if any loss of tax were brought about "carelessly", then there would be no bar to any of the assessments, but argued that as the appellant had relied on a professional accountant to draw up his accounts and make his returns, he could not be regarded as careless.

35. Mr Yeung's skeleton argument also appeared to argue that the supervised cash-up exercise in May 2015 demonstrated that the appellant's records were completely reliable, as the officers discovered no irregularities on that day. We consider this misses the point, as the key issue arising for HMRC from that exercise was the level of gross takings recorded, compared to the usual reported amounts.

36. Mr Yeung's skeleton argument also raised the question of the existence of a second, unnamed, account with X Limited operated by the appellant. At the hearing, the appellant simply denied there was any concealed unnamed second purchase account with X Limited. Whatever appeared on the X Limited address list was completely irrelevant – it did not prove the existence of a second account operated by the appellant.

37. In his witness statement, the appellant said this:

> "**[X Limited] Account**
>
> I do not accept there was an unnamed account and the account belonged to me. That is an unfair accusation. R[1] could say that to any taxpayer who had a named account with [X Limited]. There is no evidence whatsoever to support R's accusation."

38. On the morning of the second day of the hearing, Mr Yeung indicated he wished to produce new evidence, in the form of an email contact with X Limited overnight concerning the unnamed second account. He also wished to apply for a witness summons to require the director of X Limited to attend and give evidence before the Tribunal on the question of the alleged unnamed second account (which would obviously involve an adjournment of the hearing). He said that if he had been aware of this evidence earlier, he would have made this application before. Ms Roberts pointed out that the allegation about the second unnamed account had been communicated to the appellant in HMRC's letter dated 2 October 2015 and it had also been covered in Officer Clarkson's witness statement. We asked why the appellant had not approached

[1] "R" means the Respondent, HMRC.

X Limited himself when it was clear from the witness evidence that HMRC were persisting with their earlier allegation of the existence of the second unnamed purchase account. Mr Yeung said first that the appellant had denied the existence of such an account and second that there did not appear to him to be any evidence in the bundle of a named account linked to the appellant, so he was happy to proceed without investigating matters further with X Limited. He also said that he had previously asked the X Limited salesman about the second account, who had told him he had said he would deny it. It was, he said, only when the full details of the meeting with X Limited had come out during Mr Clarkson's oral evidence, that it became apparent that he would need further evidence.

39. After retiring to consider our decision, we indicated to Mr Yeung that the email contact with X Limited would not be admitted in evidence, nor would we adjourn the proceedings in order to issue a witness summons to the director. It had been quite clear since HMRC's 2 October 2015 letter that a core part of their case was the existence of the undisclosed second purchase account; this had been reinforced in Officer Clarkson's witness statement and the appellant had had every opportunity to seek evidence from X Limited before the hearing to support the appellant's case. We could see no reasonable basis upon which the approach to X Limited could properly have been left in abeyance until the hearing was already under way, whatever extra detail had come out of Officer Clarkson's oral testimony.

40. The appellant's evidence was that after he became aware HMRC were claiming that he had an undisclosed purchase account with X Limited, he had asked the X Limited visiting salesman about it, and was told there was "no such thing". After that time, he took no further notice of the point, as far as he was concerned he was operating a single purchase account.

41. As to the supervised "cash-up" exercise, he confirmed the figures given by HMRC were correct. His explanation of why there should have been a float of over £200 that night when his "normal" float was around £100 was vague, probably something to do with the fact that he might have had more £5 notes than usual. His explanation for the high gross takings on that day was due to football fans "pre-celebrating" before an important match the following day involving Norwich City playing Ipswich Town in a play-off semi-final and/or an episode of "Big Brother" on television that evening.

Discussion and decision

42. In the face of the clear evidence on the documents and the testimony of Officer Clarkson, we cannot accept the appellant's evidence as credible. We find that he did knowingly operate a second purchase account with X Limited and he deliberately did not include the records of the purchases on that account in his business records, in order to conceal a corresponding suppression of takings whilst maintaining the apparent credibility of the overall profitability of the business.

43. We consider that Officer Maybin's assessments were clearly calculated to the best of her judgment on the basis of the information available to her, and nothing in the

evidence we heard from the appellant persuades us that Officer Maybin's calculations (or those of Officer Matthews) were flawed in any way; indeed, Mr Yeung in his closing submissions said that if we found the existence of a second undisclosed purchase account to be established, the appeal would be bound to fail.

44. Given our findings set out above, and the appellant's continued denials throughout (including in the hearing itself), we consider his conduct to have involved dishonesty and to have been deliberate and concealed. We can see no basis for interfering with the mitigation which HMRC have applied in calculating the various penalties.

45. We therefore DISMISS the appeal and uphold the various assessments, amendments to the appellant's self-assessments and penalties in the amounts originally calculated.

46. 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: 26 JUNE 2018