TC01565

Appeal number: TC/2010/00616

VALUE ADDED TAX; Section 73 Value Added Tax Act 1994: Partnership assessment; repayment claims credibility check: mark-ups on best selling lines not in line with expected outcomes; local convenience stores; unlikely patterns of trading; no adherence to any accepted retail scheme. Appeal dismissed.

FIRST-TIER TRIBUNAL

TAX

MESSRS TUFAIL, DIN, AKBAR & TUFAIL **Appellant**

- and -

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

TRIBUNAL JUDGE: W Ruthven Gemmell, WS
Member: Peter R Sheppard, F.C.I.S., F.C.I.B., ATII

Sitting in public at George House, 126 George Street, Edinburgh on Tuesday 20 September 2011

Mr Stuart Tough, for the Appellant

Miss Kim Tilling, for the Respondents

DECISION

Introduction

1. This is an Appeal by Messrs Tufail, Din, Akbar & Tufail ("Tufail") against an assessment to Value Added Tax ("VAT") dated 4 July 2008 for the sum of £15,515 plus interest for VAT for the periods ending 07/05 to 07/07 inclusive. Following subsequent correspondence the assessment was upheld by Her Majesty's Revenue and Customs (HMRC) in a letter dated 20 November 2009.

2. Tufail are in partnership trading as general grocers from three premises in Dundee located at Cheviot Crescent, Dundonald Street and Hebrides Drive.

3. Tufail had no witness and HMRC had one witness, Gail Samson, a Higher Officer of HMRC, who was credible.

Legislation

4. Section 73 Value Added Tax Act (VATA) 1994; Value Added Tax Regulations SI 1995/2519, Regulation 31; Public Notice number 727 and associated numbers.

5. All the authorities referred to above were provided in full in a list of authorities to Tufail and the Tribunal by HMRC. They are not quoted in full here and may be referred to for their terms in the list of authorities so provided.

Cases Referred To

Van Boeckel v Customs and Excise Commissioners [1981] STC 290

Stephen You Seto v Customs and Excise Commissioners [1981] STC 698

Rahman (t/as Khayam Restaurant) v Customs and Excise Commissioners (No 2) [2003] STC 150

Custom and Excise Commissioners v Pegasus Birds Ltd [2004] STC 1509

Javid Aslam(A Bankrupt) & Ashia Aslam – T/A Ramzan Foodstore [2009] UKFTT 48 (TC)

The Facts

6. The following facts were found:-

7. The assessment at issue was made following an unannounced visit to each of Tufail's three shop premises where meetings took place with the different partners running each shop on 27 July 2006.

8. On 15 February 2007, HMRC visited Tufail at the Dundonald Street premises and uplifted the available business records.

9. Tufail had been registered as a VAT partnership with effect from 1 November 1990 under the registration number 658 3201 38.

10. It was stated that the Dundonald Street shop was in a good part of Dundee in terms of trading but that the Cheviot Crescent and Hebrides Drive were situated in areas of dense local authority housing with alcohol and drug related problems and, consequently, higher levels of shoplifting.

11. As Tufail was a store selling a variety of items it was entitled to account for VAT by using any of the retail schemes described in VAT Public Notices 727 and associated numbers or under any other retail scheme, if it was pre-arranged and approved by HMRC. Tufail could choose any of the available retail schemes described in the public notices without reference to HMRC.

12. The Public Notices give details of five recognised retail schemes. They are –

(1) Point of Sale Scheme

(2) Apportionment Scheme 1 and Scheme 2

(3) Direct Calculation Scheme 1 and Scheme 2

13. Full descriptions of these schemes and how they operate are found in the VAT Public Notice 727 and associated numbers.

14. Once chosen, that scheme requires to be adhered to and followed, according to the methodology set out in VAT Public Notices 727 and associated numbers.

15. The tills at each of the stores were not used to record every transaction showing different VAT rates for each of the goods sold and Tufail was not therefore in a position to use the Point of Sale Scheme calculations for its VAT returns.

