

VAT update – September 2024 (Lecture B1455 – 22.57 minutes)

Suppressed sales and purchases

Summary – The taxpayer had suppressed zero rated cash purchases of food, meaning that sales were deliberately understated.

Good Choice 2016 Limited was incorporated on 16 November 2016, operating as a Chinese takeaway until March 2020, when it ceased trading. Throughout this time, Mrs Guo was the sole director of the company.

In November 2019, HMRC began a VAT and corporation tax check and, as part of that check, obtained purchase data from a supplier for the period 4 July 2017 to 26 January 2018. This data showed that the company made purchases using an invoice account as well as a separate cash account, but only the purchases from the invoice account had been recorded in the company's accounts. Mrs Guo stated that purchases made by cash account had been for family use only and had not kept the invoices for those purchases.

HMRC:

- concluded that both zero rated purchases and standard rated sales had been suppressed;
- calculated the revised gross sales figures using the suppression rate for cash purchases derived from the purchase data received from the supplier, applying that rate to the sales declared in the corporation tax accounts, and applying the presumption of continuity;
- issued VAT assessments for the periods 08/19 and 11/19, for £2,970 and £2,773 respectively;
- raised VAT discovery assessments following on from corresponding amendments for corporation tax purposes for the years ended 30 November 2017, 2018, and 2019 totalling £50,000;
- issued VAT and corporation tax related penalties totalling £45,000;
- issued Personal Liability Notices to Mrs Guo, in respect of the penalties issued to the Company.

Both the company and director appealed.

Decision

The First Tier Tribunal found Mrs Guo to be an unreliable witness, who provided inconsistent evidence, and did not accept her defence that:

- she had health issues and her medication created memory problems;
- the cash account was used for her family's private food - £20,000 for a six-month period was clearly excessive.
- HMRC's projected turnover was excessive for a take-away business that had suffered reputational damage due to a problem with rat infestations;

The Tribunal concluded that turnover was not accurately recorded and that HMRC's best judgement figures for suppressed purchases and sales were correct, including the s.455 CTA 2010 charges for the extraction of undeclared, additional profits.

The Tribunal agreed with HMRC that the behaviour was deliberate and so the penalties were upheld.

The appeals were dismissed.

Good Choice 2016 Limited and Mrs Fang Bo Guo v HMRC (TC09214)

Collagen-based drink

Summary – A collagen drink designed to improve skin condition was not zero rated “food of a kind used for human consumption”. It was standard rated.

Bottled Science Limited sold a product called Skinade, described on its website as a 'uniquely formulated drink' that should be used as 'part of your daily skincare regime'. It contained marine collagen with flavourings and preservatives to mask the taste.

In November 2020 the company submitted an error correction notice for overdeclared output tax declared in VAT periods 12/16 - 09/20 inclusive totalling £1.25 million on the basis that Skinade was zero-rated food.

However, in May 2021 HMRC refused the claim on the basis that it was a beauty product, sold in beauty salons and cosmetic clinics rather than to food suppliers. Further, the product had won industry awards.

Decision

The First Tier Tribunal needed to determine whether the drink product was a 'Food of a kind used for human consumption' and so zero within Item 1, Group 1, Schedule 9 VATA 1994.

The First Tier Tribunal considered what a 'broad-minded VAT payer', would consider the drink to be by considering its name, nutritional value, palatability and taste, as well as the application of food safety regulations.

The key factor determining the First Tier Tribunal's decision was the marketing and packaging. The product's appearance was more akin to products found in 'in a chemist's shop rather than a grocer' and was marketed as something to be included as "a part of your daily skincare regime".

In conclusion, the First Tier Tribunal found that a broad-minded VAT payer would have found that 'Skinade was not a food.'

The appeal was dismissed

Bottled Science Limited v HMRC (TC09231)

Mobile phone plan bundles

Summary – The company was making the single supply of standard rated telecommunication services with VAT accounted for when the consideration was paid and not when actually used. The other services were merely ancillary to the main supply.

Lycamobile UK Limited supplied mobile phone plan bundles that included calls, texts and data to UK customers. These bundles:

- lasted for a specified period, usually 30 days, and at the end of which the unused allowances were lost;
- varied significantly in composition in terms of number of minutes, text and volume of data;
- could include the right to access specified "value added services" by using part of the monthly data and call allowances, including a "sports update "service and "non-EU Roaming Calls " service.

Lycamobile UK Limited argued that no service was being provided to the customer until the whole service had been used on the plan as buying a bundle was like buying a voucher, with no VAT charged until the credit on the voucher was spent. At the time consideration was received, the extent to which the customer would use the services was unclear, as was the nature of the services that would be used and the related VAT treatment of those services. This would only be certain when the customer used the services. If correct, VAT was chargeable on the consideration relating the part of the bundle actually used at the end of each period, and then only to the extent that the services were standard rated supplies.

By contrast, HMRC argued the services were supplied at the time of sale, meaning that the full consideration received for each bundle would be taken into account for VAT purposes when paid. However, it was accepted that there could be an adjustment to the extent that the usage did not involve a standard-rated supply. HMRC issued assessments on this basis, totalling some £51 million for the periods 07/12 to 08/19.

