



TC05820

Appeal number: TC/2014/01998

VAT – under-declared sales – best judgment assessments by HMRC – Value Added Tax Act 1994 s73(1) – whether amount of assessment correct – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

FIO'S CASH AND CARRY LTD

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE THOMAS SCOTT
SONIA GABLE**

**Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 5 and 6
December 2016**

Abbas Lakha QC of Counsel for the Appellant

**Natasha Barnes of Counsel, instructed by the General Counsel and Solicitor to
HM Revenue and Customs, for the Respondents**

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DECISION

Introduction

1. Fio's Cash & Carry Limited ("Fio's") appeals against a number of assessments to VAT raised by HMRC in respect of under-declared sales. The assessed periods were 09/12, 12/12 and 03/13 ("the Assessed Periods"). The amount of the assessment for period 09/12 is £192,129; for period 12/12 £53,205, and for period 03/13 £234,168. The aggregate amount of the disputed assessments is £479,503.
2. The assessments were "best judgment" assessments made by HMRC under section 73(1) of the Value Added Tax Act 1994 ("VATA").
3. It is not disputed that VAT was under-declared for the Assessed Periods. The appeal relates solely to the amount of the assessments.
4. The correct amount of the assessments turns on two factors, namely the total value of under-declared sales for the Assessed Periods, and the proportion of those sales which were zero-rated.
5. The primary issue for the Tribunal was to determine the correct amount of VAT to be assessed for the Assessed Periods. This turned on an evaluation and comparison of the methodologies used by HMRC and Fio's respectively to calculate the under-declared sales and consequential VAT due for the Assessed Periods.

Evidence

6. We were presented with correspondence and documents, including some of the underlying documents and records generated by the business during, before and after the Assessed Periods.
7. We were also presented with approximately fifteen lever arch files of documents to which we were not specifically directed by either party. The index for the files gave no meaningful information in relation to their contents. We offered both counsel the opportunity to take us to any documents they considered material, or wished to take into account, and that opportunity was declined. Mr Lakha stated that he saw "very little purpose" in the Tribunal considering their contents. Therefore, we did not admit those files as evidence in the proceedings.
8. For the Appellant, we heard witness evidence from Muhammad Raheem, an accountant whose firm, S Asghar & Co, was instructed by Fio's to "reconstruct" Fio's accounts for the period from 1 June 2012 to 31 May 2013. The purpose of that exercise was to calculate (accurately, say Fio's) the amount of undeclared sales, and the proportion of that amount which was zero-rated, for the Assessed Periods.
9. For HMRC, we heard witness evidence from Barry Patterson, a VAT assurance officer with HMRC. Mr Patterson raised the assessments which are the subject of this appeal.

10. Both Mr Raheem and Mr Patterson were examined and cross-examined, and we had the opportunity to question them. We comment below on their evidence.
11. We also had a witness statement from Sajjad Asghar, a senior accountant at Asghar & Co. Mr Asghar was unwell and unable to attend the hearing. Since he was therefore unavailable for cross-examination, we decided, with HMRC's agreement, to admit his statement, but to give it reduced weight. We note that in any event there was nothing material in Mr Asghar's witness statement which was not dealt with adequately by the written and oral evidence of Mr Raheem.

The Law

12. The assessments were made under section 73 of the VATA. This provides, so far as relevant, as follows:

“73 Failure to make returns etc

(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.”

13. Section 83(1)(p) VATA provides that an appeal shall lie to the tribunal with respect to an assessment under section 73(1) “or the amount of such an assessment.”
14. In considering an appeal against an assessment under section 73(1), the approach to be adopted by the tribunal was set out in two Court of Appeal decisions, *Rahman (t/a Khayam Restaurant) v Customs and Excise Commissioners* [2002] EWCA Civ 1881, and *Pegasus Birds Ltd v Customs and Excise Commissioners* [2004] EWCA Civ 1015. The law was more recently summarised by the Upper Tribunal in *Mithras (Wine Bars) Limited v HMRC* [2010] UKUT 115 (TCC).
15. The first stage is for the tribunal to consider whether, at the time such an assessment was made, it was made to the best judgment of the Commissioners. At this stage, the tribunal's jurisdiction is akin to a supervisory judicial review jurisdiction. As stated by Chadwick LJ (as he then was) in *Rahman* (at [32]):

“In such cases... the relevant question is whether the mistake is consistent with an honest and genuine attempt to make a reasoned assessment of the VAT payable; or is of such a nature that it compels the conclusion that no officer seeking to exercise best judgment could have made it. Or there may be no explanation; in which case the proper inference may be that the assessment was, indeed arbitrary.”
16. Chadwick LJ observed (at [43]) that instances of a failure to exercise best judgment would be rare. As he stated at [36]:

“... But the fact that a different methodology would, or might, have led to a different – even to a more accurate – result does not compel the conclusion that the methodology that was adopted was so obviously flawed that it could and should have had no place in an exercise in best judgment.”

17. Where the tribunal is satisfied that the Commissioners have used their best judgment in making the assessment, the second stage for the Tribunal is to consider whether the amount assessed is correct. As *Mithras* makes clear, in relation to this second stage the tribunal has a full appellate jurisdiction. It can therefore consider all available evidence, including material not available to HMRC at the time when the assessment was made, in substituting its own judgment as to the correct amount of the assessment.

