



TC08138

VALUE ADDED TAX – bespoke retail scheme – regulations 67 and 68 VAT Regulations 1995 – no provision for closing stock adjustment on ceasing to use the scheme – whether the scheme produced a fair and reasonable valuation of taxable supplies – R v Customs & Excise Commissioners (ex parte Littlewoods Home Shopping Group Limited) considered – held, the scheme did produce a fair and reasonable valuation – in any event, the respondents were not entitled to assess VAT on the basis that the scheme included a closing stock adjustment – appeal allowed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2019/04091

BETWEEN

POUNDLAND LIMITED

Appellant

-and-

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

Respondents

TRIBUNAL: JUDGE JONATHAN CANNAN

Sitting in public by way of a video hearing using the Video Hearing service on 10 December 2020

Mr Andrew Hitchmough QC instructed by KPMG LLP for the Appellant

Mr Howard Watkinson instructed by HM Revenue and Customs Solicitor’s Office and Legal Services for the Respondents

DECISION

INTRODUCTION

1. This is an appeal against an assessment to VAT (“the Assessment”) pursuant to section 73 Value Added Tax Act 1994 (“VATA 1994”). The Assessment was made on 28 September 2018 in the sum of £2,349,471. It was later reduced to £2,150,777 which is the sum in issue on the appeal. The Assessment was made in the context of a retail scheme operated by the appellant (“Poundland”) which is a well-known high street retailer. I describe the nature of retail schemes in general and the specific schemes operated by Poundland in more detail below. Very briefly at this stage, Poundland operated a bespoke retail scheme agreed with HMRC between December 2002 and March 2017 (“the Old Scheme”). It moved to a new bespoke retail scheme also agreed with HMRC (“the New Scheme”) with effect from 27 March 2017. Essentially, the issue between the parties is whether in calculating Poundland’s VAT liability for the final accounting period of the Old Scheme, an adjustment ought to be made to recognise the closing stock held by Poundland in its retail stores at the end of that period.

2. I set out below a description of the legal framework for the operation of retail schemes, followed by my findings of fact relevant to the issue on the appeal. There were no factual issues between the parties. The evidence by reference to which I make my findings of fact included a witness statement from Ms Charlotte Berrow, who is employed by Poundland and has particular responsibility in relation to its stock and finance systems, and a witness statement from Mr Graeme Royston who is a tax specialist with HMRC working in its retail unit of expertise. I was also referred to certain documentary evidence adduced by the parties.

RETAIL SCHEMES – LEGAL FRAMEWORK

3. VAT is charged on each taxable supply of goods. This can pose practical problems for retailers, in particular ascertaining the output tax due when the retailer has sales at different rates of VAT including standard rated sales and zero rated sales. Article 395 of the Principal VAT Directive permits member states to introduce special measures to simplify the procedures for collecting VAT. It provides as follows:

Article 395

1. The Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance.

Measures intended to simplify the procedure for collecting VAT may not, except to a negligible extent, affect the overall amount of the tax revenue of the Member State collected at the stage of final consumption.

4. The measures adopted by the UK in the context of retailers are described as retail schemes. Those measures take the form of provisions in VATA 1994, the Value Added Tax Regulations 1995 (“the 1995 Regulations”) and various notices which have the force of law. The measures enable retailers to calculate their output tax liability without reference to each individual supply.

5. Paragraph 2(6) Schedule 11 VATA 1994 provides as follows:

Regulations under this paragraph may make special provision for such taxable supplies by retailers of any goods or of any description of goods ... as may be determined by or under the regulations and, in particular:

(a) for permitting the value which is to be taken as the value of the supplies in any prescribed accounting period or part thereof to be determined, subject to any limitations or restrictions, by such method or one of such methods as may have been described in any notice published by the Commissioners in pursuance of the regulations and not withdrawn by a further notice or as may be agreed with the Commissioners;

(b) for determining the proportion of the value of the supplies which is to be attributed to any description of supplies; and

(c) for adjusting that value and proportion for periods comprising two or more prescribed accounting periods or parts thereof.

6. Regulations 67-75 of the 1995 Regulations are made pursuant to paragraph 2(6) and in so far as relevant provide as follows:

67(1) The Commissioners may permit the value which is to be taken as the value, in any prescribed accounting period or part thereof, of supplies by a retailer which are taxable at other than the zero rate to be determined by a method agreed with that retailer or by any method described in a notice published by the Commissioners for that purpose; and they may publish any notice accordingly.

(2) The Commissioners may vary the terms of any method by —

(a) publishing a fresh notice,

(b) publishing a notice which amends an existing notice, or

(c) adapting any method by agreement with any retailer.

68 The Commissioners may refuse to permit the value of taxable supplies to be determined in accordance with a scheme if it appears to them —

(a) that the use of any particular scheme does not produce a fair and reasonable valuation during any period,

(b) that it is necessary to do so for the protection of the revenue, or

(c) that the retailer could reasonably be expected to account for VAT in accordance with regulations made under paragraph 2(1) of Schedule 11 to the Act.

7. HMRC has published various notices pursuant to regulation 67(1), including Notice 727 which describes the retail schemes available. More particularly Notice 727/4 describes how to work the Apportionment Schemes 1 and 2 and Notice 727/5 describes how to work the Direct Calculation Schemes 1 and 2 (“DC1” and “DC2”). The Notices identify certain provisions of the schemes which have force of law under the regulations.

8. Retail schemes all have the same aim, which is to identify an estimate of the value of standard rated supplies made in an accounting period, thus saving the retailer from the administrative burden of having to precisely identify the value of standard rated supplies on a transaction by transaction basis.

9. In broad terms, Apportionment Scheme 1 is a simple scheme designed for smaller businesses. It involves calculating the value of purchases for resale at different rates of VAT and applying the proportion of those values to the total sales in order to calculate the output tax. Apportionment Scheme 2 involves calculating the expected selling price (“ESP”) of all standard and reduced rated goods received, working out the ratio of these to the expected selling prices of all goods received and applying this ratio to the gross takings.

10. DC1 and DC2 involve calculating the ESP of a class of goods for retail sale which attract the same rate of VAT. In DC1, retailers may use “minority goods” or “majority goods” as the relevant class of goods. Minority goods are the class of goods at a rate of tax which forms the smallest proportion of retail sales. The ESP for the relevant class of goods is then used to establish the proportion of daily gross takings (“DGT”) on which VAT is due at the relevant rate. The proportion of goods sold at other rates of VAT can then be calculated. DC1 is for retailers with an annual tax exclusive turnover of not more than £1 million.