16. From an examination of the records that were uplifted from Tufail or provided by Mr Tough, it appeared to HMRC that Tufail was not using any of the recognised retail schemes to calculate its VAT liabilities, as provided in the VAT Public Notice 727 and associated numbers which in the recognition of retail schemes have the force of law. Nor had they applied for the approval of any other retail scheme.

17. The method used by Tufail was based on ascertaining the costs of zero-rated items purchased and estimating their mark up, then taking account of theft, wastage and any similar adjustments. Having ascertained this adjusted figure for takings for the zero rated items this amount was then deducted from the total sales. This left a total for standard rated sales to which a calculation of 17.5/117.5ths (i.e.7/47ths) was applied and, consequently, the figure for the output VAT due was arrived at. The assessment covered a period where the standard rate of VAT was 17.5% throughout. The Appellant advised, and it was not contested, that the amount of sales at the lower rate of 5% was negligible).

18. HMRC discovered working papers for the VAT period 10/04 were missing and arranged a further visit on 22 October 2007 requesting further records, some of which were provided on 22 October 2007.

19. On 19 November 2007, HMRC visited the Dundonald Street premises and purchases/expenses invoices were uplifted together with till audit rolls. In addition, details of best selling lines for both standard rated and zero rated sales were provided and on 21 January 2008 HMRC visited the remaining two premises and obtained details of the selling process and best selling lines at each of those stores.

20. As HMRC believed that the methodology used to calculate Tufail's VAT liability was invalid, the fact that till rolls were incomplete and that the operation of the till in respect of the separation of standard and zero rated sales was flawed, HMRC, accordingly, decided to establish the credibility of Tufail's declared VAT liability. In order to do so, HMRC used the information provided to produce a mark-up exercise against each of the best selling lines at each of the premises.

21. The outcome of the exercise indicated that the mark-up on standard rated sales actually being achieved was significantly higher than those declared and therefore confirmed HMRC's belief that the methodology of the scheme that was being used produced an unfair and unreasonable outcome.

22. On 3 April 2008, HMRC wrote to Tufail with the outcome of their findings requesting an explanation within 14 days. No reply was received and a further reminder was sent on 8 May to Tufail and to Mr Tough.

23. In the absence of any reply, HMRC considered that there had been a potential under declaration of output tax.

24. In establishing the amount of potential under declaration, in each quarterly VAT period, HMRC used the calculation method Apportionment Scheme 1 to establish if an under declaration had occurred.

25. This approach divided the tax inclusive figure for standard rated purchases by the total purchase figure for each quarterly VAT period. In doing so this gave a percentage figure for standard rated purchases for each quarterly VAT period. Applying this figure against the total daily gross takings figures for the same quarter and thereafter applying the VAT fraction, 7/47ths, gave the output tax due for each quarter.

26. This in turn, was compared with the output tax as declared for each quarterly VAT period, against the periods ending 07/05 to 07/07 and showed an under declaration of output tax in a total sum of £15,515.

27. Mr Tough explained that Tufail did not use the Apportionment Scheme because they sell a lot of low margin products subject to VAT and because, even although the Apportionment Scheme is easier to use than the mark up basis, it would result in them paying more VAT. HMRC had advised Tufail on three previous occasions that the methodology being used for calculating their tax returns was not acceptable.

28. In relation to the mark-up exercise, on 24 December 2008, Mr Tough asked whether any allowances had been made for theft, special deals, offers and stock changes.

29. Tufail kept no stock records and Mr Tough confirmed that in working out the allowances to be made for theft, special deals, offers and stock changes he made an "educated guess" to adjust the mark-up rate.

30. On 24 December 2008, HMRC advised that the original figures recorded in Mr Tough's own workings were applied to the Apportionment Scheme 1 and that the figures had not been altered. HMRC assumed that Mr Tough's figures would already reflect any theft, special deals, offers and stock changes. In evidence it was clarified that no such allowance had been made but no evidence was produced to support the amount of any adjustments for theft, special deals, offers and stock changes or the "educated guess" calculations.

