



TC03544

Appeal number: TC/2012/09583

VAT – whether turnover under declared – assessment of turnover by HMRC using business economics exercise and mark up of purchases – whether correctly assessed to best judgement – yes – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

DAWN OWENS t/a BIZAR HAIR SALON

Appellant

- and -

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

**TRIBUNAL: JUDGE MICHAEL S CONNELL
ALAN SPIER**

**Sitting in public at Alexandra House, The Parsonage, Manchester M3 2JA on 18
July 2013**

**Stephen Howarth and James Howarth of ma2 Chartered Accountants for the
Appellant who did not attend**

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

DECISION

The Appeal

1. This is an appeal by Dawn Owens t/a Bizar Hair Stylist (“the Appellant”) against the decision of the Commissioners for Her Majesty's Revenue and Customs (“HMRC”) dated 18 July 2012 that she was liable to be registered for the purposes of Value Added Tax (“VAT”) with effect from 1 June 2006 in accordance with the provisions of Schedule 1(1) of the Value Added Tax Act 1994 (“the Act”).

2. The Appellant carries on a business as a hair salon and operates from premises at 97 Highfield Road, Blackpool, Lancashire FY4 2JF. The business started on 1 July 2005. It was formerly VAT registered as a partnership between the Appellant and Anna Quarmby up until 30 June 2005. The reason given for deregistration from VAT was that the partnership was dissolved, Anna Quarmby having left the salon setting up a separate business and taking clients with her.

3. Following a check of the Appellant’s self-assessment records on 28 March 2011, it appeared to HMRC that the levels of goods purchased for use in the Appellant’s business did not reasonably correlate to the declared sales. Further enquiries and an examination of the Appellant’s records and cash book for the year ending 31 March 2011 showed that turnover to 16 March 2011 was £70,800, which was in excess of the VAT threshold of £70,00 for that year with two weeks remaining.

4. HMRC looked at the Appellant’s records for the earlier years ended 31 March 2008 and 2010 and conducted a business economics exercise for each of those years. Records for the year ending 31 March 2009 were not available, but the accounts and the Appellant’s self-assessment showed purchases and stock at similar levels, as did accounts for the years to 31 March 2006 and 2007.

5. HMRC noted the amount of stock (colours and shampoo) purchased, and ‘marked up’ the stock, based on standard usage for similar types of business, to arrive at an estimated turnover figure. The amount of shampoo and colours per hairdo was based on the Appellant’s own estimates given in interview. From the resultant estimated turnover, HMRC concluded that the Appellant should have registered for VAT with effect from 1 June 2006. HMRC said that their calculations were based on a comparison of the Appellant’s gross profit rate and an average of those for a similar type of business. They had used a combination of information volunteered by the Appellant, her bookkeeper, advice from hairdressing training colleges and other hairdressers in arriving at their decision.

6. HMRC calculated that the total amount of underpaid output tax, from 1 June 2006 to 31 August 2012 prior to setting off input tax was £64,267.

7. The Appellant disputed HMRC’s conclusions and appealed HMRC’s decision by Notice of Appeal to the Tribunal on 15 October 2012.

Evidence

8. The evidence consisted of a bundle of documents containing copy correspondence between the Appellant, her accountants and HMRC, copy notes of meetings, copy purchase ledgers, tax returns, 'Z' readings from till rolls and copies of the Appellant's bank statements, an HMRC VAT audit report and computations. A witness statement was provided by Mr Duxbury, the investigating HMRC Officer, and Ms J Dewhirst, the Appellant's bookkeeper.

The Background

9. The Appellant does not dispute that she should be registered for VAT, but contends that registration should have been from 1 May 2010, this being the first date she exceeded the VAT threshold. She says that her books give a true and fair view of her business. She says that her lifestyle does not concur with someone concealing income and that both her bookkeeper and accountants, having reviewed her records and returns, are of the view that no income has been concealed.

10. The Appellant's accountants submitted calculations, which they said were based on information from till rolls and extracted bookkeeping records relating to the amount of colour and shampoo purchased. They said that the 'Z' readings, as declared, gave a summary of turnover that accurately reflected a hairdressing salon's average use of colour, and that shampoo usage reflected the Appellant's higher usage. They said that HMRC's figures were overstated as they were based on a usage of colour and shampoo that was lower than actual usage. They also said that HMRC's calculations were based on average sale prices (for 'cut and blows' and other 'hairdos'), that were higher than those charged by the Appellant. They maintained that HMRC's figures did not account for any wastage or pilfering. They also suggested that for one year, 2009-10, there was a possibility of missing purchase invoices.

11. HMRC re-worked the business economics exercise using the Appellant's representative's figures for average colour and shampoo, prices and usage. They also factored in sales for dry cuts, which had not previously been considered. The outcome remained that estimated turnover was above the VAT threshold and that turnover had been understated.