11. DC2 is for retailers with an annual tax exclusive turnover of more than £1 million but not more than £100 million. Traders with a turnover greater than £100 million must use a bespoke scheme. DC2 operates in the same way as DC1 but in DC2 the ESP of “minority goods” must be used. Important in the present context, DC2 also requires annual stock adjustments based on stocktakes to give a more accurate estimate of the value of standard rated goods sold in the year. When a trader ceases to use DC2 a closing stock adjustment is required.

12. Notice 727/5 describes with the force of law the various steps that are required to calculate output tax liability using DC1 and DC2. In broad terms, if the ESP for zero rated goods is being used the trader identifies the DGT for the accounting period and deducts the ESP of all zero rated goods purchased or received for retail sale. This gives the standard rated sales and the output tax to be accounted for is $1/6^{\text{th}}$ of the difference, assuming a 20% rate of VAT.

13. The annual stock adjustment for scheme DC2 is described at [4.5] of the notice as follows:

4.5 Annual adjustment (for Scheme 2 only)

This paragraph details the annual adjustment required if you use Direct Calculation Scheme 2.

Scheme 2 is based on your retail trade over a full year. This year runs from the beginning of the first tax period in which you use the scheme.

At the end of each year you must make an adjustment to reflect the actual sales made by your retail outlets during the year. It compares the movement in stock and levels of goods received, made or grown for retail resale with what has been accounted for under the scheme calculations for the year.

The next sentence has the force of law.

Once you’ve calculated your output tax due under the retail scheme for the fourth quarter as in paragraph 4.4, you must carry out the annual adjustment as described below.

14. The annual adjustment involves adding up the DGT for the four periods in the year, assuming quarterly accounting. The ESP of zero rated goods received in those periods together with the ESP of the opening stock of zero rated goods less the ESP of the closing stock of zero rated goods is deducted from DGT to give the standard rated gross takings for the year. The output tax on those takings is then compared to the output tax accounted for in the four quarterly periods and the difference is either added to or subtracted from the output tax which would otherwise have been due in the fourth quarter without any annual adjustment.

15. DC2 includes a requirement for a closing adjustment when a trader ceases to use the scheme. This is dealt with at [3.6.2] which has the force of law and provides as follows:

3.6 Ceasing to use the scheme

...

3.6.2 Direct Calculation Scheme 2

If you cease to use Direct Calculation Scheme 2 you must do a closing adjustment, as for the annual adjustment (paragraph 4.5), for the tax periods since your last adjustment.

16. Regulation 67 also makes provision for a retailer to use “*a method agreed with that retailer*”. Schemes agreed with individual traders are known as “bespoke retail schemes”. Traders with a turnover greater than £100 million must use a bespoke scheme. Traders with a turnover less than £100 million may agree a bespoke scheme. If a trader does not apply a retail scheme set out in a notice, or a bespoke retail scheme agreed with HMRC, the retailer must account for VAT at the appropriate rate on a transaction by transaction basis. I shall describe this as “normal VAT accounting”.

17. The published schemes described above were introduced in 1997. Immediately prior to being introduced there were a series of schemes known as Retail Schemes A, B, B1, C and D. DC1 is similar to and effectively replaced Retail Scheme B, whilst DC2 is similar to and effectively replaced Retail Scheme B1.

18. Scheme B was considered by the Court of Appeal in *United Norwest Co-operatives Limited v Customs & Excise Commissioners* [1999] STC 686. I do not need to consider the facts of that case in any detail. Briefly, the retailer transferred two retail outlets to a subsidiary. In operating Scheme B the retailer excluded from DGT the zero rated goods transferred but sought to include those goods in calculating the ESP of zero rated goods. The operation of Schemes B and B1 was described by Jonathan Parker J (as he then was) as follows:

The short question for decision is whether the January transfer was a '[sale] where you don't receive the expected selling price', within the meaning of para 22 of the notice. Before turning to para 22 itself, however, I first consider the general context in which para 22 has to be read.

Scheme B provides a simple but somewhat rough-and-ready method of calculating the output tax of a retailer who sells both standard-rated and zero-rated goods, and whose takings from sales of zero-rated goods do not account for more than 50% of his annual turnover. As the judge said ([1998] STC 1065 at 1070): 'the purpose [of scheme B] is clear and the aim is to produce a figure which is as accurate as possible consistent with the simplicity of the method employed by the scheme.'

In calculating his output tax under scheme B, the retailer brings into account sales of zero-rated goods by reference not to the takings from actual sales of zero-rated goods (a process which would involve accounting for each individual sale) but by reference to the volume of zero-rated goods brought into stock (a much easier and simpler calculation). Zero-rated stock 'received, made or grown for resale' is brought into account at its expected selling prices (ie its expected *retail* selling prices) but para 22 requires adjustments to be made in respect of 'any sales where you don't receive the expected selling price'.

The basic assumption underlying scheme B—and it is, perhaps inevitably, a somewhat crude one—is that while he continues to trade the retailer will sell his zero-rated stock by way of retail sale, and will replenish his stock with zero-rated goods to replace zero-rated goods which are sold. On that basis, over time the volume of zero-rated goods brought into stock in any period will approximate to the volume of zero-rated goods sold during that period. If it should happen that a retailer's closing stock on his ceasing to trade is less than his opening stock when he commenced trading (assuming for this purpose that he acquired the business as a going concern with existing stock) he will, if he is using scheme B, have understated his zero-rated sales over the period of trading (and in consequence have overstated his output tax liability) since the volume of zero-rated goods sold will, ex hypothesi, have exceeded the volume of goods coming in by way of replenishment of stock. If, on the other hand, his closing stock is greater than his opening stock, the reverse will be the case. There is, therefore, an element of 'swings and roundabouts' in the scheme B calculation. No doubt this is a factor of which the retailer will normally take account when deciding whether to use scheme B.

Scheme B1, by contrast, is a somewhat more sophisticated scheme, reflecting the fact that it is designed for retailers whose takings from zero-rated sales exceed 50% of their annual turnover: ie for cases where the zero-rated element forms a larger proportion of the retailer's gross takings than under scheme B. Under scheme B1 an annual adjustment is required to be made to take account of changes in levels of stock over the year, thereby eliminating the 'swings and roundabouts' element in scheme B referred to above...

19. Notice 727/2 describes bespoke retail schemes which are retail schemes agreed between HMRC and individual retailers. In 1994, when Poundland commenced using the Old Scheme, I understand that Notice 727/2 provided as follows at [4.2]:

What will the agreement include?

