VAT invigilations: when best judgement isn't even good

Tony Monger looks at two recent Tribunal and wonders how just why proceedings were allowed to go as far as they did.

Anyone who has only been involved with tax since 2005 might not be aware that prior to that point, rather than there being one HM Revenue and Customs, there had been two departments – the Inland Revenue and HM Customs & Excise. Of the two departments, Customs & Excise always thought of itself as the senior service, in much the same way as the navy views the army. They had been set up long before income tax was even thought of, to levy Customs and Excise duties on imports coming over our shores – and fight off those who sought to evade duties by smuggling.

Customs and Excise was itself the merger of two even older departments: Her Majesty's Excise department was set up in 1643 and mention of HM Customs goes back to the middle ages, whereas the younger Inland Revenue department began life in 1849. No wonder then that HM C&E looked upon the Inland Revenue as a mere uncultured stripling.

However, time has its way with all of us, even government departments, and by the late 1960s the functions and usefulness of HM C&E had largely fallen away and the department was reduced to little more than checking luggage at airports and cargo at docks. But then the UK joined the EU and, as part of its harmonisation, the UK Government was obliged to introduce VAT. And this led to the question of which government department should be tasked with policing it.

Logic dictated that the job should go to the Inland Revenue. After all, it was the income tax inspectors who checked business records, visited shop premises and so on. However, because of concerns that the 'senior' department was shrinking to the point of disappearance, it was decided instead that the task of administering VAT should go to Customs & Excise. And that simple decision has resulted in something akin to a schizophrenia – a truly split personality – in the approach of Her Majesty's Revenue and Customs that exists to this very day. For the reality is that the approach that a taxpayer receives from the hands of HMRC will depend very much on whether the officer carrying out the review is coming to talk about income tax or VAT – that is whether they come from the Revenue or whether they come from Customs.

The differing approach of the two sides has long been noticeable. While no generalisation is wholly true, the Revenue side has typically been more inclined to the clinical and technical approach – carefully examining the records, considering the legal position, formulating the arguments and then presenting their conclusions, to be argued through the courts if necessary. Whereas the Customs approach has been more – how can we put it – robust. Rough and ready. Or, to use an analogy from the old Wild West, their tendency has been to shoot first and ask questions after.

Of course, whether an assessment is made by the Revenue or Customs side, the taxpayer has the same rights of appeal – but with the distinction that, with a VAT assessment, the taxpayer has to pay the tax before they can take the appeal to the Tribunal unless they can show that paying the tax would cause undue hardship. For other taxes – Income Tax, Corporation Tax, Capital Gains Tax, etc – the taxpayer can simply ask for the payment of the tax to be postponed until the appeal is settled, and it usually is. Theoretically, the tax officer could dispute the postponement request but they rarely do – and, even then, the taxpayer could take the postponement application itself to the Tribunal.

However, on the VAT side there is a check on the officer's powers in that the officer has to show that he has made an assessment to his best judgement and, if he hasn't, the assessment is wiped out as invalid. Having seen some recent VAT Tribunal cases, one can only offer a small prayer of thanks for the inclusion of this safeguard in the legislation – because nowhere is the distinction in the differing approaches of the two parts of HMRC more apparent than in their attitudes to investigation and the making of estimated assessments.

A recent example comes in the case of FW Services v HMRC [2020] UKFTT 00143 (TC) which involved a VAT investigation into a service station selling petrol and diesel fuel. HMRC officers visited the station on five

occasions between 9 June 2016 and 22 June 2017 and carried out what they referred to as 'invigilations', which essentially means that they stayed for a few hours and recorded how much fuel of each type was sold. The amount of time that they stayed ranged from just under an hour to almost five hours and they made particular note of the amount of diesel fuel sold. This ranged from a low of 270 litres in an hour to as much 528 litres an hour, and averaged out at 350 litres per hour. On this slim – and statistically invalid – sample, the HMRC officers decided that the business must have been consistently achieving diesel sales at a rate of 350 litres per hour during every hour that it was open between 1/6/2015 and 31/10/17, and made VAT assessments to charge additional VAT of £686,054.00.

Just to make it clear what that means in real terms, this would have required the service station to understate its diesel sales by £4,116,324 over the assessed quarters 08/15 to 10/17 – a period of 29 months or 792 days. This works out at just slightly short of £5,200 per day for every day of the 792 days.

Thankfully, the Tribunal was not impressed by HMRC's 'judgement' in arriving at these figures. Among the factors considered was the point made by the proprietor and his representatives that HMRC had not found any undisclosed bank account and the HMRC officer himself conceded that he had seen no evidence of a separate bank account and had not seen any evidence of the pumps being tampered with. As the proprietor pointed out, the alleged omitted sales of £5,200 per day would necessarily have had to be in cash (for them not to appear in the bank account) which would have required the collusion of a large portion of the local population. Indeed, even if you take the average fuel purchase of a full tank of diesel at, say, £70, it would have necessitated 74 members of the local population turning up to fill their tanks with diesel and pay in cash every day for 792 days.