31. Further correspondence took place from 7 April 2009, HMRC concerning the use of an appropriate retail scheme but this related to a period which was not the subject of the appeal.

32. On 27 July 2009, HMRC issued a letter to Mr Tough advising him that his clients had been advised on 25 June 1991, 11 June 1996 and 16 November 2000 that the scheme being used to calculate output tax was not one of the recognised retail schemes and they had no entitlement to use it.

33. HMRC advised that they considered Tufail had not adhered to the requirements of any of the recognised retail schemes. The method that had been used did not produce a fair and reasonable result as the mark-ups that were being achieved on standard rated products were not being reflected in the VAT declarations.

34. It is for the trader to choose a recognised retail scheme and to account for VAT within that scheme. Alternatively, a different scheme could be agreed with HMRC provided it gives a fair and reasonable result.

35. If the trader chooses to use one of the recognised retail schemes, he is under no obligation to advise HMRC of which scheme he is using but he must then carry out his accounting in accordance with that scheme.

36. If a trader chooses to use Direct Calculation Scheme (1) or (2), he must keep a record of his daily gross takings. He must keep a record of the cost, including VAT, of all goods received in the period for retail sales at the standard rate; he must also add up the costs including VAT of all goods received in the period for retail sale at lower rates. He then calculates his output tax by applying the relevant VAT fraction to the standard rate in takings and the relevant fractions to the various other proportions of takings respectively. Every year he does a proportionate calculation on the annual figure as a check. If he is dealing in any matters outwith the VAT scheme, he must account separately for VAT on such transactions.

37. Accounting arrangements could be made by Tufail either for Apportionment Scheme 1 or for Direct Calculation Scheme 1. At the end of each tax year, it would therefore be possible to calculate what proportion of the daily gross takings comes from sales at different rates using the step by step methodology laid out.

Submissions

38. For HMRC, Miss Tilling stated that the burden of proof lay on the taxpayer to show why the disputed assessment was incorrect.

39. HMRC say that Tufail have failed to establish the facts to do so; that no evidence was given by the partners of Tufail and that Mr Tough only completes VAT returns on the basis of Tufail's instructions.

40. HMRC say that there is no requirement to undertake Tufail's work in making good records; that there was information on which assessments could be made; that an error in the assessments had been noted and then corrected and, in any event, was only to the extent of £50 and that no evidence was given as to what, if any, the allowance should be for theft, special deals, offers and stock changes.

41. HMRC say that Tufail have not made any effort to displace the calculation of the assessment.

42. HMRC say that Tufail have not in any measure produced information to meet the requirements of *Van Boeckel or Rahman cases.*

43. HMRC say, following the *Pegasus* case, that the Tribunal's primary task on appeal against an assessment to VAT is to find the correct amount of tax and that HMRC made a honest and genuine attempt to make a reasoned assessment of the VAT payable and that it was in best judgement.

44. HMRC referred to the *Seto* case where Lord President Emslie stated that the question of reasonableness of the method used to arrive at the average mark up on a figure in making an assessment was a question of fact for the Tribunal to decide and that the burden was on the taxpayer to displace the assessment.

45. HMRC say that Tufail had been told on three separate occasions in 1991, 1996 and in 2000 that the scheme used to calculate output tax was not one of the recognised retail schemes and they had no entitlement to use it.

46. HMRC say that the mark-up exercise was a 'litmus test' and provided an indication that the methodology used by Tufail was resulting in an under declaration of tax.

47. HMRC then worked on an assessment based on Apportionment Scheme 1, as it was the simplest method to apply with the information available to them.

48. HMRC say that Tufail did not use this simple method because it would result in a higher VAT liability; that Tufail's methodology by supplier line was not appropriate when buying goods from a supplier such as a 'cash and carry'.

