[2017] UKFTT 013 (TC)

TC05579

Appeal number: TC/2014/04401

VAT – output tax – whether assessments made by HMRC correct – best judgment – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

MORRELLA LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS
RUTH WATTS DAVIES

Sitting in public at The Royal Courts of Justice on 24 to 26 October 2016 and having considered written closing submissions from HMRC dated 2 December 2016 and from the Appellant dated 9 December 2016

Eamon McNicholas, instructed by Salhan Accountants Limited, accountants, for the Appellant

Bernard Haley, Officer of HM Revenue & Customs, for the Respondents

DECISION

1. At the material times the appellant company (the "Company") operated a restaurant called "Noodle Time". It is appealing against VAT assessments made for periods from, and including, 04/12 to, and including, 01/13. HMRC made the assessments because they considered that the Company was "suppressing" sales at a restaurant it operated. The total amount of those assessments (as adjusted following an HMRC internal review) is £85,594.

Evidence and procedural matters

2. For the Company, we had evidence from Mr Zexing Lin, the sole director and shareholder of the Company at the relevant times. We also had evidence from Mr Victor Man, the Company's accountant at the relevant times. Both Mr Lin and Mr Man provided witness statements and were cross-examined.

3. Mr Man's second witness statement consisted in large part of opinion as to why the methodology that HMRC had employed to make their assessment (which was based on a single day's observation of business at the restaurant) was statistically unsound. No expertise in the field of statistics was claimed for Mr Man and Mr McNicholas accepted (as he had to) that, since Mr Man was the Company's adviser, he was not sufficiently independent to give expert evidence in any event. We have disregarded Mr Man's opinion evidence. However, we have considered for ourselves whether the method HMRC used to make the assessments was so unsustainable that it had to be set aside or replaced by another method.

4. In correspondence with HMRC prior to the hearing, the Company referred to a report prepared by a Dr Salhan (who holds a PhD in Mathematics) on the statistical basis underpinning HMRC's assessment. However, Dr Salhan did not produce a witness statement and was not produced for cross-examination. Her report, therefore, was not evidence that HMRC's methodology was statistically unsound and we have not treated it as such.

5. HMRC relied on witness evidence from the "case officer", Officer Kenneth Rhodes, and from other officers who had undertaken observations at the restaurant. All of the following HMRC officers provided witness statements and were cross-examined:

(1) Kenneth Rhodes

(2) Keith Martin

(3) Darren Howell

(4) Bogden Kuriata

(5) Emma Moore

6. Officer Clive Chivers undertook observations at the restaurant and prepared a witness statement prior to the hearing. However, he did not attend the hearing for

cross-examination as he had retired from HMRC prior to the hearing. At [44] to [46] below, we explain the approach that we have taken to Officer Chivers's witness statement in these circumstances.

7. The HMRC case officer at the time HMRC performed observations at the Company's restaurant was Officer Jonathan Archibald and Officer Archibald himself performed some observations. Officer Archibald also made the assessments against which the Company is appealing. The hearing bundle contained a witness statement Officer Archibald prepared which dealt primarily with the methodology that he used to make the assessments and the chain of correspondence between HMRC and the Company both leading up to, and subsequent to the assessments. We were not shown any witness statement from Officer Archibald dealing with the observations that he performed at the restaurant, although Mr Haley told us that such a witness statement had been prepared.

8. Officer Archibald had left HMRC by the time of the hearing and HMRC did not call him as a witness; nor had the Company applied for a witness summons requiring him to attend. In his witness statement, Officer Rhodes confirmed that the statements in Officer Archibald's witness statement referred to at [7] were correct.

9. We have decided to admit Officer Archibald's witness statement as evidence even though he did not attend for cross-examination. We did not agree with Mr McNicholas that HMRC were seeking to "slip in Officer Archibald's prime evidence by the back door" given that Officer Rhodes's witness statement referred expressly to that of Officer Archibald and stated that it was true. Moreover, Officer Archibald's witness statement consisted largely of an explanation of arithmetic calculations that he had performed and of various correspondence between HMRC and the Company. Mr McNicholas could (and did) challenge the evidence on such issues by putting points to Officer Rhodes in cross-examination. However, there were parts of Officer Archibald's witness statement that could not be challenged in this way: for example, Officer Archibald's subjective reasons for deciding to investigate the Company and for deciding to adopt the methodology he did for making the assessments. We have taken into account the fact that Mr McNicholas had no opportunity to challenge evidence such as this when assessing its weight.

10. Nevertheless, despite the approach set out at [9], we had no direct evidence of observations that Officer Archibald made during his visit to the restaurant although we did have some indirect evidence as Officer Archibald's observations had been incorporated into other calculations. At [51] we explain how we have approached this issue.

11. The hearing was listed for four days. On the third day of the hearing, after all witness evidence had been heard, Mr Haley and Mr McNicholas made a joint application requesting that the remainder of the hearing be vacated with closing arguments to be made at a later date. We were somewhat surprised at this application as we saw no reason why the hearing could not proceed straight to closing arguments. However, since both parties made the application (and stated that they would explore settlement opportunities in the interim), we granted it. We decided, however, that the

delay and expense involved in reconvening for oral closing arguments would be disproportionate and agreed with Mr Haley that closing arguments should be in writing and gave the parties until 2 December 2016 (a date they both agreed to) to prepare those arguments.

12. On 29 November 2016, the Company made an application to the Tribunal for HMRC to disclose information and requested an extension of time to submit its closing arguments (broadly so that those arguments could take into account the information it hoped to obtain). On 5 December 2016, we refused the application for disclosure and gave reasons. Since the Company's application for an extension of time was predicated on its application for disclosure being successful, and the Company had made no general application for an extension of time, we required the Company's closing submissions within two days (the deadline of 2 December 2016 already having passed). The Company complied with this direction.

13. However, HMRC had separately voluntarily provided the Company with some or all of the information requested. The Company therefore submitted further written closing submissions (which the Tribunal had not requested) stating that these were relevant in the light of the information it had obtained from HMRC. Those additional closing submissions were not by way of reply to any points that Mr Haley made in his written closing arguments: they sought to expand on allegations of racism that Mr McNicholas had raised both at the hearing and in his own written closing arguments. In the circumstances, we have not considered Mr McNicholas's additional closing submissions. We refused the Company's application for disclosure precisely because we did not consider it right that the Company should seek new evidence when the Tribunal had already heard witness evidence from both sides. (Indeed, in the course of discussions as to whether to end the hearing on its third day, Mr McNicholas had specifically stated the request was not motivated by any desire of the Company to seek new evidence). Even though the Company has obtained some new material from HMRC, that material was not in evidence before the Tribunal. We therefore saw no reason to consider additional submissions on it.

PART I – FINDINGS OF FACT

The methodology HMRC used to make the assessments

14. In order to understand the issues arising in this appeal, it is necessary to appreciate precisely how HMRC have calculated the assessments. The process adopted is set out in this section. Later sections of this decision will consider the accuracy of the assessments.

15. On 17 January 2013, on the instruction of Officer Archibald, a number of HMRC officers visited the Company's restaurant to observe a whole day's trade. Those officers dined in the restaurant and Officer Archibald asked them to record, among other matters, the number of "transactions" that they saw taking place at the till. A "transaction" for these purposes was an actual payment at the till, whether made by credit or debit card or in cash. Therefore, if a party of five dined at the restaurant, and one member of the party paid the bill, that would count as one transaction. By contrast, if a party of two dined together, but paid separately for their

meals, that would count as two transactions. The officers were asked to exclude transactions with HMRC officers from the calculation (so that HMRC's observations did not have a distorting effect).

