Lies, damned lies, statistics – and HMRC invigilations

Tony Monger highlights a particularly egregious case where an HMRC invigilation came up with some very fishy conclusions

Every three months HMRC publishes a list of 'Deliberate Defaulters' – and if you are not familiar with it, I heartily recommend it. It makes fascinating reading. Essentially, it lists those taxpayers who, in the previous quarter, have been found to have evaded more than £25,000 of tax and who are considered to have done so deliberately – by which I mean that they are considered to have known what they were doing and intended to do it.

The amounts involved are sometimes quite astonishing. So, for example, in the list of details published in June 2020 you'll find a company called P J Eastbourne Ltd who had been assessed for evaded duties of £261,707.51 for the period from 2 May 2016 to 2 August 2020, and had also been hit with a penalty of £151,136.08, which works out as 57.75% of the duties. The period assessed suggests that this is VAT – and, if that is so, and assuming a 20% VAT rate, that would suggest that the company had evaded VAT on income of five times the duties – which comes to a whopping £1.3 million over, what, four years and three months. That's around £300k per year, an astonishing amount.

It makes you wonder why the directors of the company haven't been sent to prison – but, before leaping to any conclusions, it might be worth reading the tax case of Chrisovalandis Georgiou (and Ninos Koumettou, the liquidator of the company of which Mr Georgiou used to be a director) v HMRC, 2022 UKFTT 00455.

In that case, HMRC was suggesting that the company had also understated profits in the region of £1m over a four-year period. HMRC made VAT assessments and raised penalties on the company, and then CT assessments and CT penalties, and followed this up with Personal Liability Notices pursuing Mr Georgiou for liability. It is worth noting that the CT assessments included a substantial Section 455 charge for an overdrawn director's loan account on the premise that the director must have appropriated the undeclared profits. As you'll have gathered, the company has already been liquidated but, as it records in the tax case, somewhat unusually Mr Georgiou wished to challenge the assessments against the company to "restore the reputation of himself and his family".

The background to the case is somewhat sad. The company carried on a fish and chip business, previously from four premises simultaneously, and seems to have largely been successful when Mr Georgiou Senior, the founder, had been in charge. However, Mr Georgiou Snr became ill with pancreatic cancer and died. The illness and death, together with a period of mourning in Cyprus, as well as other domestic issues, meant that the businesses suffered quite badly. It was a few months before Mr Georgiou Jnr, the appellant, took control and took a range of steps to, so to speak, steady the ship which included such things as increasing prices, seeking to reduce wastage, banding with other traders to cut costs by volume buying and so on. As time went by, Mr Georgiou decided to close and rent out two of the premises, retaining one in a fairly affluent area and one in a poorer area. And whilst this was going on, HMRC decided to conduct an investigation.

The first HMRC investigator, a Mr Tromans, carried out what was described as a 'cash reconciliation' exercise. This seems to have involved adding up the sums banked plus the cash used for purchases and wages to arrive at the minimum cash required by the business and comparing the total with the recorded takings. Those readers who are familiar with HMRC enquiries will be unsurprised to hear that Mr Tromans concluded that there were not enough recorded takings to meet all the amounts spent or banked, so he concluded that the takings must have been understated. It is an interesting point that whilst this cash reconciliation exercise was initially referred to as a ‘credibility check’, as time went by, and as other investigators came on the scene, it seems to have mutated into ‘proof of suppression’ of sales.

I will leave out a great deal of the very tedious history of the enquiry (which involved all kinds of checks and reviews of the tills, pursuit of till rolls and ‘Z’ readings – in other words, the usual HMRC shenanigans) and jump forward. There came a point where HMRC actually spent time at the premises, checking to see whether takings were being run up on the till (they were) and then they carried out what they refer to as ‘invigilations’.

Those readers who think of invigilation as the supervision of students in an examination need to know that in Revenue-speak the term means to conduct covert surveillance on a business’s premises. If you think about the covert surveillance of a fish and chip shop, you will appreciate that, sitting outside a fish and chip shop, it must be very difficult to gain any credible information on what is being bought by whom. Are those four people together? Does that bag contain one meal or four? Is that a large bag of chips, or three portions of chicken? Is that a fishcake or scampi? As you’ll appreciate, an enormous number of assumptions are involved. What is also involved is the reliability of those conducting the invigilation.

Needless to say, HMRC again concluded that their invigilation proved that the sales were being suppressed at the two sets of premises that remained open. What is particularly astonishing about that particular conclusion was that one of these invigilations took place at a fish and chip shop after Georgiou and Co had ceased to operate from there – and yet HMRC took this as evidence that Georgiou and Co were suppressing their sales.

Reader, if you are beginning to gasp with astonishment, the shocks do not end there. It turns out that, when the initial officer did his cash flow exercise, it seems that he failed to take account of the fact that a hefty chunk of the bankings came from rents received from the two premises had been let out to tenants. As the Tribunal records (para 164), “the cash reconciliations do not prove anything”.

