[2015] UKFTT 0546 (TC)

TC04703

Appeal number: TC/2013/06971

VAT and Income tax - whether turnover under declared - assessment of turnover and profits for five year period by HMRC using business economics exercise and mark-up of purchases - Appellant providing a sales re-statement exercise based on a detailed analysis of primary records for one full year - whether HMRC correctly assessed turnover and profits to best judgement - no - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ERNEST O BUSTARD **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL CONNELL
MEMBER ANTHONY HENNESSY

Sitting in public at Bedford House 16-22 Bedford Street Belfast on 18 & 19 March 2015

Mr. Michael Boyd FCCA for the Appellant

Ms Sharon Spence Officer of HM Revenue and Customs for the Respondents

DECISION

The Appeal

1. This is an appeal by Mr Ernest O Bustard ("the Appellant") against the following HMRC decisions:

Indirect tax - VAT

i. An assessment to VAT made pursuant to s 73 of the Value Added Tax Act 1994 ("VATA") in the sum of £26,342, plus statutory interest, in respect of periods 04/06 - 10/12, notified by way of –

   Notice of Assessment issued 19 March 2013, in the sum of tax due to HMRC £55,039 plus interest; amended by

   Notice of Assessment issued 11 November 2013, in the sum of tax due from HRMC £4,630 (CR); and

   Notice of Assessment issued 2 January 2014 in the sum of tax due from HRMC £24,067 (CR).

ii. An amended Notice of Penalty Assessment issued on 7 March 2014, under s 97 Schedule 24 Para 15(1) FA 2007, in the amount of £11,050, in respect of inaccuracies contained in the Appellant's VAT Returns for the periods 04/09, 01/10, 01/11, 04/11, 07/11 and 10/11, as a result of deliberate and concealed conduct.

iii. A civil evasion penalty under s 60(1) of VATA in the sum of £14,362; issued on 22 August 2014 for periods from 1 February 2006 to 31 January 2009; resulting from the Appellant knowingly understating the VAT due on sales.

Direct Tax - Income Tax Self-Assessment

iv. Closure Notice under s 28A(1) and (2) Taxes Management Act ("TMA") 1970 in respect of an enquiry notice given in relation to the Appellant's 2007-08 Tax Return issued on 27 February 2013.

v. Discovery Assessments issued under s 29 TMA 1970 for the years 2006-07, 2008-09, 2009-10 and 2010-11 in accordance with the time limits and extended time limits set out in s 34 and 36 TMA 1970 issued on 27 February 2013.

   The additional amount assessed and revised additional tax and NIC, which HMRC say is due, is as set out in Table 1 below. The additional assessments remain relevant to the appeal as the revised additional assessments were notified to the Appellant, but not issued as agreement could not be reached.

Table 1

Year	Description	Additional Amount Assessed	Additional Tax & NIC Due	Revised Additional Assessed	Revised Additional Tax & NIC
2006-07	Further Assessment Notice	£169,809	£69,713.87	£41,024	£16,912.02
2007-08	Enquiry Closure Notice	£80,196	£80,124.39	£80,196	£32,880.36
2008-09	Further Assessment Notice	£93,612	£38,380.92	£26,455	£10,846.55
2009-10	Further Assessment Notice	£38,034	£15,593.94	£-10,689	£-4,382.49
2010-11	Further Assessment Notice	£79,297	£36,986.04	£42,646	£18,294.03

vi. Penalty Determination covering the years 2006-07 to 2007-08 issued under s 100 TMA 1970 in respect of penalties arising under s 95(1)(a) TMA 1970 for fraudulent conduct in delivering to an officer of HM Revenue and Customs incorrect returns under Section 8 of the Act. [Table 2 below]

vii. Penalty Assessment for the years 2008-09 to 2010-11 in respect of penalties arising under Paragraph 1 Schedule 24 Finance Act ("FA") 2007 in respect of deliberate and concealed inaccuracies contained in the Appellant's 2008-09 – 2010-11Tax Returns. [Table 2]

Table 2

Year	Description	Date of Issue	Date of Appeal	Amount of Penalty	Revised Penalty
2006-07	Penalty Determination	27 February 2013	25 April 2013	£41,828.00	£10,147.21
2007-08	Penalty Determination	27 February 2013	25 April 2013	£21,345.00	£19,728.21
2008-09	Penalty Assessment	21 February 2013	25 April 2013	£38,380.92	£5,423.28
2009-10	Penalty Assessment	25 January 2012	25 April 2013	£15,593.94	Nil

2010-11	Penalty Assessment	25 January 2012	25April 2013	£36,986.04	£9,933.04

Issues to be determined

2. The issue to be determined by the Tribunal is whether HMRC's VAT and income tax assessments as set out above are correct to best judgement. The burden of showing that the assessments have not been made to the best of HMRC's judgement falls on the taxpayer. They are based on a business economics exercise ('BEE') undertaken by HMRC using VAT period 07/09 as a representative period. HMRC say that the BEE is necessary because the Appellant had destroyed till rolls and records of Z readings which meant that there was either no or insufficient information on which the Appellant could rely in support of his VAT and self-assessment returns.

3. The Appellant accepts that he has not retained till rolls and records of Z readings but says that that has been his method of working for thirty years. He says that the till readings are often unreliable because they rarely reconcile with the cash in the till and in any event he knows from many years' experience what the takings should be. He says that period 07/09 is not a representative period and that HMRC's methodology in arriving at the assessments is flawed and overestimates his gross profit margin. The Appellant's accountant Mr Boyd, who represented the Appellant at the hearing, analysed the Appellant's accounts including primary records using the year 2009-10 as a sample period in order to undertake a sales restatement exercise ('SRE') and show in his view that the Appellant's VAT and income tax returns were in fact correct.

4. Although the parties provided a joint bundle, this did not include an agreed statement of facts. The Tribunal is therefore also concerned with a fact-finding exercise. The chronology below, which sets out events, meetings between the parties and the methodology used by each in justifying their calculations of the Appellant's VAT and income for the years in question, identifies the main facts and issues in dispute.

Evidence

5. We were provided with several ring binders of documents and evidence consisting of:

i. Copy correspondence between the parties.

ii. HMRC's notes of meetings; HMRC's analysis of the Appellant's purchase invoices for the period 07/09 and mark-up calculations; a summary of the Appellant's Profit & Loss Accounts for 2006-11; the Appellant's SRE in respect of year 2009-10. A summary of the Appellant's accounts showing drawings and capital introduced for the periods 2006-11 inclusive.

iii. HMRC's notes and guidance regarding - the undertaking of a business economics exercise; business ratios; the recalculation of gross profits and mark-ups. These included:

> HMRC Business Economic Notes 13: Fish and Chip Shops: [withdrawn]
> VAEC1510 — Power of assessment: Best judgement: Determine the overall credibility of your assessment

EM3082 — Examining Accounts: Business Ratios: Gross Profit Rate
EM3508 — Recalculating Profits: Business Models: Gross Profit Rate Model —Example
EM3509 Recalculating Profits: Business Models: Wastage
EM3560 — Recalculating Profits: Private Side — Private Bank Accounts
EM3571 — Recalculating Profits — Private Side — Means Test: Uses
EM2593 — Recalculating Profits: Private Side — Capital
Statement: Information from Bank Accounts
V1-37 Mark-up control note
HMRC letter guidance GPR % rates for fast food outlets.

iv. Witness statements for the Appellant were provided by – the Appellant, Mr Ernest O Bustard; the Appellant's son and manager of the business, Mr Alistair Bustard; Mr Gareth McGee the Appellant's bookkeeper; Mr Michael Boyd his accountant; Miss Corbet and Miss Wilkinson, employees of the Appellant; Mr Kelly and Mr Murdoch taxi drivers; Mr Peter Rollins, steward of Ballymoney Methodist Church and Mr Greg Alexander, Minister of Ballymoney Methodist Church.

v. Witness statements for HMRC were provided by VAT Officer Mark Lecky; direct tax Officer Alana Wallace; VAT Officer Robert McGill. Officer M Archibald (direct taxes) who had been involved in the initial enquiry was unable to attend the hearing but provided a signed witness statement.

Each of the witnesses gave sworn evidence subject to cross-examination, save for Mr Kelly.

vi. A copy of the publication - *Merlin Scott Associates Limited – Fast Food Outlets*, March 2014 Edition, which provides statistical evidence relating to the average gross profit margins of most types of business, using data and accounts filed at Companies House.

Background

6. The Appellant is a sole proprietor carrying on the business of a hot food take-away/fish &chip shop known as 'Flash in the Pan,' from premises at 51 Queen Street, Ballymoney, Co Antrim BT53 6JD. His son Alistair Bustard runs a branch of the business at 77 Main Street, Bushmills, Co Antrim. The Appellant has been registered for the purposes of VAT with effect from 12 May 1986 under VAT registration number 432 6172 70.

7. On 11 September 2009, following receipt of the Appellant's self-assessment return for 2007-08, HMRC wrote to him to advise that they would be undertaking a check of his return, under s 9A of TMA 1970. HMRC proposed a meeting with the Appellant and his accountant on 12 October 2009 and advised that the meeting would include compliance checks covering both direct and indirect Taxes. In advance of the meeting HMRC requested a copy of the Appellants financial accounts for the period 01/06/2006 to 31/05/2007 to include the trading and profit and loss account, balance sheet, income tax and capital allowances computations, a computation showing how the Appellant's turnover (£750,580) had been calculated, a copy of any cash account, a copy of any bank reconciliations, an analysis of the cost of sales records covering the period under enquiry, till rolls, purchases invoices, cash book, expenses

receipts, stock records, wages records, VAT records etc, bank/building society statements, cheque stubs and lodgment counterfoils.

8. At the meeting, the Appellant attended with his agent Mr McGee. The Officers attending from HMRC were Officer Archibald (direct taxes) and Officer Lecky (indirect taxes). The Appellant confirmed that he ran his business as a sole proprietor, that the business had been operating for twenty years or more and that business was steady all year round. He operated seven days per week. Opening times were 11.00am - 12.00pm (Monday - Thursday); 11.00am - 02.00am (Friday and Saturday) and 12.00am – 12.00pm (Sunday). The premises only closed on Christmas day and Boxing Day each year.

9. The Appellant confirmed that he owned the business premises. His financial year end was 31st May. He also owned business premises at 74 Castle Street, Ballycastle, but these were rented to a Mr Burke. The Appellant confirmed that no cash from his business had been invested in property, or investment accounts, during the previous three years.

10. He had no associated businesses but had previously acted in a consultancy role for another fish and chip business operated in Magherafelt and Omagh. Only the Omagh shop remained open. The Appellant confirmed that he had no other business income.

11. The Appellant said that Mr McGee prepared his accounts and VAT Returns. Business records were maintained on a manual rather than electronic basis. He maintained a daily gross takings book, purchase record and cheque journal. His brother completes the business records.

12. Only the Appellant and authorised employees could order goods. Suppliers always deliver to the premises. The employee present would sign for goods. In the event of shortages/damaged goods, the supplier would be contacted and where necessary, goods returned. No goods would be paid for on delivery. Goods are paid for by cheque, usually within thirty days.

13. The Appellant's main sales are hot food take-aways. Prices are set by the Appellant. There are no credit card sales. Sales invoices were only raised upon request. Prices change usually no more than once a year.

14. There are 16 employees (13 full-time and 3 part-time). Rates of pay are £6.50 per hour for full-time staff and £5.73 per hour for part-time staff. Employees are paid in cash weekly. They get occasional free meals, but pay for any soft drinks.

15. There are minimal cash expenses. Stock checks are carried out twice a year by the Appellant and employees. Stock is valued at cost. There had been recent employee theft of cash from the till, but this had been minimal and not reported to police.

16. During the whole of the assessment period (2006-10) the Appellant had one till (a Samsung ER5200 till, serial no B5A290003BB), which had a keyboard of 117 programmable keys, of which 110 were used.