18. The courts have emphasised that in most appeals against a best judgment assessment the tribunal's focus should be on determining the correct amount of VAT. As Carnwath LJ stated in *Pegasus Birds* (at [38]):

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

19. In relation to the burden of proof in this appeal, we have been guided by the following statements of Carnwath LJ in the Court of Appeal decision in *Khan v HMRC* [2006] EWCA Civ 89, at [69]:

“The position on an appeal against a “best of judgment” assessment is well-established. The burden lies on the taxpayer to establish the correct amount of tax due:

“The element of guess-work and the almost unavoidable inaccuracy in a properly made best of judgment assessment, as the cases have established, do not serve to displace the validity of the assessments, which are *prima facie* right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessment right or more nearly right” (*Bi-Flex Caribbean Ltd v Board of Inland Revenue* (1990) 63 TC 515, 522-3 PC per Lord Lowry).

This was confirmed by this court, after a detailed review of the authorities, in *Customs and Excise Commissioners v Pegasus Birds Ltd...*”

Agreed facts and chronology

20. The following facts were agreed between the parties.

21. The Appellant was incorporated as a limited company on 3 June 2009. Its name at that stage was DamDam North Ltd and it was registered for VAT on 14 July 2009.

22. On 10 December 2013 the Appellant changed its name to Fio’s Cash and Carry Ltd.

23. On receipt of Fio’s VAT returns for periods 12/11 and 3/12, HMRC noted that the returns showed an excess of expenditure over income. In a letter to Fio’s dated 19 July 2012, HMRC requested documentary evidence of the source of funding for the business in view of the excess.

24. On 10 September 2013 Officers Bullivant and Kanabar of HMRC met with Mr Kumar, Fio’s accountant. At the meeting, he informed HMRC that Fio’s auditors, Anthony Croft Ezekiel Ltd (“ACE”), had found that sales totalling

approximately £2 million had not been declared for the year ending 31 May 2012. Mr Kumar’s explanation for the under-declaration was as follows:

“He stated that this was due to the introduction of the new SAKS computer system at this time. He stated data entry clerks were employed to input sales data into the new system from the old system but they did not enter all the required information leading to this under-declaration.”

25. HMRC’s note of the visit on 10 September 2013 continues as follows:

“I have requested the details of the amounts under-declared in each affected period and informed Mr Kumar I would be in touch with the auditor to clarify the procedures going forwards. I enquired if there would also be an under declaration in sales after 31/05/12 and Mr Kumar stated he believed there would be up to the end of 2012.”

26. On 16 October 2013 Mr Kumar Farooq of ACE sent an email to HMRC stating that the under-declared sales for the year ending 31 May 2012 totalled £2,831,550. The email stated that the sales were:

“... unidentified/under-declared due to the breakdown of the accounting software in the process of the move to the new premises, material loss and corruption of the accounting data resulted in under declaration of sales.”

27. HMRC informed Fio’s by a letter dated 9 December 2013 that they intended to issue VAT assessments for periods 12/11 to 03/13 inclusive, in accordance with the calculations set out in that letter. The assessments totalled £637,941, broken down as follows:

VAT Period	VAT due on undeclared standard rated sales	Assessed Amount
12/11	£132,712	£59,780
03/12	£173,961	£11,233
06/12	£214,016	£87,424
09/12	£243,072	£192,130
12/12	£239,283	£53,205
03/13	£234,169	£234,169
Total	<u>£1,237,213</u>	<u>£637,941</u>

28. Having not received any response to their letter of 9 December 2013, HMRC raised the assessments and notified Fio’s of the assessments for periods 12/11 to 12/12 on 14 January 2014, and for 03/13 on 20 January 2014.

29. Fio’s appealed against the assessments for the Assessed Periods on 11 April 2014. The appeal was therefore brought out of time, but HMRC did not object. The assessments for the earlier periods from 12/11 to 06/12 were not appealed.

HMRC's Methodology

30. In reaching his judgment as to the amount of undeclared sales, and resultant unpaid VAT, Officer Patterson made a number of assumptions. The following is based on HMRC's skeleton argument and Officer Patterson's evidence which we accept as a reliable summary of his assumptions and reasoning.
31. The first assumption was that Fio's only declared 75.28% of its true sales for the Assessed Periods. This assumption was based on the admission in the letter from Fio's auditors dated 16 October 2013 that it failed to declare £2,831,550 in sales during the year ending 31 May 2012.
32. The basis on which Officer Patterson derived a percentage of 75.28% from this figure was explained by him as follows:
 - (a) Fio's explanation for the under-declaration related to confusion resulting from their move of premises. That move took place on 21 November 2011.
 - (b) He therefore looked at Fio's declared sales in periods 12/11, 03/12 and 06/12, before excluding sales that took place in June 2012. He could also have excluded sales that took place between October 2011 and 20 November 2011 as this was prior to the move of premises. Choosing not to exclude those sales worked in Fio's favour.
 - (c) Fio's declared sales from 1 October 2011 to 31 May 2012 were £8,618,935.
 - (d) He therefore calculated the true sales as £11,450,485. This is the aggregate of the total declared sales of £8,618,935 and the admitted undeclared sales of £2,831,550.
 - (e) The value of the undeclared sales (£2,831,550) expressed as a percentage of total sales (£11,450,485) was 24.72%. This meant that Fio's only declared 75.28% of its sales between October 2011 and May 2012.
33. The second assumption was that the circumstances which led to the under-declaration persisted until period 03/13.
34. Officer Patterson considered that he was entitled to make this assumption for the following reasons:

- (a) Fio's had accepted that the error in under-declaring sales continued past the end of May 2012, and Fio's accountant had stated (during the visit to Fio's on 10 September 2013) that he believed the problem continued up until the end of 2012.
 - (b) The amount of sales declared on Fio's VAT returns for each of the Assessed Periods was not appreciably more than the sales declared on the VAT return for the period immediately prior to the Assessed Periods, namely 06/12. Net declared sales were £4,116,286 in 06/12, £4,675,141 in 09/12, £4,602,248 in 12/12 and £4,503,885 in 03/13.
 - (c) On Fio's own case, the figure of £4,116,286 for sales in June 2012 was vitiated by under-declaring its sales in April and May 2012.
 - (d) The fact that sales did not notably increase in the periods 09/12 to 03/13 would suggest that the error continued throughout those periods. If the error had in fact been corrected by period 09/12 then one would have expected to see a corresponding increase in sales of approximately 25%.
 - (e) The declared sales did increase very markedly between 03/13 (£4,503,885) and 06/13 (£6,324,870). This represents a 40% jump in sales. In the absence of any alternative explanation for this jump, he was entitled to conclude that it was explicable by the fact that Fio's had rectified the error and was no longer failing to declare all its sales.
35. The third assumption was that 5% of Fio's sales for the Assessed Periods were zero-rated and could therefore be discounted when determining the amount of additional VAT due.
36. Officer Patterson considered that this was a reasonable assumption for two reasons. First, it was reasonable to assume that under-declared sales would incorporate both zero-rated and standard rated sales, given that Fio's declared sales included both. This assumption was to Fio's benefit. Secondly, 5% was a reasonable percentage to assume because that was the average percentage of declared sales which were zero-rated.

Fio's Criticisms

37. Fio's made several criticisms of HMRC's methodology. These will be considered in more detail when we consider and contrast the details of Fio's own methodology. In summary, however, the criticisms put forward in Fio's skeleton argument are as follows.

38. The overarching argument, relied on heavily by Mr Lakha in the proceedings, is set out in the skeleton as follows:

“.... The Respondents rely on an arithmetic construct based on a set of assumptions with little reference to (or basis in) known or verifiable facts, whereas the Appellant uses figures produced by qualified professionals in the course of a disciplined process involving the review and consideration of actual invoices, records and statements, applying standards commonly applied by members of the accounting profession..... The Appellant’s submission is that, because its own methodology is based on standard book-keeping procedures, and is grounded in the real world, it produces a more accurate result than the Respondent’s purely numeric construct, and is thus more appropriate.”

39. Fio’s also submits that the assumptions underlying HMRC’s methodology are flawed. The assumption that the under-declared sales occurred after the premises move in November 2011 is based on a misunderstanding of the information provided by Mr Kumar (see [23]) and by Mr Farooq (see [25]). It is more sensible to assume that they also occurred before the move, from June 2011 onwards.
40. Thirdly, argued Mr Lakha, HMRC has been inconsistent in their approach to the results of the audit work carried out by ACE. They made the assumption that the figure for under-declared sales of £2,831,550 produced by ACE for the year ended 31 May 2012 was correct. However, HMRC had not accepted as accurate the figure of £1,596,411 produced by ACE as the value of under-declared sales for the year ended 31 May 2013 in its audit for that year.
41. Fourthly, Mr Lakha argued that HMRC’s methodology was flawed in assuming that the under-declaration for the year ending 31 May 2012 occurred uniformly at a rate of 24.72% over that period. That is inherently unlikely and takes no account of “real world” variations.

Best Judgment

42. It was not argued by Mr Lakha that HMRC had failed to exercise best judgment in making the assessments. It was not alleged that HMRC had acted capriciously or improperly or in bad faith. While recognizing that ultimately it would be for the tribunal to determine whether there had been a failure of best judgement, Fio’s case as set out in its skeleton argument urged us to concentrate on establishing the correct amount of VAT, as follows:

“The question is not whether the Respondents’ methodology represents their best judgment at the time they made the assessments, but whether taking account of all the materials available now (which include materials not available to the Respondents at the time they made the assessments), it represents the better approach in determining the amount of VAT properly due from the Appellant in relation to the Assessed Periods.”

43. In our judgment, that was indeed the appropriate focus for the purpose of considering the appeal. We saw no evidence to suggest that HMRC failed to exercise their best judgment in making the assessments. The issue was whether Fio’s could discharge the burden of proving that its calculation of the VAT due for the Assessed Periods was more accurate than that of HMRC. This entailed a critical comparison of the respective methodologies.