16. The results of those observations as recorded by HMRC are set out in the following table. Later sections will consider the accuracy of these observations:

Time of visit	Officers involved	Number of transactions recorded
12.30 to 13.50	Martin	27
14.00 to 15.35	Rhodes & Onojighofia	26/23[1]
15.29 to 17.15	Chivers & Slide	28
17.00 to 18.40	Kuriata & Renders	15
18.30 to 20.05	Archibald & Hunter	14
20.00 to 21.29	Howell & Robbins	20/18[2]
21.21 to 23.17	Moore & Hassan	1[3]

17. Officer Archibald considered that he had not been given adequate access to the Company's business records in order to determine an average "transaction price" at the restaurant. He therefore determined an average transaction price by considering four "Streamline" statements with which he was provided covering the months from, and including, November 2012 to, and including, February 2013. Those statements gave details of total amounts spent at the restaurant on credit and debit cards only and, in summary, contained the following information:

Month	Number of transactions in month	Gross value of transactions (£) in month
November 2012	1,878	32,713.18
December 2012	1,546	29,044.74
January 2013	1,549	29,680.36
February 2013	1,971	35,488.44
Total	**6,944**	**126,936.72**

18. From the above figures, Officer Archibald concluded that the average transaction price for a transaction covered by the "Streamline" statements was £18.28 (126,936.72 ÷ 6,944). At the time he was making his assessments, he believed that there were 130 transactions on 17 January 2013, the date of HMRC's observation visit. Faced with what he considered to be a lack of co-operation by the Company (including Mr Lin's failure to attend a "PN160 interview" with HMRC) and a lack of information as to what the actual takings of the restaurant were, he took the figure of

[1] 26 transactions were taken into account when making the assessment, but Officer Rhodes's witness statement mentioned a figure of 23.

[2] Initially, HMRC calculated 20 transactions in this period. However, during an internal review which was completed on 17 July 2014, they concluded that the actual figure was 18.

[3] Officers Moore and Hassan did not follow the instructions to calculate transactions. Therefore, HMRC recorded just one transaction during the period of their visit to the restaurant.

£2,376.40 (130 x £18.28) as the "expected gross takings" of the restaurant for 17 January 2013.

19. Officer Archibald was provided with a "Z reading" from the electronic purchase order system ("EPOS") that the Company used at the restaurant. That suggested that, on 17 January 2013, orders to a value of £1,209.50 were processed through the EPOS system. Officer Archibald compared that figure with the expected gross takings of £2,376.40 and concluded that the Company was declaring only 50.9% (£1,209.50 ÷ £2,376.40) of its takings.

20. Officer Archibald then took the VAT-inclusive sales that the Company declared on its VAT returns for the periods from, and including 04/12 to, and including, 04/13. He concluded that these represented only 50.9% of the Company's actual VAT-inclusive sales and increased those sales by a factor of $\frac{100}{50.9}$ so as to calculate what he considered to be the true VAT-inclusive sales for each of those periods.

21. He then calculated the amount of output VAT that would be due on what he considered to be the Company's actual VAT-inclusive sales, compared it with the amount of VAT that had been declared and raised assessments for the difference. It was common ground that, in this calculation, Officer Archibald made no adjustment in relation to the Company's allowable input tax.

22. Following an internal review, HMRC concluded that there were only 128, not 130, transactions at the restaurant on 17 January 2013. That had consequences for the entire calculation of the assessments: for example, it resulted in HMRC concluding that the Company was declaring 51.7% of its sales (slightly higher than the 50.9% it had previously assumed). HMRC therefore recalculated the assessments using the above methodology but making the consequential changes necessary. HMRC's internal review also established that the assessment for 04/13 was not valid. After removing the invalid assessment and recalculating on the basis of 128 transactions, the total amount of the assessments stood at £85,594.

The nature of the restaurant, the EPOS system used and the Company's record keeping

23. Before the Company acquired the restaurant, it was owned by a Mr Kok Yin Low. Mr Lin worked for Mr Low as a manager and waiter in the restaurant and knew it well. In 2012 Mr Low indicated that he was prepared to sell the restaurant and Mr Lin, who had little business experience, but was keen to run his own business, said he would buy it. The Company was incorporated as the entity through which the business would be run, it duly acquired the business from Mr Low by way of a "transfer of a business as a going concern" for VAT purposes and started trading in February 2012.

24. There was no dispute that the restaurant is a budget restaurant. Local students represented a large part of its clientele and they were attracted to the restaurant by its low prices and large portions. We have accepted Mr Lin's unchallenged evidence that students would often buy cheaper meals, for example peas fried rice which cost just

£2.80. We have also accepted his unchallenged evidence that the large portion sizes meant that customers often shared meals.

25. Mr Lin has first-hand knowledge of the Company's EPOS system. Despite being an accountant who did not use the EPOS system himself, Mr Man also had first-hand knowledge of it. Mr Man's practice was not that of a traditional accountant. As well as providing his clients with the usual accounting and tax services, he also provided general consulting services: for example, he would visit his clients' restaurants to check that staff were working efficiently. He provided such a service to the previous owner of the restaurant who was using the same EPOS system that the Company inherited when it purchased the business. He acquired first-hand knowledge of the EPOS system in the course of those consulting activities.

26. Almost all the evidence on the EPOS system was given orally at the hearing for the first time in response to Mr McNicholas's "supplemental" questions. It was not included within either Mr Lin's or Mr Man's witness statements. When it became clear that this new evidence was emerging, we asked Mr Haley if he objected to it. He said that he had no objection and indeed HMRC positively wanted to hear it. Since there was no objection, we have admitted the new evidence, though it did seem to us that it put Mr Haley in the difficult position of having to cross-examine a witness on evidence being given for the first time at the hearing.

27. When customers were seated at a table in the restaurant, they would be provided with an order slip (on which the waiter wrote the relevant table number) and a pen. That order slip was in two parts: a white page on the front and a pink carbon copy behind it. Customers would tick boxes on the front white page (which would then be duplicated on the pink copy behind it) to record their order. A waiter would, in due course, pick up the white copy and take it to the EPOS terminal.

28. The waiter would key the order into the EPOS system. As soon as the order was keyed in, a copy of it would be printed out in the kitchen so that the kitchen knew what to cook. If the customer had ordered drinks, a copy of the drinks order would be printed out in the bar. The printer in the kitchen printed out the order in both Chinese and English so that the Chinese-speaking cooks could understand the order. In the bar, the order was printed out in English only.

29. As soon as the order was inputted into the EPOS system, the system would automatically generate and print out a bill. The waiter would attach that bill with a paperclip to the white order slip and would place it in a box next to the EPOS terminal within a tabbed divider marked with the relevant table number.

30. Mr Lin's clear evidence was that, once an order had been recorded in the EPOS system, there was no way to delete it manually or to remove it. We found that evidence somewhat surprising as it seemed to us that there must be entirely legitimate circumstances in which one might wish to delete orders that had been recorded. For example, if a waiter inputted the order incorrectly, we thought that it might be desirable for the EPOS system to offer the facility of deleting the incorrect order and replacing it with the correct one. Similarly, if a customer left the restaurant without

paying, it might be desirable for the order to be deleted given that the Company would have received no payment for it. However, Mr Lin's evidence in this regard was not challenged and we have, therefore, accepted it.

31. If the customer ordered more food or drink after making an initial order, the customer would not use the order slip (as that was no longer available, having been used to make the initial order). Instead, the customer would attract the attention of the waiter who would record the order and go to the EPOS terminal to input it. The order would again be printed out in the kitchen and bar as necessary and a further bill generated in respect only of the subsequent order (not a cumulative total including the initial order). In order to work out the total amount shown on the two bills (and so the total amount that the customer had to pay), a waiter would use a calculator to add together the two amounts. He or she would add the second bill to the set of documents held together with the paper clip and would handwrite the total amount due on the uppermost bill. The same procedure would be followed with any subsequent orders.

32. When the customer came to pay, he or she would go up to the till area carrying the pink order slip (which would record the customer's first order and also show the relevant table number). The waiter would locate the bill (or bills if there had been more than one order) corresponding to that table number and identify the total amount due. Mr Lin's evidence (which was not challenged, and which we have accepted) was that no further inputs into the EPOS terminal were needed in order to accept payment. In particular, there was no need to input information into the EPOS system as to whether the customer was paying by cash or by credit or debit card or to press any button to "close down" the order that had been recorded within the EPOS system. Therefore, the process for accepting payment did not involve the EPOS system at all. If the customer wished to pay by credit or debit card, he or she was handed the "PDQ" machine for processing card payments and asked to input the PIN number of the card involved. If the customer was paying cash, the waiter would simply open a cash drawer (without needing to press any buttons on the EPOS system, or on any till to do so), would deposit the cash received into that drawer and would give the customer any change due. The cash drawer was not connected electronically to the EPOS system. It was a drawer under the counter which contained the daily float money and any cash received from customers.