A bespoke scheme will be agreed in writing and will include:

- the start date, review date and end date of the agreement. The agreement will specify how output tax will be calculated in any period between the date of the agreement and the date at which your business became ineligible to use a published scheme;
- details of supplies which will be accounted for within a bespoke scheme, and of those which will not form part of the scheme and will therefore be accounted for normally (...);
- Any items in the Daily Gross Takings (DGT) tables at 6 and appropriate to your method of valuing taxable retail supplies (...). The tables are only a guide. Any special circumstances or transactions not included in the tables should still be covered in the agreement; and
- the name, status and signature of one of our officers, and of an authorised signatory of the registered person/business.

20. It is common ground that bespoke retail schemes are to be construed in the same way as commercial contracts – see *The Boots Company Plc v HM Revenue & Customs* [2009] EWCA Civ 1396 at [41] – [43].

21. Article 395 provides that measures intended to simplify the procedure for collecting VAT may not affect the overall amount of tax revenue collected at the stage of final consumption, save to a negligible extent. As appears below, that proviso is aimed at ensuring that the tax charged to the final consumer is not affected by the measure. In the context of retail schemes, the tax charged to the final consumer remains the same. The consumer pays the VAT inclusive price set by the retailer.

22. Finally, in relation to the Assessment it was made under section 73 VATA 1994 which provides as follows:

73(1) Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.

FINDINGS OF FACT

23. Poundland registered for VAT on 13 December 1990, and has operated a retail scheme to account for VAT since at least June 1994. Between June 1994 and 29 December 2002 it operated Retail Scheme B. With effect from 30 December 2002, Poundland and HMRC agreed to the use of the Old Scheme as a bespoke retail scheme in place of Scheme B. The Old Scheme was based on Scheme B and like Scheme B and its successor DC1 it did not require any annual

adjustments for stock movements or any adjustment for closing stock on ceasing to use the scheme.

24. The terms of the Old Scheme provided that Poundland's liability to VAT for each accounting period was calculated by reference to the ESP of zero rated stock delivered to its stores during that period. The ESP of that zero rated stock, together with the zero rated element of any multi rated items was deducted from Poundland's DGT for the period in order to arrive at the value of Poundland's standard rated sales on which it was liable to VAT.

25. The Old Scheme was operated by Poundland until 26 March 2017. With effect from 27 March 2017 Poundland has adopted the New Scheme with the agreement of HMRC and it continues to operate the New Scheme. The New Scheme uses data captured by Poundland's electronic point of sale ("EPOS") system in order to calculate its liability for VAT. The use of EPOS data means that the calculation of Poundland's liability to VAT under the New Scheme is very accurate and reliable.

26. The start date and lifespan of the Old Scheme was set out in clause 3.1 as follows:

3.1 Start Date and Lifespan

The first VAT return under this agreement will be for the first VAT return period finishing after 29 December 2002, which will be Poundland Limited's VAT period finishing on 30 March 2003. The start date is therefore 30 December 2002. The agreement will continue for six VAT periods (quarters) following 12/02 unless reviewed or re-negotiated within that time, but with the option to extend it beyond that date with the agreement of both parties.

27. The methodology of the Old Scheme is described in clause 4. Poundland's retail stores identify DGT, including zero rated sales. Poundland is then required to identify zero rated stock delivered to its retail stores, either from its warehouses or by suppliers directly to the stores. It then establishes the ESP of that zero rated stock and deducts that from the DGT for each VAT period. The balancing figure is taken as the value of standard rated retail sales. Provision is made to adjustment DGT and zero rated stock for items such as refunds, dishonoured cheques, theft of stock and stock returns.

28. Clause 4.2 defined stock for these purposes by reference to goods intended to be sold by way of retail sale. Hence goods intended for wholesale, transfers of stock as part of a going concern and transfers between associated traders operating separate retail scheme are expressly excluded. The clause states that:

The intention of these provisions is to prevent double counting of zero-rated goods in two schemes so allowing unfair advantage.

29. In any given accounting period, Poundland's output tax liability was therefore calculated by reference to the zero rated stock delivered to its retail stores, whether or not that stock was actually sold in the period.

30. Clause 4.3 of the Old Scheme provided as follows:

4.3 Annual Adjustment

There is no requirement to perform an annual adjustment. This will be reviewed in accordance with Paragraphs 3.1 and 6.3.

31. This must have been a reference to an annual stock adjustment similar to that required by Scheme B1. Paragraph 3.1 is set out above. It appears that the reference to paragraph 6.3 is an error, and ought to be a reference to paragraph 6.4 which provides as follows:

6.4 Review

This agreement will be reviewed within one year and six months, to ensure a fair and reasonable result. If in the course of that review, or at any other point during the life of the agreement, both parties agree that the method is fundamentally flawed so that the resultant output tax is neither fair nor reasonable, a new method will be negotiated to eliminate the flaw.

The terms of the agreement shall not of themselves restrict the right of either party to obtain settlement of the tax mis-declared by virtue of the fundamental flaw. However, the term fundamental flaw will not be considered to be appropriate purely because a different method of calculation would have provided either a higher or lower value of retail output tax.

In the absence of a fundamental flaw in the method, if either party wishes to vary the agreement or calculation methods detailed herein, this can be achieved prospectively with the agreement of both parties.

32. Clause 6.6 concerns dispute resolution and provides as follows:

6.6 Procedures in the Event of a Dispute concerning the Terms and Conditions

... In accordance with existing law, where a dispute arises over the operation of this agreement as to whether it yields a fair and reasonable result, Customs and Excise may assess any misdeclaration of tax on a best judgment basis and Poundland Limited has the right to dispute any assessment and have a further right to appeal to a VAT and Duties Tribunal.

33. In late 2006, Poundland explored with HMRC the possibility of moving from the Old Scheme to a new bespoke retail scheme. However, HMRC maintained that on a change of scheme it would be necessary for Poundland to make a closing stock adjustment. A closing stock adjustment would require Poundland to deduct the ESP of zero rated stock held in retail outlets when it ceased to use the Old Scheme from the zero rated stock delivered to retail stores in the final period. The effect of such an adjustment would be to reduce the value attributed to zero rated sales in that period with a corresponding increase in the value of standard rated sales by reference to which output tax would be calculated. In the event, Poundland continued to operate the Old Scheme.

