



[2019] UKFTT 0663 (TC)

TC07438

VAT – section 73 of Value Added Tax Act 1994 – whether assessment to best judgment – whether the quantum of the assessment to be varied – Tribunal’s appellate jurisdiction in relation to quantum under section 83 – Van Boeckel, Rahman and Mithras – methodology in quantifying shortfall – evaluation of evidence as alternative basis of assessment – whether duplication relevant – appeal allowed in part

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2016/05899

BETWEEN

EURO SYSTEMS (SCOTLAND) LTD

Appellant

-and-

**THE COMMISSIONERS FOR
HER MAJESTY’S REVENUE AND CUSTOMS**

Respondents

**TRIBUNAL: JUDGE HEIDI POON
JAMES ROBERTSON**

Sitting in public at George House, Edinburgh on 25, 26, and 27 March 2019

David Small QC, instructed by RSM Tax and Accounting Limited, for the Appellant

Mark Boyle, litigator of HM Revenue and Customs’ Solicitor’s Office, for the Respondents

DECISION

INTRODUCTION

1. Euro Systems (Scotland) Limited ('the appellant' or ESL) appeals against the VAT assessment raised by the respondents ('HMRC') under section 73 of the Value Added Tax Act 1994 ('VATA') in the sum of £296,689, which is the combined total of input VAT claimed being disallowed, and additional output VAT being assessed.

2. Following the Alternative Dispute Resolution ('ADR') meeting on 24 August 2017, the appellant no longer contests against the liability of £206,074. The balance of the assessment which remains in dispute amounts to £90,615, and concerns the following matters:

- (1) input VAT difference of £20,171 – the 'Input Tax' issue';
- (2) output VAT difference of £19,922 – the 'Turnover' issue';
- (3) balance-sheet difference of £50,522 – the 'Balance Sheet' issue.

EVIDENCE

3. A 'Joint Minute of Agreement' signed on 25 March 2019 by the parties' representatives was lodged for the purpose of the appeal. Parties also filed two big bundles: one for correspondence, and one for the related documents and accounting schedules. The agreed facts, together with the documents bundle of circa 1,200 pages, so far as they are relevant to the remaining issues under appeal, are incorporated into the findings of fact.

4. We heard the evidence from three witnesses, who have each lodged a witness statement, and were cross-examined in the order of:

- (1) Mr Eddie Robertson, Managing Director and founder of the appellant;
- (2) Mr Michael Hayes, chartered accountant, and the Group Finance Director of NCS Office Holdings Limited ('NCS'), which acquired the appellant company;
- (3) Mr William O'Pray, a Higher Officer of HMRC in the ISBC Complex and Agents team, who led the VAT enquiry that resulted in the assessment.

5. We have no issue as to the credibility of Mr Hayes and Mr O'Pray. We accept aspects of their evidence without qualification insofar as they pertain to matters of fact, which we distinguish from those aspects of their evidence pertaining to their opinions or interpretations of the relevant primary facts. We have reservations as regards Mr Robertson's evidence, which we relate in the discussion part of this Decision.

RELEVANT LEGISLATION

6. The provisions relevant to this appeal are under VATA, of which:

- (1) Section 24 sets out the conditions for the recovery of input VAT by a taxable person in relation to the goods or services used or to be used in the making of the taxable supplies. It also provides for output tax to be charged on the value of the taxable supplies.
- (2) Section 25 provides for the payment of VAT by reference to accounting periods and for the credit arising from input tax to be set against output tax.
- (3) Section 26 determines the input tax allowable for offset against output tax liability.
- (4) Section 73 provides HMRC with the powers to raise an assessment where HMRC consider that there is under-declaration of output VAT in a submitted VAT return, or to

disallow a claim for input tax or VAT repayment that is considered not to be due. Sub-section 73(1) states as follows:

‘Where a person has failed to make any returns required under 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.’

- (5) Section 74 provides for default interest to be charged on an assessment.
- (6) Section 76 sets out the conditions for assessment of amounts due by way of penalty, interest or surcharge.
- (7) Section 77 provides for the time limits for a s 73 assessment and supplementary assessments to be issued for up to 4 years prior to the date of the assessment.
- (8) Section 83 sets out a series of actions, decisions, and other matters arising under VATA in respect of which there is a right of appeal. The current appeal is brought under paragraph (p) of section 83, which provides the right of appeal as follows:

‘... (p) an assessment – (i) under section 73(1) or (2) in respect of a period for which the appellant has made a return under this Act ... or the amount of such an assessment ...’

7. In respect of the statutory requirements for record keeping, HMRC refer to the following provisions under the VAT Regulations 1995 (‘the 1995 Regulations’) and Companies Act 2006 (‘CA 2006’).

- (1) Regulation 13 states that a taxable person is required to provide another taxable person with a VAT invoice when they have made a supply.
- (2) Regulation 29 states that evidence is required to support a claim for input tax.
- (3) Regulation 31 states that a taxable person is required to keep specific records in order to account for VAT.
- (4) Section 386 CA 2006 states that a company has a duty to keep adequate accounting records which explain the company transactions and the financial position of the company at the time.
- (5) Section 388 CA 2006 indicates that a company must keep and preserve its records for a period of six years from the end of the period for which a tax return may be required.

THE FACTS

Background

8. The appellant was founded by Mr Robertson in 2009. As a graduate of Computer Science, Mr Robertson was able to identify ‘a gap in the market’ by selling IT systems to small businesses to include a ‘wrap around maintenance service’. At the start of ESL, Mr Robertson was the only shareholder, and the business model was to sell IT equipment to small businesses on finance packages, which allowed ESL to add on ongoing maintenance and support.

9. ESL was registered for VAT from 7 September 2009, and all its turnover (excepting a small amount of income from Hewlett Packard) was subject to VAT at the standard rate. The company’s accounting period end (‘APE’) is 30 June.

A previous VAT check in 2013 resulting in a Notice of Direction

10. On 30 April 2013, a VAT compliance visit took place in relation to the repayment claim made in the VAT return for period quarter 03/13, which amounted to £28,571.04. Prior to the visit, ESL was informed that the check of records would cover periods dating from 06/11.

11. On 1 May 2013, Officer Hight wrote to inform ESL of the outcome of his check into 03/13, which allowed the VAT credit claim of £28,545.08 for 03/13 after adjusting for an error:

‘VAT was claimed on “flights” £14 and “amended flights” £11.96. There is no VAT on passenger transport.’

12. On 1 May 2013, HMRC wrote to request further information in relation to the VAT return calculations for the periods from 06/11 to 09/12. The information requested included detailed listing of sale and purchase invoices, reconciliation of the figures stated in the VAT returns with those in the financial accounts, and a further VAT visit was arranged for 29 May 2013.

13. HMRC’s attempts to audit the business became protracted following the two VAT visits. On 14 February 2014, Officer Hight issued a Notice of Direction in the following terms:

‘... I am concerned that ... some basic information is not retained by the company to allow it to monitor the profitability of a contract. Without this information how could you determine your profit or loss per contract, and also put up a business case to lenders when buying further capital equipment?’

... Given that the business has been trading for more than 4 years we would have expected that at least some of the VAT returns would show either a VAT payment due, or at least the income declared would continue to rise as new contracts are won. That pattern has not occurred.’

14. The Notice of Direction made reference to the statutory requirement to maintain supporting documents under para 6 of Sch 11 to VATA. The Notice of Direction specified the records to be maintained by the appellant going forward:

- (1) a VAT account detailing sales and purchases declared on return;
- (2) accounts for each customer with details of the sales made;
- (3) cash flow records to evidence the movements of funds.

It was advised that repayments of VAT would be made on a ‘without prejudice’ basis pending full review of these records, and that the failure to maintain the records notified could result in the input tax being disallowed and potentially a penalty.

Corporate restructuring of ESL

15. In April 2014, ESL purchased an IT services company, 2Ci Ltd (‘2Ci’). The acquisition provided ESL ‘the needed resources and revenue to break into the maintenance only market’, which is where ESL now operates primarily. The acquisition brought with it a portfolio of key customers for maintenance services, technical professionals, additional support staff, and a change in the scale of operation, which was reflected by ESL’s move of premises, from its 500sqm warehouse premises to a purpose-built 5000sqm office space.

16. According to Mr Robertson, a number of ‘experienced technical professionals and back-office systems joined the operation of ESL’; all invoicing of 2Ci’s customers was ‘immediately’ carried out by ESL post-acquisition; 2Ci’s customers were imported into ESL’s for credit control, and most 2Ci customers were moved to Direct Debit for payment collection.

17. In November 2014, NCS bought 65% of ESL. In the space of eight months, ESL bought one company 2Ci, and the new entity amalgamating 2Ci was in turn bought by NCS.

18. In February 2015, ESL acquired Acumen IT Consultancy Limited ('Acumen').

19. On 22 October 2015, the appellant made an application to form a VAT group with ESL, 2Ci and Acumen as members. At the time the VAT grouping application was filed, the structure of the group of companies involving ESL was the following:

- (1) ESL was 65% owned by NCS, and 35% by Mr Robertson;
- (2) ESL wholly owned 2Ci and Acumen.

The VAT enquiry in 2016

20. Following the formation of the VAT group, a VAT visit on 5 and 6 January 2016 was carried out by Officer O'Pray to check ESL's VAT records for:

- (1) the year ending 30 June 2014 ('APE 2014'), and extended to cover
- (2) the accounting year ending 30 June 2013 ('APE 2013'), and
- (3) a shorter accounting period ending 28 February 2015 ('APE 2015').

21. The input and output tax declared by ESL for APEs 2013 and 2014 that remain in dispute are summarised as follows. Except for the return period 03/13, where the input tax was reduced to £49,531 (to disallow the input tax on flights by Officer Highet), and the corresponding repayment was reduced to £28,545, the tabulated figures are those as stated on the VAT returns submitted, and remained unaltered as at Officer O'Pray's visit in January 2016.