33. At the end of each day's trading, Mr Lin or an employee of the Company would perform a procedure called "closing the till". That involved obtaining a "day end report" from the EPOS system with a view to calculating the total value of all orders inputted into the EPOS system during the day. On swiping a "supervisor card" through the PDQ machine, the PDQ machine would generate a report showing the total value of all credit and debit card transactions on that day. The difference between those two figures was expected to be the total amount of cash collected on that day. To verify that this was the case, the initial "float" of £300 that had been put into the cash box at the start of the day's trading was removed (and used to constitute the "float" for the next day). What was left was then counted to check whether it corresponded with the expected amount of cash. If it did not correspond, any shortfall would be made up out of tips that had been left for waiting staff.

34. Mr Lin confirmed that, in the first few weeks in which the Company was running the restaurant, his practice was to keep a paper record of every transaction (whether in cash or by credit or debit card) and to use these paper records to perform the "closing the till" procedure. However, he soon came to regard that as impracticable and Mr Man advised him that it was not necessary to keep these paper records as all necessary information could be extracted from the EPOS system and the PDQ machine as outlined at [33] above. He did not, therefore, keep paper records of any transaction at his restaurant in the times relevant to this appeal.

35. Mr Lin would send Mr Man day end reports obtained from the EPOS system together with details of the Company's outgoings (for example on the purchase of food, staff wages, rent and such matters). Mr Man would use these figures to maintain a "petty cash book" in the form of an Excel spreadsheet. He would reconcile the figures with which he was presented with bank and credit card statements and would prepare the Company's quarterly VAT return.

36. We were shown examples of the day end reports (also known as "z readings") from the EPOS system for 16, 17 and 18 January 2013. Those reports set out the date (but not the time) on which they were prepared and contained information on total sales separated into restaurant sales and those for take-away orders. The day end report for 17 January 2013 showed total sales of £1,209.50 (which tallied with Mr Man's petty cash book). However, there were oddities with the day end reports. At the foot of the report for 17 January 2013 were the words "Z reading: 384". At the foot of the report for 16 January were the words "Z reading: 382". The report for 18 January 2013 was numbered "Z reading: 387". Mr Lin's evidence was that a single day end report was prepared each day and we concluded that, in that case, the reports should be sequentially numbered. However, they were not.

37. Within the hearing bundle was a schedule which we took to have been prepared by Officer Archibald in the course of his enquiries. It contained a list of dates from, and including, 9 February 2012 to, and including, 22 March 2013 with a column headed "z number" next to each date[4]. The figure in the "z number" column was not an amount of money (so was not evidence of the amount of the restaurant's takings on any particular day). Rather, we have concluded that it recorded the number that the EPOS system had allocated to a particular "z reading" taken on that day. That schedule showed numerous instances on which a "z number" recorded on one date did not follow the "z number" recorded for the previous day. Moreover, on some days no "z number" was recorded at all. On some days, the "z number" shown for one day was identical to the one shown for the previous day.

38. Both Mr Man and Mr Lin were asked about the "z numbers" in cross-examination. Mr Man was not able to explain the oddities specifically, but said that he

[4] The schedule actually started on 1 February 2012 and ended on 31 March 2013 (although no z numbers were recorded for 1 to 8 February 2012, or from 23 to 31 March 2013). We have concluded that Officer Archibald was only recording z numbers from 9 February 2012 to 22 March 2013 because, following his visit to Man & Co's offices on 18 July 2013, he gave Man & Co a receipt for "z readings from 9/2/12 – 22/3/13".

knew the Company's EPOS system well from his experience with the previous operator of the restaurant. It was an old machine and while it was supposed to produce a single "z reading" each day, it was unreliable and occasionally could go "haywire". He accepted that he could not be sure that the Company's record of its takings (which was based largely on readings from its EPOS system) was correct. Mr Lin could not explain why the "z numbers" we saw were not sequential or why Officer Archibald's schedule did not record any "z numbers" for certain days as he said that his focus was on the total amounts shown in the day end reports and not whether they were, or were not, sequentially numbered. However, he accepted that there had sometimes been problems with the EPOS system with orders input into it not being received. We have concluded from this evidence that such "z readings" as the EPOS system generated on a particular day were not necessarily reliable records of the relevant day's total takings. In particular, we are not satisfied that the restaurant's takings for 17 January 2013 were £1,209.50 (the figure recorded in the "z reading" referred to at [36]) not least because, since we were not satisfied that the EPOS system produced a single (consecutively numbered) "z reading" for each day, we were not satisfied that the figure of £1,209.50 included all sales the Company made on 17 January 2013. Nor was the schedule of "z numbers" able to satisfy us of the restaurant's takings over the period covered by the assessments since that schedule recorded only the "z numbers" and not the underlying "z readings" representing transactions going through the EPOS system.

The HMRC officers' observation visits

The visit of Officer Martin from 12.30 to 13.50

39. Officer Martin arrived at the restaurant at 12.30 on 17 January 2013 and left at 13.50. He had been scheduled to stay until 14.00 but he left 10 minutes early because he felt that he had stretched out his visit as long as he could and was in danger of looking conspicuous. During his visit, Officer Martin was sitting at a table with a good view of the till. He made contemporaneous notes of what he saw in the restaurant during his visit and, on 17 January 2013, he wrote these up into his notebook which he signed. He did not record the precise time on 17 January 2013 when he wrote up his notebook, but that did not cause us to doubt the observations he recorded.

40. Mr McNicholas put it to Officer Martin that he might not have seen 27 transactions take place. He suggested to him that, because he was recording other matters as well (for example the number of customers he saw in the restaurant and the tables at which they were sitting) there was room for error. Officer Martin was adamant that he saw at least 27 transactions take place and we have accepted his evidence.

The visit of Officers Rhodes & Onojighofia from 14.00 to 15.35

41. Officers Rhodes and Onojighofia arrived at around 14.00 on 17 January 2013 and left at around 15.35. During their visit, they were sitting at a table with a good view of the till area. They made notes while in the restaurant of what they saw with Officer Onojighofia primarily recording the number of customers (but also recording two transactions) and Officer Rhodes recording 21 transactions as taking place.

42. Officer Rhodes wrote up his notebook from contemporaneous notes that he made during his visit, supplemented by his recollections. Officer Rhodes signed his contemporaneous notes at 15.53 on 17 January (and Officer Onojighofia did not sign them). He also signed his notebook entry as made at 17.37 on 17 January 2013. Officer Onojighofia signed Officer Rhodes's notebook on the same day, but the precise time of that signature is not recorded. Mr McNicholas suggested to Officer Rhodes that Officer Onojighofia's failure to sign the contemporaneous notes or to indicate the precise time at which Officer Rhodes's notebook was signed called into question the accuracy of the observations recorded. Officer Rhodes rejected that suggestion and we have concluded that the notebooks and contemporaneous notes are reliable records of what the officers observed.

43. Mr McNicholas put it to Officer Rhodes that, because he and Officer Onojighofia were doing a number of things at the same time (for example counting both transactions and customers), they may have been mistaken as to the number of transactions that took place. He also put it to Officer Rhodes that their view might have been obscured because, as Officer Rhodes himself noted in his witness statement, customers sometimes stood directly in front of the till when they were paying with the result that it was not possible to observe every payment. Officer Rhodes was clear in his evidence that, unless he or Officer Onojighofia clearly saw a transaction take place, it would not be recorded. Therefore, he expressed confidence that at least 23 transactions took place during their visit and in fact the true number could have been higher. We have accepted that evidence.

The visit of Officers Chivers and Slide from 15.29 to 17.15

44. Officer Chivers prepared a witness statement recording the observations made during his visit and stated that 28 transactions took place while he and Officer Slide were on the premises from 15.29 to 17.15 on 17 January 2013. However, he did not attend the hearing for cross-examination. Mr McNicholas applied for Officer Chivers's witness statement not to be admitted as evidence and Mr Haley did not oppose that application.

45. There is, therefore, a question as to how we should determine how many, if any, transactions took place at the restaurant between 15.29 and 17.15. It seemed to us that the fact that Officer Chivers did not attend for cross-examination should not cause us to conclude that no transactions at all took place in this period particularly since the burden is on the Company to prove the correct amount of the VAT assessment (not on HMRC to prove that all transaction taken into account in making the assessment actually took place). It seemed to us unlikely that no-one at all would pay for a meal at the restaurant in the relevant period of 106 minutes. Moreover, it seemed to us that we should accept that Officer Chivers and Officer Slide did indeed visit the restaurant as Officer Rhodes gave unchallenged evidence that he saw them arrive and Mr McNicholas had not suggested to any of the other HMRC witnesses that their witness statements were fabricated and no visit had in fact taken place.