17. The HMRC Officers established that:

i. The Appellant is responsible for cashing up each day. Daily gross takings are arrived at by counting the cash in the till and adding back cash wages that had been paid and expenses as recorded in the cash book.

ii. The Appellant records his daily gross takings in a cash book.

iii. Z readings are taken daily and once a week, but are then destroyed. The Appellant does not reconcile the daily Z readings or the daily gross takings figures with the cash in the till; Cash is only reconciled once per week with the weekly Z reading.

iv. The Appellant agreed that he was operating a 'point of sale' scheme. [A point of sale scheme is one of a number of standard retail schemes recognised by HMRC. When operating a point of sale scheme certain rules apply in terms of the records that should be maintained, for example, daily gross takings and also the method of calculating output VAT. The point of sale scheme works by identifying the VAT liability of the goods or services that the trader sells at the time he makes the sale. This usually means using a till system which can distinguish between goods sold at different rates of VAT. HMRC accept any system provided the trader separates his sales, for example by using separate tills for different rates.]

v. The Appellant had been treating 2.5% of the gross sales as zero-rated (salads and baps). However he had no till rolls/Z readings to verify the total zero-rated figure.

vi. The Appellant was told that Officer Archibald would issue a letter regarding the requirement for the Appellant to register gross takings on a daily basis and for till rolls/Z readings to be retained. He was also told not to zero the till and to include the full value of any credit or non-cash supplies made at the time of supply and reminded of his obligation under VATA 1994, Schedule 11, s 6(1) and the VAT Regulations 1995 s 31, to retain his business and accounting records for a period of six years. All purchase invoices for supplies made to the business had to be retained.

18. A further meeting with the Appellant and his agent was held at the business premises on 10 November 2009, HMRC Officers Lecky and McGill attending. Officer McGill's examination of the till indicated that the Appellant was still zeroing the till each week, generally on a Sunday. As there were no till rolls/readings to interrogate, Officer Lecky informed the Appellant that HMRC were left with no option but to examine purchase invoices in detail and carry out mark-up exercise.

19. HMRC said that it would be necessary to ascertain the mark up on each product, and then undertake a weighted mark-up exercise [to take into account the fact that sales of some products were more numerous than others, thus affecting the overall average mark-up.] This would allow the Gross Profit Ratio ('GPR') to be determined.

20. The GPR can be measured in two ways. One is to add the cost of goods sold i.e. direct materials, direct labour and overheads, subtract them from the total sales, and divide the result by the sales. This is the more comprehensive approach. However, this method includes a number of fixed costs, which HMRC regard as inappropriate to a 'point of sale' business, preferring a more restrictive version to include only direct materials on the basis that they are the only truly variable element of the cost of goods sold. This method is said to present a more accurate view of the margin gained on each individual sale irrespective of fixed costs, and is the method adopted by HMRC in conducting a BEE]. The formula used is:

$$\frac{\text{Sales} - \textit{Direct} \text{ materials}}{\text{Sales}}$$

21. The Appellant had already provided HMRC with the cost of sales figures for the year-end 2006-07. From this, the Officers arrived at a mark-up of 139% and a GPR of 58.2%, before the cost of packaging was removed. After taking out packaging costs the mark-up was 160% and the GPR 61.57%. The Officers considered this to be too low and therefore informed the Appellant that it would be necessary to examine actual purchase invoices, the VAT account book, prices from the counter menu and, taking VAT period 07/09 as a representative period, undertake a detailed weighted mark-up exercise.

22. HMRC's notes of the meeting of 10 November 2009 stated:

> 'Uplifted several prices from the menu above the counter. Conducted quick mark-up exercise, whilst agreeing sample quantities of various purchases (namely fish) with EB. Quick mark-up exercise intimating majority of traders goods attracting mark-ups of over 500% (those with chips) , except fish (200%) and soft drinks (100%). …ML stated that for this business the mark-up should be at least 200% but accounts were only showing 160%. EB and GM were unable to give any satisfactory answer as to why, except for food vouchers issued, extra dripping costs and other allowances. ML and BM informed both that 'allowances' would be given for these items but that overall, they would not affect mark-up markedly. ML and BM informed EB that HMRC were left with no option but to carry out detailed weighted, mark-up exercise and agreed period 07/09 as representative period.'

23. HMRC determined a mark-up exercise for each product (see Table 3 below) and formed the view that a minimum mark-up of 200% would be in line with the average mark up for other similar traders. HMRC's submissions did not include the calculations and methodology to show how the mark-ups had been decided.

Table 3

Food Item	**Sale Price**	**SP (Net of vat)**	**Packaging**	**M-Up**	**WM-Up**
Chips	£1.95	£1.70	25p	580%	580%
Sausages (2)	£1.75	£1.52	24p	533%	337%
Hot Dog	£1.40	£1.22	51p	142%	337%
Pastie	£1.40	£1.22	23p	430%	430%
Chicken Breast	£2.70	£2.35	58p	305%	269%
Chicken Goujons	£3.45	£3.00	90p	233%	269%
2oz Burger	£1.90	£1.65	48p	243%	241%
1/4 lb. Burger	£2.50	£2.17	64p	239%	241%
Soft drink can	80p	70p	28p	150%	115%
Soft drink 500 ml	£1.10	96p	47p	104%	115%
Lucozade	£1.10	96p	50p	92%	115%
Cod	£3.35	£2.91	£1.03	183%	183%

Haddock	£3.35	£2.91	£1.29	125%	125%
Whiting	£3.05	£2.65	£1.36	95%	95%

24. Using Period 07/09 as a representative period, HMRC then divided purchases into the main categories of best-selling products and applied weighted mark-up percentages to arrive at 'expected sales' (see Table 4 below).

Table 4

Food Item	**Total Net Purchases**	**WM-Up**	**Expected Sales**
Chips	7770	580%	52836
Sausages	1812	337%	7918
Pasties	234	430%	1240
Burgers	4739	241%	16159
Chicken	9846	269%	36331
Soft Drinks	6762	115%	14538
Cod	2895	183%	8193
Haddock	36	125%	81
Whiting	7398	95%	14426
TOTALS	**41,492**		**151,722**

25. On 24 March 2010, HMRC provided the Appellant with a copy of their mark-up exercise which showed a mark-up rate of 265%, and a GPR of 73% before allowing for items such as employees' food, wastage, and zero-rated food.

Weighted Mark-Up rate $= \frac{151{,}722 - 41{,}492 \times 100}{41{,}492} = 265\%$

Gross profit rate $= \frac{151{,}722 - 41492}{151{,}722} = 73\%$ GPR

26. HMRC then totalled net food purchases for all the periods under review, using the Appellant's records, and then applied a weighted mark-up percentage to determine the 'expected sales'. 'Declared Sales' figures taken from VAT returns were then compared to 'Expected Sales' figures, to show the differences/discrepancies in each period. (See Table 5 below).

Table 5

Period	Purchases	WM-UP	Expected Sales	Declared Sales	Differences
10/09	43261	265%	157,902	158,619	- 717
07/09	51908	265%	189,464	160,274	29,190
04/09	58346	265%	212,962	164,483	48,479
01/09	44278	265%	161,614	152,038	9,576
10/08	63398	265%	231,402	180,915	50,487
07/08	67865	265%	247,707	171,836	75,871
04/08	56159	265%	204,980	157,499	47,481
01/08	59977	265%	218,916	157,119	61,797
10/07	69499	265%	253,671	182,652	71,019
07/07	58893	265%	214,959	168,276	46,683
04/07	61529	265%	224,580	178,791	45,789
01/07	64247	265%	234,501	183,536	50,965
10/06	76229	265%	278,235	207,481	70,754
07/06	67853	265%	247,663	210,090	37,573
04/06	61164	265%	223,248	180,341	42,967
TOTALS	**904,606**		**3,301,804**	**2,613,950**	**687,854**

27. On 20 November 2010, at a further meeting between HMRC, the Appellant and his agent, the Appellant agreed that he was still zeroing the till, having spoken to a friend's accountant prior to HMRC's visit and being advised to clear his till and wipe the history.

28. The agent Mr McGee had prepared his own BEE which showed a GPR of 58%. However HMRC considered that the agent's cost of goods for resale figure was too low, as allowances for wastage were in their view excessive and unproven. Whilst HMRC were prepared to accept 50% wastage on potatoes for unwashed and un-prepared potatoes, they could not accept that figure for pre-cut prepared chips which made up the bulk of the Appellant's chip purchases. [No further information was available relating to the 20 November meeting as unfortunately HMRC's notes of the meeting were not included in the agreed bundle]

29. There then followed a lengthy period of liaison between HMRC, the Appellant and his agent to establish and confirm purchases figures, employee food, free food and allowances, wastage, levels of zero-rated food, and offers/discounts.

30. The allowance for employee food, zero rated food, wastage and free food were then provisionally determined as below:

Employees Food

Allowance £1 cost x 12 employees x 7 days =
£84 per week x 13 weeks x 15 periods =
£16,380

Zero-rated Food

Allowance 1% = 904,606 x 1% = £9046

Wastage

Allowance £10per day x 7 = £70 per week

X 13 weeks x 15 periods = £13,650

Free Food
Allowance £1 cost x 10 meals per week =
£10 per week x 13 weeks x 15 periods =
£1950

Total allowances = £41,026

31. Net purchases were then amended to (£904,606 [being the total net purchases for all periods] - £41,026 [total allowances]) = £863,580, which at a mark-up of 265% amounted to £3,152,067 expected sales. Declared sales were £2,613,950, which meant an overall 'under declared' sales total of £538,117 equating to £92,993 undeclared VAT.

32. In February 2011, the Appellant appointed Mr Michael Boyd as his new representative. Mr Boyd did not accept HMRC's figures or methodology and therefore undertook a 'Sales Restatement Exercise' ('SRE'), using all available invoices for the accounting year ending 2009-10 (being the most recent accounting year then available) which showed a GPR of 57%. Mr Boyd said that if the Appellant had diverted undeclared cash funds of £538,117, equivalent to £10,000 a month, he had to ask the question 'what had he done with the money?' There had been no change to Mr Boyd's lifestyle and no suggestion of any money-laundering activity.

33. Following a further meeting on 20 September 2011, HMRC examined the Appellant's cash book and purchase invoices for the year 2009-10, which led to further queries, principally regarding monies received in respect of outside catering which HMRC said did not appear in the Appellant's daily gross takings record. An inspection of the Appellant's purchase day book for 2009-10 had indicated unusual purchasing patterns; that is, goods had been purchased which would not normally be used in the type of business ordinarily operated by the Appellant. The goods included sliced sirloins, T-bone steaks, vegetables such as asparagus, Greek feta cheese, grapes, melons, strawberries occasional purchases of items such as Christmas crackers, large cakes, roast ducks and superior prawns, which HMRC said indicated that goods had been purchased to enable outside catering to be carried out. A

comparison of the purchase dates of the goods with the Appellant's cash book revealed no corresponding entries.

34. On 13 August 2012, at HMRC's request, the Appellant provided till rolls/Z readings for the quarter period to May 2012, which HMRC said showed that there was still reason for concern regarding the operation of the till.

i. Daily Z reading numbers were missing for the whole period
ii. The times of readings were missing from daily Z readings for the whole period.
iii. The running gross takings figure was missing from the Z readings for the whole period.
iv. There had been an unusually high use of the 'cancel' 'and 'no sale' buttons. On one day, there was a total of 36 cancels, amounting to £416.10, an average of £11.55 per cancel. There were also 41 no sales. Together that meant that the till was operated as a cancel or no sale 77 times out of a total number of 471 times, which equated to 1 in 6 times that the till was used. HMRC requested permission to examine and reset the till to their preferred settings and also required access to a wider range of Z readings to see if any pattern could be identified.

35. Mr Boyd, in a letter to HMRC dated 28 September 2012, said that there were numerous genuine reasons why the no sale or cancel keys would be used.