Period	Output	Input	Payment/(Repayment)
APE 2013	£	£	£
09/12	23,250	49,878	(26,628)
12/12	24,026	54,045	(30,019)
03/13	20,986	49,557	(28,571)
Adjusted to		49,531	see §11 above (28,545)
06/13	32,699	60,265	(27,566)
APE 2014	£	£	£
09/13	35,748	58,811	(23,063)
12/13	35,978	38,171	(2,193)
03/14	46,485	50,091	(3,605)
06/14	47,337	41,382	5,954

22. On 8 January 2016, Officer O'Pray wrote a 5-page letter summarising the issues he had identified during his visit, and requested further information and a reply to his questions. Some of the issues raised do not concern this appeal, but the substance of the issues under appeal first set out in this letter remains the core basis for the subsequent s 73 assessment raised. Aspects of the 8 January 2016 letter relevant to this appeal are summarised below under the headings of the issues that remain in dispute.

The Input Tax issue

23. Officer O'Pray carried out a comparison of the figures for input tax on the VAT returns against the input VAT that would have been borne based on the total expenses as stated in the annual accounts. The methodology is illustrated with reference to the figures for the APE 2013.

- (1) Input tax claimed per VAT returns for periods 09/12 to 06/13 totalled £213,720.79.
- (2) The total for the four quarters' returns was grossed up (ie multiplied by 5) to arrive at the value of total purchases (net of VAT) falling in APE 2013, this being **£1,068,603**.
- (3) The list of expenses from the annual accounts which would have borne input VAT were totalled up to estimate the total net value of purchases corresponding to the VAT periods, and this amounted to **£319,176** only.
- (4) The value of net purchases from the VAT return periods of £1,068,603 was compared with the annual total as stated in the accounts of £319,176.
- (5) The difference of **£749,427** at the VAT rate of 20% represents the potential amount of input tax that was overstated in the VAT returns.

24. The same calculation was carried out in relation to APE 2014 with the result being:

- (1) Input tax claimed per VAT returns for periods 09/13 to 06/14 totalled £188,456.95.
- (2) Grossing up the input VAT gave the total value of net purchases of **£942,284**.
- (3) Total expenses with input tax borne per annual accounts equalled **£560,462**.
- (4) The difference of **£381,822** at 20% represents potential overstatement of input tax in the VAT returns.

25. The pattern of input VAT being overstated when compared to the annual accounts continued into the shorter accounting period ending 28 February 2015. (The change of the accounting period end coincided with ESL becoming a group company of NCS consequent to the November 2014 sale to NCS.) An equivalent comparison delivered the following results:

- (1) Input VAT claimed in periods 09/14 and 12/14 plus the two months of January and February 2015 (by averaging the quarter) totalled £166,363.78.
- (2) Grossing up the input tax total, the net value of purchases was £826,818.
- (3) From the annual accounts, the net total of relevant expenses having borne input VAT was £592,029.
- (4) The difference of £234,789 at 20% (namely £46,957) represented potential input VAT being overstated.

26. As Mr Hayes stated in the witness statement, the VAT periods 'initially assessed by HMRC were 09/12 to 03/15'. He continued by stating:

'However, the period to 03/15 which included the VAT quarters ending 30 September 2014, 31 December 2014 and 31 March 2015 was settled at an earlier date.'

The particulars in relation to the settlement of the amount of £46,957 originally assessed for APE 2015 were not covered in the evidence, as no remaining issues are extant from APE 2015.

The Turnover issue

27. To check the completeness and accuracy of the output VAT declared, similar reconciliation calculations were carried out by Officer O'Pray. While the turnover figures for APE 2013 and APE 2015 did reconcile to the combined total for 'Net Sales' from the VAT returns for the corresponding periods, there was a difference in relation to APE 2014.

28. The relevant figures for the Turnover issue in relation to APE 2014 are as follows.

- (1) the annual accounts stated turnover at £933,143;
- (2) the total value of 'Net Sales' from the corresponding VAT returns 09/13 to 06/14 was £833,521;
- (3) the difference of £99,622 at 20% represents the output tax potentially under-stated.

The Balance Sheet issue

29. The balance sheet differences noted in Officer O'Pray's letter of 8 January 2016 concern:

- (1) APE 2013 – annual accounts stated VAT creditor of £38,032, compared with VAT repayable (a debtor) of £27,566 per VAT return filed for 06/13;
- (2) APE June 2014 – annual accounts stated VAT creditor of £55,624, compared with VAT payable (a creditor) of £5,954 per VAT return filed for 06/14.
- (3) APE February 2015, VAT debtor/ creditor not shown separately on the accounts and a note of the period end balance was requested.

The VAT assessments

30. The differences identified by Officer O'Pray in his 8 January 2016 letter formed the basis of the VAT assessments in the total sum of £296,689, which was set out in his letter of 14 July 2016. The overall assessment has the following components.

- (1) Input VAT issue – the unexplained difference of net value of purchases for each APE was quantified as the purchases on which input VAT had been overstated. The input VAT disallowed for each period was quantified as follows:
 - (a) APE 2103 – difference of £749,427 at 20% equal to **£149,885** input VAT disallowed;
 - (b) APE 2014 – difference of £381,822 at 20% equal to **£76,364** input VAT disallowed;
 - (c) the total input VAT disallowed for each APE was apportioned to the four corresponding VAT return periods by applying a relevant fraction;
 - (d) for example, the fraction applied to the VAT period 06/13 has the numerator as the input tax declared for 06/13, over the denominator as the aggregate of all input tax that had been declared for the four quarters 09/12 to 06/13;
 - (e) APE 2015 – the difference of £234,789 was assessed to input tax disallowed of £46,957, and was separately settled (see §26).
- (2) Turnover issue – the unexplained difference arising in APE 2014 of £99,622 was assessed to output VAT at 20%, equating to £19,924. The total was then apportioned to the four quarters falling in APE 2014 by applying the relevant fractions, and rounded down to arrive at the overall assessed total of **£19,922**.
- (3) Balance Sheet issue – the differences were assessed to VAT arrears as follows.

- (a) APE 2013 – the year-end VAT creditor of £38,032 was compared to the VAT repayable balance of £27,566 for return period 06/13, which gave rise to an overall difference of £65,598.
- (b) Adjustment was made to the £65,598 overall difference by reducing it by the allocated amount of input VAT disallowed for 06/13 of £42,265 to reach the VAT arrears assessed of **£23,333**.
- (c) APE 2014 – the year-end VAT creditor of £55,624 was compared to the VAT payable balance of £5,954, which gave rise to a net difference of £49,670.
- (d) Adjustments to the net difference of £49,670 were made by offsetting against the input VAT disallowed (by apportionment) for period 06/14 of £16,768 and the amount of additional output VAT assessed (by apportionment) for period 06/14 of £5,713.
- (e) The net sum of **£27,189**, being £49,670 less £16,768 (disallowed input) less £5,713 (additional output), was assessed for APE 2014.

31. The basis of assessment as set out in Officer O’Pray’s letter of July 2016 delivered an overall total of £296,689 and the allocation to each of the three issues are as follows.

- (1) Input VAT issue – an overall assessment of £226,249, of which **£20,171** remains in dispute; the balance of £206,078 is no longer in dispute; and the liability of £206,074 (due to rounding) has been accepted and settled;
- (2) Turnover issue – **£19,922**, and the whole sum remains in dispute;
- (3) Balance sheet issue – **£50,522** and the whole sum remains in dispute.

32. Included in the bundle is Officer O’Pray’s letter dated 27 April 2016, which preceded the letter of July 2016 by setting out for the first time the basis of the assessment that he intended to raise. For completeness, we note two aspects of this earlier letter when compared with the letter of 14 July 2016.

- (1) In relation to the Input Tax issue, the sum of £46,957 was assessed for APE 2015 and included in the 27 April 2016 letter. This sum was subsequently ‘settled at an earlier time’, and was therefore not included in Mr O’Pray letter of 14 July 2016.
- (2) In relation to the Balance Sheet issue, Mr O’Pray did not reduce the supposed VAT shortfall by the amount of the disallowed input apportioned to the quarter period of 06/13 and 06/14, which he subsequently did in his July 2016 letter.

33. On 3 August 2016, HMRC issued VAT assessments allocated to the relevant return periods in the total sum of **£296,689**, having considered the information provided by ESL subsequent to the letter of 14 July 2016.

Review conclusion and ADR

34. On 18 August 2016, ESL requested a review, stating its contention that only £129,227 of the £149,883 input tax for 2013, and £61,874 of the £76,362 input tax for 2014 should be disallowed. It also indicated its disagreement to the assessment in relation to additional output tax and the balance sheet differences.

35. On 29 September 2016, HMRC issued the review decision, which upheld the assessment of 3 August 2016 in full.

36. On 28 October 2016, ESL lodged an appeal with the Tribunal.

37. On 19 December 2016, ESL applied for the ADR process which was accepted by HMRC. A meeting took place on 24 August 2017 under the ADR procedure, and the process formally ended in February 2018 without achieving a resolution.

38. Parties agreed to refer the remaining issues in dispute, being those under the present appeal, together with an assessment to Deliberate Penalty, to be referred to independent HMRC specialists who had no connection with the dispute. On 5 March 2018, HMRC wrote to the appellant with the responses from the independent HMRC specialists as summarised below.

(1) HMRC issued VAT assessments totalling £341,386 based on information presented in ESL's 2013 and 2014 financial statements and its VAT submissions. ESL has accepted £250,771 of the assessments. (The figures stated in this letter would appear to include interest or surcharges, as they are higher than the basic total of £296,689 related earlier.)

(2) It confirmed the quantum of the assessment that remains in dispute to be £90,615, which relates to the issues of Input Tax, Output Tax and Balance sheet differences.

(3) The penalty assessment would be amended from 'Deliberate' to 'Careless', and proposed suspension conditions for the penalty assessment were set out in an accompanying letter for acceptance by the appellant.

Mr Robertson's evidence

39. Mr Robertson's evidence concerned mainly the accounting records and system being maintained to perform the accounting functions in ESL. He stressed the fact that ESL's business has grown steadily over the years, as indicated by its staff of four in 2010, to seven in 2013, to twenty-six in 2019.

40. With reference to the concern raised by Officer Highet in the Notice of Direction issued on 14 February 2014, the question was put to Mr Robertson by the Tribunal why he thought his business should have been continuing in a VAT repayment situation if the business was growing steadily, and making profits as per the annual accounts. Mr Robertson's response was to say that 'the key indicator of success' of the business was 'the cash in the bank, plus debtors less creditors'. In other words, the VAT repayment position was of no account as an indicator.