34. In 2015, Poundland and HMRC were again discussing replacing the Old Scheme with a bespoke scheme based on EPOS data. Again, HMRC maintained that a closing stock adjustment would be necessary. In a letter dated 12 January 2016, HMRC proposed to withdraw the Old Scheme with effect from 26 June 2016. On that basis HMRC invited Poundland to submit proposals for a new scheme with effect from that date. They observed that any new scheme would have to be agreed before that date.

35. On 8 August 2016, HMRC wrote to Poundland to say that the Old Scheme would be withdrawn at the end of the current VAT period, that is 25 September 2016. They stated that a closing stock adjustment would have to be included in the calculation for period 09/16.

36. Discussions continued between the parties without agreement. The Old Scheme was not withdrawn and Poundland continued to use it. However, in April 2017 it seems to have been agreed that the New Scheme could be implemented whilst discussions continued as to the need for a closing stock adjustment in the final period of the Old Scheme. HMRC considered that they could make an assessment for underpaid VAT in the event that there was no agreement for a closing stock adjustment. Poundland used the New Scheme in accounting period 06/17 and thereafter.

37. On 28 September 2018, HMRC gave notice of the Assessment to Poundland giving effect to a closing stock adjustment in period 03/17. The Assessment was made under section 73 VATA 1994. The VAT charged by the Assessment was £2,349,471, although this was later reduced to £2,150,777. Poundland requested a review and the Assessment was confirmed in a review letter dated 9 May 2019. Poundland notified this appeal to the tribunal on 4 June 2019.

38. Poundland's New Scheme is based on EPOS data and hence provides an accurate figure for the value of standard rated sales in any accounting period. Ms Berrow has also used EPOS data to identify the actual value of standard rated sales in period 03/17. VAT due for the final period under the Old Scheme without any stock adjustment was £49,588,731. Using EPOS data, the VAT due would have been £48,771,715. In other words, using normal VAT accounting Poundland's output tax for period 03/17 would have been £817,016 less than was accounted for under the Old Scheme.

DISCUSSION

39. Poundland's grounds of appeal may be summarised as follows:

(1) The Old Scheme did not understate Poundland's liability for VAT in its final period. There was no requirement in the Old Scheme for Poundland to make a closing stock adjustment.

(2) Even if the Old Scheme did understate Poundland's VAT liability in its final period, HMRC cannot make an assessment for the VAT that would have been due as if the Old Scheme had required a closing stock adjustment.

40. In relation to the first ground of appeal, HMRC say that the Old Scheme was "fundamentally flawed". That is not a statutory term, but it is a term used in the Old Scheme. Clause 6.4 uses the term in the context of reviewing the Old Scheme. Both parties acknowledge that the term refers to circumstances where the Old Scheme does not produce a fair and reasonable valuation of taxable supplies and therefore of the output tax to be accounted for. HMRC say that the Old Scheme was fundamentally flawed because it did not make provision for any closing stock adjustment when Poundland ceased to use the scheme.

41. HMRC accept that the terms of the Old Scheme did not expressly require a closing stock adjustment. However, they say that the need for an adjustment is obvious. Unless a closing adjustment is carried out before the New Scheme is brought into effect, Poundland would effectively be claiming zero rating twice on the same goods. Once at the point at which zero rated goods move from the Appellant's warehouse into its retail stores under the Old Scheme, thereby reducing the value of standard rated sales made. Then again if those goods were not supplied within the last VAT period under the Old Scheme, and the same goods are supplied and accounted for as zero rated supplies under the New Scheme through the EPOS system.

42. In support of HMRC's case, Mr Watkinson submitted that a bespoke scheme is not intended to be a complete code of accounting for identifying the value of standard rated retail supplies. It should not be expected to make provision for every possible future contingency. Bespoke schemes will inevitably be silent on some issues. The fact that a bespoke scheme is silent as to some potential future issue, such as the consequence of changing from one scheme to another cannot prevent the Respondents from either requiring a closing stock adjustment or assessing VAT based on a closing adjustment.

43. It is HMRC's case that the absence of provision for a closing stock adjustment amounted to a fundamental flaw. The flaw is said to arise in two ways:

(1) There is double counting of zero rated goods in the Old Scheme and the New Scheme, and

(2) There is an understatement of VAT over the lifetime of the Old Scheme in the sum of approximately £2.15m

44. Poundland says that there is no fundamental flaw in the Old Scheme and criticises HMRC's approach as follows:

(1) HMRC's rationale for applying a closing stock adjustment is misconceived. Poundland is not "claiming" zero rating twice on the same goods. Zero rating is applied once, at the time of supply. The significance of the ESP of zero rated stock delivered to Poundland's retail stores under the Old Scheme is that it is a proxy for the value of zero rated goods supplied in the period. Under the New Scheme, supplies of zero rated goods which were in stock at the end of period 03/17 would be supplied for VAT purposes in later periods. Those supplies would properly be treated as zero rated supplies at the time of supply in later periods. There is no question of supplies of zero rated stock reducing the value of standard rated supplies. The value of zero rated stock delivered to stores is simply used as a proxy or estimate for the value of zero rated goods actually supplied.

(2) Making a closing stock adjustment in the final period without any opening stock adjustment in the opening period would distort the value attributed to standard rated sales over the lifetime of the Old Scheme.

(3) The requirement for stock adjustments was not simply overlooked, as Mr Watkinson suggested. The parties clearly agreed to a bespoke scheme which did not include any requirement for an annual stock adjustment or a closing stock adjustment.

(4) It cannot be assumed that a bespoke scheme is flawed simply because an alternative approach might produce a different result. The Old Scheme expressly recognises that point at clause 6.4.

45. In relation to the second ground of appeal, HMRC say that where there is a fundamental flaw in the Old Scheme they are entitled to recover any understatement of VAT caused by reason of that flaw by way of assessment.

46. Mr Hitchmough identified what he said were a number of difficulties with HMRC's case on their entitlement to make the Assessment:

(1) HMRC have no power to insist upon an amendment to the Old Scheme. Any variation to the Old Scheme must be by way of agreement between the parties and in the absence of agreement Poundland would be required to fall back on normal VAT accounting pursuant to which there has been no understatement of VAT.

(2) The manner in which HMRC have sought to remedy what they say is a defect in the Old Scheme is itself fundamentally flawed. HMRC have made an adjustment for closing stock without any corresponding adjustment for opening stock when Poundland started to use the Old Scheme.

47. I shall consider each ground of appeal in turn.

(1) Requirement to make a closing stock adjustment

48. It is clear that retail schemes are intended to produce a fair and reasonable valuation of standard rated supplies in any accounting period. Hence, regulation 68 provides that HMRC may refuse to permit the value of taxable supplies to be determined in accordance with a scheme if the scheme does not produce a fair and reasonable valuation of taxable supplies during any period.