Fio's Methodology

44. On 16 September 2014 Fio's instructed a firm of accountants, S. Asghar Co. ("Asghars") to "reconstruct" Fio's accounts for the period from 1 June 2012 to 31 May 2013.
45. This exercise was carried out by Mr Asghar and Mr Raheem, both qualified chartered accountants. Asghars and those two individuals (who were employed by Asghars) were independent of Fio's and their independence was not challenged by HMRC.
46. Mr Raheem described the methodology used in his second witness statement as follows:

"Our calculations are based on a review of the Appellant's bank deposits/receipts and payments, cash receipts and expenses, daily till sheets, and "Sacs" sale receipts (including sales, day book, daily till sheets, purchase day book, expenses, wages and the Appellant's banking and (sometimes incomplete) cash records), as well as information and explanations provided by the Appellant. This was explained to HMRC in a letter dated 5 January 2015. Our calculations were based on records of actual events – that is what happened in the real world – and not a hypothesis (like Mr. Patterson's calculations) and for this reason our calculations are more accurate.

We calculated the value of undeclared sales by comparing:

- (a) the records of sales, purchases and expenses (including "Sacs" sales receipts) against sales; and
- (b) bank receipts and payments.

We uncovered "over-banking" – that is movements in the bank accounts that were unsupported by the records reviewed – and this was the basis for our finding that there had been undeclared sales. We also reviewed all the invoices that were made available to us.

The methodology we used consists of standard bookkeeping procedures on records of sales, purchases, expenses, bank receipts and payments, cash payments and receipts. In my opinion, the vast majority of accountants and auditors (around 95%) would use the same methodology we used if they were asked to carry out the same exercise we were asked to carry out. HM Revenue & Customs are able easily to verify the calculations independently."

47. Using this methodology, Asghars calculated the aggregate value of Fio's under-declared sales, both standard rated and zero-rated, for the Assessed Periods to be £1,612,633. This figure breaks down as follows:
 - (a) 9/12- £1,326,611
 - (b) 12/12- £1,333,149
 - (c) 03/13- (£1,047,126)
48. We were not provided with figures for the VAT payable for the Assessed Periods on the basis of Fio's methodology. However, assuming that 5% of the aggregate figure comprised zero-rated supplies (see further below), VAT of 20% on 95% of £1,612,633 would be £306,400. HMRC's assessments, by contrast, amount in aggregate to £479,503.

49. One of HMRC criticisms of Fio's calculations was that it was simply not clear how the figures had been arrived at. We return to this issue below but for our part we also found it difficult to pin down the underlying assumptions and workings which led to Fio's figures. The evidence from Mr Raheem set out at [46] refers several times to the source materials he used but beyond stating that the calculation "compared...the records of sales, purchases and expenses, against sales and bank receipts and payments" the actual workings and assumptions supporting the calculations were in our opinion opaque.
50. We asked Mr Raheem to clarify the basis of his methodology. He explained that since the undeclared sales were by definition not apparent from the business records, his starting point was to look at declared sales and to focus on movements of cash. He stated that he established from company bank records what had been banked, adjusted that figure for creditors, and added the resulting figure to expenses, which he took steps to verify. That total figure was then deducted from the aggregate figure for sales (taken from documents such as the daily till sheets). The difference was then taken to consist in the undeclared sales, as set out at [47].

Discussion

51. We have considered and compared the strengths and weaknesses of each methodology and taken into account all available evidence, including materials not available to HMRC when the assessments were made, in determining so far as possible the correct amount of VAT for the Assessed Periods. In doing so, we have been guided throughout by the statement in *Bi-flex* set out at [19] above that:

"the assessments... are prima facie right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessment right or more nearly right."

52. We consider firstly the HMRC methodology and address the criticisms of it raised by Fio's.
53. The overarching criticism of the HMRC methodology made by Fio's is that it is based on an arithmetic construct or formula, and not on "real world" figures. Mr. Lakha argued that it was self-evident that this in itself made the Fio's methodology more reliable: see [38] above. As he expressed it in his closing submission, how could a theoretical model based on assumptions ever be better than a method based on actual material, given that "fact trumps theory"?
54. As a matter of principle, facts are indeed preferable to theories. But that is of little material assistance in the exercise before us. Given that it is accepted that Fio's sales were materially under-declared over a significant period, the "real world" figures are clearly incomplete and, by definition, not entirely accurate. In that event, any methodology which attempts to establish the quantum and timing of the under-declarations will of necessity involve assumptions, based on the admittedly incomplete available data. In our judgment, what matters in relation to either HMRC's or Fio's methodology is the reliability and reasonableness of the assumptions; the rationale behind the assumptions; the extent to which the results of the methodology are consistent with other data,

and the degree to which the results are within a range of reasonable expectations given all the facts and circumstances.