In-house operation

41. Speaking of ESL's internal system, Mr Robertson stated that between 2012 and 2014, all general book-keeping, office administration, and purchasing was carried out by ESL's receptionist, a Ms Simpson, who has no formal qualifications and was paid £16,000 per annum.

42. According to Mr Robertson, he was often working in excess of 15 hours per day, selling to customers during normal business hours, and carrying out server and remote work on systems in the evenings. Due to budget constraints, the accounting system operating in ESL prior to the acquisition of 2Ci was described as follows:

(1) ESL used a mixture of spreadsheets and Sage for invoicing and managing debtors and creditors.

(2) Ms Simpson managed all back-office functions and was unsupervised. VAT returns were prepared either by Ms Simpson or Mr Robertson, using Sage, and filed online. The returns were not checked by anyone else before they were filed.

(3) Mr Robertson stated that: 'I have no qualification or training in accountancy. Being involved in IT I am familiar with the general function of Sage.'

43. In relation to the preparation and submission of the VAT returns, at paragraph 21 of his witness statement, Mr Robertson stated:

‘The VAT returns were submitted electronically using the HMRC e-service. These were sometimes produced by me, sometimes by [Ms Simpson]. The figures were produced by using the inbuilt Sage calculations and reports –there was no manual process, verification or checking of the information. I would then log onto HMRC online system and submit the returns. We did not use the accounting system to submit the returns electronically.’

Services provided by external accountants

44. Mr Robertson said that the information used to generate the VAT returns was the same as that provided to a firm of chartered accountants (henceforth ‘B&C’) to prepare the annual accounts for ESL. His witness statement stated that:

‘[B&C] are a small firm, employing around 10 staff. They charged between £1300 and £1500 for the preparation of the accounts, filing at Companies House, and carrying out all other statutory obligations and corporation tax computation and return. Accounts were produced based on the paperwork provided and the information from ESS’s accounting system. [B&C] did not carry out any verification of the VAT returns and they were not provided with any management account (we did not produce any).’

45. B&C did not carry out any verification of the VAT return, though they requested sample purchase and sale invoices. There was no meeting to discuss the annual accounts, which were sent by post to ESL with a note of any corporation tax due.

46. A copy of the letter of engagement from B&C was lodged, and the following aspects are highlighted to the Tribunal:

‘As director of [ESL] ... you are responsible for ensuring that, to the best of your knowledge and belief, financial information, whether used by the company or for the accounts, is reliable.

[...]

Our work as the compilers of the annual accounts will not be an audit of the accounts in accordance with Auditing Standards. Consequently our work will not provide any assurance that the accounting records or the accounts are free from material misstatement, whether caused by fraud, other irregularities or error.’

47. B&C furnished the draft annual accounts some 8 months after the financial year end. For example, the draft accounts were provided on 18 February 2013 (for APE 30 June 2012), on 17 February 2014 (for APE 2013), and on 20 February 2015 (for APE 2014). In evidence, Mr Robertson also stated that he thought B&C had produced the VAT creditor balances.

48. After being bought by NCS, ESL changed its accountants to RSM, the accountants for the group. Mr Robertson stated: ‘This change, compounded with the fact that [B&C] were not involved with the sale of the company to NCS’ caused a ‘breakdown’ in relationship.

‘Working with a small firm, the owner, in his sixties, seemed to take the disengagement personally. At the same time of RSM being appointed, our primary contact, Mr B, suffered a heart attack and now spends limited time in the office. ...’

Consequently, Mr Robertson stated that he had made several attempts to obtain further information of how B&C produced the annual accounts without success.

Corruption to data held on Sage

49. Of the data corruption affecting ESL's Sage accounting system, Mr Robertson stated:

‘We had several corruptions within the Sage system, which Officer O’Pray saw first hand at his visit. He received a written report from Sage. This resulted in the inability to produce detailed automated reports from the accounting system.’

50. Mr Robertson stated: ‘This loss of data prevents us from being able to produce historic reports and detailed transactional lists’, and that:

- (1) All data before November 2015 has been affected;
- (2) High-level information is available but detailed information is not available;
- (3) ESL could not answer HMRC's queries by interrogating ESL's system.

Manual listing to reconstruct input tax total on purchases

51. In August 2017, Mr Robertson, Mr Hayes and RSM representatives, attended an ADR meeting with HMRC to resolve the remaining issues. For the meeting, Mr Robertson had listed all purchase invoices with input VAT in the period from 1 July 2012 to 30 June 2014. This was a manual process by reviewing every purchase invoice, which had been scanned and cross-referenced against bank statements. The task was carried out by the accounts team and supervised by Mr Robertson.

52. The manual listing of the purchase invoices shows input tax incurred in the 24-month period to be £196,104.

Mr Hayes' evidence

53. Mr Hayes is a chartered accountant, and he qualified with a BigFour firm before joining NCS over 20 years ago, and is now its Group Finance Director. While due diligence was carried out by NCS prior to the acquisition of ESL in November 2014, Mr Hayes stated that the due diligence exercise did not include a review of the VAT compliance of ESL.

54. It was in April 2016 (about three months after Officer O’Pray’s January visit) when Mr Hayes first became aware of the VAT queries raised by HMRC, since Mr Robertson had been dealing with the enquiry up to that point. Having reviewed the correspondence up to April 2016, Mr Hayes brought in RSM to assist in dealing with the VAT enquiry. Mr Hayes’ evidence focused on explaining the basis for asserting that the quantum of the VAT assessment is too high by the amounts in dispute.

On the Input VAT issue

55. Mr Hayes stated that on review ‘it became quickly evident that errors had been made in the completion and subsequent submission of the VAT returns’. The errors identified included keying errors (e.g. 5,000 keyed in as 50,000) and the inclusion of quotations as purchase invoices, thereby claiming the same input VAT twice. There were also ‘entries on the system for which [NCS group] could not trace any documentation’.

56. ESL had accepted that in the periods concerned, it had ‘inadvertently over claimed input tax to a significant extent’ (Mr Hayes’ words). The over-claimed input tax identified by ESL amounted to £129,227 for APE 2013 and £61,874 for APE 2014; a total of £191,101.

57. Prior to the ADR meeting, Mr Hayes understood that it was suggested on behalf of HMRC that if ESL could list all the input invoices for the periods this could break the impasse on the issue. ‘Rather reluctantly’, said Mr Hayes, ESL undertook the task of listing all the expense invoices with input VAT for the two-year period to 30 June 2014. The task of listing over 3,000 invoices had taken considerable amount of time, and was principally carried out by Mr Robertson. The total input VAT on the listed invoices was £196,104.12, and is ‘the amount of input tax which ESL believes it is entitled to deduct’ between 1 July 2012 to 30 June 2014.

58. Based on the listing of all invoices, the total input tax over claimed stood at £129,930 for APE 2013, and £76,143 for APE 2014. The combined total of £206,073 differs by £20,176 from the £226,249 assessed based on the annual accounts for the corresponding periods.

59. HMRC were given a copy of the invoice listing at the ADR meeting in August 2017, and again by RSM in November 2017. HMRC have not asked to examine any of the invoices.

60. Mr Hayes stated that the conclusions of RSM’s investigations, and detailed listing of invoices supported his contention that the financial statements for 2012, 2013 and 2014 could not be relied upon because:

(1) The costs bearing VAT are not there on the face of the accounts, separate from the costs which do not bear VAT. To get at the number they think is right, HMRC have had to make inference and assumptions. There is bound to be room for error.

(2) Even if HMRC were 100% accurate in what they have done, it is not unusual that small and particularly new and rapidly growing companies have errors in their financial statements, which are often completed just in time for the 9-month filing deadline.

(3) The accounts and the underlying records on which they are based may well contain errors like those we have found here. Unless a detailed review is undertaken or the company is audited there would be no mechanism to check that the figures are correct.

61. Mr Hayes referred to RSM’s letter dated 30 June 2016 to Officer O’Pray, which set out the details of the appellant’s contentions as regards the fairness of the financial statements. For example, in relation to the profit and loss account ending 30 June 2013, RSM stated:

‘[ESL] reported a gross profit of £286,177 in the year ending 2013. This gross profit is almost identical to the gross profit achieved in the year ending 2012, £288,872.

Our client would generally expect to achieve such a similar gross profit, if its turnover remained similar. However the turnover in 2013 (£491,985) was circa 30% less than the turnover in 2012 (£702,643). Moreover, the cost of sales in year ending 2013 (£205,808) was circa 50% less than the cost of sales in 2012 (£413,771). As a result, [ESL] appeared to achieve a gross margin of circa 58% in 2013 compared to a gross margin of circa 41.11% in 2012.

Generally speaking, it is unusual to achieve a greater gross margin ... it is more common to achieve a slightly reduced gross margin when buying power is reduced.

As a result of the above, our client has revised the gross profit achieved in 2013. ... it is our client’s best judgment that the costs of sales have been understated by £84,000. ...’

The Turnover issue

62. Mr Hayes' evidence in relation to the inclusion of 2Ci's revenue into ESL's turnover is to be read as adopting the substance of RSM's memo of November 2017 on this issue. The appellant contends that the difference between Turnover and Net Sales per VAT returns concerns APE 2014 can be explained by three separate components:

- (1) The inclusion of 2Ci revenue of £51,880.27 in ESL's turnover;
- (2) The mis-posting of VAT repayments of £56,392.63 as revenue income;
- (3) The movement in deferred income of £11,267.96.