49. I am satisfied from the terms of the Old Scheme that the need for annual adjustments was not overlooked by the parties. There is specific reference at clause 4.3 to the fact that there was no requirement for any annual adjustment. Provision is made for a review of the position in relation to annual adjustments. Clause 3.1 refers to the possibility of a review or re-negotiation in the first 18 months of the scheme and for the Old Scheme to be extended beyond period 06/03 with the agreement of both parties. The Old Scheme was extended beyond 06/03 which must be taken to have been with the agreement of both parties. Both parties must also be taken

to have accepted that there was no need for any annual adjustments to reflect changing stock levels.

50. It is common ground that the Old Scheme is to be construed on the basis that it is a commercial contract. Having said that, HMRC do not suggest that the requirement for a closing stock adjustment can be read into the Old Scheme as a matter of contractual construction. I consider they are right not to do so. In my view it is not possible to read in any requirement for a closing stock adjustment. To do so would be to re-write the Old Scheme, rather than to construe it according to its terms. The real question is whether the Old Scheme failed to give a fair and reasonable valuation of standard rated supplies. In other words, was it fundamentally flawed.

51. The fundamental flaw identified by HMRC is that without a closing stock adjustment Poundland would effectively be claiming zero-rating twice on the same goods, once in the final period of the Old Scheme and again in subsequent periods using the New Scheme when the goods were sold. Mr Hitchmough submits that this analysis is incorrect because it fails to recognise that the ESP of zero rated deliveries is simply used as a proxy for the value of zero rated supplies in calculating the value of standard rated supplies. He submits that the zero rated deliveries are not treated as being supplied twice. They were supplied only once, at the point of sale to customers when they are treated as zero rated supplies.

52. Mr Hitchmough drew my attention to the element of swings and roundabouts identified by Jonathan Parker J in *United Norwest Co-operatives* in the context of Scheme B. He submitted that such swings and roundabouts could not amount to a fundamental flaw in the operation of the Old Scheme. Indeed, the absence of any closing adjustment was described in that case as “*a factor of which the retailer will normally take account when deciding whether to use scheme B*”.

53. Mr Hitchmough relied heavily on the Court of Appeal decision in *R v Customs & Excise Commissioners (ex parte Littlewoods Home Shopping Group Limited)* [1998] STC 445 (“Littlewoods”). It is necessary to consider Littlewoods in some detail.

54. Littlewoods was a large mail order retailer. It sold goods to customers through a catalogue on self-financed credit terms. Applying normal VAT accounting, Littlewoods would have accounted for VAT on the price charged to the customer on delivery of the goods sold, even though it would only receive payment over a period of many weeks or months. Littlewoods operated what was then a published retail scheme which modified normal VAT accounting. The scheme had been introduced in 1973 but it was subsequently withdrawn by HMCE. The case concerned the implications of withdrawal of the scheme, in particular the correct treatment of outstanding sums due from customer at the time Littlewoods ceased to use the scheme. The scheme was described by Millett LJ as follows at p449g-h:

Fundamental to the operation of the special schemes for retailers is the concept of daily gross takings. Prior to the withdrawal of the standard method of calculating daily gross takings retailers were offered two alternative methods of calculating these, known as the standard method and the optional method. The optional method was based on the total amount charged to customers, that is to say, on the total value of the supplies, in conformity with the general structure of the tax laid down by the Act. The standard method (or SMGT) was based on the payments received by the taxpayer, and marked a radical departure from the norm. It was, however, favourable to retailers who sold goods on self-financed credit terms, since it avoided any adverse effect which might be occasioned to their cash flow by the need to account for value added tax on the sale price of goods before payment was received. It was introduced by Customs and Excise Notice No. 707 dated March 1973, which had the force of law. It is this method which has now been withdrawn.

55. HMCE withdrew the SMGT with effect from March 1997 and at the same time required traders to account for VAT on the outstanding credit balance for goods which had been sold on credit terms. The Court of Appeal held that HMCE could not require Littlewoods to account for VAT on the outstanding credit balance. To do so would amount to double taxation.

56. When the SMGT was first introduced, retailers were concerned that calculating liabilities by reference to payments received in an accounting period relating to supplies made prior to that period would have the effect of retrospectively charging VAT on goods supplied before the introduction of VAT. The concern was that the value of supplies in the first period in which the scheme was used would include payments received for goods supplied before the introduction of VAT. Millett LJ described why this was a misunderstanding at p453a-f:

It is common ground that SMGT does not involve any alteration in the time at which supplies are treated as taking place or in the subject-matter of the tax. It is still charged on the value of the supply and not on the amount of the payments received in respect of the supply. SMGT is merely a method of calculating a retailer's liability for output tax for a given period by taking the amount of his receipts during the period *as the measure of the value of his taxable supplies during that period...*

The assumption on which SMGT was based, as the Commissioners explained, was that over time the value of supplies should broadly equate with receipts. If bad debts are disregarded - for provision is made for these whichever method of calculating gross takings is adopted - this assumption is good so long as turnover remains broadly level. When this is the case receipts in any one accounting period in respect of supplies made during earlier periods will be broadly matched by outstanding balances in respect of supplies made during the period which are disregarded and carried forward for use as the measure of supplies in future periods. It is only when turnover is rising, as in the case of a new or expanding business, that SMGT favours the taxpayer; and conversely only when it is falling that it favours the Commissioners. Continuing inflation since 1973, of course, has meant that overall it has benefited the taxpayer.

57. The reference to receipts during a period being a measure of the value of taxable supplies during that period is what is often referred to these days as a proxy. In other words, the cash receipts in an accounting period were a proxy or estimate of the value of taxable supplies made in that period.

58. In the present appeal Mr Hitchmough described the ESP of zero rated goods delivered to Poundland's retail outlets as being a proxy for the value of standard rated supplies. Strictly, it is the DGT less the ESP of zero rated goods delivered to outlets that is a proxy for the value of standard rated supplies. He also submitted that the assumption described by Millett LJ, that over time the value of supplies would broadly equate with receipts held good in the present appeal. The value of zero rated goods delivered to retail stores would broadly equate to the value of zero rated supplies. Mr Watkinson did not take issue with that submission, and acknowledged that if the Old Scheme had operated in perpetuity it would not involve any flaw.