36. Mr Boyd also raised the issue of wastage. He said that taking June 2009 by way of example, a total of 387 bags of chips weighing 20 lbs per bag were purchased weighing 10,836 lbs. He explained that as a wet product, during the cooking process, a great deal of moisture is lost. The Appellant's son Mr Ross Bustard had undertaken some experiments in weight loss during cooking, as had the Fish Fryers Association, and it had been established that only 59% in weight remained after cooking. He estimated that a further 10% would be wasted.

37. Mr Boyd also argued that if HMRC insisted that the Appellant had indeed made undeclared sales of over £538,117, it was necessary for them to disprove his calculations and show what the Appellant had sold, particularly given that there were no purchase invoices unaccounted for. He argued that the only way that was possible, was for the Appellant to purchase goods for cash and not to pass them through the accounts, but that would still have left a paper trail through his suppliers.

38. HMRC remained concerned that the till was still being zeroed on a weekly basis and on 3 October 2012 visited the Appellant to undertake a till interrogation. They found that the Z readings only totalled 9 – suggesting that the till had been cleared 9 days previously. HMRC found that there had been 72 cancelled sales totalling £511, and 134 'no sales', averaging of 14 per day.

39. On 19 November 2012, HMRC wrote to the Appellant's agent to advise that no reliance could be placed on the till readings or the agents SRE. They revisited their mark-up calculations having taken into account the various allowances agreed. HMRC's revised assessments included an element of wastage (see Table 6 below), the main item being 30% for chips. Other food items were shown as having 5% wastage. This reduced the weighted mark-up from 265% to 217%, and the GPR from 73% to 68%.

Table 6

Wastagee %	Food Item	Net Purchases	Purchases Minus Wastage	WM-Up	Expected sales
30	Chips	7,770	5,439	580%	36,988
5	Sausages	1,812	1,721	337%	7,522
5	Pasties	234	222	430%	1,178
5	Burgers	4,739	4,502	241%	15,351
5	Chicken	9,846	9,353	269%	34,515
0	Soft Drinks	6,762	6,762	115%	14,538
5	Cod	2,895	2,750	183%	7,783
5	Haddock	36	34	125%	76
5	Whiting	7,398	7,028	95%	13,704
	TOTALS	**41,492**			**131,655**

Weighted Mark-Up Percentage: $\frac{131,655 - 41,492}{41,492} \times 100 = 217\%$ mark up

and a GPR of 68%

40. Mr Boyd acknowledged that whilst the wiping of the till was a "very silly thing to do", his detailed exercises based on primary records held, were sufficient to confirm a GPR of 58%. He said that the investigation had lasted six years and asked HMRC to issue assessments so that the Appellant could appeal.

41. In February 2013, HMRC wrote to the Appellant setting out proposed revised Income Tax assessments for the tax years 2006-07 to 2010-11 and a revised VAT assessment for periods 04/06 to 10/12.

42. On 8 February 2013, Mr Boyd rejected the revised assessments and requested a review. He set out reasons why he considered the BEE carried out by HMRC to be inaccurate. He enclosed a copy of his SRE and set out a number of arguments in support of his calculations.

> i). Whereas HMRC had not produced any records or other evidence to substantiate its claims, he had access to a database of over 3,500 companies/traders in fast food. This allowed him to extract GPR results for the industry over 5 years. The industry average for 2009 was, for example, 59.50%. His analysis of the Appellant's trading profits for the three years 2005-07, showed an improving position. In 2005 GPR was 54%, in 2006 it was 56.4% and in respect of the year under investigation, 57.5%.
>
> ii). HMRC had assumed throughout its enquiry that period 07/09 was a representative period. However the standard rate of VAT for the year under enquiry was 17.5%. The rate dropped to 15% on 1st December 2008 and returned to 17.5% on 1st January 2010.He asked whether HMRC could correctly assume that a change in VAT rates

had no effect on the computations and therefore allowed a direct comparison between years.

iii). With regard to wastage, Mr Boyd said that he could produce evidence from Loughery College in Cookstown in support of his calculations. In his calculations, only wastage for chips had been allowed for. He had made no adjustments for other items, or for example, meal deal offers which would have an impact on GPR.

iv). The GPR exercise carried out by HMRC used an incomplete three months of invoices, whereas his exercise related to almost a complete year. He had a much larger sample size (almost 90%) whereas HMRC's sample size was less than 25%.

v). Whilst acknowledging that the Appellant was wrong to zero the till, that had no effect on his SRE. He did not use any information from the till. His calculations were based entirely on the primary business's records and invoices available for the accounting year 2009-10.

43. Mr Boyd's SRE included a detailed monthly summary and analysis of all purchases, that is the main food groups, packaging condiments, bread and oils. He compiled a detailed summary of sales revenue on a month by month basis, waste, net sales, and net sales after waste. The summary and analysis extended to 57 pages and effectively included every sale made by the Appellant in the period 2009-10. From this Mr Boyd calculated a GPR of 57.26% (see summary Table 7 below).

Table 7

Description	**Dr**	**Cr**
Gross Sales Income from unit sales		737,794.57
Less Waste applied to all sales income at HMRC rates	126,343.14	
VAT on net sales	84,642.92	
Sales Net of VAT		526,808.51
Main food groups	153,420.15	
Condiments	30,831.98	
Bread	9,110.48	
Oils	18,273.38	
Packaging	13,505.47	
Total Cost of Sales		225,141.46
Gross Profit		301,667.05

GPR% = $\frac{301667.05}{526,808}$ = 57.26%

44. On 7 March 2013 HMRC responded to the points put forward by Mr Boyd, saying:

i. HMRC's original mark-up, which calculated the Appellant's GPR at 73%, was put out for discussion, only because the Appellant had provided no evidence of wastage, allowances, or free food given to employees. His till had been repeatedly wiped and only a few Z readings were retained. Nonetheless, HMRC reduced their mark-up in January 2013 to 217% to take into account wastage, allowances and free food, which resulted in a reduced GPR of 68%. HMRC further acknowledged that by taking into account packaging, sauces and other direct overheads, the Appellant's GPR would most likely be under 60%.

ii. The change in rate of VAT had no effect on GPR/mark-up, because figures net of VAT were used to undertake the mark-up exercise.

iii. HMRC accepted that wastage and shrinkage had to be taken into account. They had not applied wastage rate of 50% as the Appellant purchased mainly cut chips ready for cooking. They had also accepted a 5% wastage for most of the other items sold and included allowances for free food and employee's food, despite no evidence having been offered. Mr Boyd's calculations more or less equalled sales declared in VAT Returns. If adjustments were made for other waste or meal deal offers, that would mean the Appellant had over-declared sales, which suggested that his calculations were not credible.

iv. HMRC said that they were satisfied that the sample size of three months was sufficient to calculate the Appellant's mark-up/GPR. Mr Boyd's sample size may have been larger, but his SRE was not in their view credible.

v. The Appellant had wiped his till, at least twice and after being told not to at the initial visit, and after also being reminded not to do so in writing. He thereby destroyed all evidence of his sales. This was a deliberate attempt to conceal his true sales/takings. The Appellant had also not voluntarily disclosed his outside catering. It was for that reason that the mark-up/GPR exercise was necessary.

45. On 13 March 2013, the Appellant's agent responded, requesting an HMRC internal review on the basis of the following submissions:

i. HMRC's methodology and calculation of the Weighted Mark-up and Gross Profit Ratio

a) The accounts for the year 2009-10 showed that sales for the year were £627,805 and cost of sales of £252,223. This resulted in gross profit of £375,582 and a GPR of 59.82%. In previous years GPR was 54% (2005), 56.44% (2006), and 57.70% (2007). This showed an improving trading position for the Appellant and was not indicative of a trader trying to under declare profits.

HMRC's exercise applies the weighted mark-up to the value of food groups including the cost of other unidentified sales products to achieve an 'expected sales' value. The exercise mentions that packaging, dripping and sauces have been excluded when calculating each net food purchase figure but there had been no further explanation as to how the final mark-up figures had been arrived at. The 2009-10 year, for which the SRE had been undertaken, showed the cost of sales at

£252,223. Included in the figure is packaging and other items which the BEE excludes. Packaging was £13,506, cooking oil £18,273 and condiments, salad vegetables and cheese £30,832. If these were excluded from the calculations, the cost of sales figure is £189,612 which results in a GPR 69.80%. Although Mr Boyd had not been provided with HMRC's calculations, this figure was directly comparable to the 68% figure arrived at by HMRC in their BEE. Mr. Boyd said that if the BEE model is used (albeit unhelpfully not co-terminus with the accounts) and after including a reduction for condiments oil and bread, the following GPR is produced [The figure condiments, oils and breads figures are extracted from actual invoices and are not assumed, or arrived at by best judgement]:

Table 8

Turnover Expected sales from BEE	131,655 (GPR 68%)
Less Cost of Sales	
Food Groups	41,492
Condiments (June, July, August 2009)	8,906
Oils (June, July, August 2009)	2,206
Bread (June, July, August 2009)	3,483
Gross Profit	75,568
GP%	57.39%

Mr. Boyd said that if the 'additional unidentified costs' in the BEE model were indeed condiments, oils and bread as he had surmised, they should have been excluded from the costs, not grossed up in the mark up and added to sales income. The logic that the BEE is using is that customers are served their purchase in their hand (as there is no packaging), and are asked if they would like it cooked or otherwise (as cooking oils are grossed up and therefore generate additional revenues if chosen). So fish would have different sales prices depending on whether they wanted it battered or not, and burgers would be priced depending on whether customers asked for a bap, mayo, lettuce, tomato or onions as these have all been grossed up and therefore form part of a variable selling price rather than fixed prices which the Appellant operates. Clearly that could not be correct methodology. Whilst some of the condiments, such as cheese, will generate additional revenue they would not do so to any material amount.

b) Mr Boyd said that he had asked for (but not received), copies of the invoices supporting the figure of £41,492 [see table 4] for purchase costs and the other invoices that had been added, to arrive at the final grossed up figure. This was the basis for the entire calculation and had to be disclosed. HMRC had not provided any calculations or disclosed any assumptions that had been made as to how the sum of £904,606 (see Table 5) had been arrived at.

c) As HMRC had accepted the purchase costs as accurate and had not questioned recorded VAT inputs, then it was possible to extrapolate the sales revenue from those costs. The SRE model extracts the number of units available and sells them

at the agreed price. This provided a more accurate and complete method of establishing gross income. The BEE model should only be used when the business concerned has a 'value added process', that is, no single item can be identified and sold. An example would be chicken in a restaurant which could be sold in any number of dishes with greatly varying prices and costs. In the Appellant's business every single potential sale can be identified.

ii. Wastage

The wastage rates used were chips 30%, dirty potatoes 50% all other food groups 5%. This resulted in a GPR of 57%, which was lower than the sales restatement model. If HMRC's computation for staff consumption and meal deals (the sum of the whole being less than the sum of the parts) were factored in, this reduced GPR even further.

iii. Unrepresentative period chosen by HMRC

The invoices used for HMRC's BEE were purchase invoices for the three months of May, June and July 2009 whereas the invoices used for the SRE were the purchase invoices for the full accounting year 2009-10. Using complete accounting years allows for comparison between years and tax returns. HMRC had assumed that the period which they selected was representative, which not the case. June and July 2009 had amongst the highest gross profit figures. If the period used was November, December 2009 and January 2010, the answer would have been dramatically different and in the Appellant's favour. The sample size used in the BEE was 22.18% of the total cost of sales in the accounts. The comparative figure for the SRE is 87.8%. The larger the sample size the more accurate the result.

iv. No unusual cash dealings by the Appellant

There was no evidence of unaccounted for transactions. According to HMRC's calculations the Appellant had extracted, over a five year period, £742,564 (£8,709 net per month) in addition to recorded drawings of £533,117 for the same period. It would be safe to assume, that if that was correct, the Appellant would have enjoyed a very expensive life style which most certainly would have left a paper trail. However there was no evidence of that and there had been no change in his lifestyle.