63. The details in relation to the inclusion of 2Ci's revenue into ESL's turnover are:

- (1) Following 'a more detailed review' of the process by Mr Robertson, it was discovered that errors had occurred prior and during the acquisition process of 2Ci.
- (2) Mr Hayes explained, that to 'aid the merger 2Ci's sales ledger had been loaded on to the ESL ledger without consideration of the effect that it would have on the revenue figure.' This was done as ESL assisted and undertook the debt collection on the 2Ci's trade debtors.
- (3) Mr Hayes went on to state that in terms of company acquisitions, it is not unusual for the acquiring company to assume the debtors, 'although it is unusual that this should be done prior to formal agreement of acquisition' – ESL formally acquired 2Ci on 13 April 2014 but 2Ci's sales from 1 April were transferred into ESL's records.
- (4) Mr Hayes said that when the balances were transferred on to the ESL ledger, there should have been a matching (inter-company) creditor to 2Ci. However, what actually happened was that the outstanding invoices in 2Ci were loaded on to ESL ledger 'to provide for greater visibility', and this led to the 2Ci's invoices being credited as turnover in ESL (for accounting purposes).
- (5) 2Ci was still reporting the VAT on its sales. ESL had correctly identified that the amounts should not be recorded for VAT within ESL by using the T9 code on Sage, which takes a transaction entry outside the scope of VAT accounting.
- (6) RSM identified £51,880.27 of 2Ci sales that were believed to have been processed via the ESL ledger and included in the turnover of ESL for APE 2014. The ledger showing the relevant 2Ci invoices are produced.
- (7) The quantum of £51,880.27 is by reference to RSM's memo to HMRC of 15 November 2017, which states as follows:

'This view can be supported by the fact that 2Ci's VAT return covering 1 April 2014 to 30 June 2014 declared net sales of £44,372 (Gross £53,246). Consequently, £1,365.73 of gross 2Ci pre-acquisition sales was declared on 2Ci's VAT return, but not processed via Euro Systems financial systems.'

64. The second component of the explanation is to attribute £56,392.63 of the Turnover difference to VAT repayments being credited as turnover. Mr Hayes' evidence stated that: 'The second reason identified arose from discussions with [Mr Robertson]' and the details are:

- (1) £27,566.24 repayment received on 23 October 2013 for period 06/13;
- (2) £2,193.07 repayment received on 20 February 2013 for period 12/13;
- (3) £23,027.40 repayment received on 25 February 2013 for period 09/13; (there is a discrepancy with repayment balance stated on the VAT return of £23,063.40);

(4) £3,605.92 repayment received on 30 May 2013 for period 03/14.

(5) As to proof, RSM's memo of November 2017 states as follows:

‘... due to the lack of working papers [ESL] cannot prove the above beyond reasonable doubt. However, [ESL] cannot identify any other income or bank receipts other than the VAT repayments that could explain this difference. Consequently, in our view, it would be *highly coincidental* that the value [of] £56,392.63 of VAT repayments almost matches the remaining difference of unexplained revenue stated in FYE 2014.’ (emphasis added)

65. The first and second components combine to explain a difference totalling £108,272.90, which requires the third component to reduce the overall difference so explained. The third component pertains to the movement in deferred income, with the details being:

(1) Deferred income in ESL's accounts related to invoices prior to the year-end for which VAT had been accounted in the relevant period by the dates of the invoices.

(2) The work was not yet undertaken or completed until the following financial year and therefore the income was recorded in the following year's turnover.

(3) The deferred income at 30 June 2013 was £6,196.40 (being sales supposed to have been declared in 06/13 return while the revenue was accounted in APE 2014).

(4) The deferred income at 30 June 2014 was £17,646.36 (being sales supposed to have been declared in 06/14 return while the revenue was accounted for in APE 2015).

(5) There was a net increase of £11,267.96 in the movement of the deferred income.

66. RSM's explanation as adopted in Mr Hayes' evidence was to say that this increase in deferred income provision at the year-end was reflected as a balance sheet credit, giving rise to a corresponding debit to the turnover figure on the profit and loss accounts. The combined total of £108,272.90 explained by the first and second components is reduced by £11,267.96 increase in deferred income, which brings the overall difference as explained to £97,004.94.

67. Between the figure of £97,004.94 and the £99,622, RSM stated in their memo: ‘the remaining difference of £2,617.06 is immaterial in our view and therefore can be ignored’.

68. Mr Hayes was asked by the Tribunal whether ESL had sought to amend its corporation tax (‘CT’) return if it had been found that its financial statements for APE 2014 had overstated assessable profits by £99,622. Mr Hayes replied in the negative, giving as reasons: (a) ‘the bigger and more significant error’ was to do with the VAT returns, and it was ‘not worth further antagonising’ HMRC by making a CT amendment; and (b) that it was out of time, and it was accepted that it would not have been out of time to make a CT amendment to the return for APE 2014 by 30 June 2016.

The Balance Sheet issue

69. Mr Hayes stated that the VAT debtor or creditor as stated in ESL's financial statements cannot be explained other than that it was the number as presented in the trial balance and assumed to be correct and used by B&C for that purpose. If there is a mis-posting on one account, said Mr Hayes, then there is likelihood that the balancing posting to the year-end VAT account balance would also be mis-posted.

70. Mr Hayes stated that since the VAT returns were found to have been wrong, the VAT debtor or creditor balances at 30 June 2013 and 2014 ‘bear no relation to what they should have been’. Given that HMRC and ESL had agreed that the VAT returns were wrong, it would be

incorrect to use the numbers from the VAT returns to represent the VAT creditor (or debtor). Rather the creditor (or debtor) would have to be reconstructed using the reconstructed VAT returns. Mr Hayes stated that ‘since we do not know how the VAT figures in the financial statements were arrived at, or how they relate to the true position as per the reconstructed VAT returns, it would be incorrect to rely on them either’.

71. Mr Hayes said that the only ‘hard information we have is what the VAT returns should have shown based on the reconstructed numbers, in respect of which there is now only relatively limited difference between HMRC and ESL’.

Officer O’Pray’s evidence

72. The basis of his assessment as set out in the letter dated 14 July 2016 remained the foundation of Officer O’Pray’s evidence that the assessment had been raised to best judgment. In the main, he emphasised his reliance on the financial statements as the best alternative available to raise an assessment since: (a) the primary records that would have provided the audit trail for the figures declared on the VAT returns could no longer be accessed due to data corruption; and (b) the financial statements were prepared by a professional firm of accountants and the figures stated on the annual accounts were at least of some inherent integrity.

The Input Tax issue

73. In cross-examination, Officer O’Pray was asked repeatedly why he refused to accept the explanations given by ESL for the amounts in dispute despite the additional evidence that had been produced for the ADR procedure; that the listing of all purchase invoices should form a creditable alternative to the amount of input VAT that the appellant was entitled to claim.

74. Officer O’Pray was referred to the letter he received from RSM dated 30 June 2016, in which an analysis was put forward on the increased costs of sales based on ESL’s gross profit.

‘[ESL] reported a gross profit of £286,177 in the year ending 2013. This gross profit is almost identical to the gross profit achieved in the year ending 2012, £288,872.

[ESL] would generally expect to achieve such a similar gross profit, if its turnover remained similar. However the turnover in 2013 (£491,985) was circa 30% less than the turnover in 2012 (£702,643). Moreover, the cost of sales in year ending 2013 (£205,808) was circa 50% less than the cost of sales in 2012 (£413,771). As a result, [ESL] appeared to achieve a gross margin of circa 58% in 2013 compared to gross margin of circa 41.11% in 2012.

... it is usual to achieve a greater gross margin, in this marketplace, when buying power is reduced. ... As a result of the above, [ESL] has revised the gross profit achieved in 2013 ... to circa £202,000 ... our client’s best judgement [is] that the costs of sales have been understated by £84,000, ...’

75. On this point, Officer O’Pray did not deviate from his original basis of assessment. He was firm in his view that here he was dealing with an over-statement of input tax on an *extensive* scale. Officer O’Pray kept referring to the ‘credibility gap’ in the appellant’s evidence, and that in the absence of any audit trail, there was no basis for him to assess the invoice listing to give it any credence.

The Turnover issue

76. Officer O’Pray was put to questions as regards each component in the appellant’s explanation for the turnover difference. He referred again to the ‘credibility gap’ in the

appellant's records and in the overall explanation given; he remained firm in his view that to rely on the financial statements was the only credible basis. He accepted that the overall difference could indeed be 'attributable to various things', but that he was unable to accept RSM's memo proposing the likely explanations for the difference without the audit trail to close the credibility gap.

77. In particular, Officer O'Pray deliberated on the fact that out of the records for the three years he had examined, he was able to reconcile the turnover in APE 2013 and APE 2015 to the total 'Net Sales' in the corresponding VAT periods, and that it was only APE 2014 that presented a difference of £99,622. For this reason, Officer O'Pray drew inference that unlike the input tax aspect of the returns, there was more consistency between the annual turnover and the Net Sales figures, as he had managed to reconcile two out of the three years. Officer O'Pray was sharply interrupted by counsel for the appellant at this point, who interjected by saying: 'Please don't make any reference to 2015 as it plays no part in this appeal.'

The Balance Sheet issue

78. Questions were put to Officer O'Pray that by assessing the difference under the Balance Sheet issue, he was double counting. In the same vein, Officer O'Pray asserted the validity of the financial statements as the basis for assessing the differences arising from the Balance Sheet year-end VAT creditor/debtor balance and the submitted returns.

THE APPELLANT'S CASE

Appeal against quantum and not 'best judgment'

79. Mr Small submits that the appeal should be distinguished as whether it is against 'best judgment' or against the quantum of the assessment: *Mithras*¹. Mr Small admits that if he cannot persuade the Tribunal that the assessments in relation to the three issues are wrong on the balance of probabilities, then he is unable to show that the assessments were wholly unreasonable at the time the assessments were made.

On the evidence adduced

80. Mr Small submits that contrary to Officer O'Pray's approach, something can be more probable than not even though there is no audit trail to follow to that conclusion. The Tribunal is 'entitled to give weight to sworn oral evidence even though the matter being spoken to is not backed up by written evidence or conclusive analysis'. Furthermore:

- (1) Where errors have been made, or records are not what they should be, the blame attaching to the taxpayer for that failing should not be allowed unduly to influence the separate issue of how much tax, on the balance of probabilities, is due. The appellant accepts that it has over-claimed a large amount of input tax due to poor record keeping, but that should not prejudice the Tribunal against it on other matters.
- (2) The appellant has done a lot of work to investigate the records due to the corruption of Sage, and have accepted liability to £206,000 of the £297,000 assessed.
- (3) No evidence was led by HMRC to show that any failure to keep the records specified in the Direction of 14 February 2014 actually occurred, or if it did that it contributed to any difficulties in answering Officer O'Pray's enquiries. No reference was made to the Direction in correspondence either.