59. The Court of Appeal in Littlewoods considered a decision of Judge J (as he then was) in *Customs & Excise Commissioners v Next Plc and Grattan Plc* [1995] STC 651. Those cases also concerned the SMGT, in the context of an increase in the rate of VAT from 15% to 17½% in April 1991. Pursuant to the SMGT, payments received before the change of rate were taken as the measure of supplies chargeable at the old rate and payments received after the change of rate were taken as the measure of supplies chargeable at the new rate. Next and Grattan challenged this as being inconsistent with what was then the Sixth Directive. They were successful in the VAT Tribunal and Judge J dismissed HMCE's appeal. He held that the SMGT affected the amount of tax "due at the final consumption stage" to more than "a negligible extent" and was therefore not permitted by the proviso to what is now Article 395 of the PVD.

There was no appeal against that decision and HMCE made considerable refunds to affected traders. It was this decision which caused HMCE to withdraw the SMGT.

60. In *Littlewoods*, the Court of Appeal held that Next and Grattan had been wrongly decided. Indeed, HMCE in *Littlewoods* did not seek to support the decision. In particular Judge J had misconstrued the proviso to what is now Article 395 and had wrongly rejected HMCE's argument that the tax due at the final stage of consumption referred to the input tax payable by the ultimate consumer to the supplier. Article 395 sought to simplify the collection of output tax from the supplier provided that the amount of input tax borne by the ultimate consumer was not appreciably affected. The proviso therefore required consideration not of whether the change in the rate of tax would affect the ultimate consumer, which it plainly would, but on whether adopting the SMGT instead of normal accounting would affect the ultimate consumer.

61. Millett LJ expressed the Court of Appeal's overall conclusion as follows at p457e – 458a:

In my judgment, there is no statutory basis for taxing outstanding balances on the withdrawal of SMGT or otherwise. All supplies made after the withdrawal of SMGT (or after a retailer ceases to trade or to use SMGT) must be taxed in the normal way, that is to say, on the value of the supply, such value being the amount of the consideration whether or not payment is deferred; no other basis is available for valuing the supply. Nor, after the withdrawal of SMGT, will there be any basis for charging tax by reference to payments received; the only basis for doing so will have been withdrawn. Thereafter tax will be chargeable on supplies in the ordinary way. But there will be no outstanding untaxed supplies; supplies made before the withdrawal of SMGT will have been fully charged to tax under SMGT.

In my judgment the taxpayer is correct in saying that the quashing of the Commissioner's decisions will not result in a loss of tax, but that on the contrary their proposal to tax outstanding balances will result in double taxation. Payments outstanding at the date of the withdrawal of SMGT in respect of goods supplied before such withdrawal will not fall out of tax. Such payments relate to supplies made in earlier periods on which tax has been fully paid. The fallacy in the Commissioners' thinking is exposed by the language which they employed to describe the effect of their decision. They referred to the sums which would become due as

"any VAT outstanding on goods already supplied"

and as

"value added tax due on outstanding credit balances but deferred under SMGT..."

But on the withdrawal of SMGT no tax was outstanding on goods already supplied; tax had been fully paid on the value of such goods measured by a prescribed method. SMGT did not operate to defer payment of tax or to make it payable on outstanding balances: tax was payable at the end of the normal accounting period on the value of goods supplied during that period; it affected only the manner in which the value of the goods was measured.

62. Mr Hitchmough submitted that this conclusion may be applied by direct analogy to the present appeal. When Poundland ceased to use the Old Scheme, VAT was fully paid on the value of standard rated goods supplied in the period, as measured by the prescribed scheme. The Old Scheme did not operate to accelerate the availability of zero rating or to tax any goods at the zero rate other than those items actually sold. The method affected only the manner in which the value of the appellant's zero rated supplies and thereby its standard rated supplies were measured.

63. Mr Watkinson submitted that *Littlewoods* was irrelevant to the present issue. He submitted that Mr Hitchmough was wrong to portray HMRC's case as somehow amending the time of supply. HMRC are simply contending that by including zero rated closing stock in the valuation of standard rated supplies in the final accounting period, Poundland has sought to "twice claim zero rating on the same goods under two [retail schemes]".

64. In my view Littlewoods is relevant, although I do not think there is a direct analogy. It illustrates that where receipts have been used as a proxy for the value of standard rated supplies in an accounting period, sums yet to be received when the scheme ceases are not chargeable to VAT. It is necessary to differentiate the way in which a supply is valued by reference to receipts and the supply itself. Outstanding balances could not be charged to tax because they related to supplies which had already been taxed in full. Any charge to tax on the outstanding balances would amount to double taxation.

65. In the present case, HMRC argue that there has been double counting because zero rated goods delivered to stores claim the benefit of zero rating twice. Once when delivered to the store and used in the calculation of standard rated supplies in the period of delivery, and again when they are actually supplied under the New Scheme.

66. It seems to me that HMRC are falling into the same trap as HMCE in Littlewoods, and the language they use exposes the fallacy of the argument. There are not two “claims” to zero rating. Under the Old Scheme, the value of zero rated goods delivered to stores whether or not they were sold as at 26 March 2017 is simply used to estimate the value of standard rated supplies. The goods are not supplied at that time and there is no “claim” to zero rating. They are supplied in the following accounting periods when they are sold to customers and properly treated as zero rated supplies. In my view there is no double counting of zero rated stock.

67. Both parties placed reliance on the way in which the DC1 and DC2 schemes operated when addressing the question of whether the Old Scheme contained a fundamental flaw.

68. Mr Watkinson submitted that DC2 required a closing stock adjustment because of the effect of output tax liability being calculated by reference to goods that have not actually been sold. He submitted that if there was no closing stock adjustment there would be an “understatement of standard rated supplies, and potential double counting of zero rated supplies”. He relied on a reference in clause 4.2 of the Old Scheme to the intention of preventing double counting. However, the reference to double counting there was in the context of transfers between associated traders and their separate retail schemes. Having said that, it is not controversial to say that any retail scheme should avoid double counting which would give a valuation for taxable supplies which is not fair and reasonable.

69. Mr Hitchmough submitted that Schemes B and DC1 must give a result which is within the bounds of being fair and reasonable, otherwise those schemes would not be authorised by HMRC. On HMRC’s case those schemes suffer from the same alleged flaw in that without a closing stock adjustment the retailer claims the benefit of zero rating twice on the same goods. In my view, Mr Hitchmough’s submission is a rather simplistic view of the position. Scheme DC1 is limited to businesses which have a turnover not more than £1 million. Any difference between the estimate of value which it gives and the application of normal VAT accounting would be magnified for businesses with a larger turnover. It cannot be inferred therefore that Scheme DC1 would give a fair and reasonable result for a business with a turnover of £100 million.