46. The Appellant then provided HMRC with mandates authorising HMRC to obtain copy invoices from all main suppliers. These included:

Lynas Foods (frozen foods), V Semple (chips), Bap Express (breads), Byrne Fish (fish), Europa Foods (meat products), Golden Glen (packaging, dripping, batter mix), Hendersons (dry goods and drinks, cleaning products, condiments) and Arnotts (fruit & veg).

47. Having examined the copy invoices supplied, HMRC said that in respect of three of five suppliers approached, there appeared to be some purchases omitted from the Appellant's purchases totalling approximately £8,494. This included an undeclared cash account with Lynas Foods.

48. On 30 August 2013, Mr Lecky wrote to Mr Boyd having re-worked both the BEE assessment figures and also Mr Boyd's SRE summary, using the adjusted purchase figures.

These now had condiments and oils deducted so that purchase figures included only items for use in resales. An allowance of 30% had been given for wastage on chips. HMRC's recalculation of the Appellant's purchases and expected sale were significantly reduced resulting in the'difference' figure for sales being reduced from £253,643 to £171,535. Mr Boyd said that even based on HMRC's figures this reduced net profit figures, after adjusting purchases for further allowances (free food/employees food) to a GPR of 64%.

49. On 23 September 2013 HMRC issued a final revised calculation of the additional income tax & class IV NIC due using the adjusted purchase figures and allowances as follows:

Table 9

Year	Initial due	Assessed due	Revised due
2006-2007	£9,616.05	£26,528.07	£16,912.02
2007-2008	£44,550.74	£77,431.10	£32,880.36
2008-2009	£54,616.68	£65,463.23	£10,846.55
2009-2010	£43,204.81	£38,822.32	-£4,382.49
2010-2011	£34,181.30	£54,047.36	£19,866.06
Total	£186,169.58	£262, 292.08	£76,122.50

50. HMRC calculated penalties due as follows:

Table 10

Year	Old Penalty %	Additional Tax/NIC	Penalty Chargeable
2006-2007	60%	£16,912.02	£10,147.21
2007-2008	60%	£32,880.36	£19,728.21
Year	New Penalty %	Additional Tax/NIC	Penalty Chargeable
2008-2009	50%	£10,846.55	£5,423.28
2009-2010	N/A	x	Nil
2010-2011	50%	£19,866.06	£9,933.03

51. On 10 October 2013, the Appellant lodged an appeal against the assessments and penalties with the Tribunal.

52. On 11 November 2013 HMRC issued revised VAT assessments for periods 07/09, 04/10 to 10/10 and 01/12 to 04/12, crediting £4,630; and on 2nd January 2014 issued an assessment for periods 04/06 to 10/12 crediting £24,067, thus reducing the original VAT assessment to £26,342.

53. On 7 March 2014 HMRC issued an amended Notice of Penalty Assessment, under s 97 Schedule 24 paragraph 15(1) FA 2007, in the amount of £11,050, in respect of inaccuracies contained in the Appellant's VAT Returns for the periods 04/09, 01/10, 01/11, 04/11, 07/11 and 10/11, as a result of deliberate and concealed conduct.

HMRC Guidance notes

54. *HMRC Business Economic Notes 13: Fish and Chip Shops*:

These notes (which were withdrawn some time ago) are described as being:

> 'Issued to Inspectors of Taxes to assist them in examining accounts. They are intended to provide a general background to the trade, with some explanation of its most important features. Business Economic Notes are not intended to provide an exhaustive or definitive picture of any particular trade or profession. …Fried fish and chips have been the traditional British "fast food" since Victorian times. Almost all shops take in raw potatoes and fish fillets and prepare and cook them on the premises. Ready prepared chips and fish are rarely utilised. Each shop's output is accordingly the product of the individual fryer concerned and is consequently somewhat different from those of its neighbouring rivals.
>
> The (profit) margin actually achieved depends on his ability to minimise the wastage suffered while the food is prepared and sold, and to set the prices and portions best suited to his business, bearing in mind the local competition.
>
> Accordingly, the gross profit margin on sales (gross profit divided by turnover) achieved by different businesses can vary widely. In 1988 many businesses seemed to attain gross profit rates (GPRs) of about 45 percent upwards, commonly around about 50 percent, although neither figure should be regarded as a norm.
>
> Where the fryer is more efficient or has been able to establish higher prices or smaller portions than the common norm, the gross profit rate achieved can be well over 50 percent. Conversely, the less fortunate may not attain 45 percent.
>
> A fryer's profit margin is constantly varying, reflecting the seasonal fluctuations in the quality of the potatoes and to a lesser extent, the fish purchased each month.
>
> The models below show the stages at which losses can occur during preparation, and the cumulative effect that such losses can have on yields.'

The Model then refers to various types of preparation losses (by weight) such as 'substandard potatoes' 2-3%, 'losses on peeling' 20-30%, losses on frying' 35-40%.

VAEC1510 — *Power of assessment: Best judgement: Determine the overall credibility of your assessment*

The notes state:

> 'Once you have calculated the arrears to best judgement, you should ask yourself is this figure credible? If the amount you calculate does not pass the credibility test then your assessment may not be to best judgement. Ensure you have given enough consideration to all the facts and evidence.'

EM3082 — *Examining Accounts: Business Ratios: Gross Profit Rate*

> 'Gross profit rate (GPR) is the most commonly used business ratio in HMRC. The relevance of GPR in the distributive trades is obvious but its significance will vary according to the conditions of the trade. Although the concept is simple, skill is needed in using GPR. The limitations and possible pitfalls need to be understood. Initially, an unexpected or abnormally low rate of gross profit may raise legitimate doubts but an attempt to re-compute the true profits

of a business by using the 'mean' or most common rates achieved by other apparently similar businesses should only be done where there is no co-operation from the trader.

Average gross profit rates have very limited uses if the case goes to a tribunal hearing. Even an enquiry officer who has spent many years on enquiry work is most unlikely to be accepted by the tribunal as an expert on the trading patterns and operations of any particular type of business. The Tribunals Caseworker cannot simply try to put in a summary of gross profit rates showing what other businesses have achieved (and by inference casting doubts on the taxpayer's results). There is the very real objection that this is probably a breach of confidentiality. Such information is hearsay evidence and it is unlikely to be directly relevant to the issues being considered by the tribunal.

Evidence about other businesses such as average profit rates or levels is not evidence about the taxpayer's business. It can be a justification for selecting a case for enquiry. Equally, it may have assisted you in making a 'best of judgement' assessment, and it is quite in order to say so. What the tribunal needs is evidence to demonstrate that the taxpayer's profits are inadequate'.

EM3508 — *Recalculating Profits: Business Models: Gross Profit Rate Model —Example*.

'The model used most often to establish likely omissions and recalculate takings is based on gross profit rate. There is a basic pattern to such models, although the model for every different trade, indeed every individual business, will require tailoring to fit the particular circumstances.

[An example of how GPR may be determined is given]. In this example the enquiry officer acknowledges that the business economics exercise based on the sample period may not be precise but remains satisfied that the records are unreliable and that they are entitled to base their estimate on appropriate evidence.

The taxpayer is offered the opportunity to present a revised calculation based on a detailed analysis of the whole year's invoices (or some other representative period) using the agreed mark-ups if he wishes to undertake the task'.

EM3509 *Recalculating Profits: Business Models: Wastage*

'It is often a relatively straightforward matter to calculate what the profits might have been on the basis of some form of mark-up exercise. However, the turnover will have been the amount projected only if every item was sold at the normal price. This will rarely, if ever, be the case. The business model will produce a theoretical maximum before allowance for wastage. There will be some wastage in any business but the proprietor will try to keep this to a minimum. This should reduce with experience. You should discuss possible wastage with the proprietor - preferably in precise terms such as the number of occasions, the number of items involved and so on. Does it seem reasonable from what you know of this business, similar business and the trade in general?'

EM3560 — *Recalculating Profits: Private Side — Private Bank Accounts*

'No full private side examination can be undertaken without access to private bank account statements. For example, you may find that drawings have not been fully recorded and you will need to see the private bank account statements to satisfy yourself that these are consistent with declared drawings, and other information provided.

Before undertaking any specific tests, you should look at the statements generally. Is there a pattern to spending habits? Are there any indications of transfers from or to other accounts? You might not know of these accounts, and you will probably want to see them. Transfers to or

from a partner's or spouse's account confirm that his or her personal finances are linked to those of the person under enquiry, and should therefore be brought into the enquiry'.

EM3571 — *Recalculating Profits — Private Side — Means Test: Uses*

'A means test might be used as further evidence to show the unreliability of declared figures, or to support Revenue amendments or discovery assessments in a case where there has been little co-operation. It will rarely be sufficiently complete to rely upon as the principal tool for recalculating profits.'

EM2593 — *Recalculating Profits: Private Side — Capital Statement: Information from Bank Accounts*

'In a full enquiry where you are looking in detail at private assets and spending you should see statements or passbooks of all bank, building society and savings accounts, including e-bank accounts, as well as credit card statements. Paying-in slips, cheque counterfoils and returned cheques, where these are available, should be required where necessary.

The main purpose of a detailed examination of bank and credit accounts is to ensure that all bank and savings accounts and other significant assets have been disclosed, to look for any unidentified lodgements which may be undisclosed business profits, and to collect information about personal spending. As well as the tests suggested in EM356Q, you should consider whether

- there are any gaps in the pattern of withdrawals, indicating use of another account or reliance on cash?
- regular use of bank or credit card accounts, including large numbers of small items, may imply that large amounts of cash are not saved or accumulated
- the amounts claimed to be spent on purchases of property; investments or other assets should be reflected in your total worth computation. How strong is the evidence that particular receipts represent sales of assets?
- a claim that a life policy has matured, or a loan was received, can be traced to a bank account. If not what happened to the cheque?
- income from investments reconciles with your capital statement? Does all income tie in with known assets, and are there any items of income which you would expect to see but which do not appear - if so where are they credited?
- all regular payments such as mortgage, insurance, tax, etc appear? If not, how were they met? Similarly, can you trace individual items such as payments for holidays, cars, etc? Can any known cheque receipts be traced, for instance tax repayments - if not, what happened to the cheque? It may have been paid into an account of which you are unaware
- there are satisfactory explanations for cancelled debit or credit items?
- large debits identified as payments for particular items of personal expenditure, such as school fees, a car, holidays, etc., have related expenses (for example, school uniforms, currency, etc.) and what the particular payment says about the taxpayer's lifestyle.'

<u>Independent data</u>

The Merlin Scott Associates Limited – Fast Food Outlets, March 2014 Edition. A table listing gross profit margins by industry type states that the average GPR for a fast food outlet is 59.50% and a restaurant 58.58%.

The Bank of Ireland. A letter dated 18 January 2011 addressed to the Appellant in answer to a query raised with bank as to the average GPR% of fast food outlets states that, based on information held by the bank across its customer base, the average GPR is 50%.

Witness evidence

Alistair Bustard

55. In evidence given under oath, the Appellant's son, Alistair Bustard, said that there were a number of reasons why the 'no sale' and 'cancel' keys, would be used.

i. Telephone orders were a major reason for using the cancel button. Customers could pre-order to collect or use taxis to collect orders. When a customer telephoned to place an order, the till operator would ring in the order and give the price to the customer. The member of staff would then cancel the sale as no money is tendered. The shop would then prepare the order, the taxi or the person would arrive, collect the order and the till operator would ring the order into the till.

ii. The till had no mechanism to reverse a keyed entry. If a customer placed an order, and the till operator makes an error in keying a single entry, it could not be cancelled. The full entry would have to be cancelled. If somebody placed an order and then changed their mind the person taking the order would have to cancel the sale and start again. These cancelled transactions are recorded as cancelled sales but are really corrections.

iii. If a customer queried the price quoted, it would be checked by redoing the calculation on the till and then cancelling the transaction.

iv. Change was kept in the till drawer. If change was needed, to purchase something for the shop, the no sale was used to open the till.

v. The Shop was robbed once. Since then they do frequent money drops especially over the weekends. To do so, they open the till using the no sale button.

vi. The keys for the outside store are retained in the till. If they required anything from the store they operate the no sale button and when returning the keys again operate the no sale button. The same routine applies when the cleaners come into the shop in the morning.

