

## **Business tax round up (Lecture B1316 – 21.31 minutes)**

### **Suppressed restaurant cash takings**

*Summary - HMRC's calculations based on evidence that included an undisclosed bank account and test meals were an appropriate way to determine the additional tax owed by a restaurant owner.*

Wuttinan Kotpat, a sole trader, operated a Thai restaurant that he had acquired in July 2013. HMRC officers undertook a lunchtime test meal at his restaurant in February 2016 and further test meals in June 2016. A few months later, HMRC opened an enquiry into Mr Kopat's 2014/15 tax return, requesting various requested information and documents.

A month later, at a meeting between HMRC, Mr Kopat and his accountant, Mr Kopat explained the systems that he had in place for dealing with cash sales. The business had no till or cash register and cash takings were recorded by keeping handwritten meal tickets which were passed to his accountant. He confirmed that this cash was often used to pay both suppliers and employees, as well as his own drawings (up to £250 per week). With no records of these drawings, the accountant confirmed that drawings were calculated as an estimated balancing figure when preparing the balance sheet.

HMRC concluded that Mr Kopat had failed to declare all of his cash takings as:

- only two of the six test meals carried out by HMRC had been included in the records provided by Mr Kotpat to HMRC; and
- HMRC found evidence of a second business bank account but that Mr Kotpat had failed to declare takings paid into this account.

HMRC issued a discovery assessment for 2013/14 and three closure notices for 2014/15, 2015/16 and 2016/2017 on the grounds that cash takings were underdeclared.

Mr Kotpat appealed. He argued that HMRC had not provided any clear evidence to support their case. He stated that he had not understated cash takings nor omitted any takings generally, including those relating to any test meals. HMRC had not provided any receipts supporting the test purchases, only handwritten notes outlining HMRC acting as customers, which he contended did not prove that they had made the alleged purchases. HMRC had based their assessments on inaccurate assumptions and that the amounts misrepresented the business.

#### *Decision*

The First Tier Tribunal found that the evidence provided confirmed that there was a second bank account, albeit not in Mr Kopat's name. The business had access to a second bank account with HSBC.

The Tribunal confirmed that the test purchases were evidence that cash takings were not fully recorded but were not used as the basis of the assessments that were raised. HMRC's assessments were based on material available to them using best judgement. Indeed, the card/cash split used was favourable to Mr Kotpat by comparison with the split available from his own records

The First Tier Tribunal agreed with the assessments raised and upheld the penalties raised in the basis of deliberate behaviour.

## **Wind tunnel and suppressed purchases**

*Summary – The partnership deliberately failed to keep accurate records and filed inaccurate returns. A wind tunnel outside of the shop was no excuse for missing purchase invoices.*

Tasleem and Salim Balesaria were married and formed a partnership, which traded as Best on Convenience Store from premises in Blackpool.

On 12 November 2012, HMRC opened an enquiry into the partnership's income tax return for the tax year ended 5 April 2011. With both purchases and sales found to be missing from the accounting records, HMRC opened a COP9 investigation. This resulted in HMRC amending the partnership's income tax returns, assessing Mr and Mrs Balesaria to income tax, and the partnership to VAT, in respect of undeclared income. Input tax was not an issue because the business used the flat rate scheme, and the assessment was calculated in line with the scheme. Further, HMRC charged penalties for deliberate and concealed, and for dishonest, behaviours.

The assessments were arrived at by using 2010/11 as the base year, and then calculating an average purchases suppression rate, which was then extrapolated to other years and used to calculate projected unrecorded takings on these purchases.

The couple said that the suppression of purchases was not deliberate. It was caused by the fact that the street outside the shop was like a wind tunnel, and so when they unloaded stock from their car, any invoices in the boot would blow away. They were asked why they did not take precautions to prevent this from happening, and the response from both of them was that they were busy with the shop and did not learn from their mistakes.

Further, the couple argued that HMRC's projection of sales was not consistent with the financial difficulties faced by the business, and the fact that working capital was funded by business and personal loans.

### *Decision*

Unsurprisingly, the First Tier Tribunal concluded it was not credible that invoices blew down the street on pretty much every occasion that they opened the boot of their car. The Tribunal found that the missing invoices were thrown away deliberately in order to conceal the true extent of their stock purchases.

Further, the Tribunal did not believe that the audit rolls from their till were thrown away through carelessness virtually every time. The Tribunal found that the audit rolls were thrown away deliberately in order to conceal the true extent of the partnership's gross daily takings.