46. Therefore, we are satisfied that the visit took place and at least some transactions took place during that visit. We have approached the question of how many transactions took place by reference to Officer Chivers's witness statement and

we have, therefore, admitted it as evidence for that purpose. However, given that Officer Chivers did not attend for cross-examination, we have ascribed that statement little weight. Having given that statement little weight, we have concluded that we should not accept that the following transactions should be included within the total he recorded:

(1) One transaction was recorded at 15.30, before Officers Rhodes and Onojighofia left the restaurant. We have concluded that this would already have been included within Officer Rhodes's total.

(2) Officer Chivers recorded the transaction under which payment was made for Officer Rhodes's and Officer Onojighofia's meal. That should be excluded since the purpose of the exercise was to record transactions not involving HMRC officers (as noted at [15]).

(3) Officer Chivers recorded 9 transactions as taking place but recorded the method of settlement as "not identified". Having given the statement little weight, we have concluded that, if Officer Chivers could not be certain as to the type of payment, he could not be certain that a transaction had indeed taken place. We have therefore excluded these transactions from his total.

(4) Although Officers Chivers and Slide were at the restaurant until 17.15 (so their visit overlapped by 15 minutes with that of Officer Kuriata and Renders), Officer Chivers recorded no transactions as taking place after 16.58. Therefore, we do not consider that any other transactions recorded by Officers Chivers and Slide were double-counted.

47. We have therefore concluded that 17 transactions (the 28 recorded less the 11 excluded as set out at [46]) took place during the visit of Officer Chivers and Officer Slide.

The visit of Officer Kuriata and Officer Renders from 17.00 to 18.40

48. Officers Kuriata and Renders entered the restaurant at around 17.00 on 17 January 2013 and left at around 18.40. They made contemporaneous notes of the observations made while they were in the restaurant. Officer Renders signed those contemporaneous notes on 17 January 2013 (but did not record the time of signature). Officer Kuriata did not sign those notes. Officer Kuriata wrote up his notebook on 17 January and signed that notebook at 21.07 on 17 January. Officer Renders did not also sign that notebook. We regarded it as unimportant that both officers had not signed both documents (and timed their signature of both documents) and we considered the notes and Officer Kuriata's notebook to be reliable evidence of what took place.

49. Officers Kuriata and Renders divided up tasks between them. Officer Kuriata focused on counting transactions. Officer Renders focused on counting the number of people in the restaurant. However, they did not perform these tasks in isolation: if Officer Renders saw a transaction taking place, he would point it out to Officer Kuriata.

50. There were some minor errors in Officer Kuriata's contemporaneous notes and his witness statement. For example, when recording details of his order, he recorded

satay chicken as number 6 and spare ribs as number 12 when in fact they were numbered the other way around. Mr McNicholas put to him that, minor as these errors were, they suggested his overall count of transactions could not be relied upon. Officer Kuriata acknowledged the small errors he had made but was clear in his evidence that he saw at least 15 transactions. We have accepted that evidence.

The visit of Officers Archibald and Hunter

51. Officer Archibald prepared his assessment on the basis that 14 transactions took place during the visit that he and Officer Hunter made. However, there was no witness statement either from him or Officer Hunter dealing with that visit. Mr Haley explained that Officer Archibald had prepared a witness statement dealing with this issue. However, Mr McNicholas was clearly not aware of it and no such witness statement was contained in the hearing bundle.

52. We were shown a spreadsheet, which we took to be prepared by Officer Archibald, scheduling the various officers' observations. That spreadsheet showed that "Me + Jo" (i.e. Officer Archibald and Officer Jo Hunter) were "Team 5". In a column headed "Trans" (which we have concluded was a shorthand for "transactions") the number 14 corresponded with Team 5. Moreover, the spreadsheet indicated that this number had been checked with contemporaneous notes. Therefore, there was evidence that Officer Archibald thought that Team 5 saw 14 transactions and thought that conclusion had been checked against contemporaneous notes.

53. Mr McNicholas urged us to conclude, from the absence of a witness statement from Officer Archibald that no transactions were observed. However, for reasons similar to those set out at [45], we have concluded that we should accept that Officer Archibald and Officer Hunter visited the restaurant, that at least some transactions took place during their visit and that Officer Archibald recorded 14 transactions as taking place. Moreover, we have accepted Officer Kuriata's evidence that he saw Officer Archibald enter the restaurant at 18.30 (and Officer Kuriata and Officer Renders ceased recording transactions from that point). We have also accepted Officer Howell's evidence that he saw Officers Archibald and Hunter in the restaurant when Officer Howell arrived at 20.00 and that they left at 20.05.

54. It remains to be determined how many transactions Officers Archibald and Hunter actually saw. We have concluded as follows:

(1) Officers Archibald and Hunter considered that they saw 14 transactions. However, with Officer Chivers (who also did not attend for cross examination) we have concluded that 11 of the 28 recorded observations (39%) did not take place. In the absence of any other information, or even a witness statement from the officers involved, we have concluded that Officer Archibald and Hunter actually saw 9 transactions (61% of the 14 they recorded).

(2) Officers Archibald and Hunter saw 9 transactions in the course of a visit lasting 95 minutes (a rate of one every ten minutes or so). Their visit overlapped by 5 minutes with that of Officers Howell and Robbins. There was sufficient

time for one transaction to take place in this period that was counted by both teams of officers.

(3) Therefore, Officers Archibald and Hunter saw 8 transactions (after allowing for the double-count of one transaction).

The visit of Officers Howell and Robbins

55. Officers Howell and Robbins arrived at the restaurant at approximately 20.00 on 17 January and left at around 21.29. During their visit, Officer Howell had a good view of the till area but Officer Robbins was seated with his back to the till.

56. Officer Howell made contemporaneous notes while he was in the restaurant. Both he and Officer Robbins signed those notes and dated and timed their signature at 21.51 and 21.54 respectively on 17 January 2013. Officer Howell wrote up his observations into his note book and timed his signature at 22.35 on 17 January 2013. Officer Robbins also signed Officer Howell's notebook, and noted by his signature that he had been facing away from the till area.

57. HMRC's assessments (as adjusted following the review) proceeded on the basis that Officers Howell and Robbins observed 18 transactions while they were on the premises. Having read both Officer Howell's witness statement and his notebook and contemporaneous notes, it seems to us possible that he actually recorded 19 transactions. However, since this point wasn't put to Officer Howell when he was giving his evidence, we will proceed on the basis that he recorded 18 transactions (which seemed to be the position that both parties adopted).

58. Officer Howell recorded, both in his contemporaneous notes and his witness statement, details of the meal that he and Officer Robbins ate. That included "Szechuan King Prawn" (which Officer Howell said was one of his favourite Chinese dishes). However, that dish did not appear on the restaurant's printed menu that was given as evidence in the hearing bundle and Mr Lin said, in unchallenged evidence, that this was the menu in use in the restaurant at the time. However, Mr Lin said that customers ordering dishes not on the menu could sometimes be accommodated and that king prawns could be substituted into an order of "Beef in Szechuan Sauce" at a cost of £5.60. Therefore, we accept that Officer Howell recorded his order correctly. However, Officer Howell recorded in his witness statement that the officers' total bill was £26.50. If Szechuan King Prawn was priced at £5.60, the total bill would have come to £29.15. We have therefore concluded that Officer Howell recorded the total bill incorrectly.

59. Mr McNicholas suggested to Officer Howell in cross-examination that, since he did not record other details accurately, he must have been mistaken about the number of transactions he saw. Officer Howell, insisted that, even if he had misdescribed his order, his record of transactions was accurate. We have accepted this evidence.

The visit of Officers Moore and Hassan

60. Officers Moore and Hassan arrived at the restaurant at 21.21 on 17 January 2013. They left at 23.17. They did not, however, follow Officer Archibald's

instructions to count transactions taking place although they did record seeing one customer pay cash. In calculating the assessments, HMRC have assumed that Officers Moore and Hassan observed just one transaction taking place although reason suggests that there was probably at least one more as Officer Moore's unchallenged evidence was that, while she was on the premises, three customers entered (not including the one who was observed to pay cash). The restaurant's menu indicated that it shut at 11.30pm and therefore, unless these three customers left without paying (or without ordering), they must have generated at least one transaction.