56. Mr Bustard said that the till was programmed with 110 keys. It was not practical to have keys for meal deals due to their number and frequent changes. The shop operates a menu board for daily specials. This would include special prices for the school trade and passing business. The board is put up from opening time, 11a.m until 4 p.m. The offers are heavily discounted in order to get sales and to match competition in the area.

57. Lunchtimes were busy with school children due to heavily promotional and discounted prices. The menu included a five picture meal deals which became popular as it was similar in style to a McDonald's menu, with the price being discounted to include a drink. After lunch any pre-prepared food was discarded due to it being quiet until they prepared for the

evening rush. Examples of such pricing would be chips, beans and sausages for £2.55 discounted from £5.00. Chicken fillet, chips and coke £2.70 discounted from £4.85. Chips, beans and pastie £2.55 discounted from £4.80. Meal deals included bottles of coke or similar soft drink discounted by 15%.

58. Another sale promotion was given to a local Youth Club in Ballymoney. They received, every Friday night, special promotional offers with an order over £50.

59. All promotional sales were rung in using the miscellaneous sale button.

60. Mr Bustard said that wastage in any fast food operation is always going to happen. He does not record how much is wasted or destroyed in a day, and the staff are not required to record such events. At best it would be a guess and staff are not likely to confess to making mistakes. The shop works on a four day rotation, after which anything remaining must be dumped. Chips are blanched (pre-cooked to a certain stage). Anything that remains in the colanders at the end of the night is discarded. Anything remaining in the heaters is also discarded (beans, gravy, curry sauce etc.) at the end of each evening. During the day some produce is over cooked, dropped or spilled moving from chip bin to pan. Anything which is cooked is kept warm. However this can only be done for a very short period of time, the shelf life for cooked food is very short. McDonalds, for example, remove all cooked produce after 12 minutes shelf life. The Appellant allows slightly longer but again it comes down to judgement.

61. Portion control is also something which can cause problems. Some members of staff are more generous than others. In McDonald's, portion sizes are rigorously controlled, the staff have no discretion, but in the Appellant's shop portion size is not controlled. Chips would be the main problem. It is not uncommon, if a customer orders just a burger for some members of staff to give half a scoop of chips with it. If the chips were about to be dumped there was no harm, and it is good PR, but it does not generate revenue for the shop.

Ernest Bustard

62. The Appellant said he accepted that he should not have zeroed the till. In his witness statement he said that he did so on the advice of fellow traders, having been told that till readings had to exactly match returns. He said that for numerous reasons, there was no chance of that happening, new staff training, mistakes, till breakdowns, grandson pressing buttons, over-rings, un-cancelled orders that had not been collected, staff using the till as a calculator for telephone orders, customers changing their minds and so on. In any event, he knew from experience what the daily figures would be. In evidence at the hearing he said that he had been zeroing the till for twenty years.

63. With regard to outside sales, the Appellant agreed that during the period June 2007 to August 2011 there were a total of £17,000 of outside sales that have not been included in the daily gross takings record used for VAT purposes. He said that in May 2009 he purchased a hog roast bbq. He also advertised for hog roast services. Unfortunately the hog roast had not proven very successful. The Appellant also agreed that HMRC had identified purchases which would not be used in the shop, but would be consumed at external functions. He said that the purchases were all recorded and all external sales were also recorded in the cash book. Although they may not have been correctly accounted for in VAT and/or tax returns, that issue had now been resolved, and he had accepted the additional assessments raised in that regard.

64. He said that HMRC had been told that he had a burger van or some such operation and that this was based on a large purchase of burgers by him on 11 July 2009. In fact, the July 12th celebrations were being held in Ballymoney that year and because his shop was open for this, that was the reason for the large purchase of burgers.

65. The Appellant said that there were a number of functions that he carried out for which he did not receive payment. Through his church he would undertake catering for funerals, old age pensioner functions and other church activities. He did not ask for payment. A considerable amount of the purchases and external sales related to those activities.

66. He had freely consented to HMRC obtaining copy purchase invoices from all his major suppliers. The only supplier not to respond was Bap Express as they were bankrupt. It was as a result of HMRC's analysis of the purchase invoices that a number of cash purchases were discovered at Lynas Foods. The Appellant said that he could not recall the specific purchases but they arose for perfectly legitimate reasons. Friends, family and staff were constantly asking for favours. If they needed a large number of sausages, burgers etc. he would either sell the product (if he had it) from his own fridge or direct them to Lynas Food, where they could use his trade discount and pay for it themselves. That is what normally happened.

Mr Gareth McGee

67. Mr McGee said that he had worked for the Appellant, as his accountant, for over twenty years. He was responsible for preparing the VAT returns, the weekly payroll and the Appellant's annual accounts, along with his income tax returns.

68. The VAT returns were due quarterly, in July, October, January and April. The VAT periods are not co-terminus with the accounting period. To do the VAT returns, for the input VAT, he used the purchase invoices supplied by the Appellant. The input VAT would be the summation of those invoices.

69. The output VAT was extracted from the cash book. It was calculated by adding the total receipts recorded for the quarter and calculating the VAT on the total. An allowance of 2.5% was made for zero rated sales. He said that he did not know why he and the Appellant estimated that zero rated foods amounted to 2.5% of sales.

70. The annual accounts were produced in a different manner. The method he used was to post from the cheque journal, rather than posting invoices. Within the cheque figures were costs in relation to packaging, cooking oils, cleaning materials and other goods not strictly speaking related to sales.

71. Mr McGee agreed that within the sales figures there were sales which related to 'outside catering'. He had mistakenly not included these figures in the VAT returns as he believed at the time that it was a separate revenue source. It had also been brought to his attention during a meeting with HMRC that the Appellant had received payment for some consultancy work for which he did not charge VAT. Mr McGee again said he believed this to be a separate revenue source and therefore not part of the shop's revenue on which no VAT needed to be charged. HMRC had corrected these misunderstandings and he took full responsibility for the mistakes.

72. Mr McGee said that at the meeting of 12 October 2009, Officer Lecky said that he believed that the GPR% was 'too low', even allowing for packaging etc. and that it was lower

than the GPR for comparable local businesses, which revealed a GPR% of 73%. Mr McGee said that he was not given any further information; he said that Officer Lecky did not ask to see his working papers or examine how the accounts were prepared.

73. Mr McGee said that in December 2010 he received Officer Lecky's calculations, but was not provided with any detail as to how net purchases had been established. In the calculations, Officer Lecky had arrived at a weighted mark-up % and applied it to 'purchases' but gave no explanation as to how the purchase figures had been calculated. Officer Lecky said that he had included allowances but did not explain what these were.

74. Mr McGee said that Mr Magill appeared to be preoccupied with the concept of recording wastage in some form of book, saying that if the Appellant could not prove wastage it could not be included in the computations. Mr McGee said that he was not aware of any establishment that operated a wastage book.

Gail Wilkinson and Melissa Corbet.

75. Two employees, Ms Wilkinson and Ms Corbet, provided witness statements which were not challenged by HMRC. They said that the cancel button on the till was often used for telephone orders, or when a customer wanted to know the price of an item before placing an order. Sometimes they changed their mind or a mistake was made, so that the cancel button had to be used. Ms Wilkinson said that telephone orders created a lot of waste. Orders would sometimes not be collected. During busy periods, the wrong order would be handed out, and by the time the error was discovered, the correct order was past its best and had to be thrown away. Some orders were taken down wrongly or customers changed their mind when calling to collect them. This also caused lots of waste.

Albert Kelly and David Murdock

76. Two taxi drivers, Mr Kelly and Mr Murdock provided witness statements to say that particularly on a Friday and Saturday night they would frequently be asked by customers to collect and deliver orders from 'Flash in the Pan.' The statements were not challenged by HMRC. Mr Murdock gave evidence under oath.

Peter Rollins and Reverend Greg Alexander.

77. Mr Peter Rollins, a society steward for Ballymoney Methodist Church provided a witness statement and said that the Appellant had carried out numerous catering events and that for most of these he did not receive any payment. Sometimes he would return monies paid to help with the development of the Sunday School.

78. Rev Greg Alexander also provided a statement and gave evidence on oath saying that the Appellant caters for numerous church activities for which he does not receive payment.

Michael Boyd

79. Mr Boyd said that in his view, the use of a mark-up exercise is more appropriate when a business buys and sells goods in the same condition, e.g. a grocery shop, a tobacconist or a pub for its wet sales, In the V1-37 Mark-up Control notes issued by HMRC they use the example of a newsagent selling tobacco, newspapers, confectionery, soft drinks and greetings cards. In a fish and chip shop, the mark-up exercise is very difficult to apply because the

condition of goods changes between purchase and sale. There is a value added process; portion sizes vary, wastage is a much bigger factor than HMRC had allowed for.

80. He said that he had tried to look at the problem from HMRC's point of view to see how they could have achieved a 73 GPR%, as initially argued. He researched HMRC's archived HMRC *Business Economic Notes 13 (Fish & Chip Shops)* which explained how HMRC would look at the issue. *EM3082 - Examining Accounts: Business Ratios: Gross Profit Rate*, clearly explained the limited use of GPR% and what else HMRC should look for when examining accounts. *EM3515 - Recalculating Profits: Business Models: Other Types of Model* states that the GPR model is only one basis for a business model and is best suited for retailing trades.

81. *EM3508 - Recalculating Profits: Business Model: Gross Profit Rate Model - Example* gave a clear example of applying the mark-up exercise which says that in the case of a difference of opinion

> 'the taxpayer is offered the opportunity to present revised calculation based on a detailed analysis of the whole year's invoices (or some other representative period) using the agreed mark-ups if he wishes to undertake the task.'

He therefore prepared the SRE using records for 2009-10 as a representative period.

82. Mr Boyd said that the method used by Mr Magee when preparing accounts, of posting from the cheque journal, was a fairly blunt method of posting costs which did not allow for any kind of analysis. The business has eight or nine major suppliers which account for over 98% of the cost of sales. The posting method was to debit cost of sales and credit bank with the cheque value. VAT is analysed from the posted cost of sales totals. This did not allow for any breakdown of cost of sales. The reason for posting in this manner was down to speed and to align the accounts with the tax return.

83. HMRC's BEE used figures taken from a three month period representing 22.18% of the cost of sales compared to his SRE in which the sample size was 87.8%. He converted invoices from invoice value to sale units/portions. The unit sale price as agreed with HMRC was then applied to the units sold and totalled to give sales value. The total gross income, less VAT and less cost of sales (being the major suppliers) allowed him to arrive at an accurate assessment of the gross profit.

84. He said that the calculation, simply put, is if a customer orders a 4oz burger, the revenue is £2.50. The cost is made up of the cost of a burger, bap, cooking (oils etc.), packaging, condiments (relish, mayo, some veg, salt and vinegar and sauce) and occasionally 'a hand full of chips'. The revenue figure in the SRE is based upon unit sale. The HMRC model applied the margin to all costs which is clearly wrong as the additional costs - packaging, batter mix, dripping condiments etc. - do not generate any additional revenue (as explained, there is a value added process) so they should not be uplifted by the mark-up rate.