70. Mr Watkinson submitted that the requirement for a closing stock adjustment in the DC2 scheme exposed a fallacy in Poundland’s argument. Namely that there was no double counting of zero rated supplies. He submitted that the closing stock adjustment in DC2 prevented such double counting. I do not accept that as a fair description of the rationale for the closing stock adjustment in the DC2 scheme. It is not to prevent double counting, it is to ensure consistency in the final period of operation of the DC2 scheme where there has been an opening stock adjustment and subsequent annual adjustments. I agree with Mr Hitchmough that the closing stock adjustment on ceasing to use DC2 works together with any opening stock adjustment. It is part of an overall scheme taking into account opening stock and annual adjustments the aim

of which is to give a greater degree of accuracy in identifying the value of zero rated goods sold in any particular period.

71. Mr Watkinson submitted that no distortion arises from the absence of an opening stock adjustment. There was no evidence that Poundland had ever accounted for VAT based on normal VAT accounting. If Poundland had operated a retail scheme since it commenced trading then no opening stock adjustment would have been necessary.

72. It is common ground that from at least 1994 onwards Poundland used Scheme B which did not require any stock adjustments and when it started to use the Old Scheme in 2002 there was no opening stock adjustment. There is no evidence as to how Poundland accounted for VAT in the periods between 1990 when it commenced trading and 1994. In my view however, Poundland are entitled to look at the position when the Old Scheme commenced in December 2002. There is no suggestion that it has not accounted fully for VAT in the period prior to December 2002, and if any adjustment was required when it ceased to use Scheme B then that was the time HMCE ought to have addressed the matter. There is no doubt that Poundland would have held significant stock in stores in December 2002 when it started using the Old Scheme.

73. In short, I agree with Mr Hitchmough that an adjustment for closing stock without any corresponding adjustment for opening stock does not make the Old Scheme any more fair and reasonable than it is without any adjustment at all.

74. Mr Watkinson submitted that the quantum of the Assessment, which was agreed at £2,150,777, itself indicates that the Old Scheme does not give a fair and reasonable valuation of standard rated supplies. Such a sum was beyond the “swings and roundabouts” referred to by Jonathan Parker J. However, the Old Scheme was in operation for just over 14 years. Ignoring the question of opening stock, the Assessment can be viewed as the cumulative effect of failing to have annual adjustments in calculating Poundland’s output tax over that period, which by my calculation amounts to approximately £38,000 per period on average. I do not know Poundland’s average output tax liability over that period, but I do not accept that the quantum of the Assessment can be viewed in isolation as indicating that the Old Scheme did not give a fair and reasonable valuation.

75. Finally, I should mention Mr Watkinson’s submission that the absence of a closing stock adjustment simply illustrates the fact that bespoke retail schemes are not expected to make provision for every contingency. I do not see the absence of a closing stock adjustment as a matter of mere oversight. In fact, it is consistent with the Old Scheme being treated as a rough and ready method of calculating output tax with an element of swings and roundabouts. In circumstances where there had been no opening stock adjustment and where there was no requirement for annual adjustments it is not surprising that there was no requirement for a closing stock adjustment.

76. For all these reasons I have reached the conclusion that the Old Scheme did not suffer from a fundamental flaw and the appeal should be allowed on this ground.

(2) Entitlement to make the Assessment

77. If HMRC were correct in their submission that the Old Scheme contained a fundamental flaw, an issue arises as to whether they were entitled to make the Assessment. For the reasons given above, I do not consider that the Old Scheme contained a fundamental flaw. In those circumstances I shall address this ground of appeal on the assumption that by reason of the absence of any closing stock adjustment the Old Scheme did have a fundamental flaw.

78. Regulation 67(2) of the Regulations sets out the means by which HMRC may vary the terms of any method described in a notice or agreed with a retailer. HMRC may publish a fresh

notice, amend an existing notice or adapt the method by agreement with the retailer. It is clear that HMRC cannot unilaterally amend a bespoke scheme.

79. In the case of a bespoke retail scheme, if the agreed scheme does not produce a fair and reasonable valuation during any period then HMRC can seek to agree a variation of the scheme or may exercise their power under regulation 68 to refuse to permit the scheme to be used to determine the value of taxable supplies. The issue with which this ground of appeal is concerned is the basis on which HMRC may assess any understatement of output tax arising from the fundamental flaw.

80. It seems to me that HMRC's power to assess the understatement they have identified must be based on a legal power to assess either in VATA 1994, in the 1995 Regulations or as a matter of contract pursuant to the terms of the Old Scheme.

81. Mr Watkinson stated that the basis for the Assessment was HMRC's discretion under regulation 68 to refuse permission to use the Old Scheme as a method of valuing standard rated supplies. He maintained that on the facts HMRC had withdrawn permission for Poundland to use the Old Scheme on the basis that it was fundamentally flawed. He went on to submit that the Tribunal's jurisdiction over HMRC's exercise of discretion under regulation 68 was supervisory and that to challenge the exercise of that discretion Poundland would have to establish that no reasonable officer could have concluded that the Old Scheme did not produce a fair and reasonable valuation of the output tax due in period 03/17. At the same time, he accepted that the Tribunal had a full appellate jurisdiction in relation to the Assessment.

82. I do not see how HMRC's discretion under regulation 68 can be the basis of the Assessment. I agree with Mr Hitchmough that there was no decision by HMRC that Poundland was not permitted to use the Old Scheme in period 03/17. Consequently, there has been no appeal against any such decision. The correspondence and discussions in 2016 and 2017 evidence HMRC's intention to refuse permission to use the Old Scheme. In the event however, HMRC and Poundland came to an agreement that for period 06/17 onwards Poundland would use the New Scheme. At no stage did HMRC refuse permission for Poundland to use the Old Scheme in period 03/17. On the contrary, it seems to me that their position is that in using the Old Scheme for period 03/17, Poundland must incorporate a closing stock adjustment.