12. During interviews the Appellant estimated that she would use one and a half tubes of colour (60 ml) to perform a full head colour for a customer with black hair, and possibly two tubes on a customer with grey hair. This was contrary to what HM Revenue & Customs had been advised by training colleges/schools and experienced hairdressers in the trade (ten years or more experience). They advised that a half to one tube would be needed for a full head colouring. With regard to shampoo usage, the Appellant said that she was unable to provide an estimate of the amount of shampoo used per customer. However information provided by training colleges indicated that 20 to 25 ml of shampoo would be ample.

13. For 2009-10 HMRC calculated an estimated turnover (excluding dry cuts) using the following method:

Recorded number of colours purchased was 1507, and if two colour tubes were used per hairdo then $753 \times \text{£}35$ per hairdo produced a turnover of $\text{£}26,355$.

5 Recorded amount of shampoo purchased was 125,500 ml, which at 25 ml usage per customer produced 5020 customers. After allowing for a deduction of 753 (to avoid double counting) the total turnover for shampoo hairdos at $\text{£}9.99$ each was, $4267 \times \text{£}9.99 = \text{£}42,628$. The total was therefore $\text{£}68,983$.

10 14. HMRC's calculations indicated that the VAT threshold had been breached in the years under review (the threshold from 1 May 2009 was $\text{£}68,000$ and from 1 April 2010 was $\text{£}70,000$). HMRC said that their figures were a minimum, and had been calculated from what the Appellant told them regarding quantities of colours used (i.e. one and a half to two 60 ml tubes per full head). If they take into account what they had been told by colleges, training schools and experienced hairdressers about the
15 amount of colour that would normally be used (half to one full 60 ml tube per 'hairdo') then estimated sales would increase dramatically.

15 15. HMRC estimated the Appellant's turnover during the years 2009-10 and 2010-11, saying that their figures were a minimum because they did not take into account any sales derived from dry cuts which according to the Appellant was the most
20 popular sale in the salon. The records showed that amount of sales for dry cuts represented 15.15% of total sales, which meant that 84.85% of sales were for colours and shampoo hairdos. Applying this to HMRC's earlier calculations, the Appellant's total revised estimated turnover was:

25 2009-10 - $\text{£}68,983 =$ estimated sales based on using a 120 ml colour (two 60 ml tubes) & 25 ml of shampoo per hairdo. Therefore $\text{£}68,983 \div 84.85 \times 100 =$ estimated sales for the year of $\text{£}81,299$.

2010-11 - $\text{£}85,365 =$ estimated sales based on using 120 ml colour (two 60 ml tubes) & 25 ml of shampoo per hairdo. Therefore $\text{£}85,365 \div 84.85 \times 100 =$ estimated sales for the year of $\text{£}100,606$.

30 16. In March 2011 when HMRC visited the Appellant, stock levels in the salon were far lower than the value that has been included in annual accounts previously. The Appellant said that this was due to using up stock on hand and being unable to replenish it due to the recession and problems with cash flow. HMRC pointed out that
35 if this had happened, then estimated turnover in their calculations would be higher still, to take into account stock used that was on hand at the beginning of the accounting year.

17. In addition to using the 'mark-up' method HMRC also examined the Appellant's appointment records to calculate the estimated number of customers per year. Taking into account the amount of colour purchased and the Appellant's
40 assertion that 120 ml (two 60 ml tubes) of colour was used per hairdo, this indicated sales of 13-14 hairdos per week in year 2010-11 and 14-15 full heads per week in year

2009-10. However, having taken at random one week of the Appellant's appointment diary, (week ending 12 March 2011), HMRC identified sales using colours of 30 for the week, which was more in line with usage of 60 ml (one tube) or less for each colour hairdo. The week analysed appeared similar to other weeks in the diary.

5 18. HMRC then carried out an exercise to determine how much colour would be needed based on the declared colour hairdos input through the Appellant's till. This could only be performed on the details from year 2010-11 as all 'Z' readings were not made available for year 2009-10 and although the majority were available from years 2006-07 and 2007-08, any result would be affected by missing invoices from the
10 supplier.

19. The total value of recorded 'colour' sales in 2010-11 was £39,287 based on declared colour hairdos input through the till. The total customers for these sales was 1,205 (average sale was £32.60 per customer). If, as the Appellant said, two tubes or 120 ml was used for a hairdo, then 120 ml x 1,205 customers = 144,600 mls of
15 colours was needed for hairdos in the year 2010-11, whereas invoices and records showed that the Appellant purchased only 84,840 mls of colour. This indicated that less colour was used in hairdos than had been stated. The conclusion was that this supported the estimated turnover as calculated using the marking up of purchases. Alternatively, there were missing purchases of colour tubes, which would inflate
20 estimated turnover when included.