55. Fio's also argued that its methodology must necessarily be more accurate than HMRC's, because Fio's methodology was a "disciplined process" carried out by "qualified professionals" taking into account "generally accepted accounting standards".
56. To an extent, these points are simply an elaboration of the "formula versus real figures" argument. We do not accept that these factors must *necessarily* mean that the Fio's methodology is more accurate. It cannot be right to generalize that any HMRC "best judgment" assessment is necessarily inferior to an assessment carried out by an accountant on the instruction of the taxpayer. It all depends on the facts. In our judgment, the HMRC methodology, as set out at [29] to [35], can fairly be described as a "disciplined process". Even if one accepts that most accountants asked to "reconstruct" a company's accounts in circumstances such as these would follow a similar approach to that adopted by Asghars – as to which we had the evidence of Mr Raheem – it does not follow that the result is *a priori* more accurate than HMRC's methodology. Again, therefore, we did not find these points of material assistance in the exercise of establishing the correct amount of VAT for the Assessed Periods.
57. Turning to Fio's more specific criticisms, it argues that the assumptions underlying HMRC's methodology are flawed. In particular, it argues that Officer Patterson's assumptions regarding when the under-declarations started and when they finished were wrongly made.
58. Officer Patterson made the assumption that the under-declarations for the year ending 31 May 2012 began to occur after November 2011. Fio's argues that it would be more reasonable to assume that they began earlier, say in June 2011. This is relevant to the amount of under-declared sales for the Assessed Periods because it directly affects the percentage of under-declared sales assumed in the HMRC methodology. An assumption that the under-declaration began in June 2011 would, submitted Mr Lakha, produce a percentage of 17.83% rather than 24.72% to be applied in the HMRC formula.
59. Officer Patterson's assumption derived from the two explanations provided to HMRC on behalf of Fio's for the under-declarations of sales. As summarized at [23] to [25] above, Mr Kumar (Fio's accountant) attributed the under-declarations to errors by data entry clerks in operating the company's new computer system, whereas Mr Farooq of ACE (Fio's auditor) attributed them to "...the breakdown of the accounting software in the process of the move to the new premises...".
60. We observe that while both explanations relate to problems regarding Fio's computer systems, the first ascribes the problem to human error and the second to software error. In light of this inconsistency Officer Patterson chose to attribute the commencement of the under-declarations to the only verifiable fact, which was that the company moved premises on 21 November 2011 and the computer system was being replaced across the date of that move.

61. Mr Lakha submitted that this approach was premised on a misunderstanding of the information provided by Mr Kumar and Mr Farooq. Fio's skeleton argument set out this submission as follows:

"The Respondents have interpreted what Mr Kumar and Mr Farooq said to mean only data entered after the move on 21 November was inaccurate or unreliable. This reading is too narrow, especially in light of Mr Kumar's reference to "the old system" and Mr Farooq's references to "loss" and "corruption" (which suggest that data that was once accessible was no longer available). The more sensible reading is that, whatever the position was after the move, there was also an issue with the failure to transfer data that was previously on the old system to the new system.

Data on the old system would include details of sales made prior to the move. Whether Mr Kumar or Mr Farooq's explanation is preferred – and what both are saying is in essence the same (being simply that migration, whether to new premises or a new system has caused IT problems – a common enough phenomenon all businesses (and possibly even the Respondents) are familiar with – if missing data is the basis of the under-declarations, and that missing data includes details of sales, made prior to the move, there is no basis for excluding June, July, August or September 2011 from the [assumed period]."

62. In our judgment, Officer Patterson's assumption was not unreasonable given the two conflicting explanations received by HMRC for the under-declarations. What Mr Kumar and Mr Farooq were saying was not "in essence the same". Clearly, however, it was entirely open to Fio's to present us with evidence not before Officer Patterson at the time he made the assessments to demonstrate to us the contrary assumption put forward by Mr Lakha and set out at [61]. That contrary assumption is also plausible in principle.
63. However, we were presented with no evidence at all to support Mr Lakha's criticism of Office Patterson's assumption. We were given no evidence from Mr Farooq or Mr Kumar. Moreover, we were presented with no evidence at all, on this or any other issue, from the Appellant itself. No evidence was forthcoming as to the reasons for the under-declarations. Mr Raheem made it clear that he was not instructed to consider the possible reasons, and had no view on the topic. We were given no other evidence regarding the switch to the new computer system or the source of the related problems.
64. We do not accept Fio's criticism of the date selected by Officer Patterson as the assumed commencement date of the under-declarations. The burden of proof rests on the Appellant to establish the correct amount of VAT for the Assessed Periods.
65. Fio's second specific criticism of HMRC's methodology was related to the period of time over which Office Patterson assumed the under-declarations to have continued. We confess to finding this ground of criticism somewhat surprising. This was that Officer Patterson had assumed the under-declarations all to have occurred by March 2013, whereas it was plausible that they might have continued beyond that date. Again, if this were correct, it would have the effect of reducing the unpaid VAT for the Assessed Periods.
66. We regard this argument as without merit. It was clarified by Mr Lakha and Mr Raheem that Fio's had not made any voluntary disclosure of under-declared sales for periods after March 2013. No evidence was presented to

support the argument that under-declarations in fact continued after March 2013. Finally, as Office Patterson pointed out, the fact that declared sales increased by some 40% in 06/13 over 03/13 strongly suggested that, whatever the cause of the under-declaration had been, it had come to an end by the 06/13 period.