61. Since there was no challenge to Officer Moore's evidence that she saw one transaction, we will not deal any further with her evidence.

Overall conclusion on the officers' visits

62. Overall, we have concluded that the officers observed 109 transactions during their visits to the restaurant.

HMRC's investigation and the Company's approach to it

63. On 4 March 2013, some six weeks after HMRC had performed their observations at the restaurant, Officer Archibald wrote to the Company to say that they would be visiting the premises on 27 March 2013 and that they wanted to be able to go through some of the Company's business records with a responsible person within the Company. HMRC explained in their letter that the purpose of the visit was to assist the Company in rendering accurate VAT returns and to address any VAT queries the Company might have.

64. On 20 March 2013, Man & Co wrote to Officer Archibald to explain that Mr Lin's family circumstances meant that he had to leave the UK for two weeks from 25 March 2013 and he would not, therefore, be available for a meeting on 27 March. We were satisfied that this statement was true as we have accepted Mr Lin's evidence that he travelled to China at or around this time to seek treatment for health problems from which he was suffering.

65. On 22 March 2013, an application to deregister the Company for VAT purposes was submitted to HMRC on the grounds that the Company's business had been transferred to another company. Officer Archibald was not aware that this application was made until 14 June 2013.

66. Officer Archibald said in his witness statement that he called Man & Co on 20 March 2013, 12 April 2013 and 24 April 2013 to try to rearrange the visit. In each of those calls he was told that Man & Co would try to contact Mr Lin and would get back to Officer Archibald but they did not do so. While acknowledging the point relevant to the weight of Officer Archibald's evidence made at [9], we have accepted that evidence as it was consistent with notes of telephone conversations (albeit undated notes) that were in the hearing bundle.

67. Officer Archibald said in his witness statement that he performed an unannounced visit to the restaurant on 13 June 2013, asked to speak to Mr Lin but was told by a member of staff that he was not there. Officer Archibald stated that he

left an urgent message to be contacted as he had been trying to arrange a VAT inspection for some months. We have accepted that evidence. On 18 June 2013, following a telephone conversation with Man & Co on 14 June 2013, Officer Archibald wrote to Man & Co confirming the arrangements for him to visit Man & Co at their offices on 18 July 2013 in order to inspect the Company's VAT records. That letter included an express requirement (underlined for emphasis) that Mr Lin be present at the meeting as HMRC wanted to discuss the trading activities of the business. It also set out a list of documents, and categories of documents, that Officer Archibald wanted to examine during the meeting which included, among others, all "sales and purchase invoices".

68. A meeting duly took place on 18 July 2013. However, Mr Lin did not attend that meeting because he was feeling unwell. Instead, Mr Man greeted Officer Archibald and showed him into a room that contained a number of documents relating to the business. Mr Man did not spend any time discussing those records with Officer Archibald (though he said, and we accept, that if Officer Archibald had asked to speak to him he would have done so). There was some dispute as to what documents precisely were available for Officer Archibald to examine. We have accepted Mr Man's evidence that all of the documents that HMRC wished to see were available for inspection during the meeting including purchase invoices of the Company. However, we have concluded from a receipt that Officer Archibald signed on 18 July 2013 that he only took some of those documents away with him (namely "z readings" for the period 9 February 2012 and 22 March 2013 and bank statements for the period 22 February 2012 to 15 April 2013).

69. On 23 September 2013, Officer Archibald wrote to the Company at Mr Lin's home address stating that he had reason to believe that there were "serious inaccuracies" in the Company's VAT returns. He asked to meet with Mr Lin on 7 November 2013 and stated that Mr Lin's adviser was welcome to attend. The letter stated that the meeting would take place under the procedure set out in Public Notice 160 ("PN160") and would provide Mr Lin and the Company with the opportunity to mitigate any penalties that may apply. He sent a copy of that letter to Man & Co.

70. On 1 October 2013, Man & Co requested "further and better particulars" (as they put it) and wrote:

> Please let us know:
>
> 1. What checks and enquiries you have made
>
> 2. What are the serious inaccuracies you refer to
>
> 3. Let us have a copy of your audit file.

71. On 8 October 2013, Officer Archibald answered those points as follows:

> 1. I have made various checks into the sales declarations of your client.
>
> 2. The serious inaccuracies refer to the sales declared by your client.
>
> 3. I am not prepared to release my audit file at this stage. I am entitled to withhold this information as I believe it would jeopardise the

> assessment or collection of tax, duties or other impositions of a similar nature.

72. On 31 October 2013, Man & Co replied to that letter. That letter repeated the request for HMRC to disclose information, stated that a request for an interview without disclosure of that information "ignored the spirit of CPR 31.6" and that they had advised their client not to attend a meeting until they had received the information requested.

73. On 18 November 2013, HMRC wrote to Man & Co expressing disappointment that Mr Lin had not attended the PN160 interview and asking if, nevertheless, the Company wished to make any disclosure in relation to its sales. Man & Co's response, on 9 December 2013, was that the Company would not be making any disclosure on sales until HMRC made "sensible disclosure" itself.

74. On 28 January 2014, Officer Archibald wrote to Man & Co setting out his view that the Company had under-declared VAT totalling £103,183.86 explaining how he came to that figure. By the same letter, he raised assessments, totalling £103,183.86 for VAT periods from, and including, 04/12 to, and including, 04/13.

75. Some further correspondence ensued with Man & Co continuing to press HMRC for disclosure (and complaining that the absence of such disclosure made it impossible for them to comment on the accuracy of the assessments) and criticising the logic underpinning the calculation of the assessments. In the course of that correspondence, Man & Co provided no significant evidence to substantiate what they considered to be the true amount of the Company's VAT liability.

76. On 26 March 2014, Officer Archibald provided Man & Co with copies of the notes of the officers who made the test purchases. He also offered to return records that he had taken during his visit on 18 July 2013 by courier.

77. In April 2014, the Company instructed Salhan Accountants Limited to act for it and they made an application for disclosure of information under the Freedom of Information Act.

The allegation of racism

78. The Company's Notice of Appeal indicated that one ground of appeal was:

> The assessment was not made to best judgment, is tainted and hence void in that it:-
>
> …
>
> (k) is to a material degree based on tax risk assessment or profiling using possibly inappropriate and/or illegal and/or race criteria.

79. We did not understand HMRC to have objected to that statement prior to the hearing on the grounds that it was an insufficiently particularised allegation of bad faith on the part of HMRC. Nor did we understand HMRC to have said, prior to the hearing, that permitting an insufficiently particularised allegation such as this to form part of the Company's case would run the risk of the hearing not being conducted in

accordance with guidance that the Court of Appeal gave to the Tribunal in *Pegasus Birds v Commissioners for Her Majesty's Revenue & Customs* [2004] STC 1509.

80. In his skeleton argument served shortly before the hearing, Mr McNicholas said:

> For the avoidance of doubt no allegations of dishonesty or wrongdoing are made or pleaded by the Appellant against HMRC, see *Pegasus Birds* at para 38(iii).

81. During the hearing, HMRC made available to the Company a copy of the briefing notes that Officer Archibald provided to officers who visited the restaurant to make observations on 17 January 2013. In the section headed "Background", Officer Archibald wrote as follows:

> The trader is a medium-sized noodle restaurant in the heart of Greenwich. A visit to a previous entity identified that the business was potentially suppressing its purchase invoices (as well as its sales) to produce a credible gross profit ratio. Test purchases were conducted circa 1 year ago also established that transactions were being deleted from the till.

82. In cross-examination, Mr McNicholas pressed Officer Rhodes on why perceived non-compliance by a previous operator of the restaurant was relevant to the decision to investigate the Company. Mr Rhodes's response was that HMRC understood there to have been a succession of 6 or 7 similar restaurants being run at the same premises in the same style but these ventures were all short-lived. HMRC had suspicions that the previous trader at the restaurant was suppressing its takings, but accepted in cross-examination that no assessments had been raised against the previous trader because HMRC "never got to that point". He said that there were apparent links between the various businesses (for example they all used Man & Co as adviser) and Mr Lin had himself been an employee at the same restaurant, as noted at [23]. All of these factors caused HMRC to have concerns that the Company might be involved in "phoenix trading" and these concerns prompted the decision to perform the initial visit to the restaurant on 17 January 2013.