85. In the first SRE in May 2011, the model only had wastage for chips. The subsequent model was adjusted to allow for HMRC wastage rates for the various food groups (30% for chips and 5% for everything else but drinks) and the sale prices used were those used by HMRC. He had looked at the sale prices of other products and used more analysis than the BEE. The SRE model confirmed that the Appellant's GPR% was roughly in line with the

accounts. He had made no allowance for staff or meal deals [a burger, chips and a drink is sold for £4.00 rather than the full retail price of £5.25.]

86. Mr Boyd said that he had found it very difficult to review and analyse HMRC's calculations because they had not provided the information on which their calculations were based or any explanation as to how the exercise was carried out. However by a process of deduction he was able to see that HMRC had included items which had no sale value and uplifted by the mark-up.

87. He said that in his personal experience of the catering industry he had never seen records for wastage. *EM3509 - Recalculating Profits: Business Models; Wastage* highlights how the mark-up exercise is 'a theoretical maximum' and should be adjusted. It also assumes that everything is sold at the normal price which it states is not possible. Wastage is also recognised in EM3082, EM3505, EM3508 and EM3509

88. Within the SRE he had included a column for private use and external catering. This followed guidance in *EM3510 - Recalculating Profits: Business Models: Own Goods Adjustment*.

89. According to the HMRC's initial BEE, the amount of missing revenue during fifteen quarters amounted to £538,117 which equated to £2,750 per week. According to the accounts from 2006-09, Ernest Bustard had drawings of £452,295, with capital introduced of £94,385, a net outflow of £357,910. This added to HMRC's figure meant that the Appellant had supposedly withdrawn and spent £896,027 in a little over four years. This clearly begged the question 'what did he do with it?' This was asked of HMRC on many occasions. *EM3520 - Recalculating Profits: Business Models: Comparison with Private Life and EM3550, EM3555, EM3571 and EM3572, EM3651, EM3660, EM3680, EM3681, EM3682, EM3683* all cover the issue of funding a life style. In his view, HMRC had never considered the matter despite having their attention drawn to it. The Appellant had offered HMRC unrestricted access to his private accounts, permission to contact any and every financial institution, credit union or anybody else they wanted to speak to in order to trace the supposed undeclared receipts .

90. Mr Boyd said that a great deal of discussion with HMRC had been around external sales. During his interviews with HMRC, external sales had not been hidden. They were recorded in the cash book. That was far from deliberate concealment. They were not in the VAT computation because, naively, the Appellant on Mr McGee's advice believed that VAT was not due on sales not made through the shop. The Appellant had also carried out some consultancy work for which he did not charge VAT for the same reason. Mr Magee had given Mr Boyd his working papers for the accounts for year ending 31 May 2009 and it was clear that external sales had been included in returned turnover figures and therefore taxed as income.

91. He had submitted calculations to HMRC which clearly showed that the period 07/09 was not representative. The archived *HMRC Business Economic Notes 13 (Fish & Chip Shops)* highlights the seasonal nature of the business, which is also mentioned in other HMRC manuals already referred to. The period selected was the last VAT period before the inspection in October 2009. In his calculations, the GPR% ranged by month from 47% to 62%. The months of June, July, and August 2009 had a GPR% of 62%, 60% and 62% whilst March, April, May 2010 had a GPR% of 56%, 47% and 57%.

92. The business accounts showed that in May 2006, GPR was 55.13%, in May 2007, 57.09%, in May 2008 58.38%, in May 2009 58.10%, and in May 2010, 58.62%. This was a fairly consistent performance over the years despite adverse trading conditions experienced generally in the economy. HMRC said that the GPR% was too low, having compared the Appellant's figures to other businesses in the area, but would not provide any comparable evidence, even in generic form.

93. Mr Boyd said that he had obtained reports produced by Merlin Scott Associates Ltd for accounts submitted at Companies House. The reports show that the Appellant's GPR was above average. A GPR of 73% is extremely unlikely (if not impossible), 68% is also in this category and at 64% Ernest Bustard would be an accomplished manager at the top of his game. However this is a fish and chip shop in Ballymoney and 'not fine dining in Belfast.'

94. HMRC at the meeting in April 2013 asked that they be allowed to approach the Appellant's major suppliers to obtain all the transactions for the accounting year ending 31st May 2010 and cross check the SRE. It transpired that a few thousand pounds of cash purchases occurred through Lynas Foods for which the Appellant has given a reasonable explanation.

95. HMRC have brought their GPR figure down from 73% to 68% and subsequently indicated that they may have been prepared to agree a GPR of 64%. Their final figure had been arrived at by combining the BEE income and the SRE cost of sales but no explanation had been provided for their figures; he was not provided with any schedules or cross referencing and therefore their reasoning was impossible to follow.

96. HMRC eventually assessed the Appellant for under-declared VAT of £26,324. This covers the period from February 2006 to December 2012, a total of twenty seven quarters. In eleven of the quarters the Appellant is alleged to have had overstated his VAT by £16,804 and in sixteen quarters understated VAT by £43,146. Mr Boyd says that this is an example of dogmatism and tunnel vision taking over from logic. Why would the Appellant overstate his VAT in any of those VAT periods?

Officer Lecky

97. Officer Lecky said that he did not agree that the 07/09 period was unrepresentative. He said that the figures were broadly in line with the figures in the quarterly periods immediately before and after that quarter. It was very much an average period as reflected by the Appellant's VAT returns. Further, Mr McGee did not challenge HMRC's decision to use 07/09 as a representative period.

98. With regard to the natural wastage, Officer Lecky agreed that there was a substantial difference between what he was prepared to agree to, that is 30% for chips and the 50% proposed by the Appellant. However he said that the Appellant used bagged pre-prepared chips for which there was much less wastage, and that this could amount to as much as £3,500 a month. He accepted that the Appellant's SRE used HMRC's wastage rates for chips but, did not accept the Appellant's argument that portion sizes was also an issue.

99. Officer Lecky accepted that his initial estimate of the Appellant's mark-up GPR at 73%, had only been arrived at because the Appellant had not provided any reliable information on which he could base any calculations. The Appellant had deliberately zeroed the till even

when asked not to do so prior to prearranged inspections at the premises His figure was 68%. The Appellant's was 58%. He had never actually agreed 64% as suggested by Mr Boyd.

100. He agreed that he had not provided Mr Boyd with detailed calculations and figures in order that Mr Boyd could understand how the Tables had been populated. He agreed that in a letter to Mr Boyd, he said that if packaging condiments and oils and other items were taken out of the mark-up process the GPR could be reduced to less than 60%. He also agreed that he had not discussed the percentage mark-up figures with Officer McGill.

101. Officer Lecky said that the assessed VAT of £26,000 grossed up to £140,000 over a six-year period, and that the Appellant could easily dissipate that additional undeclared profit at £500 per week.

102. In cross examination Officer Lecky was unable to say why he considered Mr Boyd's SRE to be wrong, other than to say that 11% of the purchase invoices for 2009-10 were missing, and that the SRE did not agree with his wastage figures which he considered to be accurate.

Alana Wallace

103. Officer Wallace said that she took over the investigation in 2013 from Officer Archibald. She agreed that Mr Boyd's SRE 'make sense' and could be correct but that 11% of purchase invoices were missing from the analysis.

Officer McGill

104. Officer McGill said that the original estimate of 73% GPR did not come from him. He agreed that he had not discussed the mark-up methodology with Officer Lecky except in the very early stages He also agreed that he had not read Mr Boyd's SRE.

Relevant legislation

105. The relevant VAT legislation is contained in VATA:

> **Section 4 Scope of VAT on taxable supplies**
>
> (1) VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.
>
> (2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.
>
> **Section 73 Failure to make returns**
>
> (1) 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 judgement and notify it to him.

(6) 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, but (subject to that section) where further such evidence comes to the Commissioners' knowledge after the making of an assessment under subsection (1), (2) or (3) above, another assessment may be made under that subsection, in addition to any earlier assessment.

Section 77 of the Act states -

(1) 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 or importation or acquisition concerned.

Section 77(4) of the Act (prior to 1 April 2009 and relevant to VAT periods prior to 04/09) previously read as follows—

(4) Subject to subsection (5) below, if VAT has been lost—

(a) as a result of conduct falling within section 60(1) or for which a person has been convicted of fraud, or

(b) an assessment may be made as if, in subsection (1) above, each reference to [3 years] were a reference to 20 years.

Section 77(4) of the Act provides (w.e.f 1 April 2009) -

(4) In any case falling within subsection (4A), an assessment of a person("P"), or of an amount payable by P, may be made at any time not more than 20 years after the end of the prescribed accounting period or the importation, acquisition or event giving rise to the penalty, as appropriate (subject to subsection (5)).

(4A) Those cases are-

(a) a case involving a loss of VAT brought about deliberately by P (or by another person acting on P's behalf).

Schedule 11, section 6 of the Act – contains the rules regarding the Duty to keep records

6(1) Every taxable person shall keep such records as the Commissioners may by regulations require, and every person who, at a time when he is not a taxable person, acquires in the United Kingdom from another member State any goods which are subject to a duty of excise or consist in a new means of transport shall keep such records with respect to the acquisition (if it is a taxable acquisition and is not in pursuance of a taxable supply) as the Commissioners may so require.

(2) Regulations under sub-paragraph (1) above may make different provision for different cases and may be framed by reference to such records as may be specified in any notice published by the Commissioners in pursuance of the regulations and not withdrawn by a further notice.

(3) The Commissioners may require any records kept in pursuance of this paragraph to be preserved for such period not exceeding 6 years as they may [specify in writing (and different periods may be specified for different cases)11.
(4) The duty under this paragraph to preserve records may be discharged—
(a) by preserving them in any form and by any means, or
(b) by preserving the information contained in them in any form and by any means,
subject to any conditions or exceptions specified in writing by the Commissioners for Her Majesty's Revenue and Customs.

Regulation 31 of the Value Added Tax Regulations 1995 provides -
Records
(1) Every taxable person shall, for the purpose of accounting for VAT, keep the following records—
(a) his business and accounting records,
(b) his VAT account,
(c) copies of all VAT invoices issued by him,
(d) all VAT invoices received by him, ...

Schedule 24 Finance Act 2007 – Penalties for errors (effective from 1 April 2009 and relevant to penalties issued for VAT periods 04/09, 01/10, 01/11, 04/11, 07/11 and 10/11).

Section 60(1) of the Act provides –
(1) In any case where—
(a) for the purpose of evading VAT, a person does any act or omits to take any action, and
(b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability),
he shall be liable, subject to subsection (6) below, to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by his conduct.

Section 60(7) of the Act provides that the burden of proof of liability to a section 60(1) civil evasion penalty lies upon the Commissioners.

Section 70(1) allows the Commissioners to mitigate the penalty including to nil.

Section 76(1)(b) provides for the making of an assessment of a Section 60 penalty.

Section 77(2) provides that a civil evasion penalty assessment (under section 60) must be made at any time before the expiry of the period of two years beginning with the time when the amount of VAT due for the prescribed accounting period concerned has been finally determined.

106. Direct Tax - Legislation

Section 9A TMA 1970 - Notice of Enquiry into Appellant's 2007/08 Tax Return

Section 28A TMA 1970 - Completion of enquiries into personal or trustee return

Section 29 TMA 1970 - Assessment where loss of tax discovered 4.4 Section 34

TMA 1970 - Ordinary time limit of [4 years].

Section 36 TMA 1970 - Loss of tax brought about carelessly or deliberately (Extended time limit)

Section 95 TMA 1970 - Incorrect return or accounts for income tax or capital gains tax (Old penalties up to 2007/08)

Section 100 TMA 1970 - Determination of penalties by officer of Board.