67. The third specific criticism raised by Fio's is that HMRC's methodology assumes that the under-declarations occurred uniformly at the rate of 24.72% over the assumed period. That was inherently unlikely and took no account of "real world" variations.
68. We agree that it is inherently unlikely that the under-declared sales occurred at precisely the same percentage to two decimal points for each month. However, that is in the nature of an average. The real issue in our judgment is whether the particular average chosen by Officer Patterson was a reasonable choice. In light of his detailed reasoning as set out at [31] above we conclude that it was both logical and reasonable. Since Fio's decided to produce no evidence as to the reasons for the under-declarations, let alone the detailed timing impact of those reasons in terms of month by month fluctuations, we find no evidence to suggest that the averaging methodology was flawed as Mr Lakha suggests.
69. The final specific criticism of HMRC's methodology raised by Fio's is that it is inconsistent in its approach to the results of the audit work carried out by ACE. HMRC made the assumption that the figure of £2,831,550 produced by ACE for under-declared sales for the year ended 31 May 2012 was correct. However HMRC's methodology did not accept as accurate the figure of £1,596,411 produced by ACE for under-declared sales in its audit for the year ended 31 May 2013, even though ACE used substantially the same methodologies for both years.
70. We heard in evidence that the 2013 audited accounts for Fio's were not provided to HMRC, although they were filed with the Registrar of Companies. However, our remit is to consider all evidence available to us in comparing the two methodologies, so we considered the 2013 audited accounts in our determination.
71. HMRC made two points in response to this ground of criticism. The first was that the two periods were not co-terminous, as the 2012 accounts ran from 1 June 2012 to 31 May 2012 whereas the 2013 accounts ran from 1 July 2012 to 30 June 2012. Since neither set of accounts broke down information month by month, it was not readily possible to do a "like for like" comparison. The second was that in choosing not to appeal against the VAT assessments for the three earlier periods 12/11 to 06/12 (the latter of which included June 2012, not covered by either ACE audit), Fio's had effectively conceded that the 24.72% taken as the average under-declaration of sales was accurate for those earlier periods. It was therefore illogical to argue that the same percentage was "fatally flawed" for the Assessed Periods.
72. In our judgment, the absence of any appeal for the three earlier periods is not a good answer to the criticism that HMRC's methodology accepts the 2012 audit results but not those for 2013. The one month difference between the two audits is relevant to carrying out a like-for-like comparison but it would have

been straightforward to factor this in to the comparison by making an assumption regarding the missing month.

73. We therefore conclude that there was an inconsistency in the HMRC methodology in its approach to the ACE audit results. That is relevant to the first part of the test identified by Lord Lowry in *Bi-flex*, namely whether or not the assessments, while *prima facie* right, are in fact wrong. Before determining that question, however, it is sensible, since this case is in essence a comparison of the methodologies, to consider the second part of the test identified in *Bi-flex*. That is whether Fio's alternative calculation "...also shows positively what corrections should be made in order to make [the assessments] right or more nearly right".
74. We therefore turn to consider that question in relation to Fio's methodology.
75. As we have already described, we found the calculations and assumptions underpinning Asghar's methodology to be opaque. Even after questioning Mr Raheem we found it difficult to be confident that we had been given complete information regarding the assumptions made by Asghars in the reconstruction process.
76. Mr Raheem's evidence regarding the extent to which the reconstruction process took sales invoices for the Assessed Periods into account appeared to us to be inconsistent. He stated that he had taken account of invoices for zero-rated sales, but not for standard rated sales. That approach appears to us to be somewhat curious. He also gave evidence however, that in a situation where sales had been under-declared, invoices were simply not relevant in reconstruction of the accounts. In contrast, in his second witness statement (at [46] above) he stated that he had "reviewed all the invoices that were made available to us".
77. The result of Asghars' reconstruction process was two documents of approximately twenty pages each. One was headed "Fio's Cash & Carry Ltd. 30 September 2012, Bank: Petty cash from 01/06/12 to 31/03/13" and the other was headed "Fio's Cash & Carry Ltd. 31 May 2013, Bank: Petty cash, from 01/06/12 to 31/05/13". Neither document contains any narrative, commentary, or stated assumptions. Each shows by date a number of "receipts" and "payments". The difference between total receipts and payments is taken to be the under-declared sales for VAT purposes for each of the periods included in the documents.
78. It appears to us that the first two underlying assumptions behind the calculations are that the records of expenses were complete and accurate and that the records of amounts banked were complete and accurate. The third assumption was that when those two amounts were added together and adjusted for creditors, the difference between that adjusted aggregate on the one hand and total documented sales on the other shows the under-declared sales.
79. In determining whether Fio's had discharged the burden of proof to show positively what corrections should be made to HMRC's assessments to make

them “right or more nearly right”, we considered the following questions in particular as well as all the relevant facts and circumstances:

- (a) is the methodology reasonable in principle?
- (b) is the methodology adequately supported by underlying business records, and are those records reliable?
- (c) does the methodology proper account of the particular facts?
- (d) does the methodology produce any surprising or counter-intuitive results and, if so, is there a good explanation for them?