As for the invigilations, the Tribunal seems to have been unimpressed both by the HMRC observations or the many assumptions applied to them. There was some doubt as to whether the HMRC observers were recording individuals or groups and there were discrepancies between the groups entering and the number of packages leaving. The Tribunal also seems sceptical at the claim by one HMRC officer that he saw 56 customers at the one shop between 5pm and 5.30pm, when they point out that photographs of the premises suggested that it would be full with 20 customers in there. The Tribunal also noted that this jarred with an unannounced visit made by one of the HMRC investigators who recorded that the shop was “almost empty” at 5.50pm on another night.

The Tribunal was similarly uninspired by the HMRC suggestion that the typical purchase price by a customer would be the same for the two shops when they were each situated in vastly different areas (with different clientele of very different affluence) and by the fact that they then used the ‘results’ from their surveillance from two days in November to extrapolate their suggested omissions back over for years, regardless of price changes over that period or even the fact that, in the very earliest period, the businesses were being run by the late Mr Georgiou Senior.

As the Tribunal put it (para 192): “It cannot be said that the two nights in November were representative of the whole period of trading. Apart from the disruption to the business caused by the death (of Mr Georgiou Senior), the shedding of two shops, the seasonal variations, the differences between (the one premises) and (the other), the differences between transaction numbers on different days during the week and at the weekend and the efficiencies implemented, sales can vary for many random reasons. The weather, holidays, a big football match on the television and many other contingencies can affect the sales on a particular day. To say that the observed sales on two nights, five nights apart is representative of the whole period is unrealistic.”

There are many other facets to this farce, some with quite far-reaching consequences. The Tribunal unsurprisingly concluded that the VAT assessments had not been made to best judgement and discharged the lot of them. The VAT penalty, which rested on the VAT liability, fell away at the same time. So then we come to the Corporation Tax assessments.

It transpires that the CT Inspector, a Mrs O'Connor, did nothing more than read the VAT officers' papers and base her assessments upon them. When asked in cross examination whether she had given any consideration to the fact that her assessments would mean that Mr Georgiou had taken over £850,000 from the business over a four-year period and whether she had looked at Mr Georgiou's lifestyle, Mrs O'Connor responded that she had not carried out any credibility check whatsoever. It was, she said, "standard procedure" to review the corporation tax position based purely on the VAT figures. However, she did calculate the GPR of the business based on the revised sales figures, which came to 72% or 73% as compared to the norm which was in the range of 51% to 58%. Again, in cross examination she accepted that the revised GPR was "not credible" but she did not see fit to make any further enquiries as it was "not standard practice to do so".

The CT assessments had been made on the grounds that the Inspector had discovered that there had been a loss of tax. However – and this is an important facet – the Tribunal noted that in order to constitute a discovery, the Inspector's belief in that loss of tax (an insufficiency to use the language of the judgement) has to be objectively reasonable. Her unquestioning reliance upon the results of the VAT enquiry, and her failure to carry out any sort of credibility check, meant that her decision was not "objectively reasonable" and, on that basis, she did not make a discovery within the terms of the Act. As a result, the CT assessments – and the Section 455 charges – and the penalty based upon them – and the Personal Liability Notice all failed.

Readers who are unfamiliar with HMRC's "cash flow test and covert invigilations" approach may be shocked and horrified by this case history and at the entire process to which Mr Georgiou and his family have been subjected. If that is so, I can only recommend that you read the full transcript of the case, all 33 pages and 265 paragraphs of it, because the foregoing is no more than a brief summary of the most salient features. For my part, whilst horrified, I cannot say that I am shocked because I have come across similar "enquiry" approaches in other cases. Space prevents me from going into details other than to mention the Subway franchise where HMRC argued that the percentage of hot food sold on a cold December day would be the same as a hot summer day; or the Indian Restaurant where the HMRC observers concluded that a table of eight had been omitted from the sales, not recognising that the diners had asked for four separate bills: or the barbershop where, based on a half-hour's observation on a Saturday morning, HMRC concluded that the shop must be cutting the hair of 10 customers per hour for six days of the week – also overlooking the fact that the shop was only open for four-and-a-half days per week.

The trouble is that, to fight off these kinds of enquiries, you need an experienced specialist to find the (many and fatal) flaws in the HMRC arguments. That, of itself, takes both money (to hire the right specialists) and nerve. Or, as in the case of Mr Georgiou, a sense of injustice so great that you feel the need to fight to "restore the reputation of himself and his family". The sad reality is that many taxpayers, when faced with these kinds of challenges, and by assessments that charge such astonishingly excessive amounts, feel their only recourse may be to throw in the towel, close the business and walk away.

And this takes us neatly back to our starting point and the HMRC list of deliberate defaulters. For if you look at the case mentioned, that of PJ Eastbourne, you will see that the address is shown as formerly of 77 Seaside, Eastbourne. In other words, the business has closed and gone away. In fact, when you look through the list of deliberate defaulters, you'll find a surprising number of them – and especially the restaurants and takeaways, of which there are a considerable number – show the address as 'formerly of'. One cannot help but wonder how much, if any, of the duties and penalties so proudly proclaimed by HMRC on the list of deliberate defaulters actually gets paid – or how much of it, like the assessments made on Georgiou and Co, is nothing more than an HMRC invention. Perhaps this is something that the Public Accounts Committee could also consider when next reflecting upon HMRC's claimed achievements?

A remark attributed by Mark Twain to Disraeli said there were three types of lies: lies, damned lies and statistics. I'd add a fourth – HMRC invigilations.

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