83. In response to that evidence, Mr McNicholas put to Officer Rhodes the allegation that the Company had been selected for investigation and/or assessment because it was specifically a Chinese restaurant, an allegation that Officer Rhodes denied. He also put it to Officer Rhodes that HMRC held a "grudge" against previous proprietors of the restaurant and then, when the Company bought the business, it also "bought the grudge". Officer Rhodes denied all of these allegations stating that the factors set out at [82] would raise HMRC suspicions whatever the style of restaurant, or race of owners and advisers, involved and that HMRC do not hold "grudges".

84. At the conclusion of his cross-examination, Mr McNicholas requested permission to amend the appellant's Grounds of Appeal to include an allegation of bad faith against HMRC. At no point either during Mr McNicholas's cross-examination or the discussion of his application to amend the Company's Grounds of

Appeal were we referred to the following guidance that the Court of Appeal gave in *Pegasus Birds:*

> (ii) Where the taxpayer seeks to challenge the assessment as a whole on 'best of their judgment' grounds, it is essential that the grounds are clearly and fully stated before the hearing begins.
>
> (iii) In particular the tribunal should insist at the outset that any allegation of dishonesty or other wrongdoing against those acting for the Commissioners should be stated unequivocally; that the allegation and the basis for it should be fully particularised; and that it is responded to in writing by the Commissioners. The tribunal should not in any circumstances allow cross-examination of the Customs officers concerned, until that is done.

85. Since we were not referred to that guidance, we concluded that Mr McNicholas did not need permission to amend his Grounds of Appeal to allege bad faith since the Grounds of Appeal referred to at [78] already contained the allegation that Mr McNicholas put to Officer Rhodes in cross-examination. While we had concerns about the lack of particulars in that allegation, HMRC had not objected to the Company's pleaded case prior to the hearing. In those circumstances, it seemed to us that it would be unfair to preclude Mr McNicholas from putting his questions to Officer Rhodes.

86. In the course of preparing this decision, which has involved us reading the *Pegasus Birds* authority in detail, we have concluded that the Tribunal should have taken a different approach. Early on in proceedings, and before the hearing, the Company should have provided fuller particulars of its allegation of racism and HMRC should have responded to that allegation before the point was put to Officer Rhodes in cross-examination. It would have been helpful if HMRC had suggested this procedure in an interlocutory application. However, the exchanges set out above did not occupy a large part of the hearing (although Mr McNicholas has made detailed submissions in his closing arguments).

87. Having heard the evidence, we are satisfied that there is no force at all in the allegation that HMRC behaved in a discriminatory manner. That allegation should simply never have been made. Mr McNicholas relied strongly on his cross-examination of Officer Rhodes referred to at [82] and [83]. However, all that evidence demonstrates is that HMRC had some suspicions about whether the Company was complying with its VAT obligations that were based on objective factors. We have accepted Mr Man's unchallenged evidence that, in his capacity as adviser to the immediately preceding operator of the restaurant, he was not aware of any VAT assessments being made or HMRC alleging that any VAT was due. However, it was not necessary for HMRC to have made assessments on a previous business in order for them to have reasonable suspicions as to whether the Company was paying the amount of VAT that it owed. Mr Man seems to have taken HMRC's reference to Man & Co acting as advisers to the various businesses as a slur on his good name, and that of Man & Co. We think he was over-reacting. HMRC made no allegations against Man & Co or Mr Man: they simply said that this factor caused them to consider whether there were links between the various businesses operated at the premises. In

short, we have accepted Officer Rhodes's evidence that HMRC had genuine suspicions about the Company's VAT compliance and would have had those suspicions whatever the race of those involved in the Company and whatever the race of its advisers. We reject entirely Mr McNicholas's suggestion that HMRC engaged in "racial profiling" in selecting the Company for investigation.

88. Other evidence before the Tribunal supports the conclusion that HMRC were not at all racist in their dealings with the Company. Having decided to pursue investigations, HMRC gave the Company every opportunity to co-operate with them in order to establish whether the correct amount of VAT was being paid. We have concluded that during the course of HMRC's investigation, outlined at [63] to [77] the Company adopted an uncooperative approach and did not engage with HMRC's attempts to ascertain the amount of its VAT liability. Even at the hearing, Mr Haley was acceding to the Company's requests for documentation (which he had no obligation to provide since the deadline for exchange of evidence had long since passed) and made no objection when HMRC were put in the position of having to deal with new evidence given by Mr Lin for the first time in the witness box. Those actions were completely inconsistent with what Mr McNicholas submitted was a racially motivated assessment on the Company.

89. We will not make any finding that the Company was actually engaged in "phoenix trading". However, HMRC cannot be criticised for having concerns on this issue as the Company's own actions served to increase those concerns. It was reasonable for HMRC to consider, in the period leading up to the making of the assessments, that a company that de-registered for VAT purposes shortly after becoming aware that HMRC were investigating it, and which appeared not to be co-operating with HMRC's enquiries, might be involved in "phoenix trading". There is no evidence, therefore, that HMRC's suspicions suggest a discriminatory approach to their dealings with the Company.

90. Mr McNicholas sought, in his written closing submissions, to bolster the Company's allegation of racism by referring to various reports, conferences and news articles on underlying racism in Britain with a particular emphasis on racism suffered by the Chinese community. However, those items were not in evidence before the Tribunal. In any event, at most, they referred to issues of discrimination generally and did not come close to satisfying us that HMRC behaved in a discriminatory way in their dealings with the Company specifically.

PART II – THE LAW

91. The authority to make the assessments in dispute is set out in s73 of the Value Added Tax Act 1994 ("VATA 1994") which provides, relevantly, 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.

92. The Company has not sought to argue that the assessments were made out of time and I will not, therefore, reproduce the law setting out applicable time limits. I simply note that the assessments were all made within two years of the end of the applicable VAT period and were therefore in time by virtue of s73(6) and s77 of VATA 1994.

93. Section 73 of VATA 1994 imposes a requirement that an assessment made under that section should be to the best of the Commissioners' judgment. However, in *Pegasus Birds v Commissioners of Her Majesty's Revenue & Customs*, the Court of Appeal gave guidance to the Tribunal as to the approach that should be adopted in situations where a taxpayer sought to argue that an assessment made is invalid on the basis that it was not made to the best of the Commissioners' judgment (some of which we have already quoted and discussed):

> **Guidance to the tribunal**
>
> [38] In the light of the above discussion, I would make four points by way of guidance to the tribunal when faced with 'best of their judgment' arguments in future cases:
>
> (i) 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.
>
> …
>
> (iv) There may be a few cases where a 'best of their judgment' challenge can be dealt with shortly as a preliminary issue. However, unless it is clear that time will be saved thereby, the better course is likely to be to allow the hearing to proceed on the issue of amount, and leave any submissions on failure of best of their judgment, and its consequences, to be dealt with at the end of the hearing.

94. For reasons set out above, we have made findings on the Company's allegations of racism against HMRC. We will also deal with criticisms that Mr McNicholas made of the methodology used to make the assessment. However, the focus of this decision will be on ascertaining the correct amount of tax. We have applied the following statement of Lord Lowry in the *Bi-Flex Caribbean Ltd v Board of Inland Revenue* (1990) 63 TC 515 at 522–523 in concluding that the Company has the burden of proving the correct amount of its VAT liability:

> 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 assessments right or more nearly right.

95. Mr McNicholas submitted that the burden and standard of proof had to be understood in the context of the House of Lords' judgment in *Re H & Others* [1995] UKHL 16. In his speech, Lord Nicholls said:

> The balance of probability standard means that a court is satisfied an event occurred if the court considers that, on the evidence, the occurrence of the event was more likely than not. When assessing the probabilities the court will have in mind as a factor, to whatever extent is appropriate in the particular case, that the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability. Fraud is usually less likely than negligence. Deliberate physical injury is usually less likely than accidental physical injury… Built into the preponderance of probability standard is a generous degree of flexibility in respect of the seriousness of the allegation.
>
> Although the result is much the same, this does not mean that where a serious allegation is in issue the standard of proof required is higher. It means only that the inherent probability or improbability of an event is itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. The more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its occurrence will be established. Ungoed-Thomas J. expressed this neatly in *In re Dellow's Will Trusts* [1964] 1 W.L.R. 451, 455:
>
> > The more serious the allegation the more cogent is the evidence required to overcome the unlikelihood of what is alleged and thus to prove it.