¹ *Mithras (Wine Bars) Ltd v Revenue and Customs Comrs* [2010] UKUT 115 (TCC)

The Input Tax issue

81. Mr Small invites the Tribunal to accept that the evidence adduced in relation to the Input Tax issue was ‘unchallenged’, and to find in favour of the appellant on this issue.

(1) Mr Robertson’s 60-page listing of 3,000 entries represented the input tax vouchers held by the appellant on invoices with dates between 1 July 2012 and 30 June 2014, and that the payment of each invoice had been verified by reference to bank statements.

(2) HMRC had the list since August 2017 and have not asked to review the invoices held or the payment records. Their only argument is that the face of the accounts suggests that less expenditure was incurred.

(3) Mr Hayes’ letter of 30 June 2016 referred to unexpected gross profit rates as shown in the financial statements as a reason for thinking that the financial statements were unreliable. Mr Hayes’ explanation of the gross profit improvements in 2015 and 2016 as due to changes in the business with more service and consultancy work being done should be accepted.

(4) Mr Hayes’ belief that when invoices were paid the adjustment to cost of sales made by the company’s unqualified office assistant would (wrongly) have been VAT inclusive, thus artificially depressing cost of sales.

(5) The question is why the financial accounts for the years ending 30 June 2013 and 2014 seem to reflect about £100,000 of expenditure less than the invoices which are held for those two years suggest. ‘There is admittedly a question here to which no certain answer can be given’ (emphasis original).

(6) But certainty is not the test. It is on the balance of probabilities. If one accepts Mr Hayes’ evidence that the financial statements are of questionable accuracy the answer seems clear; it is safer to rely on the invoices.

(7) Even if one does not accept the evidence from Mr Hayes, the evidence of the invoices is, Mr Small submits: ‘stark, direct and immediate’. However, ‘unless one has a belief that all financial audited accounts are by definition, or even presumptively right’ – a belief, Mr Small submits ‘would be irrational and contrary to experience’ – then one is faced with the choice of the certain evidence weighed against the uncertainty of why they do not match up with the accounts.

(8) To find in favour of the appellant on this issue does not require a finding in fact that the financial accounts are wrong. There may be some other explanations. What is required is for the Tribunal to ‘reach the view that the possession of paid invoices unchallenged by HMRC discharges the burden of proof which initially rested on the taxpayer’.

(9) The Tribunal is invited to disregard Officer O’Pray’s evidence in relation to FYE 2015, which does not directly concern this appeal, and Officer O’Pray’s claim was unsupported by reference to documentary evidence. The appellant did not have fair warning of this point coming up such as would give it opportunity of leading evidence from its own witnesses about that year.

(10) Regulations 29 and 31 of the 1995 Regulations accord a certain primacy to invoices as evidence of input tax deduction, admittedly not to the point of guaranteeing a deduction of the input tax shown on any valid invoice, but there is no equivalent evidential status in VAT matters to financial statements. Neither is there any requirement under the 1995 Regulations for reconciliation to be kept between accounts and VAT return figures.

The Turnover issue

82. In relation to the Turnover issue, Mr Small's skeleton argument starts with the statements: 'This affects the year ended 30 June 2014 only. There is no similar issue in 2013 and 2015'. Against HMRC's contention that the excess of £99,610 in turnover per the financial statements over the total Net Sales on the VAT returns represents omitted sales in returns, Mr Small submits that the 'one-off nature of the shortfall suggests that a peculiar combination of circumstances explains it' as follows.

- (1) *2Ci acquisition on 1 April 2014* – the appellant asks the Tribunal to find that:
 - (a) £51,880 turnover was booked in ESL, whereas it should only have been booked in 2Ci;
 - (b) from the evidence (RSM Memo of 15 November 2017), it would appear that the turnover was probably booked in both 2Ci and ESL, although net of VAT in 2Ci and inclusive of VAT in ESL.
 - (c) There should be no doubt that the debtors of 2Ci were transferred into ESL's books for collection. Both witnesses spoke to that, while Mr Robertson was unsure as to whether they were debtors or invoices, Mr Hayes was clear that they were debtors.
 - (d) There would have been no reason, absent the transfer into ESL, to code them T9.
 - (e) Such a transfer makes sense from a business point of view for debt control, and unification of systems.
 - (f) The question is then whether the sales income, when paid (after the transfer) was included in ESL's turnover.
 - (g) The Tribunal is urged to bear in mind 'that the turnover/outputs issue only affects FYE 30 June 2014'. Mr Small asks what is supposed to be a rhetorical question: 'Is it merely a coincidence that the one-off event of the acquiring 2Ci and the consequent special accounting arrangements *also* occurred during the same year?' He submits that 'the satisfactory view is that the booking of £51,880 of 2CI's turnover in ESL's financial statements did indeed occur and accounts for a significant part of the unexplained "non-VATable" turnover'.
- (2) *VAT repayments*
 - (a) The RSM Turnover Disputes Memo refers to four VAT repayments received during FYE 30 June 2014 totalling £56,392.
 - (b) The Memo states that the inclusion of the VAT repayments in turnover cannot be proved beyond reasonable doubt due to the lack of positive accounting evidence; that is, due to the corruption of Sage.
 - (c) The question is again whether it is more likely than not that the VAT repayments have been counted as turnover. If so, then all but £2,617 turnover difference has been explained (taking the deferred income increase as well).
 - (d) The RSM Memo states that 'it would be highly coincidental that the value ... of the VAT Repayments almost matches the remaining difference of unexplained revenue in FYE 2014'. The Tribunal is asked to find that 'it is highly likely that the above VAT repayments were wrongly treated as revenue and therefore ESL's turnover in FYE 2014 was increased by this'.
- (3) *Deferred Income* – the income adjustment of a negative figure of £11,267 should not be controversial as per Mr Hayes' oral evidence to show the balances at year end 2013 and 2014 which account for the movement. It is clear that the document had not

been ‘newly concocted’ and he said he first saw it when organising the group’s accounting after the 2015 year end.

The Balance Sheet issue

83. Mr Small submits that the VAT creditor balances at year end 30 June 2013 and 2014 bear no relation to the VAT returns, and the corruption of Sage has prevented ESL from looking behind what appears in the balance sheet derived from Sage for the VAT creditors. Mr Small concludes that Mr Robertson was mistaken in his evidence in thinking that B&C had produced the VAT creditor numbers, since B&C was not involved in the preparation and submission of ESL’s VAT returns.

84. As to Officer O’Pray’s assumption that B&C must have got things right in making the VAT creditor balance provision, Mr Small submits that Officer O’Pray’s assumption is wrong, and that ‘his position is rather odd’ because:

(1) That position assumes that the VAT creditor number was worked out by someone who knew nothing of the very large adjustments to input and output tax that HMRC were to assess, but who did know about some other much smaller VAT liabilities which Officer O’Pray has failed to unearth.

(2) On Officer O’Pray’s own theory, the Balance Sheet numbers take no account of the input and output tax errors found by HMRC, so it must be the case that the accountants went wrong in preparing the VAT creditor numbers.

85. The appellant’s ‘headline point’ on this issue is that if the numbers in the Balance Sheet have any meaningful content it is more likely that they result not from unknown sources of liability but from some calculations (however made in the Sage system) of the simple excess of output tax on sales over input tax on purchases.

86. If that is the case, then to assess the Balance Sheet creditors as separate sources of liability is obviously double counting. The assessments in respect of the Balance Sheet creditors should therefore be reduced to nil. In support of his submission on this point, Mr Small produced some accounting schedules of reconciliations on the third day of the hearing. The Tribunal pointed out a flaw in these schedules, and their contents were not further examined.

HMRC’s case

87. The respondents’ case is that the assessment has been raised to best judgment based on the information available to Officer O’Pray at the time when the assessment was raised. Applying the relevant case law to the state of evidence, Mr Boyle submits that:

(1) The authorities of *Van Boeckel*², *Rahman*³, *Queenspice*⁴ establish that an assessment to VAT is not to be set aside merely because the Tribunal would not have made that assessment.

(2) The test of validity of the assessment is not whether HMRC have carried out a full investigation but rather whether HMRC have honestly made a fair assessment of the amount they consider to be due and whether there is material before them upon which they may reasonably act.

² *Van Boeckel v Customs and Excise Comrs* [1981] STC 290

³ *Rahman (trading as Khayam Restaurant) v Customs and Excise Comrs* [1998] STC 826

⁴ *Queenspice Ltd v Revenue and Customs Comrs* [2011] STC 1457

(3) The assessment was made following reasonable methodology and after consideration of the various factors put forward by the appellant. It was not made dishonestly, vindictively, or capriciously, nor is the assessment wholly unreasonable. The assessment has therefore been made to best judgment and in line with the aforementioned case law.

88. In relation to the Input Tax issue, the respondents submit that:

- (1) The onus is on the appellant to show that the input tax has been correctly claimed.
- (2) The evidence provided to support the claim of input tax cannot be reconciled to the annual accounts.
- (3) Given that both the invoices and the annual accounts are inter-related, the appellant has not provided evidence to support the input tax claimed on the VAT returns.

89. In relation to the Turnover issue, the respondents submit that no satisfactory evidence has been produced to support:

- (1) the appellant's contention that the turnover of the acquired company was included in the appellant's annual accounts;
- (2) the appellant's contention that a VAT repayment was incorrectly included as the appellant's turnover;
- (3) in the absence of any evidence to reconcile the discrepancies arising from turnover, an assessment of output tax is due for the difference between the turnover declared in the annual accounts and the total turnover declared in the VAT returns.