80. Dealing first with whether Asghars’ methodology is reasonable in principle, it is misleading to say, as Mr Lakha did, that HMRC’s methodology is formula-based and makes assumptions whereas Asghars’ does not. The Asghar’s methodology is no less a “formula” than that adopted by HMRC. Indeed, it is arguable that in ignoring altogether the likely causes of the under-declared sales the Asghars’ methodology is more formulaic. Further, the Asghars’ methodology does make a number of crucial assumptions, as set out at [77], although the assumptions differ from those made by HMRC.
81. In terms of the reasonableness in principle of the Asghars’ methodology in our judgment one of its weaknesses is that it appears to take into account only payments actually made or received for the period. In practice, monies received may relate to sales from previous periods and payments made may be for a wide variety of reasons other than the purchase of stock. Further, the central assumption that the difference between “money out and sales” must necessarily equal the undeclared sales for VAT purposes is only one possible explanation for that difference, and we heard no evidence as to why it was the only reasonable assumption in the circumstances. We return to this issue below.
82. It is helpful to consider together the related questions of whether the Asghars’ methodology is supported by reliable business records and whether it takes proper account of the particular facts.
83. In terms of whether the methodology was soundly based on reliable business records, there were a number of troubling inconsistencies.
84. First, as referred to above (at [76]), it was not clear from Mr Raheem’s evidence, and not dealt with in the documents supplied to HMRC and the tribunal, to what extent sales invoices had been taken into account. In his closing submissions, Mr Lakha argued that invoices were “irrelevant”. Mr Raheem, however, stated in his evidence that he had focussed on invoices for zero-rated sales, which he described as “a reasonable starting point”. We do not accept that it is a reasonable starting point, particularly given the history regarding Fio’s zero-rated sales which we discuss below.
85. Secondly, we heard conflicting evidence regarding the company’s “daily till sheets”. These were described to us by Mr Raheem as Excel sheets which record on a daily basis for each sale made the invoice number, date, customer

name, and whether payment was cash or credit. Mr Raheem stated that he relied on the daily till sheets in compiling his “Petty Cash” document. However, the daily till sheets were not supplied to HMRC or shown to the tribunal. We cannot, therefore, verify to what extent the output of the Asghars’ methodology is consistent with these important records.

86. Thirdly, in relation to “money out” while we accept the force of the assertion that taxpayers will generally wish to fully record and claim expenditure for VAT purposes, there were indications during Mr Raheem’s cross-examination that such records might not be wholly reliable in Fio’s case. Mr Raheem acknowledged in relation to bank deposits that there might be more “paying-in books” than Asghars had considered. Further, the fact that through questioning suppliers Asghars had discovered material unrecorded supplies to Fio’s might indicate that other such supplies had gone undetected.
87. We turn next to the extent to which Asghars’ methodology takes proper account of the particular facts. Given that it was accepted that sales had been under-declared, one might have expected a reconstruction exercise to take some account of the likely cause of the under-declaration. In our judgment, such an expectation would be even stronger where, as here, the information to be sought in the reconstruction was not the aggregate amount of the under-declarations but when those under-declarations occurred.
88. However, it was accepted that the Asghars’ methodology took no account of the possible causes of the under-declarations. Mr Raheem stated in evidence that he had not been instructed to consider the reasons for the under-declarations, and in any event his methodology was not sensitive to this.
89. We heard no evidence at all from Fio’s as to the possible causes of the under-declaration. Mr Lakha submitted that since HMRC were not alleging fraud or dishonesty against Fio’s in respect of the under-declaration, the causes were simply irrelevant.
90. In our judgment, this is a material weakness in the Asghar’s methodology, when contrasted to the HMRC methodology. It is a weakness because since our task is to assess on the basis of all the available materials the “right” amount of unpaid VAT for the Assessed Periods it is an important part of that exercise to understand when the under-declarations are likely to have started and finished. In order to make that judgment on an informed basis we need to understand what each party says are the reasons for the under-declarations. If the primary reasons are those given by HMRC, then that is material to when the under-declared sales are likely to have started and stopped. Mr Lakha, however, told us that while the under-declaration was “obviously linked” to the IT migration, “...we just don’t know [the reasons]... it’s unexplainable”.
91. We turn finally to the question of whether the Asghars’ methodology produces any surprising or counter-intuitive results and, if so, whether there is a good explanation for them. In this respect, there are two areas which have caused us concern. The first relates to the proportion of under-declared sales which were zero-rated. The second is the sale figure generated by the methodology for period 03/13.

92. At the risk of stating the obvious, it is in a taxpayer's interests to claim that as large a proportion as possible of any undeclared sales was in fact zero-rated. HMRC's methodology, based on 5.01% of Fio's declared sales straddling the Assessed Periods being zero-rated, was to assume that 5% of undeclared sales were zero-rated.
93. The zero-rated proportion asserted by Asghars varied very considerably over time. Following their appointment to carry out the reconstruction exercise in September 2014, Asghars wrote to HMRC on 5 January 2015 stating that having analysed Fio's records in their opinion for the year ending 31 May 2013 total under-declared sales were £1,972,365 of which zero-rated sales were £462,408. On 30 November 2015 the witness statements filed by Asghars stated that following the reconstruction of the accounts, under-declared zero-rated sales for the period 1 July 2012 to 31 March 2013 were in fact £1,285,733. That latter figure was repeated in the witness statement submitted by Mr Raheem on 2 June 2016, and again in the further witness statement submitted by Mr Raheem on 14 July 2016.
94. The explanation given by Asghars for the £1,285,733 of zero-rated sales was that in the course of their work they had discovered records of invoices for food sales "from a stand-alone computer that was not connected to the 'Sacs' network." HMRC raised a substantial number of objections in relation to these discovered invoices.
95. It is certainly surprising on its face that Asghars' methodology should have led to such a significant figure for undeclared zero-rated sales. In response to a large box of zero-rated invoices sent by Asghars to HMRC to explain the figures, HMRC raised fifteen grounds of objection or query.
96. Although the skeleton argument filed by Fio's continued to assert this figure for zero-rated sales, we were told by Mr Lakha at the hearing that this point was no longer maintained, and that the figure of 5% proposed in HMRC's methodology was in fact agreed between the parties.
97. In relation to the reliability and soundness of the Asghars' methodology and the records supporting it, we are troubled by this sequence of events. We were told by Mr Lakha that the zero-rated disagreement had "gone away", but were not told why.
98. The second surprising or counter-intuitive aspect of the Fio's calculation for the Assessed Periods relates to period 03/13.
99. It will be recalled that the reconstruction methodology utilised by Asghars assumes that the cash shortfall identified for a period must represent undeclared sales for that period. The resultant deficit produced by the methodology for period 09/12 is £1,326,611 and for period 12/12 is £1,333,149. However for period 03/13 the methodology produces a cash *excess* of £1,047,126.
100. This is in our view a very surprising result. One plausible partial explanation might have been that by the 03/13 period the under-declarations had ceased, but that was not the position put forward by Fio's, who argued that HMRC's