49. HMRC say that the retail schemes are designed to create a simple method of calculation of VAT and, if traders do not wish to follow them, they can use the usual accounting method where every item is analysed for VAT.

50. HMRC say that Tufail did not do this nor did they choose to run their business to allow them to use the Point of Sale Scheme.

51. HMRC say that an educated guess of the discount on mark-up, as used by Tufail, is not appropriate.

52. HMRC say that Tufail have failed to challenge the assessment and have not discharged the burden of proof and failed to show why they should be allowed a bespoke scheme and not one of the approved schemes.

53. HMRC say the Appeal should be dismissed.

54. Tufail say that the best judgement can be used and was in respect of their method of calculating VAT by means of the zero rated goods.

55. Tufail say that what they buy is relevant, not what the cash and carry sell and that there is no evidence to challenge the method of calculating mark-ups by using lines of produce.

56. Mr Tough says that he has extensive experience in calculating VAT and that Apportionment Schemes always produce a better result for HMRC. Mr Tough accepts that if clients such as Tufail do not use the Point of Sale Scheme it is difficult to calculate their VAT liabilities but other methods may still produce the same result.

57. Tufail say that the mark-up on standard rated items, for example cigarettes, is much lower than the mark-up on zero-rated items, for example milk. For this reason, the Apportionment Scheme used by HMRC gives a skewed result.

58. Mr Tough referred to an HMRC report in 1996 on Tufail in which no challenge was made to the mark-up system being used and says that there is no evidence that the figures he has used are incorrect.

59. Tufail say that the Apportionment Scheme as used by HMRC ignores theft, special deals, offers and stock changes.

60. Tufail say the Appeal should be allowed.

Reasons for the decision

61. Tufail had not used a recognised retail scheme accurately for accounting for its VAT. It had not followed the requirements set out in the HMRC's Public Notices.

62. Tufail had not applied for the approval of the scheme it did use. It was clear in the evidence from Mr Tough that he did not favour using the Apportionment Scheme as he believed this resulted in the payment of too much VAT to HMRC. HMRC had on three occasions notified Tufail that the scheme they were using was unacceptable. These notifications were ignored.

63. No evidence was given by Tufail and it was not possible to find out how they thought they had dealt with the calculation of VAT or complied with any of the recognised retail schemes. Mr Tough outlined his methodology of working out the VAT which he believed was accurate, taking into account losses for theft, wastages, special deals, offers and stock changes. In respect of the premises at Cheviot Crescent and Hebrides Drive, Mr Tough indicated, but produced no evidence, that theft and shoplifting were at higher than average levels.

64. No stock records were kept by Tufail and the discount applied by Mr Tough in respect of theft, special deals, offers and stock changes was made only on the basis of an "educated guess".

65. The Tribunal were not persuaded, on the basis of the lack of evidence, that Mr Tough's assertion that the mark-ups he produced were accurate and those of HMRC were inaccurate, because of the type of stock sold, predominantly cigarettes, and the area in which two of the shops were situated which resulted in, it was alleged, higher than average levels of pilferage of stock.

66. Whilst there was evidence to show that the mark-up on some standard rated items was less than the mark-up on some zero-rated items there were also examples where the converse was true, for example the average percentage mark-up on items under the heading standard rated confectionery was higher than the average for items under the heading zero-rated groceries. Similarly, the average percentage mark up on zero-rated newspapers was higher than that on standard rated alcohol.

67. The Tribunal accepted that HMRC are under no obligation to carry out exhaustive enquiries and that in terms of *Van Boeckel* and *Rahman* it is for the tax payer to ensure his returns are correct and can be backed up by records, receipts and bank accounts when requested by HMRC.

68. The Tribunal were also clear that HMRC had properly considered the information that was available to them and had used best judgement in making their assessment notwithstanding the lack of adjustment for theft etc.

69. The Appeal is refused.

70. 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.

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W RUTHVEN GEMMELL, WS
TRIBUNAL JUDGE

RELEASE DATE: 11 NOVEMBER 2011