Schedule 24 Finance Act 2007 - Penalties for errors (2008/09 onwards)

'Best Judgement' - case law authority

107. In *Van Boekel v Customs and Excise Commissioners* [1981] STC 290. Woolf J, giving judgement, said at 292:

> "The contention 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 judgement. The very use of the word 'judgement' makes it clear that the commissioners are required to exercise their powers in such a way that they make a value judgement 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 that they knew was, or thought was, in excess of the amount which could possibly be payable, and then leave it to the taxpayer to seek, on appeal, to reduce that assessment.
>
> Secondly there must be some material before the commissioners on which they can base their judgement. If there is no material at all it would be impossible to form a judgement as to what tax is due.
>
> Thirdly it should be recognised, particularly bearing in mind the primary obligation, of the taxpayer to make the 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 judgement, 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 judgement' does not envisage the burden being placed upon the commissioners of carrying out exhaustive investigations.
>
> What the words 'best of their judgement' envisage, in my view, is that the commissioners will fairly consider all material 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."

108. In *McCourtie v CEC* [Lon/92/91], Dr Brice said that

i. the facts should be objectively gathered and intelligently interpreted

ii. the calculations should be arithmetically sound

iii. any sampling techniques should be representative

109. The judgement of Woolf J in *Van Boeckel* was referred to with approval by the Privy Council in *Bi-Flex Caribbean Ltd v Board of Inland Revenue* (1990) 63 TC 515, in which the Council said:

> "The element of guess-work and the almost inevitable inaccuracy in a properly made best of judgement assessment, as the cases have established, do not serve to displace the validity of the assessments which are prima facie right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessments right or more nearly right. It is also relevant, when considering the sufficiency of evidence to displace an assessment, to remember that the facts are peculiarly within the knowledge of the taxpayer."

110. In *McNicholas Construction Co Ltd v Commissioners of Customs & Excise* (2000) STC 533 Mr Justice Dyson said that:

> "The words 'to the best of their judgement' permit the commissioners a margin of discretion in making an assessment; a taxpayer may only challenge the assessment if he can show that the commissioners acted outside the margin of their discretion, by acting in a way that no reasonable body of commissioners could do. In order to succeed, the taxpayer must show that the assessment was wrong in a material respect, and that if so, the mistake is such that the only fair inference is that the commissioners did not apply best judgement, as explained in Woolfe J in *Van Boeckel v Customs & Excise Comrs* (1981) STC 290."

111. In *Nicholson v Morris* [1976 STC 269] Walton J (approved by Geoff L J on appeal - (1977) STC 162 at 168) stated (at 280):

> "...the Taxes Management Act 1970 throws on the taxpayer the onus of showing that the assessments are wrong. It is the taxpayer who knows and the taxpayer who is in a position (or, if not in a position, who certainly should be in a position) to provide the right answer, and chapter and verse for the right answer, and it is idle for the tax payer to say to the Revenue, 'Hidden somewhere in your vaults are the right answers: go thou and dig them out of the vaults.' That is not the duty of the Revenue. If it were, it would be very onerous, very costly and a very expensive operation, the cost of which would fall entirely on the taxpayers as a body. It is the duty of every individual taxpayer to make his own return and, if challenged, to support the return he has made, or, if that return cannot be supported, to come completely clean; and if he gives no evidence whatsoever he cannot be surprised if he is finally lumbered with more than he has in fact received. It is his own fault that he is so lumbered."

112. Mr Justice Carnwath in *Rahman trading as Khayam Restaurant v CEC*, at para 6 said:

> "I have referred to the judgement in some detail, because there are dangers in taking Woolf J's analysis of the concept of 'best judgement' out of context. The Tribunal should not treat an assessment as invalid merely because it disagrees as to how the judgement should have been exercised. A much stronger finding is required; for example, that the assessment has been reached 'dishonestly or vindictively or capriciously'; or is a 'spurious estimate or guess in which all elements of judgement are missing'; or is 'wholly unreasonable'. In substance those tests are indistinguishable from the familiar Wednesbury principles (See *Associated Provincial*

Picture Houses ltd v Wednesbury Corp [1948 1 KB 223). Short of such a finding, there is no justification for setting aside the assessment."

113. Lord Justice Carnwath in *Pegasus Birds v HMRC* [2004] STC 1509 CA at para 38(i)) said:

> "The Tribunal should remember that its primary task is to find the correct amount of tax as far as possible, on the material properly available to it, the burden resting on the taxpayer. In all but very exceptional cases that should be the focus of the hearing and the Tribunal should not allow it to be diverted on an attack on the Commissioners exercise of judgement at the time of the assessment."

114. The Tribunal must consider whether, on a balance of probabilities, the Appellant has established that the assessment was not made by the Commissioners to the best of their judgement. However if it was not so made, a tribunal is not bound to reject an assessment. In *Pegasus Birds*, Carnwath LJ said-

> "Although the Tribunal's powers are not spelt out, it is implicit that it has power either to set aside the assessment or to reduce it to the correct figure... In my view, the Tribunal, faced with a 'best of their judgement' challenge, should not automatically treat it as an appeal against the assessment as such, rather than against the amount. Even if the process of assessment is found defective in some respect... the question remains whether the defect is so serious or fundamental that justice requires the whole assessment to be set aside, or whether justice can be done simply by correcting the amount to what the Tribunal finds to be a fair figure on the evidence before it. In the latter case, the Tribunal is not required to treat the assessment as a nullity, but should amend it accordingly."

115. Chadwick LJ went on to express doubt as to the appropriateness of any objective standard. At [91] he said:

> "In para 44 of my judgement in *Rahman (No 2)* I suggested that, in cases where the tribunal had material before them from which they could see why the Commissioners made the assessment that they did and it was not apparent on the face of that material that the power to assess had not been exercised in accordance with the 'best of judgement' requirement, the tribunal would be well advised to concentrate on the question 'what amount of tax is properly due from the taxpayer?'; taking the material before them as a whole and applying their own judgement …."

116. This view was followed in *Mithras (Wine Bars) Ltd v Revenue and Customs Commissioners* [2010] UKUT 115 (TCC), [2010] STC 1370, where Judge Oliver in the Upper Tribunal, in remitting the case to the first-Tier Tribunal, said:

> "The Tribunal is not restricted to any kind of quasi-supervisory function which involved referring to the Commissioners' judgement on quantum at the time the Commissioners made their assessment. The Tribunal's function is truly appellate, in that it can consider further information or argument at the hearing of the appeal and reduce the amount of the assessment, thereby substituting its own view on quantum for that of the Commissioners."

Appellant's case

117. Mr. Boyd said that the Appellant challenges the assessments on the following grounds:

i. The business economic model used by HMRC is arithmetically flawed and has been incorrectly applied. HMRC produced a mark-up exercise based on the 07/09

VAT return. In the first BEE in Nov 2010 the GP was 73% (GPR 277%), in August 2013 it became 68% (GPR 217%) and finally albeit provisionally, in September 2013, 64% (GPR 178%).

ii. The Appellant has supplied HMRC with the SRE and supporting data, based on the accounting year to May 2010 and using purchase invoices (a sample size of 89%), agreed unit sale prices, and agreed waste rates. A GP of 57% was arrived at. HMRC recognise this as being an accepted method of establishing a guidance to GP but the exercise has not been properly considered.

iii. HMRC have been offered evidence (information extracted from Companies House) showing the industry norms over the last 5 years. This indicates that the client is performing well in the industry. The industry average is 51%.

iv. The period used by HMRC in the exercise is not representative. HMRC used the VAT return for period ending 07/09. For the GPR exercise they claim that this period is representative without examining any other return. The return used represented only 22% of the recorded purchases in 2009-10 accounts. HMRC have always argued that this is a representative period but have been given extensive evidence and calculations to the contrary.

v. HMRC have not exercised best judgement. Evidence was submitted to disprove their assumptions but has been ignored. HMRC have withheld information in relation to their computations despite being repeatedly asked for it.

vi. HMRC have not followed their own published or internal guidelines.

118. The Appellant has been VAT registered from 12 May 1986 and has been trading as a sole proprietor for over twenty years. During that time he has had various inspections but never received any request to change his record keeping processes or accounting practices.

119. When HMRC's first mark-up exercise (based on the quarter period 07/09) resulted in a GPR of 73%, before allowances and deductions, Mr Magee was asked to adjust his accounts for 2006-07 in order to justify HMRC's calculations. This 'reverse engineering' involved analysing and including in the weighted mark-up of the 'non-sale items' such as packaging, oils, and condiments in order that Mr McGee could arrive at a GPR of 73.00%. The markup percentage was therefore effectively arrived at by HMRC not by Mr Magee.

120. In June 2011, HMRC was given the SRE along with all supporting purchase invoices. The exercise represents 79.3% of the cost of sales shown in the accounts (SRE £221,419/accounts £279,187). The purchase invoices are converted into sale units. The sale units are then multiplied by the agreed unit sale price and HMRC's agreed allowance for waste of 5% is allowed (30% for chips). This is cumulated and posted in accordance with the accounts and accepted accounting principles. The sales value is a theoretical maximum. The cost of sales is calculated by adding the direct material costs (burgers, chips, sausages etc. which is the basis for the theoretical maximum) and costs in the value added process (packaging, batter mix, lard, oils, vegetables, breads etc.). The exercise confirms that the records used to extract the accounts can be relied upon. It does not use any sales data, only verified purchase costs and agreed unit sale prices. The methodology used removes any possibility of income being understated.

121. HMRC have acknowledged that if packaging, sauces and condiments are taken into consideration, the GRP would very likely be below 60%. HMRC, although adopting the SRE methodology subject to reductions in Mr Boyd's proposed wastage allowances, proposed a 64% GPR without offering any calculations or reasoning that may have allowed a response.

122. Lynas Foods provided details of a cash account showing total cash purchases of £3,786 or 1.35% of the cost of sales in the accounts. At HMRC's request this was included in the SRE.

123. The Appellant is an active member of the Methodist church in Ballymoney. He regularly catered for small church functions and fund raising activities for which he was not paid. The produce used is listed in the SRE. A witness statement from the Minister and the Church Steward confirms this activity.

124. Mr Boyd said that the Appellant readily conceded that the formatting of the till should never have occurred and that HMRC were faced with no option but to enquire into his returns. However he had readily invited HMRC to carry out a detailed vigorous investigation into his affairs, in order to ensure that their assessments were correct.

125. Referring to *Van Boekel v Customs and Excise Commissioners* and *McCourtie v CEC,* Mr Boyd said that there are six underlying principles which must be observed in order for HMRC to arrive at a best judgement determination:

i. *They must perform that function honestly and bona fide.*

ii. *Clearly there must be some material before the commissioners on which they can base their judgement.* The Appellant had produced, in varying formats, all information that was requested by HMRC and had added a substantial amount of additional information. In addition to the detailed SRE, a report was obtained which extracted information from Companies House. The report demonstrated that the Appellant's GPR% is above that of industry norms. This report is independent, can be verified and had been extracted from publicly available information.

iii. *The commissioners should not be required to do the work of the taxpayer*. Taking into account the information supplied to HMRC, the answers given by the Appellant during interviews and the assistance of his agent the Appellant has assisted HMRC to the best of his ability and resources.

iv. *The facts should be objectively gathered and intelligently interpreted.* The Appellant believes that this has not been done. The investigation commenced with an accusation, based on 'a quick markup' (HMRC's words) exercise that his GPR%, was too low compared to others. HMRC then built a case around this premise. HMRC have not followed their own guidelines and published advice.

(1) *Technical Information Package T18/19*. This information was requested under the Freedom of Information Act 2000 ("FOIA") and is not normally available to persons outside of HMRC. For a fish and chip shop the normal GPR% is stated to be 54-60%. The Appellant is at the higher end of, but within this bracket

(2) *Business Economic Note 13 Fish and Chip Shops* (now archived), states that a GPR should be about 45% or upwards, and is commonly around 50%. This figure is also supported by a letter from Bank of Ireland stating the same figure.

(3) *HMRC Guidance V1 - 37 mark up control note.* This demonstrates how the GPR% should be calculated and the differences to be taken into consideration. This is also further explained and demonstrated in EM3082.