methodology was wrong because if anything the under-declarations might well have been continued beyond that period.

101. Mr Raheem was questioned during his examination as to whether this excess figure for 03/13 indicated that in fact sales had been over-declared for that period. His response was that the figure might in fact reflect sales for the previous quarter.
102. We were given no other explanation or possible explanation for such a substantial excess result from Mr Raheem, and heard no evidence on this or any other point from Fio's.
103. Given that Mr Raheem stated that Asghars' work had uncovered "over-banking" and that a central assumption of the reconstruction methodology was that the true figure for under-declared sales could be found by calculating the cash deficit for a period, we would have expected some clear explanation for the result for period 03/13. We were therefore troubled by the failure to provide any actual or likely explanation.

Conclusion

104. It was not in dispute that under-declarations of sales and associated VAT had occurred. We did not find that there was a failure of best judgement by HMRC in raising the assessments for the Assessed Periods. So the central issue before us was whether Fio's had discharged the burden of proof in establishing that the assessments, while *prima facie* right, were wrong and, if so, how they should be corrected to make them "right or more nearly right". In that exercise we took account of all available facts and information whether or not available to HMRC when the assessments were raised.
105. Looking first at whether or not HMRC's methodology was flawed, for the reasons given we were not persuaded by most of Fio's criticisms. In relation to the most likely start and end of the under-declarations, we found nothing to render unreasonable the assumptions made by HMRC on the basis of the information supplied by Mr Kumar and Mr Farooq. The timing issues turn critically on the likely reasons for the under-declarations and Fio's chose to present no evidence on that point.
106. We do find that the HMRC methodology was flawed to some degree in respect of the inconsistency in approach to the ACE audit results. While HMRC's responses to that criticism have some force, in our judgment they do not entirely address the concern.
107. However, any such shortcoming in the HMRC methodology does not of itself, in the language of *Bi-Flex*, "serve to displace the validity of the assessments". Fio's needed also show to positively what corrections should be made to the assessments in order to make them right or more nearly right.
108. As we have explained, we do not accept that Fio's methodology is necessarily superior to HMRC's simply because it is based on figures and records for the Assessed Periods. Nor is that so because Fio's methodology was carried out by an accountant using a recognized process for reconstructing accounts. In

our judgment the issues set out at [79] must all be considered. Is the methodology reasonable in principle and supported by reliable business records, does it take proper account of the particular facts, and if it produces counter-intuitive result have they been satisfactorily explained?

109. We found several serious shortcomings with the Asghars' methodology and the results which it produced. In particular we note the following points:
- (a) The workings and assumptions underpinning the "Petty Cash" document were unhelpfully opaque, making it difficult to understand and assess them with confidence.
 - (b) The failure to produce any evidence whatsoever from Fio's clearly hampered Fio's ability to discharge its burden of proof.
 - (c) We do not accept Fio's contention that the reasons behind the under-declarations are irrelevant. Those reasons are directly relevant to the central issue of when the under-declarations are likely to have occurred.
 - (d) In relation to the extent to which the methodology was based on reliable business records, there were a number of inconsistencies such as the relevance of invoices and of daily till sheets which made it difficult to access this issue with confidence.
 - (e) The huge discrepancy over the period described in the proportion of undeclared sales found by the Asghars' methodology to be zero-related cast doubt on the robustness and reliability of both the underlying data and the outcome of the process.
 - (f) The material excess cash figure produced for period 03/13 is anomalous and was not properly explained.
110. Having considered these and all other relevant facts and information we conclude that although HMRC's methodology is somewhat inconsistent on the ACE audit issue, Fio's has failed to discharge the burden of proof that its method of calculating undeclared VAT for the Assessed Periods shows the correct amounts to be assessed. We were presented with no other basis on which to adjust the amounts assessed.
111. The appeal is therefore dismissed.
112. This document contains full findings of facts 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.

**THOMAS SCOTT
TRIBUNAL JUDGE**

RELEASE DATE: 26 APRIL 2017