83. Mr Hitchmough submitted that HMRC were effectively trying to resile from the terms of the Old Scheme with retrospective effect. He referred me to what was said by Dr Nuala Brice in *Tesco Plc v Customs & Excise Commissioners* [1994] VATTR (VTD 12740) at [8.22]. Dr Brice identified the contractual nature of a retail scheme, which is not in dispute. With reference to what is now regulation 68, Dr Brice set out the following propositions which the present parties do not take issue with:

[T]he legal nature of a permission to use a retail scheme is to provide that the values of supplies are to be determined in accordance with the scheme and not in accordance with the actual nature of the supplies. It is a feature of a scheme that there will not necessarily be a link between the value of the supplies and the values upon which tax is payable. The use of a scheme may well result in less tax being payable but Customs and Excise cannot complain if that is so as they have voluntarily permitted the use of a scheme. They have power under Regulation 3 to refuse to permit the use of a scheme if they do not consider that it will give a fair and reasonable valuation or if one of the other two conditions in regulation 3 is present.

that the legal nature of an agreement as to the method is that of an offer and acceptance which results in a contract binding on both sides from which one party cannot resile; and

that the legal nature of a refusal to permit the use of a retail scheme is a decision of Customs and Excise which can be reviewed by the tribunal in the exercise of its supervisory jurisdiction and, in such a case, any illegal or improper act by the taxpayer could be taken into account.

84. Mr Hitchmough submitted that HMRC could not simply resile from a contractual agreement and impose terms which did not appear in the Old Scheme. If HMRC believe that a bespoke scheme is no longer fit for purpose, and an acceptable variation cannot be agreed with the retailer, the only avenue open to HMRC is to withdraw permission for the use of that scheme pursuant to regulation 68. Further, if a bespoke scheme is withdrawn for an accounting period and is not replaced by any other scheme there is no basis on which the trader can derogate from normal VAT accounting. The trader must account for output tax by reference to individual supplies and the power to assess arises only if the trader's return understates the output tax due by reference to normal accounting principles.

85. I agree with Mr Hitchmough's submission. In my view HMRC had two options in 2017:

(1) To agree with Poundland that there would be a closing year adjustment in the operation of the Old Scheme in period 03/17, or

(2) To refuse permission for Poundland to operate the Old Scheme in period 03/17.

86. In theory, HMRC might also have refused permission for Poundland to use the New Scheme unless there was some opening adjustment in period 06/17 equivalent to the closing adjustment in 03/17 to prevent what they saw as double counting. However, this was not canvassed in argument and I say no more about it.

87. There is nothing in the VATA 1994 or the 1995 Regulations which permits HMRC to impose a variation of the Old Scheme without the agreement of Poundland. The question which then arises, is whether there is anything in the terms of the Old Scheme which gives them power to make the Assessment.

88. Mr Watkinson submitted that where a fundamental flaw in the Old Scheme causes output tax to be understated, HMRC are not precluded from making an assessment. Indeed, he submitted that clause 6.6 of the Old Scheme provided a mechanism to make such an assessment. If there is a fundamental flaw in the operation of the scheme, then clause 6.4 says that the terms of the Scheme shall not prevent HMRC from assessing any underdeclared VAT and clause 6.6 provides that in the event of a dispute as to whether the scheme gives a fair and reasonable result then HMRC can make an assessment which Poundland can challenge before the Tribunal by way of appeal.

89. In my view those clauses are rather more limited than Mr Watkinson suggests. Clause 6.4 states that the terms of the Old Scheme shall not of themselves "*restrict the right of either party to obtain settlement of the tax mis-declared by virtue of the fundamental flaw*". Similarly, clause 6.6 provides that HMRC may assess any misdeclaration of tax "*in accordance with existing law*". The clauses do not themselves give HMRC any right to assess mis-declared VAT, but make clear that the terms of the Old Scheme do not restrict rights HMRC would have as a matter of VAT law. The existing rights HMRC had to assess under-declared VAT are in section 73 VATA 1994. Those are rights to assess VAT where a return is incorrect. HMRC must still therefore establish that the return for 03/17 is incorrect.

90. In relation to clause 6, Mr Hitchmough submitted that the second paragraph of clause 6.4 in particular reflected regulations 67 and 68 of the 1995 Regulations. If the Old Scheme contained a fundamental flaw, causing output tax to be understated, then HMRC could obtain settlement of the understated tax by refusing to permit the Old Scheme to be used in that period and if necessary assess the trader to the output tax which would fall due on the basis of normal VAT accounting. The Old Scheme was a derogation from normal VAT accounting and it is normal VAT accounting which applies if no scheme operates in a particular period. I agree with that submission.

91. It seems to me that the issue in the present case arises because HMRC's case rests on the fact that the effect of the fundamental flaw is not limited to period 03/17. It has been building throughout the period from December 2002 when Poundland first started to use the Old Scheme. Both parties agreed, subject to the need for an opening stock adjustment, that the understated VAT which had been assessed by HMRC was effectively the sum of the annual adjustments that would have been required over that period if annual adjustments had been required. In other words, the closing stock was not an increase in stock in period 03/17 but was the effect of increased stock levels and inflation since December 2002. This was the point made by Millett LJ in Littlewoods.

92. Mr Watkinson described this as a "*catching up*", and that it was in the final period that the understated VAT crystallised. He said it was a "*hangover from the lifetime of the operation of the scheme*". I agree with that description. As I understand HMRC's case, it is that normal VAT accounting in the final period required a closing stock adjustment to reflect the absence of any stock adjustments over the lifetime of the Old Scheme.

93. In my view, it is not possible to treat normal VAT accounting in the final period as encompassing a closing stock adjustment to reflect increases in the value of stock held over the 14 years in which the Old Scheme operated. In the absence of specific provision in the Old Scheme or agreement between the parties, HMRC can only assess in period 03/17 by reference to the output tax falling due on supplies made in that period. Those supplies do not include the closing stock, which by definition has not been supplied in that period.

94. The evidence of Ms Berrow derived from EPOS data for period 03/17 establishes what VAT would fall due by reference to normal VAT accounting. Using EPOS data would in fact lead to a reduction of some £817,000 in the amount of output tax accounted for in that period.

95. Mr Watkinson questioned the relevance of Ms Berrow's calculation. He suggested that it was wrong to compare the Old Scheme to the EPOS calculation for period 03/17 because the Assessment was calculated by reference all zero rated stock on hand at the end of period 03/17, which could have been delivered to stores prior to period 03/17. I do not understand the basis for this criticism. The comparison carried out by Ms Berrow is designed to show what Poundland's output tax liability would have been using normal accounting principles in 03/17. It has nothing to do with the closing stock adjustment.

96. I am satisfied therefore that even if the Old Scheme did contain a fundamental flaw, the Assessment was excessive and I would have allowed the appeal on this ground.

CONCLUSION

97. In all the circumstances and for the reasons given above the appeal is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

98. 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.

**JONATHAN CANNAN
TRIBUNAL JUDGE**

RELEASE DATE: 17 FEBRUARY 2021