(4) *HMRC Guidance VAEC1510 - powers of assessment: Best judgement*: This determines the overall credibility of HMRC's assessment. A GPR% of 73% would result in £10,000 additional cash each month. However in 2009 drawings were recorded in the accounts at £177,838. There is no record, paper trail or other evidence of any additional cash.

(5) *HMRC guidance notes EM3509, EM3560, EM3571 and EM2593* covers the private side of an investigation. The taxpayer under investigation is very unlikely not to leave evidence of such substantial unrecorded income. HMRC, in this investigation, made no effort, despite being offered unfettered access to all of the Appellant's private accounts, to find any unrecorded source of income.

v. *The calculations should be arithmetically sound.* HMRC's GPR% generates a theoretical maximum sales value. The calculations of HMRC take the invoices for the VAT period 07/09 and list them but did not contain any analysis. HMRC initially calculated a GPR% 73%, but applied that GPR% to a figure which included items not for resale. HMRC corrected this error in a letter dated 7 March 2013 and agreed that the GPR% was 'likely to be below 60% if non-food items were deducted before applying the mark-up figure'. However they did not act on this.

vi. *Any sampling techniques should be representative.* Information was given to HMRC demonstrating that the sample that they used was not representative in that the trade cycle for the 07/09 quarter was at the peak of the cycle. The SRE model was more representative and covered the full trade cycle.

126. The Appellant, despite what HMRC have suggested, did not seek to hide trading income earned outside of the shop. The accounts and cash book reflect that income but the VAT return did not. That was simply a mistake in part caused by incorrect advice from his accountant, Mr McGee. VAT should have been charged on the external catering and also on consultancy fees which he earned. HMRC were provided with all relevant information and assessments have been accepted in that regard.

Respondents' Case

127. Although the Appellant is required under VATA 1994, Schedule 11, s 6(1), and the VAT Regulations 1995, Regulation 31, to retain his business and accounting records, he did not retain his till rolls and 'Z' readings to substantiate his handwritten daily gross takings in the cash books. In accordance with HMRC published guidelines, taxpayers should retain full till rolls for 6 years (or a minimum 4 years where a concession is requested). Where 'Z' prints are taken these should be kept for the full 6 years. The Appellant has admitted that he deliberately wiped his till at regular intervals.

128. The First-tier Tribunal decision: *M Karimi Haiishoreh (Trading as Pizza 1) M Karimi Haiishoreh and K Saqhafi (Trading as Chichini's)* TC00058 is not binding on the Tribunal, however the case is similar to the present case in that the till was 'interfered with' in both cases. At para 44 the Tribunal said:

> "44. It is in our view difficult if not impossible to understand why, if they are honestly declaring their takings, traders who, like the Appellants, have invested in sophisticated tills do not take care to ensure that they are used properly and correctly, that the information they produce in the form of Z-readings is accurate, and that the information is preserved. Instead, we are asked to accept that errors (which, according to the Appellants, always had the effect of

> increasing the recorded takings and never the reverse) were commonplace and that the few Z-readings which were available when the unannounced visit was made on 12 February 1999 are unreliable. If traders fail to keep, or choose to conceal, reliable evidence of their turnover they can in our view scarcely complain that they are unable in consequence to mount an effective challenge to an assessment."

129. In the absence of an adequate audit trail, HMRC had to carry out a mark-up exercise and made an honest and genuine attempt to arrive at a reasoned assessment, taking into account all relevant and available information and material. HMRC did not take into account anything that was irrelevant.

130. Use of the representative period 07/09 was agreed with the Appellant and Mr Magee.

131. Checks on purchase invoices procured directly from the Appellant's main food suppliers showed that purchases of approximately £8,494 had been omitted from the Appellant's records which included a 'cash sales account' of £3,786 from Lynas Foods.

132. The Appellant failed to declare VAT on income from consultancy fees and external catering.

133. The additional takings, identified by the mark-up exercise, for the periods 04/06-10/12, represent undeclared business income.

134. The assessment for VAT has been calculated on the basis of best judgement.

135. The additional takings identified for the years 2006-07 and 2008-09 to 2010-11 represent undeclared business income.

136. The assessments for income tax and NIC have been derived from the VAT assessment and therefore are made to best judgement and in accordance with the time limits and extended time limits set out in Sections 34 and 36 TMA 1970.

The penalty assessments -

137. The penalty assessments have been issued under s 97 Schedule 24, para 15(1) FA 2007. The civil evasion penalty has been issued under s 60(1) VATA 94. The penalties arising under s 95(1)(a) TMA 1970 have been issued under s 100 TMA 1970 and under para 1 Schedule 24 FA 2007 which stem from the Appellan''s behaviour which HMRC considered, on evidence available, to be deliberate and concealed conduct involving dishonesty which was fraudulent or negligent.

Conclusion

138. In respect of the assessment for VAT, the Closure Notice and the Discovery Assessments, the onus of proof rests, at law, with the Appellant.

139. In respect of the penalty assessments issued under s 97 Schedule 24 para 15(1) FA 2007; s 60 VATA 94; Penalty determination issued under s 100 TMA 1970/penalties arising under s 95(1)(a) TMA 1970 and penalty assessment issued under para 1 Schedule 24 FA 2007, the onus of proof rests with HMRC to establish that their decision to issue the penalties, as determined, is not flawed.

140. The standard of proof is the ordinary Civil Standard of the balance of probabilities.

141. The determination of this appeal has not been assisted by the fact that, although we were provided with a joint bundle, this did not include an agreed statement of facts or any readily understandable explanation of HMRC's methodology and calculations in arriving at their assessment of the Appellant's GPR.

142. Clearly HMRC should not be required to do the work of the taxpayer in order to form a conclusion as to the amount of tax which is due. Despite requests not to wipe his till the Appellant did so repeatedly and only a few Z were readings retained. He provided no direct evidence of wastage, allowances or free food given to employees. HMRC were therefore entirely justified in undertaking a detailed mark-up of the Appellant's purchase invoices. The mark-up and GPR exercise was only conducted through necessity.

143. HMRC have however not produced any evidence to substantiate its claims that the Appellant's GPR, at 57.5%, is too low. The Appellant's annual profit, in respect of the year under investigation, was only 2% less than the national hot food takeaway industry average, which for 2009 was 59.50%. Over the three previous years the Appellant's profits did not deviate more than 3%. HMRC have acknowledged, without actually undertaking any calculations, that if certain non-sale items are excluded from the weighted mark-up exercise, the GPR could be less than 60%.

144. HMRC's initial justification for saying that the Appellant's GPR was too low was that other hot food takeaways in the locality had significantly higher margins. However as HMRC's internal guidance states, each shop's output is the product of the individual tradesman concerned and may be very different from that of neighbouring rivals. The profit margin actually achieved depends on his ability to minimise wastage suffered and to set the prices and portions best suited to his business bearing in mind local competition. There are also regional differences, reflecting varying customer preferences in different areas.

145. Companies House data shows that over the 2010-11 year, the average GPR for a hot food takeaway is 51%, which indicates that the Appellant is performing well in the industry. The Appellant's bank, The Bank of Ireland states that the average GPR% of fast food outlets based on information held by the bank across its customer base, is 50%.

146. HMRC's (now withdrawn) Business Economics Exercise Internal Guidance, based on 1988 data, states that many hot food takeaways seemed to attain GPRs of about 45% to 50%, but the gross profit rate achieved in some cases can be significantly more or less. This clearly indicates that it is unsafe practice to place too much reliance on the GPR's of other local hot food takeaways. As HMRC's EM8032 points out, the limitations and possible pitfalls of attempting to re-compute the true profits of a business by using the 'mean' or most common rates achieved by other apparently similar businesses need to be understood. Further such 'evidence' is based on hearsay and does not demonstrate that the taxpayer's profits have been understated. Computing a trader's profits using the GPR's of other takeaways in the locality should only be used where there is no other evidence and no co-operation from the trader. That was not the position in this case. HMRC did not use that method, but it appeared to permeate HMRC's reasoning throughout the enquiry.

147. The HMRC BEE was carried out using three months of purchase invoices, whereas Mr Boyd's sales restatement exercise was based on records for almost a complete year. Mr Boyd's SRE was based on reasonably comprehensive and accurate information. He used all

available invoices (89%) for the accounting year 2009-10 which included a detailed month by month analysis of the Appellant's primary business records. From that he was able to calculate a GPR of 57.26%. Although 11% of invoices were missing, the GPR was calculated on a pro rata basis and therefore, even if all invoices had been available, it is unlikely that the GPR would differed significantly. HMRC had in any event accepted the purchase costs as accurate and had not questioned recorded VAT inputs.

148. There was little or no evidence for HMRC's initial suggestion that the Appellant's GPR was 73%, which was subsequently accepted as being too high and had only been 'put out for discussion'. HMRC revised their mark-up to take into account wastage, allowances and free food, reducing the GPR to 68%. More significantly, HMRC later acknowledged that by taking into account packaging, sauces and other direct overheads, the Appellant's GPR would most likely be under 60%. However the assessments were not amended and remained based on a GPR of 68%.

149. As Mr Boyd showed in his calculations, if condiments, oils and bread were excluded from the mark-up rather than being included and added to sales income, that reduced the GPR from 68% to 57.39%. HMRC were provided with Mr Boyd's calculations but did not say why they considered his figures not to be correct.

150. As Mr Boyd argued, given that HMRC provisionally accepted the Appellant's GPR to be no more than 64%, and possibly under 60% if packaging, condiments oils and other non-sale items are not included in the mark-up, the only method by which the Appellant could generate additional sales would be to have substantial cash purchases not recorded in the accounts and VAT returns. However HMRC were provided with signed mandates to approach the main suppliers for copies of purchase invoices which were provided by the suppliers.

151. With regard to wastage, Mr. Boyd only applied the waste rates that HMRC used in their BEE. He had also made no allowance for staff consumption.

152. With regard to the weighted mark-up exercise, clearly individual items of food, such as fried fish or burgers, were sold at a fixed price. They were not priced depending on whether customers asked for a bap, mayo, lettuce, tomato or onions, but in HMRC's calculations it appears that these additional items had been grossed up as if they formed part of variable selling prices rather than fixed prices which the Appellant operated. As Mr Boyd said, that cannot be correct methodology.

153. HMRC's internal guidance on - Recalculating Profits: Business Model: Gross Profit Rate Model [EM3508] says that the taxpayer should be offered the opportunity to present his own calculations, based for example, on a detailed analysis of a whole year's invoices using agreed mark-ups, if he wished to undertake the task, and in this case that is precisely what Mr Boyd did when he prepared the SRE - using records for 2009-10 as a representative period.

154. HMRC said that they were satisfied that the sample size of three months for 07/09 was representative and sufficient to calculate the Appellant's mark-up/GPR for the entire six year period under enquiry. The Appellant's takings for June and July 2009 were relatively high but if the period used was 01/11, the takings were lower. Given that accounts and primary records (except till readings) were available, it has to be asked why those records were not examined in greater detail. HMRC's stance, which they retained throughout the enquiry, was that Mr Boyd's SRE was not in their view credible, but no further explanation was provided.

Whilst it is not up to HMRC to trawl through the Appellant's records to try and establish a representative period upon which to base an accurate assessment, if given the necessary information, it should not be ignored.

155. HMRC had not received any reports of unusual cash dealings involving the Appellant. He had provided HMRC with unrestricted access to his private accounts.

156. As far as possible, our primary task is to find the correct amount of tax on the material available. On the basis of all the evidence, we find that the Appellant's gross profit margin during the appeal period has been accurately reflected in his accounts and VAT returns. Although the assessments by HMRC have not been reached capriciously, arbitrarily or as a 'spurious estimate or guess in which all elements of judgement are missing', in our view, on the information and material available and for the reasons set out above, the assessments to VAT and Income Tax, are not to best judgement.

157. The appeal is therefore allowed. The assessments are discharged and the penalty assessments are reduced to nil.

158. 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.

MICHAEL CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 23 OCTOBER 2015