We agree that the authority is relevant. However, it does not alter the burden of proof: the Company still has to demonstrate the correct amount of its VAT obligation. It is right that, in considering whether the Company has discharged this burden, we should consider the inherent probability or improbability of the Company understating its VAT liabilities.

96. Although we will focus on considering whether the Company has discharged its burden of proving that it owes a lower amount of tax than HMRC has assessed, we will also consider Mr McNicholas's submission that the assessment should be set aside on the grounds that it was not made to the best of the Commissioners' judgment. We consider that the authorities establish that we should approach those submissions as follows:

(1) In assessing the amount of tax due 'to the best of their judgment', the Commissioners are required to consider fairly all material put before them by the taxpayer and on that material make a decision which was reasonable as to the amount of tax due. They are not required to make investigations so long as there was some material on which they could reasonably base an assessment, but if they did make an investigation, they had to take into account the material disclosed by that investigation (*Van Boeckel v Customs and Excise Comrs* [1981] STC 290).

(2) The Tribunal does not have a true appellate function in that it cannot set aside an assessment on the basis that it disagrees with the commissioners' decision to make the assessment. The circumstances in which the Tribunal can decide that the assessment was not raised to the best of the Commissioners' judgment, and therefore should not have been made at all, are very limited, essentially being restricted to cases where the Commissioners have acted perversely or in bad faith (*Mithras (Wine Bars) Ltd v Revenue & Customs Commissioners* [2010] UKUT 115 (TCC)).

(3) Even if there is a defect in the assessment of the kind set out at (2) it does not follow that the whole assessment must be set aside. Rather, the Tribunal should consider whether justice can be done by adjusting the amount of the assessment (*Pegasus Birds*).

Discussion

97. We will order our discussion by considering the various challenges that Mr McNicholas made to the assessment.

The argument that the assessment was inconsistent with HMRC's own figures

98. In a spreadsheet that he used to calculate the amount of the assessments, Officer Archibald noted that the Company's declared total takings for 17 January 2013 were £1,209.50. He had available to him "Streamline" statements showing credit and debit card sales at the restaurant. The "Streamline" report for 17 January 2013 gave a figure of £860.03 and that for 18 January 2013 gave a figure of £764.74. He took the figure of £764.74[5] and concluded that the balance of the day's takings of £444.76 (£1209.50 - £764.74) was received in cash. He recorded that 190 customers had been seen in the restaurant on 17 January 2013 and that 97 customers' bills had been settled in cash[6] . He accordingly worked out "ave cash dec" which we consider meant "average cash declared" of £4.59 (being £444.76 divided by 97). He also concluded that, since 190 customers had been seen and 97 of those had their bill settled in cash the "cash % obs" (which we took to be the percentage of customers whose bill was settled in cash) was 51.05% (97 divided by 190).

99. Mr McNicholas submitted that, in performing this calculation, HMRC had calculated their estimate of the average value of a cash transaction at £4.59 and they should, therefore, have applied that figure when making their assessments. He submitted that, since this was HMRC's own figure, they were obliged to use it when making their assessments (applying the decision in *Van Boeckel*).

[5] As noted, this was the figure for 18 January 2013. It may have made more sense to base the calculation off the figure of £860.03 for 17 January 2013.

[6] We do not consider Officer Archibald was concluding that 97 "transactions" out of the 128 that were observed took place in cash. Rather, the logic of his calculation, set out on the first page of the relevant Excel spreadsheet, was that, if five parties of two all settled their bill by paying cash, 10 customers' bills had been settled in cash. The figure of 97 appears to have been produced by adding up totals calculated in this way.

100. We do not, however, agree that the figure of £4.59 represents HMRC's estimate of the average cash value of a transaction for two reasons:

(1) Firstly, HMRC's calculation took as its starting point the Company's recorded takings of £1,209.50. Therefore, it calculated a figure on the assumption that the Company's recorded takings of £1,209.50 were correct. HMRC did not believe that the figure of £1,209.50 was correct. We have already explained why we are not ourselves satisfied that this figure was correct. In those circumstances, there would be no sense in HMRC basing their assessments on the figure of £4.59.

(2) Secondly, as noted at [98], the figure of £4.59 did not represent average cash value per "transaction". Officer Archibald's spreadsheet was prepared at a time when (at least according to that spreadsheet) it was considered that there were 130 transactions of which 71 were in cash and the remaining 59 were either card transactions or "unknown". If Officer Archibald was seeking to calculate a value per cash transaction, he would have divided £444.76 by 71 and not by 97. Rather, as noted at [98] Officer Archibald was calculating a figure that related to the total number of customers whose bill was settled in cash.

101. Mr McNicholas argued that HMRC should have used the £4.59 figure to produce a "weighted average transaction value" as follows:

(1) First they should have multiplied £4.59 by 51.05% (the percentage figure referred to at [98] to give a figure of £2.50[7] which would give an estimate of a cash transaction value.

(2) Second they should have multiplied £18.28 (the average figure for a credit card transaction that HMRC calculated at [18] by 48.95% (i.e. 100% less the 51.05% figure referred to in (1) above) to give an estimate of the card transaction value of £8.95.

(3) The sum of the figures at (1) and (2) was £11.45 which should be taken as the average "transaction value" appropriately weighted between cash transactions and those involving a credit or debit card.

102. We do not consider that this calculation is correct. Firstly, as we have noted at [100(1)], there would be no logic in HMRC using the figure of £4.59 when it was derived from figures that HMRC mistrusted and were seeking to test. Secondly, the percentages of 51.05% and 48.95% are percentages of customers (not percentages of transactions) and the figure of £4.59 is similarly a "per customer (not a "per transaction") figure. The calculation that Mr McNicholas is suggesting could not have produced an estimate of average transaction value.

103. Finally, Mr McNicholas submitted that there were only 87 transactions observed on the relevant day (the total asserted of 128 less the 41 transactions said to have been seen by Officers Chivers and Archibald which should be excluded altogether since

[7] Actually, 51.05% of £4.59 is £2.34 so there is an arithmetic flaw in Mr McNicholas's calculation. However, I will use his actual figures to illustrate the method he considered should be applied.

neither officer was available for cross-examination). Applying that approach, Mr McNicholas submitted that HMRC's calculation would have produced an estimate of the Company's takings on the 17 January 2013 of £996.15 (the 87 transactions multiplied by average transaction value of £11.45). Since that was comfortably less than the Company's declared takings for the day of £1,209.50 he submitted that HMRC's own figures supported the conclusion that the Company was not suppressing its VAT obligations.

104. We have already given reasons for not accepting the logic of Mr McNicholas's calculation up to this point. A further point of objection is that we have concluded that there were 109 transactions on the day in question (and not the 87 that Mr McNicholas argued for).

105. We have not, therefore, accepted Mr McNicholas's alternative calculation.

The methodology of the assessment

106. Mr McNicholas submitted that HMRC's methodology involved them extrapolating the Company's VAT liability over some several months of trading from just a single day's observation on 17 January 2013. He likened this to seeking to estimate the average height of a number of people in a room by measuring the height of one person and described HMRC's case on this point as being like a "one legged stool" that was bound to fall over.

107. More specifically, Mr McNicholas criticised HMRC's reliance on a single day's observations for the following reasons:

(1) It would have been open to HMRC to obtain more reliable data by, for example, performing more test visits. They did not do so because they had a settled view that the Company was not declaring the right amount of VAT and only ever had the intention of making assessments based on one day's observations.

(2) HMRC could, and should, have considered information from the Company's purchase invoices to consider the Company's business model and profitability. If they had done so, they would have realised that the amount of VAT that the Company was paying was completely consistent with that due from comparable restaurants and they would not have made the assessments that they did.

108. We agree with Mr McNicholas's general point that calculating a VAT liability over a period of several months by reference to the results of one day's trading is inherently unreliable. The results of the particular day selected need only be slightly more (or slightly less) than the true mean average of takings over the period for this method to produce a result that is much more (or less) than the true result. However, it is not enough for the Company to argue that there was an alternative method of calculating the assessment that would have been more reliable. The Company has to demonstrate its true VAT liability. Therefore, it would need to show what figure the alternative method would have produced and why that figure is the correct VAT liability. Alternatively, the Company would need to show that the method HMRC

actually adopted was so seriously flawed that justice could not be done by reducing the assessments and they should be set aside altogether (a situation that was described as rare in *Pegasus Birds*).

