[2022] UKFTT 89 (TC)

TC 08420/V

VAT – appeal against assessments based on allegedly unexplained deposits in a bank account - HMRC view that they arose from standard rated sales – assessments to best judgment – yes – amount of assessments – wholly satisfactory explanation and supporting evidence for the deposits – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2020/00225

BETWEEN

STARZ TRADERS LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE NIGEL POPPLEWELL
MS GILL HUNTER

Hearing conducted in public remotely by video on 23 February 2022

Zareef Kahloon of Zareef Kahloon & Co for the Appellant

Olivia Donovan Officer of HM Revenue & Customs for the Respondents

DECISION

INTRODUCTION

1. This is a VAT case. The respondents (or "**HMRC**") believe that in four VAT periods the appellant has declared sales of £262,346 yet has banked £422,308. It is their view that the difference arises from standard rated sales which attract output VAT. They have, accordingly, adjusted the appellant's VAT returns for those periods resulting in a reduced repayment to the appellant for one of those periods, and a liability to output VAT in each of the other three periods. We shall call these adjustments "**assessments**" as they have been treated as such by the parties. The total amount of VAT at stake is £40,437.84. The appellant's position is that these additional bankings arise from trade debtors, injections of cash by way of a director's loan account, further injections of cash by way of loans from an associated company and advance payments.

2. The issues which we have to consider therefore are:

(1) Whether the assessments are valid in time best judgment assessments;

(2) If so, has the appellant displaced these by establishing that they are more likely than not to be incorrect.

THE LAW

3. There was no dispute between the parties concerning the relevant law which we summarise below.

(1) By virtue of section 73(1) Value Added Tax Act 1994 ("**VAT Act**"), where it appears to HMRC that tax returns made by a taxpayer are incomplete or incorrect, HMRC may assess the amount of VAT due from him to the best of their judgment and notify it to him.

(2) Under section 73(6) VAT Act an assessment must be made not later than either 2 years after the end of the prescribed accounting period or 1 year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge (whichever is the later).

(3) The general rule is that the time limit for making an assessment is 4 years after the end of the relevant accounting period. This is found in section 77(1) VAT Act 1994.

(4) Section 83 VAT Act provides:

> "Subject to section 84, an appeal shall lie to a tribunal with respect to any of the following matters..."

(5) There is then set out a series of actions, decisions, and other matters arising under the Act listed under paragraphs (a) to (z). Paragraph (p) is as follows:

> "An assessment-
>
> (i) under section 73(1) or (2) in respect of a period for which the appellant has made a return under this Act....

or the amount of such an assessment."

(6) In *Van Boeckel v Customs and Excise Commissioners* [1981] AER 505 ("***Van Boeckel**")* the High Court (Woolf J as he then was) considered the application of best judgment.

> "It should be recognised...that the Commissioners should not be required to do the work of the taxpayer in order to form a conclusion as to the amount of tax which, to the best of their judgement is due. In the very nature of things frequently the relevant information will be readily available to the taxpayer, but it will be very difficult for the commissioners to obtain that information without carrying out exhaustive investigations. In my view, the use of the words 'best of their judgment' does not envisage the burden being placed on the commissioners of carrying out exhaustive investigations. What the words 'best of their judgement' envisage, in my view, is that the commissioners will fairly consider all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due."

(7) In the Court of Appeal decision of *Customs & Excise Commissioners v Pegasus Birds Ltd* [2004] EWCA Civ 1015, that court approved the approach of Woolf J. It went on to add that the tribunal's primary task is to find the correct amount of tax on the basis of the material before it and in all but very exceptional cases this should be the focus of the hearing; any mistake which I consider that HMRC has made in its assessment may still be to best judgment if it is consistent with an honest and genuine attempt to make a reasoned assessment of the VAT payable; and an assessment which appears to be unreasonable or wholly unreasonable may still be the result of an honest and genuine attempt to assess the VAT properly due.

(8) Generally, the burden lies on the taxpayer to establish the correct amount of tax due:

> "The element of guesswork 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." (Bi−Flex Caribbean Ltd v Board of Inland Revenue (1990) 63 TC 515, 522−3 PC, per Lord Lowry)."

EVIDENCE AND FINDINGS OF FACT

4. We were provided with a bundle of documents. Unfortunately the assessing officer, Officer Hayes, was unable to attend the hearing due to personal circumstances. She had not tendered a witness statement. Evidence for the appellant was given by the appellant's representative, Mr Kalhoon.

5. From the evidence we find the following facts:

(1) The appellant company was set up on 8 March 2016. The original founding director and shareholder resigned on 22 January 2018 and Mr Zeeshan Rafique succeeded that individual in both capacities.