The First Tier Tribunal agreed with HMRC that the partnership failed to keep the required records and filed inaccurate returns.

However, the appeal was allowed in part as HMRC's suppression rate had failed to take into account the fact that some banked amounts were loan monies being received and that the business was winding down in the period from April to October 2012.

## Understated s.455 charges

*Summary – HMRC were correct to issue their closure notices, discovery assessments and penalty notices relating to a number of transactions that had been incorrectly accounted for*

Mr and Mrs Soto each owned 50% of the ordinary shares in La Luz Residential Home Ltd, a residential care home.

In August 2015, HMRC opened an enquiry into the company's tax return for the period ended 31 July 2014. At the same time, HMRC also opened enquiries into Mr and Mrs Sotos' Self Assessment tax returns for 2013/14.

HMRC identified ten areas where transactions had not been correctly accounted for tax, the majority of which were adjusted for through the current or loan accounts, resulting in further amounts due under s.455 CTA 2010.

By 2017, the enquiries were closed, with HMRC issuing discovery and closure notices for the:

- company's accounting periods ended 31 July 2010 through to 2015;
- couple's affairs covering the periods 2010/11 to 2014/15.

Penalties were issued in the basis of deliberate underpayment of tax.

All assessments and closure notices were appealed. Those issued to La Luz Residential Home Ltd were appealed out of time however, HMRC accepted the out of time appeals.

### *Decision*

The First Tier Tribunal commented on the parties' failure to cooperate with HMRC's enquiry and a failure to provide information as and when requested.

The Tribunal also noted that there were inconsistencies across the documents that were provided to HMRC and those filed at Companies House. For example, the amended accounts for the accounting period ended 31 March 2015 were apparently signed before the originals. The Tribunal was not confident as to the provenance of the accounts and documents relied on in this case. Where there was any divergence between working papers and filed accounts those filed with Companies House were preferred.

The First Tier Tribunal considered each area in turn, including:

- expenditure on a property owned by the Sotos but recorded as an asset in the company's books. HMRC stated that the expenditure should have been debited to the Sotos' loan accounts with tax under s.455 CTA 2010 payable;
- dividends credited too early to the directors' current and loan accounts meaning that s.455 CTA 2010 relief was denied at that time;
- various items of the couple's private expenditure being deducted as the company's expenditure, which should be disallowed, with the knock-on effect creating further s.455 amounts payable;
- Unsupported management fee of £15,000 which should be debited to the loan account;
- Rental income was omitted from the couples' personal tax returns.

Overall, the assessments made by HMRC were upheld, together with the penalties for deliberate behaviour.

*La Luz Residential Home Ltd, Mrs M D Soto, Mr M A Soto v HMRC (TC08430)*

### **Split of standard and zero-rated sales**

*Summary - HMRC had used best judgment. The five testing days were reasonable and, with the onus on the director to establish that the assessment was wrong, he had failed to do so.*

This was an appeal against a VAT assessment of £18,063, issued in July 2018 in respect of the period ending 03/16 to the period ending 06/17.

In January 2014, Mangio Ltd opened a shop selling hot and cold takeaway food and drink. It also had eight stools for people eating food and drink on the premises.

The company underwent substantial change during the period that the assessment related to:

- leasing a coffee making machine, resulting in coffee sales increasing ten-fold;
- extending its opening hours from 5pm to 10pm;
- introducing deliveries through Seamless, Deliveroo, and Uber Eats.

The gross sales made during this period were not disputed but rather, the split between standard rated and zero-rated sales were challenged.

It was common ground that the way in which the till system was set up and used and that it had a number of shortcomings:

- It did not identify which customers were eating in the shop;
- It identified deliveries as zero-rated “corner shop” sales, and did not differentiate what type of food and drink was being delivered;
- It treated all sandwiches as cold food, whether or not they were toasted;
- It recorded ice cream and hot chocolate sales as zero-rated;
- A meal deal of a hot pasta dish, cup of coffee and salad box was treated as 30% standard rated, but HMRC increased this to 45%.

Using their power of best judgment, HMRC’s assessment was calculated based on analysing five days of sales in June and July 2017. This showed that 82% of total sales were standard rated, rather than the 45% declared in the company’s records.

Mr Delvecchio, Mangio Limited’s director who worked in the shop, claimed that the assessment should be reduced by about £10,000.