109. We do not consider that HMRC can be criticised for the failure to perform more than a single day's observation at the restaurant. We accept Officer Rhodes's evidence that, while there would normally be a benefit in undertaking a second observation, HMRC would first seek to discuss the results of the first observation with a trader under investigation before performing a second. That is reasonable. If the first observation and subsequent dialogue with a taxpayer suggested that VAT liabilities were correctly being returned, there would be no need for a second observation. By contrast, if following a discussion with the trader, HMRC were still concerned that there was significant suppression of takings they would be better able to determine what they were looking for in a subsequent observation. As noted at [63] to [67] HMRC took reasonable steps to arrange a meeting with the Company following their initial observation but, partly because of Mr Lin's poor health, they were unable to do so. By June 2013, when Officer Archibald became aware that the Company had applied to deregister for VAT purposes, HMRC had still not been able to speak to anyone at the Company about its business or been provided with access to the Company's books and records. In the circumstances, it was entirely reasonable for HMRC to perform only one observation visit.

110. We agree that HMRC could have calculated their assessments in a completely different way. They could have considered the Company's purchase invoices, considered whether the Company was suppressing purchases (by, for example, contacting the Company's suppliers to see whether invoices issued by the suppliers matched with invoices the Company received). If they were satisfied that the Company was not suppressing purchases, they could have applied an economic model to estimate the Company's turnover based on the purchases that it made and used that to consider whether the Company was understating its VAT liability. We also agree that Officer Archibald chose not to embark on this course and that he did not take with him purchase invoices that were available at the meeting at Man & Co's offices on 18 July 2013 referred to at [68]. We do not, however, agree with submissions that Mr McNicholas made to the effect that HMRC realised that there was no problem with the Company's purchase invoices. Even if Officer Archibald had carefully read every single one of the Company's purchase invoices at Man & Co's offices, he could not have concluded positively that no purchase invoices were being suppressed since, by definition, if purchase invoices were being suppressed, they would not have been made available.

111. We have considered whether, by failing to pursue an enquiry based on purchase invoices, HMRC failed fairly to consider material made available to them. There was no such failure. To pursue such an enquiry, they would have needed the Company's co-operation. However, beyond allowing Officer Archibald to inspect books and records, the Company provided little meaningful co-operation. It was not even prepared to make Mr Lin available to answer HMRC's questions about its business without imposing pre-conditions which would have removed much of the benefit of a meeting with Mr Lin. The Company cannot complain that HMRC have failed fairly to

consider material made available to them when it has not co-operated with HMRC's enquiry and has put forward little evidence of its own as to the amount of its VAT liability. The approach that HMRC followed in calculating the assessments was reasonable. HMRC could only use the information with which they were provided and, since the Company chose to provide only limited information to substantiate its own determination of its VAT liability, it is difficult to see what more HMRC could have done.

112. In any event, the Company has not shown what conclusion should have been drawn from an examination of purchase invoices. It did not refer to any purchase invoices in its submissions or witness statements and has not given much more detail of the economics of its business than the general statement that it was a budget restaurant and Mr Man's evidence that the gross profit rate of the Company was at the higher end of what he would expect of restaurants in the sector. That is insufficient to discharge the burden of proving the correct amount of its VAT liability.

113. Mr McNicholas made other, more minor, criticisms of HMRC's methodology. Firstly, he submitted that it was unfair and unreasonable of HMRC to approach the assessments on the footing that the Company's sales were to be increased significantly (with a corresponding increase to its output tax liability) without also increasing its credit for input tax. However, there is nothing in that point. The Company operates a restaurant. It was entirely reasonable for HMRC to assume that the vast majority of its costs were either zero rated (for example food that it bought), outside the scope of VAT (for example staff costs) or fixed costs that were not dependent on the level of sales made (for example rent and business rates). The Company has not demonstrated the amount of any increased input tax credit. Nor has it demonstrated that HMRC's failure to make what would have been small adjustments at the most means that the defects in the assessments are so fundamental that those assessments must be set aside.

114. Mr McNicholas also argued that HMRC should have familiarised themselves with the Company's EPOS system before they performed their observation visit. We do not see how that could have altered the amount of their assessments which were based on observed transactions and the Company's financial records (although we deal with a point of greater substance in relation to the EPOS system in the section below).

115. He submitted that HMRC's calculation was flawed as it used an average transaction value that was derived specifically from credit card transaction reports and that the average value of a card transaction would inevitably be greater than a cash transaction. However, that was mere submission. Aside from asking the Tribunal to adopt the flawed "weighted average" calculation referred to at [101], the Company has not put forward sufficient evidence to demonstrate either that the average amount of a cash transaction was lower than that for a card transaction, or what that lower average amount was.

116. Finally, Mr McNicholas argued that the calculations that HMRC performed at most showed that the Company had not paid the correct amount of VAT in respect of

a single day's trading and should not have been extrapolated to cover several months of trading without evidence that there was a similar inaccuracy on the other days. That submission overlooks the fact that it is for the Company to prove what its VAT liability is; it is not for HMRC to prove that the Company's takings have been suppressed on any particular day or days.

The Company's EPOS system

117. Although we do not consider that the Company's EPOS system was relevant in the sense that Mr McNicholas argued at [114], we have considered whether Mr Lin's evidence as to how that system worked was sufficient for the Company to demonstrate that its VAT liability as stated on its VAT returns was correct and should be preferred to that contained in HMRC's assessments. Mr McNicholas made no reference to the Company's VAT returns in his submissions and they were not produced as evidence. He seemed to think that it was for HMRC to do so. However, given that the Company has the burden of establishing its VAT liability, if it wished to argue that those VAT returns were correct, we would have expected the Company to put them in evidence and make submissions on them. Nevertheless, if the Company could demonstrate (i) that every order made at the restaurant was entered into, and not removed from, its EPOS system and (ii) that every order entered into its EPOS system was taken into account in its VAT returns it could have shown that its VAT liability in its return was not understated (even without referring to the specifics of those VAT returns)

118. The Company has not, however, satisfied us on these issues. While we have accepted Mr Lin's evidence that every order was inputted into the EPOS system and there was no way of manually deleting orders after input, the EPOS system was unreliable. Mr Man described the system as going occasionally "haywire" and Mr Lin accepted that he had problems with it. Moreover, no explanation was given as to why some "z readings", which were usually consecutively numbered, appeared to be absent or why there was no record of "z readings" for some days even though Mr Lin's evidence was that the procedure of "closing the till" took as its starting point these readings. Indeed, in cross-examination, Mr Man was asked how, faced with the evidence as to the apparently incomplete "z readings" he could be sure that the Company's VAT returns were correct, and replied "If you put it that way, I can't be sure". If the Company's own adviser could not be sure that the VAT return as submitted was correct, we do not see how we could be so satisfied.

119. In his written closing submissions, Mr McNicholas quite rightly said that the Tribunal should reach its conclusions on the Company's EPOS system by reference to the evidence in front of it and not by reference to experience that Mrs Watts Davies (the Tribunal member) obtained on EPOS systems generally during her career in the catering industry. As will be seen from [25] to [38] above, we have accepted Mr Lin's account of how the EPOS system worked. We accept that it is a basic system which has the bespoke capability of printing out orders in Chinese and in English. Nevertheless, the points made above mean that we have not accepted that the use of the EPOS system means that the Company's VAT returns were correct as submitted.

Conclusion

120. This appeal has caused us some anxiety. As a matter of pure impression, the assessments that HMRC have made seem high. However, we cannot determine the appeal by reference to matters of impression: it is for the Company to demonstrate the correct amount of its VAT liability. If the Company had presented us with a detailed picture of its finances and economics it may well be that it could have demonstrated that its VAT liability was lower than HMRC had calculated. However, it has not done so and has preferred instead to challenge the principle underpinning HMRC's calculations and HMRC's good faith. The alternative calculation that the Company proposed (discussed at [98] to [105]) was not based on detailed information about the Company's business and we consider it to be flawed. In those circumstances, the grounds of appeal advanced by the Company fail.

121. However, we have found that there were 109 transactions on the relevant day and not the 128 that HMRC have taken into account when making the assessments. Therefore, the assessments must be recalculated on this basis.

122. 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 RICHARDS

TRIBUNAL JUDGE
RELEASE DATE: 30 DECEMBER 2016