As for the basis on which HMRC had arrived at their figures, the Tribunal pointed out: "Four of the five invigilations were carried out during the morning with only one in the afternoon. Three of the invigilations were carried out on the same day of the week – Thursday (9 and 16 June 2016 and 22 June 2017). No invigilations were carried out at the weekend. A total of 16 hours and 31 minutes was spent invigilating. The filling station was open for a total of 97 hours each week."

The decision went on to record: "While the three witnesses for HMRC all indicated their contracts of employment did not allow them to work in the evenings or at weekends, this does not mean that HMRC can simply rely on their observations made during their permitted working hours. There was no evidence before the Tribunal in relation to evening and weekend sales."

And, most damningly, the HMRC officer "…stated that he had calculated the under-declaration by assuming that there were sales of 350 litres of diesel per hour on each day from Monday to Saturday, yet the filling station is only open for twelve-and-a-half hours on Saturdays. His calculations therefore immediately gave rise to an error even if his other assumptions were correct."

Not surprisingly, the whole bunch of assessments were thrown out as not being made to best of judgement. What is perhaps more surprising is that HMRC's Reviews and Litigation section had previously considered the decision to issue the assessments, as part of the review process, and decided it was correct and should be upheld. One cannot help but question how they could possibly claim to have reached that decision.

Nor is F W Services an isolated case. The judgement in FW Services itself refers to two other cases from 2020, those of Wei Xian Peng and Qian Hong Peng t/a Zhu Guang Restaurant [2020] UKFTT 0177 (TC) and Sital Khimji [2020] UKFTT 22 (TC), but a similar cavalier approach is apparent in many earlier cases. Indeed, the similarity of approach in FW Services to that shown in the case of Homsub v HMRC from 2017 [TC/2017/00168] is quite remarkable.

In the Homsub case the appellant company was a franchisee of the Subway brand, which operated from five different stores in five different towns. In that case the HMRC officers visited all five stores on 25 November 2015, and recorded each sale made and annotated whether it was 'eat in' or 'take out' and whether the food was 'hot' or 'cold', because these facets were relevant to the determination of the

different VAT treatment in respect of the sales.

HMRC then proceeded to add up, outlet by outlet, the number of transactions upon which VAT was due and those upon which VAT was not due. The results varied across the five stores suggesting a range of percentages of the goods sold as bearing VAT from a low of 80% to a high of 89% – but, of course, the product range sold on a cold November day is going to vary dramatically from that on a hot summer day. The VAT officers used the 'results' from this one day to extrapolate an alleged understatement of VAT but, as in F W Services, the Tribunal recorded that "…there has been no suggestion by the respondents (HMRC) that any of the appellant's tills were being improperly manipulated or that sales were not being recorded through the till. To put it bluntly, it has not been suggested that this is a case of 'fiddling the till'."

As with F W Services, the HMRC assessments in Homsub were held to be invalid as not made to best judgement.

A number of questions leap to mind. Firstly, how on earth are such cases coming to Tribunal without being stopped by HMRC's independent internal review process? Is it not the function of the internal review to prevent unmeritable cases being brought to Tribunal? And why are HMRC officers continuing to use such worthless techniques to arrive at 'projections' of profits when they have been so thoroughly rejected by the Tribunals? In the Homsub case the Tribunal went so far as to remark that: "When we read the papers and the parties' respective Skeleton Arguments for this appeal, we were immediately concerned that the assessment methodology adopted by the respondents was significantly flawed."

Why then are similar methodologies still being used many years later – to be greeted with similar scorn by the Tribunal?

But, perhaps most importantly, why is the Customs side of HMRC operating in a manner that would be wholly unacceptable on the Revenue side? The officers of the former Inland Revenue are all too aware that in presenting a case to Tribunal they need to be able to demonstrate (a) that the records of the business are less than perfect (b) that there is a reasonable basis to their projections of understatements and (c) that there is some correlation between the suggested understatements of profits and the capital position or lifestyle of the taxpayer. In common parlance, it's no good alleging a Ferrari size omission if the taxpayer is living a Ford Prefect lifestyle.

As I said at the start of this article, there's a schizophrenia within the HMRC mindset – and, unfortunately, it is causing some taxpayers to suffer unnecessarily. The time has long gone when the ailment should have been diagnosed and the proper treatment prescribed. Until that happens, more taxpayers will likely find themselves in front of the Tribunal arguing that HMRC's best judgement simply isn't good enough.

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