(2) It was registered for VAT on 7 April 2016 with an effective date of 1 March 2016. The business activities were described as "goods and services-other intermediate products importer (wholesale)"

(3) The appellant's business model was as follows. Manufacturers of goods in Pakistan (those goods including items of medical equipment and, separately, sports equipment) would be contacted by a customer in the UK or the EU who would place an order with a manufacturer. These were commercial customers and the orders were therefore substantial.

(4) The manufacturer, in Pakistan, would manufacture the goods and then box up the orders. Those boxes contained the individual orders for each customer, and each was labelled with a customer's address.

(5) The individual boxes would then be aggregated and form part of a larger consignment which would be shipped to the UK. The shipping was organised by shipping agents based in Pakistan.

(6) The appellant contracted with four shipping agents. Its role was to collect the consignment when it arrived in the UK, deliver that consignment to its warehouse in the UK, break down the consignment into the individual boxes, and then arrange for those individual boxes to be delivered to the customers in the UK or the EU. These deliveries were undertaken by Parcelforce and DPD.

(7) If the labels on the individual boxes had become damaged or illegible, the appellant relabelled those boxes using information about the customer which had been included on the manifest provided by the shipping agent.

(8) The invoices for the services provided by the appellant were given to the shipping agent with whom the appellant had contracted and who was therefore liable to pay them.

(9) Payment was made direct by that shipping agent. But payments were also made by the customers of the manufacturer to the appellant's UK bank accounts at the direction of the manufacturer. We were told that this was to avoid issues of foreign-exchange remittance restrictions in Pakistan.

(10) The appellant would credit payments made either by the shipping agent or by the customers to its outstanding invoices with the relevant shipping agent. Payments were allocated to the earliest outstanding invoices. Each shipping agent had a customer account and advance payments were allocated to those accounts.

(11) On 3 April 2019 HMRC opened an enquiry into the appellant's VAT position and sought information about the appellant's business. In an email dated 12 July 2019, Officer Hayes indicated that she had a number of questions regarding the records provided by the appellant including the amount of cash deposited in the appellant's bank account (including loans), the source of the payments, and the validity of the sales invoices.

(12) A meeting between Officer Hayes, Zeeshan Rafique and Mr Kalhoon took place on 13 August 2019 following which Officer Hayes sent an email to the appellant and Mr Kahloon thanking them for providing subsequent Dropbox data including a bank account reconciliation. She indicated that she still required sales listings and invoices as well as

loan agreements/contracts/schedule of payments/repayments to support those bank reconciliations.

(13) An email from Mr Kalhoon to Officer Hayes dated 17 September 2019 records that he had dropped all the requested information into a Dropbox and asked whether she still required further information.

(14) In an email dated 27 September 2019, Officer Hayes indicated that she had reviewed the majority of data received in the Dropbox but was still missing bank statements and was unable to match all monies deposited in the bank with sales invoices. She stated that she did not at that time have a copy of the loan agreement or repayment schedule as previously requested.

(15) On 7 October 2019 Mr Kahloon sent an email to Officer Hayes indicating that the missing bank statements had already been sent across; payments are made account and applied against outstanding invoices on the basis of first in first out; the bank analysis of the monies received and paid had been sent to HMRC via Dropbox (the safe of receipt of which had already been acknowledged by Officer Hayes); the appellant had no local customers which were subject to standard rated output VAT but had overseas customers based in Pakistan; and that he was organising the rest of the information to be supplied as soon as possible.

(16) The following day, on 8 October 2019, Officer Hayes sent an email to the appellant and Mr Kahloon acknowledging safe receipt of the outstanding bank statements but indicating that; the deadline for providing information had passed and that information had been requested on a number of occasions; HMRC still had a number of concerns reflected in the fact that the bank statements provided did not support the explanations of the business described at the meeting and that the number and volume of cash banked was not supported by sales invoices and for the four periods; sales were declared of £262,346 with banking of £422,308; the loan amounts could not be supported by agreements/schedules of repayments and appeared to be random. We were told by Ms Donovan that this was the basis on which the assessments were made.