20. HMRC acknowledged that they had not made any allowance for wastage but said that its calculations did not include all types of hairdo, including any perms which were more expensive. The figures showed that turnover for the Appellant's business was higher than had been declared. This was the case even when HMRC
25 based its calculations on information given by the Appellant. If they were to assume usage levels of shampoo and colour based on advice from the training colleges and hairdressing schools and other experienced hairdressers then the estimated turnover would be even higher.

21. HMRC concluded that in 2009-10 the Appellant's declared turnover of £68,225
30 should be uplifted to £81,299 and that in 2010-11, the declared turnover of £73,632 should be uplifted to £100,606, which equated to a 28.23% uplift. Applying that uplift to earlier years resulted in the figures shown in the table below.

Year		Declared	Uplifted	Per month
05/06	1 July 2005 to 31 March 2006	£45,751	£58,666	£6,518
06/07	1 April 2006 to 31 March 2007	£54,923	£70,427	£5,868
07/08	1 April 2007 to 31 March 2008	£63,473	£81,391	£6,782
08/09	1 April 2008 to 31 March 2009	£63,049	£80,847	£6,737
09/10	1 April 2009 to 31 March 2010	£68,225	£81,299	£6,774

10/11	1 April 2010 to 31 March 2011	£73,632	£100,606	£8,383
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As the figures for 2005-06 only related to a nine month period (1 July 2005 to 31 March 2006) i.e. £58,666, then for a full year the figure was calculated to be £64,534. The VAT threshold as at 30 April 2006 was £61,000 and the Appellant's turnover exceeded that figure. Accordingly, the VAT start date was 1 June 2006.

22. The Appellant's accountants accepted that the Appellant should have been registered for VAT. They acknowledged that the business' records showed turnover rose significantly in 2009-10 and that the threshold was reached in March 2010. They therefore maintain that registration should have been effective from 1 May 2010. They say that turnover continued to increase until July 2011 when it fell significantly and that this fall was reflected in a decrease in wages as shown in draft financial statements for 2011-12 which supported the Appellant's application for deregistration from 31 October 2011.

23. HMRC said that the Appellant appeared to use on average more than one 60 ml tube per colour hairdo and their calculations (as below) showed that the average usage per head was 68.4 ml in year 2009-10 and 63.5 ml in year 2010-11.

2009-10 1,503 tubes x 60 ml = 90,180 ml / 1,319 customers = 68.36 ml per head

2010-11 1,414 tubes x 60 ml = 84,840 ml / 1,336 customers = 63.5 ml per head

However, although training colleges had advised that less than 60 ml of colour would be used, HMRC's calculations had allowed for the maximum that the Appellant suggested may be used - two tubes or 120 ml per head, even though this would not be the amount used in every hairdo.

24. With regard to shampoo usage, colleges and hairdressing schools advised HMRC that if a cheaper shampoo is used to wash hair then only slightly more would be needed for each wash than that used with a 'normal shampoo'. HMRC were told that 20 ml of shampoo would be ample for a normal wash, usually consisting of two washes of client's hair (four squirts from a dispenser, two for each wash). This was demonstrated and measured by the colleges/schools with results of 20 ml to a maximum of 25 ml being used. HMRC accepted that there could be some wastage, but the expectation was that this would be minimal. A salon owner would keep a check on the amount of shampoo being used by juniors and new staff. The Appellant suggested that she uses 35 ml, which represented a 40% increase on the maximum training colleges and other hairdressers suggested. In any event the accountant's own calculations showed 28 ml of shampoo was per hairdo.

25. HMRC say that in making over-allowances of usage of shampoo and colours, they have effectively allowed for any wastage. Even allowing for wastage of, say 2% on consumables to reflect own use, the estimated turnover would still be in excess of the threshold to require registration on 1 June 2006. The Officer conducting the

enquiry had used minimum monetary values throughout his calculations and has not included sales of perms, which were more expensive, colourings, foils and highlights.

26. The accountant's suggestion that there are missing invoices in 2009-10 only accentuated the discrepancy, as it increased the usage of shampoo and the gross profit rate to similar levels as year 2010-11.

27. The accountants had argued that the Appellant uses shampoo on all clients, but HMRC say that could not be true because the diary that HMRC viewed actually noted that the salon had performed 'dry cuts' and also kids cuts, which one had to assume would also be a dry cut. HMRC said that they could not accept that a unisex salon did not perform any dry cuts.

28. The Appellant's accountants also said that the Appellant may use one and a half (60 ml) tubes of colour for a customer with black hair and possibly two tubes on a customer with grey hair. On average, they said that she uses over one tube per colour and that this appeared to tie in with their research of articles on the internet. Accordingly so far as colour usage was concerned, they were not disputing HMRC's calculations. In fact to assume the colour usage figures which the accountants say are correct would result in an increase in the estimate of turnover.

