

Nailed it!

Les Howard highlights the VAT issues that arose during a recent HMRC investigation

HMRC have long targeted retail businesses, usually challenging their sales figures. While major retail chains operate sophisticated EPOS systems (which are not immune from error, of course), many independent retailers still rely on less modern technology. In a recent telephone conversation I had, a prospective buyer of a small health food retail business commented that the daily sales were recorded with pen on paper (no MTD then!).

In the event that HMRC do decide to challenge the sales figures, independent retailers have comparatively limited resources to successfully challenge and overturn the decision.

Unfortunately, from HMRC's point of view, recent Tribunal cases have indicated a growing sloppiness on HMRC's part. My own experience is consistent. And the recent FTT decision of Nguyen (<https://tinyurl.com/y43ze6de>) illustrates the trend.

HMRC visited the premises, a nailbar, on a number of occasions. Their conclusion was that the turnover was understated. As a result of their observations and calculations, the taxpayer's date of registration was back-dated and she was assessed for around £90,000 in VAT. The Tribunal decision turned on the methodology HMRC used to calculate the number of customers, on which they had based the expected turnover.

HMRC had clandestinely observed the business during a week in which Mrs Nguyen had self-invigilated. The officer's calculated concluded that the correct turnover in the week was double that recorded by the taxpayer (paras 10-12). What surprised me was that the Officer who conducted the observations and calculations was not called to give evidence. Normal practice is that, if you wish to challenge the observations and calculations, make sure the Officer(s) provide Witness Statements and are cross-examined.

The Tribunal approached the calculation methodically, in contrast to HMRC's slap-dash approach. The decision includes: how many days the shop was open; the number of people serving; the time taken to serve a customer; opening hours; the number of customers served during a typical day; the average price per customer. If HMRC insist on being slap-dash, your response should be much more comprehensive (I have commented on some of these points below).

The taxpayer also provided CCTV evidence. The Tribunal commented that this

was not easily accommodated in the paper bundle! Although this evidence was not from the period covered by the assessment, the Tribunal gave weight to it. I would suggest that it is quite powerful evidence of the number of customers in the shop on any given day. Further, in the case of a nailbar, this evidence indicated how long customers would remain in the shop. A similar approach would apply to hairdressers and other similar businesses. In para 33 the Tribunal highlighted that the number of customers in the shop did not equate exactly to the number served (on which the daily gross takings figure is based). The Tribunal commented that this error infected the thinking behind HMRC's decision.

The taxpayer also provided customer testimonials which included evidence as to how long their treatments took. HMRC objected to this, alleging that they might have been 'coached' to include wording supporting the taxpayer's case. The Tribunal would be open to this possibility but concluded that this evidence should be given weight. If a retailer already gathers customer testimonials, perhaps suitable questions might be included in the absence of a HMRC investigation. For example, what was the value of their purchase? How many times did they visit the shop in a typical month?

There was some discussion of opening hours. I would comment that independent retailers tend to operate flexible opening hours. They doubtless advertise opening hours, but on occasion they will open and/or close earlier or later. Do note this detail if HMRC have based their calculation on the number of transactions per hour.

Mrs Nguyen's first language was not English. When making an Appeal it is important to mention this. The Tribunal service has access to official interpreters. This is preferable to the taxpayer bringing her own interpreter, as it removes any accusation of bias.

The Tribunal concluded that, based on the taxpayer's self-investigation and other evidence, that the weekly and annual turnover could not be as high as HMRC had calculated. There was no appeal on 'best judgment' grounds, which is a higher standard. The Tribunal indicated it would not have found for the taxpayer on this point (see para 91). Readers will know that the 'best judgment' test is hard to displace. So, it is generally better to challenge the arithmetic methodology as the taxpayer did so successfully in this case.

- Les Howard is a partner in vatadvice.org, a specialist VAT practice based in Cambridgeshire. He has over 30 years' experience in VAT, including a short spell with HMCE (as it then was). As well as assisting businesses and charities with VAT issues, he lectures on VAT and sits on the Tax Tribunal