(17) The assessments dated 7 November 2019 for all four periods referred to the email of 8 October 2019 as being the basis for HMRC's belief that there were inaccuracies in the returns for the four periods. Each assessment includes a table of boxes relating to the returns containing those inaccuracies, and a compilation of those is set out below

Period	**Amount Claimed**	**Amount declared on return**	**Adjusted Amount**
09/18	Box 1 VAT due on sales	£0.00	£10,288.00
	Box 3 Total VAT due	£0.00	£10.288.00
	Box 5 Net VAT	£13,118.17	£2,830.17
12/18	Box 1 VAT due on sales	£0.00	£18,099.98
	Box 3 Total VAT due	£0.00	£18,099.98
	Box 5 Net VAT	£9,580.74	£8,519.24
03/19	Box 1 VAT due on sales	£0.00	£14,430.86
	Box 3 Total VAT due	£0.00	£14,430.86

	Box 5 Net VAT	£8,615.67	£5,815.19
06/19	Box 1 VAT due on sales	£0.00	£13,411.87
	Box 3 Total VAT due	£0.00	£13,411.87
	Box 5 Net VAT	£9,123.23	£4,288.64

(18) In a letter dated 6 December 2019, Mr Kahloon explained that the difference between the figures set out in Officer Hayes email of 8 October 2019 was trade debtors (as per accounts to 31 March 2018) of £8,995, director's loan account (cash deposited) of £54,020, and intercompany current account of £88,350. The balance was advance payments on account to be set off against future invoices. His evidence was that this information had already been provided, via the Dropbox, to Officer Hayes. Attached to his letter were two schedules. One was of the deposits made into a variety of banks which comprise the introduction of cash by way of the director's loan account on a variety of dates between 4 April 2018 and 20 February 2019. The second was a schedule of the loans made by the associated company (SWI CS (UK) LTD) on a variety of dates between 12 April 2018 and 31 May 2019.

(19) That letter also included explanations of other matters including the appellant's business model (for example that it supplies its services to overseas customers based only in Pakistan and as such is not subject to output VAT), and that the appellant's overseas customers instruct their customers in the UK to make payments due to them directly to the appellant to alleviate foreign exchange issues). Such payments are applied to the amount outstanding against the invoices raised and accounted for in VAT returns. It also records that as "previously notified to you during the scheduled meeting that took place at our clients principal place of business, there have been foreign exchange remittance restrictions in Pakistan over the last few years due to which an arrangement was reached with the overseas customer whereby our clients invoices to them would be paid by the overseas customers contacts in the UK."

(20) Mr Kalhoon's evidence was that the information in the schedules attached to his letter of 6 December 2019 had been supplied to Officer Hayes before her email of 8 October 2019 as had all of the sales invoices which clearly identified the overseas shipping agents as customers. That evidence was tested by Ms Donovan in cross examination, but Mr Kahloon provided coherent and convincing answers to her questions as a result of which we find, as a fact, that the aforesaid information had been supplied to Officer Hayes. Unfortunately, none of those sales invoices were in the bundle of documents provided to us, nor was Officer Hayes present, in person, to explain to us, in detail, the basis on which she made the assessments.

(21) The aforementioned loan agreement is a document dated 22 January 2018 between the appellant and Swift Cargo Services UK Ltd. It then identifies "Lender" and "Borrower" but it is not at all clear which of the parties contracts in what capacity. However, it seems clear from the surrounding evidence that the appellant is the Borrower and Swift Cargo Services, the Lender. No challenge was made to the validity of this document by Ms Donovan.

(22) In the bank account reconciliation compiled, we think by Mr Kahloon, for the period 9/18, it is possible to correlate a number of payments into the company's bank account by way of director loans and associated company loans. The schedule of

associated company loans shows loans of £2,000 on 31 August 2018, a further loan of £2,000 on 3 September 2018 and a further loan on that date of £5,000. Each of these is recorded in the reconciled bank account on those dates with them word "loan" identified against the entry. A number of other loans, identified as such, can be tied up with the entries in that schedule. Similarly, for that period, there is a single entry in the director's loan schedule of £1,375 as "CASH S FABRIC" on 21 August 2018. And that is identified in the reconciled bank statement as "cash fabric".

DISCUSSION

Validity of the assessments

6. It is for HMRC to establish that the assessments have been made to best judgment and that they are in time. We accept that they are in time. We need to consider therefore whether they have been made to best judgment. HMRC submit that the appellant has failed to provide an evidenced-based explanation as to the source of the unattributed funds in its bank accounts. In the absence of a verifiable explanation HMRC has fairly considered the information and business records provided and has reached what HMRC considers to be a reasonable conclusion that the unexplained funds relate to taxable supplies which should be charged at the standard rate.

7. We accept that the bar for best judgment is a low one. HMRC must fairly consider all material placed before them and on that material come to a decision which is reasonable and not arbitrary as to the amount of tax which is due. Furthermore, we are directed to focus on finding the correct amount of tax on the basis of the material before us and to ask whether the assessment is consistent with an honest and genuine attempt to make a reasoned assessment of the VAT payable.