29. With regard to shampoo use however, the Appellant's accountants said that HMRC had not taken into account the Appellant's assertion that she purchases a cheaper shampoo and uses considerably more than normal. The cheaper shampoo and less-skilled operatives accounted for a higher usage of shampoo. The accountants argued that the figures calculated by HMRC were thus over-stated.

30. The accountants said that their calculations for 2010-11 and 2011-12 indicated a shampoo usage of 35 ml per customer and that this demonstrated that in all probability, in 2009-10, there was a possibility of unrecorded shampoo purchases. May 2009 in particular showed no purchases in the month at all. If an allowance was made for only 25,000 ml of shampoo invoices not recorded, 2009-10 would achieve the same usage as in 2011 and in 2012.

31. The Appellant's accountants also argued that the average sale price adopted by HMRC was higher than the actual sale price. In support of their argument, they referred to the 'Z' readings for 2009-10, which showed that the total number of hairdo's requiring colour was 1,319. Total colours purchased were 1,503, which equated to 1.14 average usages. They added up the total amount of sales inputted through the till and calculated the average sale price per hairdo. The average colour sale was £31 rather than £35 as had been estimated by HMRC and the average shampoo sale was £8.52 rather than £9.99.

32. They submit that a salon which makes few purchases and charges relatively high prices will achieve a considerably higher gross profit rate. However, in salons where the pricing policy is highly competitive, the gross profit rate will fall below the average. A gross profit median rate for Standard Industrial Classification (2007)

category 96020 (hairdressing and other beauty treatment) was 77.8%. The Appellant was in the lower end of the market and in a highly competitive area.

5 33. HMRC responded that an analysis of the trade suggested that the cost of goods/purchase figures in the Appellant's accounts year on year were particularly high for a business of its size, as indicated by its returned yearly profit figures. The gross profit rate of similar sized salons in the Blackpool area was 88% to 93%. The result of a business economic exercise is dependent on what levels of products (shampoo, colours, and other consumables) are purchased and a low gross profit rate or markup would be an indicator that there may be a problem with the level of sales
10 declared.

Relevant legislation

34. Relevant legislation is contained in VAT Act 1994: Section 73

'73 Failure to make returns

15 (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 judgment and notify it to him.

20 (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
25 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.

(8) In any case where -
(a) as a result of a person's failure to make a return for a prescribed
30 accounting period, the Commissioners have made an assessment under subsection (1) above for that period,
(b) the VAT assessed has been paid but no proper return has been made for the period to which the assessment related, and
(c) as a result of a failure to make a return for a later prescribed accounting
35 period, being a failure by a person referred to in paragraph (a) above or a person acting in a representative capacity in relation to him, as mentioned in subsection (5) above, the Commissioners find it necessary to make another assessment under subsection (1) above,
Then, if the Commissioners think fit, having regard to the failure referred to in
40 paragraph (a) above, they may specify in the assessment referred to in paragraph (c)

above an amount of VAT greater than that which they would otherwise have considered to be appropriate.’

Conclusion

5 35. When the quantity of colours and shampoo purchased are analysed using the
business economics exercise, the calculations clearly show that there should be higher
sales than have been declared. As HMRC say, the amount of shampoo and colours per
hairdo was based on the Appellant’s own estimates given in interview. They factored
10 in sales for dry cuts which had not previously been considered. The result was that
estimated turnover was above the VAT threshold and that turnover had been
understated. It is also apparent that the Appellant’s figures and gross profit margins in
respect of the years under review do not compare to similar sized salons in the same
area as the Appellant’s business.

15 36. The Appellant’s appointment records identified sales using colours of thirty for
the week, which was more in line with usage of 60 ml (one tube) or less for each
colour hairdo. However, HMRC have based their calculations on the Appellant’s
assertion that 120 ml (two 60 ml tubes) of colour were used per hairdo, so that
HMRC’s estimate may actually be lower than it should be.

20 37. The accountants do not argue that HMRC’s calculations based on the quantity
of colours used are incorrect, and no evidence has been provided to show that
HMRC’s calculations based on shampoo usage is incorrect. The Appellant’s
accountant’s calculations are based on figures from till rolls and assume that every
sale has been rung into the till and has been rung through correctly.

25 38. In our view, on the information and material available, HMRC have correctly
determined that the amount of stock purchased by the Appellant does not correlate to
recorded sales or turnover. The assessment to VAT is in our view appropriate, and
therefore the burden falls on the Appellant to show that the assessments are incorrect.
There is nothing to suggest that the assessments are defective. The decision maker has
30 arrived at an outcome using best judgment which has produced a result that is fair and
reasonable

39. For the above reasons we find that the decision to register the Appellant for
VAT with effect from 1 June 2006 should be upheld.

35 40. 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 S CONNELL
TRIBUNAL JUDGE**

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