90. In relation to the Balance Sheet issue, the respondents submit that:

- (1) In line with *Van Boeckel*, the onus is on the appellant to reconcile their accounts and therefore demonstrate the amounts of VAT declared were correct.
- (2) The appellant's financial accounts were prepared by a firm of Chartered Accountants that are registered as a member of the Institute of Chartered Accountants in Scotland (ICAS). They would have prepared the accounts based on the information provided by the appellant, and would have carried out reconciliations for the accounting entries.
- (3) The appellant is required by section 386 and 388 of Companies Act 2006 to retain the information provided to its accountants for preparing the accounts, which should enable HMRC to verify the appellant's explanation of the discrepancies.
- (4) The underlying information used to produce the company accounts is the property of the appellant and that they should be able to obtain this information from its former accountants.
- (5) The appellant has not provided the additional information, in the form of the correct opening balances and correct amounts due, as requested by HMRC.
- (6) The appellant's analysis of the balance sheet differences, without provision of the working papers used to prepare the financial statements, is not sufficient in itself to reconcile the accounts.
- (7) The appellant has been unable to reconcile the differences between the amounts, declared on the VAT returns and the annual accounts, and the assessment for the additional output VAT is justified.

DISCUSSION

91. The respondents' case is staked on the quantum of the assessment being made to the best of judgment, while the appellant has contended in detail aspects of the assessment as regards quantum with additional evidence that was not available at the time when Officer O'Pray made his assessment. In these circumstances, the Tribunal has regard to the body of case law in establishing the focus of our consideration in order to determine the appeal.

Case law principles

The Van Boeckel test

92. This is an appeal against a best judgment assessment, and the use of the words 'best to their judgement' as stated by Woolf J (as he then was) in *Van Boeckel* 'does not envisage that burden being placed on the commissioners of carrying out exhaustive investigations'.

'What the word "best of their judgment" envisage ... is that the commissioners will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due.'

93. As to the very use of the word 'judgment', Woolf J stated in *Van Boeckel* that it makes clear that: (a) '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'; and (b) 'they must perform that function honestly and bona fide. Woolf J's pronouncement (at 297) has given rise to what is often referred to as the *Van Boeckel* test:

'Just as the tribunal, on the material before them, were entitled to come to a conclusion as to the likelihood of pilferage being an explanation for part of the deficiency, so it was open to the commissioners, having heard what the taxpayer said, to have come to a conclusion that this was not a case where it was proper on the material before them to make a reduction ... Their bona fides were not being challenged, and on the material put before the tribunal there was no way it could be said that it was wholly unreasonable for the officers not to make further investigations into the questions of pilferage nor to come to a conclusion that there was pilferage in this case which had to be taken into account.'

94. Referring to the passage at 297 in *Van Boeckel* (cited above), Carnwath J (as he then was) clarified the test in *Rahman* in the following terms:

'... 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 judgment 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.'

Caution against the two-stage approach

95. The *Van Boeckel* test has given rise to a considerable body of case law, and to the so-called 'two-stage approach' that became common in determining an appeal involving a best judgment assessment. The two-stage approach was adopted by the tribunal in *Rahman*, whereby stage (1) was to consider whether the assessment was made according to the 'best judgment of the commissioners'; and if so, then stage (2) was to consider whether the amount

of the assessment should be reduced by reference to further evidence or further argument made available to the tribunal. Carnwath J considered this two-stage approach adopted by the lower court in *Rahman* in some length, and cautioned against a reversion in emphasis:

‘In principle there is nothing wrong in the tribunal considering the validity of the assessment as a separate and preliminary issue, when that is raised expressly or implicitly by the appeal, and, as part of that exercise, applying the *Van Boeckel* test. There is a risk, however, that the emphasis of the debate before the tribunal will be distorted. ... it is only in a very exceptional case that an assessment will be upset because of a failure by the commissioners to exercise best judgement. In the normal case the important issue will be the amount of the assessment. The danger of the two-stage approach is that it reverses the emphasis.’

96. In conclusion, Carnwath J spoke of ‘the dangers of an over-rigid adherence to the two-stage approach’ as illustrated by the tribunal’s decision in *Rahman*. Instead of a two-stage approach, Carnwath J distinguished between ‘exceptional’ and ‘normal’ cases, and that:

‘In the normal case, it should be *assumed* that the commissioners have made an honest and genuine attempt to reach a fair assessment. The debate before the tribunal should be concentrated on seeing whether the amount of the assessment should be sustained in the light of the material then available.’ (emphasis added)

The tribunal’s appellate jurisdiction in relation to quantum

97. An appeal against a s 73(1) VATA assessment is brought under s 83(p) VATA, which has clearly provided that an appeal under paragraph (p) may be: (a) against the assessment itself, or (b) against the amount of the assessment. In *Murat*⁵, Lawrence Collins J (as he then was) contrasted the tribunal’s jurisdiction in a ‘best judgment’ challenge against its jurisdiction in a challenge to the quantum of an assessment, and stated (at 926-927):

‘... an appeal against the exercise by the commissioners of their best judgement is effectively a supervisory appeal in this sense, the tribunal cannot substitute its judgment for that of the commissioners.

The *Van Boeckel* approach is correct in dealing with the initial decision of the commissioners to make an assessment and, indeed, to make an assessment in the amount that they made. When it comes to appeal, once it is accepted ... that the commissioners were fully justified in making an assessment, the amount of the assessment is a matter for the tribunal to decide for itself, and it is a true appeal rather than a supervisory jurisdiction. The tribunal then has the responsibility of looking at all the material put before it by the appellant and indeed by the commissioners, considering any evidence that is given to it and deciding for itself what should be the correct amount of the any assessment.’

98. In *Mithras*, the Upper Tribunal remitted the appeal to be heard afresh on finding that the tribunal had failed to exercise its appellate jurisdiction in relation to the quantum of the assessment, as stated at [29]:

‘In considering the appellant’s appeal against the amount of the assessments, the FTT should have exercised a full appellate jurisdiction and decided for itself the correct amount of the tax due.’

⁵ *Murat v Customs and Excise Comrs* [1998] STC 923

The appeal against quantum

99. Mr Small has helpfully stated at the outset of his submissions that the appellant's contention is not a challenge on the premise that the VAT assessment has not been raised to best judgment, and has accepted that he cannot show that the assessments were wholly unreasonable at the time they were made. Rather the appeal is brought as a challenge against the quantum of the overall assessment, and the Tribunal is urged to exercise its appellate jurisdiction in relation to quantum as has been distinguished in *Mithras*.

100. Given the foregoing, we consider the appeal as a 'normal' case, where it can be assumed that the commissioners have made an honest and genuine attempt to reach a fair assessment. Our deliberation is therefore focused on whether the amount of the overall assessment should be sustained in the light of the material made available to us.

Evaluation of evidence

101. The evidence relied upon by HMRC has been consistently the financial statements produced by B&C. These statements were produced using the Sage accounting data provided by the appellant after the accounting period end, and the annual accounts were furnished to the appellant some eight months after the relevant year end.

102. In various ways, the appellant's witnesses had tried to discredit the reliability of the financial statements. For example, Mr Robertson tried to assert the minimum level of engagement by B&C in the accounts production process, while Mr Hayes (with RSM's letter of 30 June 2016) called into question the fairness of the financial statements with involved analyses of normal trending in gross profit margin, going back as far as APE 2012.

103. We stand back and look at these financial statements, which would have served various purposes in the appellant's business. These financial statements were filed with Companies House, and had enabled the appellant's corporation tax liability to be determined. Apart from being the instruments to meet these statutory obligations, the accounts would have fulfilled various business purposes, such as arranging loans with the banks, or raising finances for equipment purchases. Significantly, the sets of accounts in question (for the two years to 30 June 2014) would also have been those scrutinised by NCS when due diligence was carried out prior to acquiring a stake in ESL.

104. We accept Mr Hayes' evidence that B&C would have produced the appellant's accounts from the Trial Balance, which is in effect a master schedule summarising all the double entries posted to the accounting system in an accounting period. The double-entry mechanism is built into any accounting software, so that every transaction recorded is made to generate a debit entry and a credit entry which balance out each other. These double entries in turn are fed into the Trial Balance, with the result that all debits and credits captured in one accounting period would balance out to nil. As Mr Robertson said, B&C produced the annual accounts 'based on the paperwork provided and the information produced from [ESL's] accounting system'. The reasonable inference is that the financial statements would have used the Trial Balance generated by Sage.

105. Even if B&C functioned no more than as a compiler of the Sage reports into financial statements, the annual accounts would still have been produced using the data generated by the appellant's Sage accounting system. If the annual accounts have been underpinned by Sage reports generated contemporaneously by the appellant, the accounts represent a fair summary of the Sage accounting data captured in the ESL's system at the time.

106. Even if the audit trail can no longer be retrieved, by using the Trial Balance entries to produce the sets of accounts, those accounts would have effectively harnessed the integrity of the double-entry mechanism built into the Sage accounting data so generated.

107. We have no reason to cast the fairness of these financial statements into doubt, which is not the same as to say that the accounts are error free. We are of the view that the financial statements represent a fair resume of the appellant's accounting records, which include its sales and purchases in the relevant financial years, because these figures have at least some inherent integrity through the checks and balances performed by the double-entry accounting system.

108. The alternative evidence the Tribunal was asked to take into account was voluminous. In terms of documentary evidence, apart from the correspondence and accounting schedules, there are hundreds of pages of accounting related documents, such as the listing of 3,000 entries of purchase invoices, sample invoices for sales and purchases, some ledger print runs from Sage, 2Ci invoice ledger listing the sales that were supposed to have been included in ESL's turnover.

109. These documents, however authentic on their own, suffer from a common defect, in that they can only represent one side of the double entry, which then creates a credibility gap, as the other side of the double entry cannot be established with any certainty. This credibility gap is not breached by the witness evidence of Mr Hayes.

110. Whilst we have no issue with Mr Hayes' credibility, we have regard to the fact that Mr Hayes simply was not on the scene to be involved with ESL's accounting system during the relevant periods. Mr Hayes' involvement came after the NCS bought 65% of ESL in November 2014. In other words, Mr Hayes cannot speak of any direct involvement in relation to ESL's accounts for the relevant years, being the two years of accounts ending 30 June 2013 and 2014.

111. As stated earlier, we accept Mr Hayes' evidence as to matters of fact. For example, when he said that it was not uncommon for an acquiring company to adopt the debtors ledger of a company that has been acquired, though it is unusual to have done so *before* the actual date of acquisition, or that B&C would most probably have used the Trial Balance to state the year-end VAT creditor/debtor in the accounts. We are unable, however, to accept his opinion evidence, such as Mr Hayes' adoption of the gross margin argument advanced in RSM's letter of 30 June 2016 to assert that the cost of sales for APE 2013 had been understated by £84,000.