### *Decision*

The First Tier Tribunal found that Mangio Limited had been unable to discharge its burden of proof in establishing that HMRC's assessment was incorrect:

1. The company had not presented any evidence to show what the make-up of the sales in fact was during the relevant periods;
2. The company's proposed adjustments to HMRC's assessment were based on broad assertions as to the nature of eat-in sales, the percentage of sandwiches which were toasted, the make-up of delivery orders and number of pasta meal sales. There was no documentary evidence to support these assertions.

The appeal was dismissed.

*Mangio Limited v HMRC (TC08422/V)*

### **Gambling, hospitality and entertainment**

*Summary – The standard method of attributing input VAT on premises costs between taxable and exempt supplies was replaced by an alternative method based on utilised floorspace.*

Hippodrome Casino Limited was a partially exempt business that made exempt gaming supplies and taxable supplies of hospitality and entertainment. The company provided gaming facilities, eight bars, a steak-house restaurant with a celebrity chef, meeting rooms, conference facilities and a theatre.

The company argued that overhead expenditure should be apportioned between taxable and exempt supplies based on the floor area utilised by each activity, rather than the standard method based on respective turnover.

HMRC disagreed, arguing that the company's alternative method did not give a more reasonable apportionment than the standard method.

Hippodrome Casino Limited appealed.

### *Decision*

The Tribunal stated that, not only were the theatre, restaurant and bars identifiable features of the Hippodrome, each was operated from clearly recognisable and defined spaces. This was also the case for the gaming areas. The Tribunal concluded that the supplies of entertainment and hospitality from these discrete and defined areas could not be regarded as merely an adjunct to, or an amenity for, gaming.

The First Tier Tribunal found in Hippodrome Casino Limited's favour, concluding that their floorspace based apportionment was a more appropriate methodology for calculating the input tax attributable to taxable and exempt supplies. This method provided 'a more fair, reasonable and precise proxy of its economic use of its overhead expenditure than the turnover based standard method, particularly given that most of those overheads are property related'.

*Hippodrome Casino Limited v HMRC (TC08441)*

## Is a flapjack a cake?

*Summary – Products described as flapjacks were not cakes and so were subject to VAT at the standard rate.*

Glanbia Performance Nutrition (UK) Limited, a member of the Glanbia Milk Limited's VAT group, was a manufacturer of nutritional sports and performance protein bars, shakes and powders.

Its customers own the product brands, and market and distribute the products to their customer bases as their own products. Glanbia Performance Nutrition (UK) Limited manufactures these products for these businesses to sell on.

In 2016, following a visit, HMRC became aware that the group had applied a zero rate of VAT to sales of 36 varieties of food products described by Glanbia Milk Limited as "flapjacks".

Later, in 2018, HMRC raised an assessment on the basis that supplies of each of the 36 products should have been standard rated 'confectionery' within the meaning of excepted item no. 2 in Group 1, Schedule 8 VATA 1994.

Excepted Item No.2 reads:

"Confectionery, not including cakes or biscuits other than biscuits wholly or partly covered with chocolate or some product similar in taste and appearance."

Glanbia Milk Limited appealed, arguing that the products were zero rated as they were 'cakes' within the meaning of this provision.

### *Decision*

It was not disputed that all of the products were 'confectionery' within the meaning of Excepted item No. 2 in Group 1 Schedule 8 VATA 1994.

The First Tier Tribunal referred to HMRC's internal manual 'VAT Food', which states in paragraph VFOOD 6200 that historically, flapjacks were accepted as a cake, and that traditional flapjacks can still be treated as a cake. However, many of today's 'flapjacks' are in fact cereal bars, which are standard-rated.

Did the products have sufficient characteristics of a cake to fall within the definition of a cake for purposes of Excepted Item 2? Analysing the products in detail, the Tribunal concluded that:

- The products were not predominantly made from flour, fat and eggs but rather oats, syrup and protein; protein is not something typically associated with cakes;
- The products in this case did not have the texture or appearance of a typical flapjack, let alone that of a typical cake. They were a dense, chewy consistency similar to a fruit or energy bar.
- The ordinary person would consider the products to be unsuitable as a dessert, as food to be consumed at an afternoon tea, or at a casual social function;
- All of the products were originally targeted at consumers in the sport nutrition market, not a place where you would expect cakes to be sold;

- When marketing the product, the word 'protein' rather than 'cake' featured on the products' wrappings.

The First Tier Tribunal found that the products were not 'cakes', and so were standard rated as "confectionery".

*Glanbia Milk Limited v HMRC (TC08439/V)*