8. We are in some difficulty in assessing the honesty and genuineness of Officer Hayes, but without having seen her give evidence, we are not in a position to make any comment about her integrity or sincerity.

9. We are also unable to get the bottom of the specific matters which she took into account when reaching her conclusion and coming to her decision regarding the assessments. We rely therefore on the documentary evidence, and the evidence of Mr Kahloon.

10. From this evidence it is our view that at the time of her decision letter 8 October 2019 Officer Hayes had been provided with the following:

(1) Sales invoices - some were missing - which identified the appellant's customers.

(2) Bank statements - some were missing.

(3) A reconciliation of the bankings with the sales invoices for the period 9/18 which showed declared sates of £75,000 and bankings of £102,429.

(4) Details of the director's loan account cash injections.

(5) Details of the loans to the appellant from SWI CS (UK) limited.

(6) An explanation of the appellant's business model including the way in which payments were made by the Pakistan manufacturers' customers into the appellant's UK bank account.

(7) An explanation that the reason for these payments was to get round Pakistan foreign exchange controls.

11. We are not certain whether she was in possession of a copy of the loan agreement but we think not, given that her email of 8 October to the appellant states that the appellant appears to have forgotten to send the loan agreement. The same is true of the repayment schedules. She was also missing bank account statements for 23 October 2018 to 22 December 2018.

12. Our understanding, too, is that the bank reconciliation for the period 9/18 had been compiled by Mr Kahloon and not by her, even though it was one of the pieces of information on which she based her assessments. But she did have sufficient information the verify the deposits described as "loans".

13. That reconciled bank statement recognises that some of the deposits were loans and includes the payment by way of directors' loan account identified at [5(22)] above. Mr Kahloon's evidence was that she had been provided with the details of these director's loan account cash injections and the loans from the associated company.

14. The one missing piece therefore was the loan agreement. Whether this would have comprised sufficient independent evidence to satisfy Officer Hayes is something we shall never know. We strongly suspect that she might have treated it as a self-serving document given that it was made between connected parties, and indeed signed on behalf of both parties by the same individual. We strongly doubt that she would have attributed much probative value to it.

15. We also suspect that Officer Hayes found the business model operated by the appellant as an unlikely one. We are not absolutely clear on this point, but we think it is likely there was a misunderstanding between the parties. Mr Kalhoon believes that the details of the business model had been explained to the HMRC officers at their meeting on 13 August 2019. That is very different from HMRC's understanding of that model which is reflected at paragraph 34 and 35 of HMRC's statement of case which suggests that the appellant had claimed that it had one customer in Pakistan which exported goods to the appellant which were then checked, labelled by an employee of the appellant, and posted back to customers in Pakistan. HMRC contend that this is not a creditable (sic) business model which would be costly and time-consuming with no clear financial benefit as the labelling and posting could have been done in Pakistan where the appellant's customers are based.

16. And in the light of this misunderstanding, Officer Hayes, we further suspect, found equally incredible that payments were made direct from the customers of the Pakistan manufacturer into the appellant's UK bank account notwithstanding that she had been told that the reason for this was to get round foreign exchange controls prior to her email of 8 October 2019.

17. Drawing all these threads together, we find that HMRC have cleared the low bar of making the assessments to best judgment. There was evidence in the reconciliation statement for the period 9/18 of a shortfall between the sales invoices and the bankings, and as HMRC have said, there was no truly objective evidence of the source of the cash injections by way of director loans or associated company loans. The schedules attached to the letter of 6 December, which Mr Kahloon says contained information which had previously been given to HMRC are not objective evidence. Officer Hayes had not seen the loan agreement, nor did she have the benefit of Mr Kahloon's eloquent testimony. We find that the assessments were made to best

judgment.

Amount of the assessments

18. The burden now swings to the appellant who must show, on the balance of probabilities, that the assessments are numerically incorrect.

19. We unhesitatingly say that it has done so. We can consider this issue in light of the evidence that was presented to the Tribunal on the day of the hearing. We have set out that evidence above and our findings of fact in relation to it. Unlike HMRC we find the appellant's business model to be thoroughly credible. We have seen the loan agreement, the schedule of payments from the associated company, the bank account reconciliation, and have heard the evidence of Mr Kahloon. He has provided us with a coherent explanation of the source of funds which make up the difference between the amounts in the sales invoices and those in the appellant's bank account. They are as identified at [5(18)] above. We accept this explanation, and those amounts, and find that it is more likely than not that they are the difference between the amounts banked and the amounts in the sales invoices.

DECISION

20. For the foregoing reasons we allow this appeal.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

21. 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.

NIGEL POPPLEWELL
TRIBUNAL JUDGE
Release date: 09 MARCH 2022