112. In relation to Mr Robertson's witness, we have expressed our reservations at the outset. The appeal does not concern any penalty, which was assessed as 'Deliberate' by Officer O'Prey, and downgraded to 'Careless' and suspended under agreed conditions following ADR. It is unnecessary for us to make a finding of fact in relation to Mr Robertson's credibility, and we reserve judgment in this respect.

113. Our reservations of Mr Robertson's evidence concern aspects of his evidence when he explained how things happened as they did. For example, in relation to the preparation of the figures for filing the VAT returns, Mr Robertson's witness statement stated (at para 21) that the VAT returns were prepared with 'the figures produced by using the inbuilt Sage calculations and reports', which would have covered the figures for both input and output tax, and net purchase and net sales used to file the VAT returns.

114. Yet somehow, when it came to the input tax total, there was a pattern of consistent overstatement on an extensive scale, with the amount of input tax being more than twice the amount of output tax for some of the periods. The pattern of overstatement extended to bring the net value of purchases consistently in line with the amount of overstated input tax. Despite

various questions put to Mr Robertson by the Tribunal as to how he would normally prepare ESL's VAT returns with '*the figures using the inbuilt Sage calculations and reports*', what checks he would be undertaking, how the figures were transferred from Sage reports to VAT returns, this aspect of Mr Robertson's evidence remained vague, discursive, and elusive.

115. It is unnecessary for us to make a finding of fact as to how errors on such a scale as the input tax overstatement arose during the migration of figures from the Sage reports to the VAT returns, quarter after quarter, with remarkable regularity and consistency under Mr Robertson's oversight. Nor is it necessary for us to find how the corruption of Sage data happened at the juncture of the VAT visit under the watch of Mr Robertson as principal, who is an IT specialist. Suffice it to state that we have some general reservations with Mr Robertson's evidence.

The Input Tax issue

116. At the centre of the Input Tax issue is whether the listing of some 3,000 purchase invoices provides sufficient evidence to settle the input tax in the appellant's favour. In other words, the Tribunal has to weigh between the financial statements and the manual invoice listing and decide which represents a more credible basis for the input tax claims.

117. The quantum of the disputed input tax at £20,171 is about one-tenth of the £206,074 that the appellant has already accepted as input tax over-claimed. The appellant's case is that from the invoice listing, ESL was entitled to claim input tax on the value of purchases of £100,855 over the eight return periods falling in APE 2013 and 2014. In other words, ESL had incurred vatable purchases of £100,855 more than the value of purchases stated in the annual accounts.

118. The listing of the 3,000 invoices was done manually in a spreadsheet format, and consists of three columns: Date, Details and Amount. For example, on 4 July 2012, ten items are listed with identical detail as 'Goods & Services' with an identical amount of input tax at £4.45. In other cases, the 'Details' noted are less generic, and are the names of the suppliers.

119. It has been argued for the appellant that Officer O'Pray's methodology may have failed to include some input tax attributable to some categories of expenses, since which costs having borne input tax are not directly discernible on the face of the accounts. Turning to the listing of invoices, we are not satisfied that it represents a more accurate basis for input tax, since not all input tax on the invoices may qualify for deduction. We note, for example, the listing from 1 to 9 July 2012 with the following details:

- (1) Five entries for 'Fuel' with a total of input tax at £45.13; but not all input tax on fuel costs may be reclaimable if there is private mileage;
- (2) Two claims on insurance of £51.26 and £33.17 while it is unusual to see input tax being paid on insurance;
- (3) Four entries for 'Goods & Services' on 1 July 2012 alone totalling £839.96, of which no further detail exists to vouch for whether the input tax on these purchases was indeed deductible.

120. We have been told about keying errors of the magnitude highlighted in Mr Hayes' evidence that had contributed to the Input Tax difference; for example, £5,000 was keyed in as £50,000. Here we are asked to take the accuracy of this *manual* invoice listing of 3,000 entries done by Mr Robertson, or by his accounts team under his oversight as given. We think not.

121. Aside the numerical accuracy aspect in reading and keying in the invoice amounts, we are also asked to take as given that Mr Robertson's judgment of the deductibility of the input tax of all these 3,000 invoices to be correct in law. We think not.

122. Under double-entry book-keeping, a debit for a purchase to profit and loss account is matched by a credit to 'Bank and Cash' on the balance sheet. If ESL's accounts had omitted £100,855 in purchases over the two years, the closing bank balance at the end of the second year on the bank statement would have reported the sizeable shortfall of £100,855; in that, the bank statement would have stated a lower balance by £100,855 than the accounting balance.

123. A bank reconciliation between the balance per accounts and the balance per bank statements would have highlighted the missing purchases to the accounting system at a much earlier stage. Businesses would normally claim all possible expenses to reduce the profits assessable to tax, and we are asked to give credence that the appellant had omitted to include some £100,855 of business expenses in their profit and loss account over two years. We are also asked to give credence to RSM's analysis of gross profit margin, which was based on a series of unverified and unverifiable assumptions, that ESL must have understated its cost of sales over the two years. We think not.

124. In the light of our reservations as regards aspects of Mr Robertson's evidence, together with some of the deficiencies which we have particularised as regards the invoice listing, we do not consider the manual invoice listing afford a more credible alternative for quantifying the input tax that should be disallowed.

125. We dismiss this part of the appeal, and uphold the assessment in relation to the Input Tax issue in the sum of £20,171.

The Turnover issue

126. Mr Small stated in his skeleton argument that the Turnover issue 'affects the year ended 30 June 2014 only', and that '[t]here is no similar issue in 2013 and 2015'. We are unimpressed that Officer O'Pray should have been sharply interrupted when he was cross-examined for referring to the fact that he could reconcile the turnover figure per accounts with the net sales in the VAT returns for APE 2015. We are unclear why Mr Small's skeleton argument should be making reference to APE 2015, when in cross-examining Office O'Pray he had implied that evidence in relation to APE 2015 was inadmissible as 'it plays no part in this appeal'.

127. It does not seem to us a level playing field if Mr Small could refer to facts in relation to APE 2015 to make his submissions, and Mr Hayes could draw on facts in relation to APE 2012, (which was not even covered in the VAT enquiry), while Officer O'Pray was cut short in his evidence when referring to APE 2015.

128. In our view, it was quite proper for Officer O'Pray to refer to his findings as regards APE 2015, since the VAT enquiry included APE 2015 right at the outset. The fact that parties settled matters arising from APE 2015 does not detract from the findings that emanate from that accounting period, nor does not mean that those findings relating to APE 2015 could not have informed Officer O'Prey view on the Turnover issue identified for APE 2014 when he set out the basis for raising the assessment.

129. The point that Officer O'Pray sought to make seems to be the other side of the same coin to what Mr Small tried to submit. Drawing on the fact that there is 'no similar issue in 2013 and 2015', Mr Small referred to the Turnover issue regarding APE 2014 as the 'one off nature

of the shortfall'. For Officer O'Pray, he also considered the sales in the VAT returns not reconciling with the turnover for APE 2014 as an aberration, and that the VAT returns were wrong. For the appellant, Mr Small argued that the aberration resided with the set of accounts for APE 2014, and that it was the turnover figure in the annual accounts that was wrong.

130. The appellant has admitted to the VAT returns being factually wrong by overstating the input tax on an extensive scale. The balance of probabilities weighs towards the returns being also wrong in relation to the output tax for the corresponding periods in APE 2014.

131. Turning to the substance of the three components used to explain the turnover difference, it is common ground that there is no audit trail to substantiate any of them. RSM admitted as much in their memo of 15 November 2017, that 'due to the lack of working papers' ESL 'cannot prove the above beyond reasonable doubt'.

132. Notwithstanding the lack of proof, we are asked to consider the accounting jigsaw presented in RSM memo of 15 November 2017 as being close to providing a flawless fit that explains the turnover shortfall puzzle. RSM stated in their memo: (a) '*it would be highly coincidental*' that the value of the VAT repayments '*almost matches* the remaining unexplained revenue'; and (b) the remaining difference of £2,617.06 after these jigsaw pieces are put together is 'immaterial' in their view and should be ignored.

133. We are of the view that if the accounting puzzle of the turnover difference had really been solved by these jigsaw pieces presented in RSM memo, and if they really were 'highly coincidental', then a perfect match should have been delivered with no remaining difference. In other words, the accounting jigsaw does not fit so perfectly together as to make us think that the components of the explanation are so 'highly coincidental' that they must be right.

134. As to the individual piece of jigsaw, the first piece is to say that the turnover of 2Ci from 1 April 2014 to 30 June 2014 had been 'booked' into ESL's ledger as turnover. Despite the documents to evidence what 2Ci had returned for that quarter in its own VAT return, we are unable to give any credence to this component of explanation without the accounting proof that 2Ci's sales for that quarter had indeed been amalgamated by mistake into ESL's turnover. Unless there is the double entry to underpin this explanation, by establishing that debit entries to 'Debtors' for 2Ci's invoices on ESL's system had been matched with credit entries to ESL's turnover, we cannot give credence to this piece of the jigsaw.

135. The second component in the explanation is to ask the Tribunal to accept that the VAT repayments had been credited as turnover. The normal double entry to record the receipt of a VAT refund would be: debit 'Bank Account', and credit 'VAT Account' on the Balance Sheet. Instead of the VAT Account, the appellant claimed that the credit entry went to Sales.

136. In other words, we are asked to give credence to the proposition that in APE 2014, the appellant's accounting system recorded the substantial sums of VAT repayments as Sales, and for which the appellant over-paid its corporation tax. More significantly, we are asked to give credence to the proposition that the mis-posting happened *only* in APE 2014, and for the *consecutive* quarters 06/13, 12/13, 09/13, and 03/14 neatly lined up, and then the mis-posting stopped, as suddenly and as inexplicably as it had started, so that 'there is no similar issue for 2013 and 2015' as Mr Small submitted. We think not.

137. The third component of deferred income appears to be a 'balancing' figure in this accounting jigsaw. The combined total of the 2Ci sales and the VAT repayments exceeded the turnover shortfall of £99,622, so a negative balance was required to complete the jigsaw.

138. An increase in the closing balance for the Deferred Income Account will result in a reduction in turnover, and vice versa. A movement between the opening and closing balances of this kind (on a balance-sheet account) that results in an adjustment to the profit and loss account is likely to be an annual occurrence. It is only in an accounting period where there is no change between opening and closing balances will there be no adjustment to Turnover figure in the profit and loss account.

139. If it is the accounting practice to adjust for Deferred Income, it is normally expected that there is movement in the opening and closing balances that requires an annual adjustment to the turnover figure. Here we are asked to give credence that *only* in APE 2014 was an adjustment required to turnover, while there no movement between the opening and closing balances for APE 2013 and APE 2015 to require any adjustment. If an adjustment were required to the Turnover in APE 2013 and APE 2015 due to deferred income movement, Officer O'Pray would have noted turnover differences for the other two accounting periods as well.

140. In any event, we have decided that we cannot give credence to the major components in the explanation of the Turnover shortfall. We dismiss this part of the appeal, and uphold the assessment in relation to the Turnover issue in the sum of £19,922.

The Balance Sheet issue

141. Mr Small and RSM have produced various reconciliations and reconstructions of the VAT Account to support the submission that the sum assessed due to the Balance Sheet difference in the VAT debtor/creditor represents double counting. We have not related these schedules in detail, since this issue can be determined as a matter of accounting principle. Our consideration in this respect focuses on three areas.

- (1) HMRC's methodology in quantifying the input and output tax returnable according to the Profit and Loss Account for the relevant years is effectively a simulation of the accounting entries in the VAT Account in relation to input and output tax.
- (2) Entries other than input and output tax into the VAT Account are not readily ascertainable for meaningful reconciliation to be attempted with the year-end balance.
- (3) The function of the Profit and Loss Account is distinguished from that of the Balance Sheet, and how duplication arises if assessment is based on both statements.

Simulation of the VAT Account for input and output tax entries

142. The accounting entries relevant to the VAT Account, which give rise to a VAT debtor (or creditor) balance at a period end are illustrated as follows, where 'B/S' stands for Balance Sheet, and 'P&L' for Profit and Loss.

- (1) A sale invoice of £1,200 inclusive of VAT is raised; the double entry postings to Sage are: (a) debit 'Trade Debtor' £1,200 on B/S, (b) credit 'Sale' £1,000 on P&L, and (c) credit VAT Account £200 on B/S (to set up a VAT creditor for the output tax).
- (2) A purchase invoice of £600 inclusive of VAT is paid; the double-entry postings to Sage are: (a) debit 'Cost of sales' £500 on P&L, (b) debit VAT Account £100 on B/S (to set up a VAT debtor for the input VAT reclaimable), and (c) credit 'Bank and Cash' on B/S £600.
- (3) Multiple entries for sales and purchases are posted throughout a VAT return quarter so that the amounts of input and output tax on relevant transactions are captured via the VAT Account. By way of an example, and for simplicity, 10 identical sales and 10

identical purchases take place in the return quarter, the period end VAT creditor will stand at £1,000.

143. In Sage, the allocation of the input and output tax to the VAT Account is done automatically by assigning a VAT code to a transaction: for example, T9 for a transaction that has no VAT implication, and T1 for a standard-rated transaction. The VAT Account captures the input and output tax so allocated to the amounts of the transactions. On the basis that the financial statements which Officer O'Pray relied on were prepared using Sage data and reports, we find as follows.

- (1) The net value of all purchases from the annual accounts is the summation of the annual total of the different expenses appearing on the Trial Balance.
- (2) The input tax relating to each purchase transaction would have been automatically allocated to the VAT Account through the year.
- (3) Similarly, the net value of turnover in the annual accounts is the summation of all the sales made in the accounting period.
- (4) The output tax relating to each sale would have been automatically allocated to the VAT Account through the year.
- (5) By extrapolating what the input tax should have been from the net value of purchases per the annual accounts, this is a simulation of what the combined total of the individual amounts of input tax posted to the VAT Account would have been.
- (6) By extrapolating what the output tax payable should have been from the value of turnover per accounts, this is a simulation of what the combined total of output tax on all the sales would have been.
- (7) Officer O'Pray's assessment on the input and output tax differences is a simulation of what the VAT Account would have captured.

144. In terms of completeness therefore, the assessment in relation to the Input Tax issue and to output tax based on the Turnover difference has captured all possible variants so far as the annual accounts can inform.

Other entries into the VAT Account

145. Secondly, a VAT Creditor/Debtor Account also captures the VAT payments made or repayments received. While the allocation of the amounts of input and output tax from transaction postings to the VAT Account is built into an accounting software, the postings relating to VAT payments or repayments between the *VAT Account* and *Bank* are not automatic. Continuing with the above example for illustration purposes, the accounting entries other than the amounts of input and output tax into the VAT Account are as follows.

- (1) When the VAT return is generated at the period end, a net liability of £1,000 is shown, and the payment for £1,000 is made.
- (2) The entries to Sage are: (a) debit VAT Account £1,000, (b) credit Bank and Cash £1,000.
- (3) Assuming that there is a nil opening balance on the VAT Account, the closing balance will be nil after the payment of £1,000.

146. In a normal repayment situation (i.e. one that is bona fide as with a zero-rated supplier), the combined total of all input tax in a return period exceeds the combined total of all output tax on sales, generating a VAT debtor balance, which indicates a repayment situation. When

the repayment is received, the double entry is: (a) debit Bank and Cash, (b) credit VAT Account to clear the debtor balance.

147. With ESL, the repayment situation is *not* bona fide, in that the input tax allocated from the postings of purchases (as per the P&L) would not have generated the VAT repayment balances as stated on the VAT returns. There would not have been a VAT debtor balance at each quarter end for a VAT refund to be set against.

148. With ESL, the true position from the financial statements (derived from Sage) is that ESL should have been in a 'payment' situation with its output tax liability exceeding its input tax reclaimable, and the VAT Account on Sage would have indicated a VAT Creditor balance.

149. When ESL received a VAT repayment, while the debit entry would probably have gone into Bank Account (on B/S), it is unclear where the corresponding credit entry would have been posted. It is unlikely to have been credited to the VAT Account (as in a normal situation), since the VAT Account from Sage would not have shown a debtor balance at each quarter end.

150. To reduce a VAT Creditor balance on making a payment, or to reduce a VAT Debtor balance on receiving a repayment, some human agency is required to make a posting to the VAT Account. With ESL, we simply do not know what amounts had been posted to the VAT Account by this human agency, to deliver the year-end balances of the VAT Account.

151. It would appear though, that some human agency would have made some accounting entries to record *payments* of ESL's VAT liabilities in order to reduce the year-end VAT Creditor balances. Without some debit entries (in the form of payments) to the VAT Account, the year-end balance would simply be the cumulative output tax liability less input tax reclaimable. That clearly was not the case, since the year-end VAT Creditor balances in question are much lower than what the cumulative VAT Creditor balances would have been.

152. What kind of posting, and for what amount, would have been made by this human agency to ESL's VAT Account is not readily ascertainable without the audit trail. For this reason, the VAT Account balance on the Trial Balance for APE 2013 and 2014 is no more than a balancing figure at year end, and cannot be used as true for raising an assessment, since there would appear to be *other* postings to the VAT Account to reduce the overall output tax liabilities, the details of which are no longer retrievable.

153. Furthermore, since the figures on the VAT returns are wrong, and the supposed VAT *payments* entries made to the VAT Account are not ascertainable, no meaningful reconciliation can be attempted between these two sets of records.

Duplication to assess on B/S in addition to P&L

154. This is a point that Officer O'Pray seemed to have tried to address with the changes he made to the Balance Sheet issue assessment (see §30(3) and §32(2)). In his letter of 27 April 2016, the Balance Sheet differences were assessed without any reduction for other sums assessed for 06/13 and 06/14. In his letter of 14 July 2016, the assessment to Balance Sheet differences was amended by giving a reduction for the input tax disallowed for 06/13 and 06/14, and for the additional output tax apportioned to 06/14.

155. It seems to us that the amendments to the Balance Sheet issue assessment indicate that Officer O'Pray recognised that there was an element of duplication, to the extent of the sum he had also assessed under the Input Tax issue, and Turnover issue.

156. Officer O’Pray is correct in recognising that there was duplication. In fact, the duplication covers the entire assessment in relation to the Balance Sheet differences. At the centre of this duplication is that Officer O’Pray had already raised his assessment based on the P&L figures to quantify what would have been the input and output tax posted to the VAT Account in an accounting period. That exercise is complete, in itself, for the purposes of quantifying any likely shortfall arising on a global level in an accounting period.

157. There is no need to assess any Balance Sheet differences. To do so would lead to duplication, not to mention that the VAT Debtor/Creditor balance cannot be taken as true as set out earlier.

158. The distinction between the P&L and B/S is significant for current purposes. The P&L is a summary of the transactions that have occurred in an accounting period, while the B/S is a snapshot of a state of affairs. Suppose ESL had produced three sets of accounts in the two years to 30 June 2014 due to corporate restructuring, and there were three different accounting period ends, would it then give rise to a further (a third) Balance Sheet difference for assessment?

159. Based on the methodology used to assess the Balance Sheet differences, a third accounting period end would then give rise to additional assessment. This is another way of illustrating the duplication that is intrinsic to assessing on the Balance Sheet differences; it is duplication because the global assessment on the P&L figures is complete in itself.

160. For the avoidance of doubt, we are of the view that Officer O’Pray’s methodology using the P&L figures to quantify the input and output tax on a global level is sound. We are not saying that a VAT assessment with reference to Balance Sheet figures is necessarily unsound. We are aware that in some instances, a VAT assessment can be soundly raised based on Balance Sheet figures (not P&L). All we are saying is that in this instance, having assessed on P&L figures, to *also* assess on B/S differences is duplication.

DISPOSITION

161. The assessment in relation to the sums of £20,171 input tax, and £19,922 output tax is confirmed.

162. The assessment in relation to the sum of £50,522 is cancelled.

163. The appeal is allowed in part.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

164. 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.

DR HEIDI POON

TRIBUNAL JUDGE

RELEASE DATE: 29 OCTOBER 2019