Decision

The First Tier Tribunal rejected the idea that the bundles were vouchers (monetary entitlements for future services), taxable when the credit was used. Instead, the First Tier Tribunal found that the company was making a single supply of telecommunication services taxable when the consideration was received, and not when the services were used.

It did not make a difference if the customer then failed to use those services.

The First Tier Tribunal considered the 1 November 2017 change to the use and enjoyment provisions. Prior to this date, supplies of business-to-consumer telecommunication services were not subject to UK VAT to the extent that they were effectively used and enjoyed outside the EU. The First Tier Tribunal concluded that services prior to this date should have been accounted for based on the full amount of the consideration when it was received, with a subsequent adjustment to reflect any non-EU roaming charges.

Lycamobile UK Limited v HMRC (TC09243)

Fraudulent wholesale drinks business

Summary – The taxpayer should have known the transactions in these cases were connected to fraud and, more likely than not, actually knew of that connection.

Drinks 4 Less (UK) Limited was a company that traded as an alcohol wholesaler but was liquidated in November 2023.

Anandpreet Singh Powar was the company's sole director and shareholder and, by his own admission, was responsible for everything done by the company, including all trading activities, from its incorporation until its liquidation.

Before establishing Drinks 4 Less (UK) Limited, Mr Powar had been employed by Great Western Cash and Carry Limited where he learned about the alcohol industry, including which products were "fast moving", and when and what to order from suppliers. He made contacts with both suppliers and customers. Great Western Cash and Carry Limited was subsequently deregistered for VAT by HMRC as a missing trader having been subject to at least one seizure of alcohol and an assessment for undeclared sales.

The company received several visits from HMRC officers at which time the importance of due diligence and of keeping accounting records was discussed and various facts were established.

Typically, the company's business involved Mr Powar being contacted by telephone or text by suppliers offering a "one-time" deal. If he was then able to find a customer willing to accept the goods, he would respond to the supplier, accepting the goods at the price without negotiation. The goods were either delivered to him at the company's registered office or he would meet the supplier somewhere else, such as a carpark, where goods would be transferred to his van for delivery to customers. He would then deliver the goods on to his customers, usually the same or next day.

HMRC established that there was a distinct lack of commercial documents, such as contracts between the parties to the transactions, other than invoices. Further, the company did not make payment until it had sold the goods and received payment from its customer.

In 2017, HMRC denied a claim for a deduction of input tax relating to 179 transactions during its accounting periods 02/13 to 05/16. The claim was disallowed as HMRC believed that the transactions were connected to a fraudulent loss of VAT and that the company knew or should have known of that connection. HMRC issued a penalty assessment for £83,019.70, against the company.

As it was considered that the company was likely to become insolvent, HMRC issued a personal liability notice (PLN) against Mr Powar making him personally liable to pay the penalty. However, having reviewed the calculation of the penalty prior to the hearing, the amount of the PLN was reduced to £74,823.63. This was on the basis that HMRC accepted that it could not establish that 45 of the deal chains could be traced back to a fraudulent loss of tax.

According to the case summary:

"At the same time as the company was engaged in the transactions which are the subject of this appeal, many of the same parties in those transaction chains were also engaged in a criminal missing trader intra-community VAT fraud which resulted in a VAT loss to HMRC of £34.2 million leading to two criminal trials at Southwark Crown Court. These trials resulted in convictions for ten of the individuals concerned with another four being acquitted."

The summary goes on to say:

"The convicted defendants, part of an organised crime group that established and controlled at least 19 purported United Kingdom alcohol buffer traders, ran a "paperwork factory" manufacturing mainly paper transactions the purpose of which was to clean smuggled alcoholic stock and make it look as though it had been purchased legitimately from the first company in the manufactured supply chain before laundering the proceeds of the diverted alcohol back to a number of overseas entities."

Decision

The First Tier Tribunal stated that there was no single factor that led to its conclusion but it was a number of factors when put together resulted in the Tribunal finding in HMRC's favour.

It seemed to be relatively easy to engage in transactions which seemed to be "too good to be true", which "a legitimate businessperson or trader" would have questioned but which Mr Powar did not. For example:

- The company did not need to source supplies; the supplies found the company;
- Mr Powar was able to find customers whose requirements exactly matched the goods the company sought to sell on;
- The company added no value to the transactions;
- There was no commercial reason for the company's place in the supply chain or reason why the suppliers did not deal directly with the customer themselves;
- There was an absence of any commercial documentation for the transactions other than sales invoices;
- There was no insurance on goods in transit;
- There was a consistent profit margin, irrespective of the goods sold;
- Payment to suppliers was not required until customers had settled up;
- Absence of due diligence despite issues raised in due diligence reports prepared, on his instructions, by a third party.

The First Tier Tribunal confirmed that the transactions had resulted in a fraudulent loss of VAT and that the company knew or should have known of that connection. The invalid claims had been made deliberately by Mr Powar, meaning that 100% of the penalty charged to the company could be transferred to him, as sole director.

The appeal was dismissed.

Anandpreet Singh Powar v HMRC (TC09175)

VAT registration estimator tool

HMRC has launched a new VAT registration estimator tool, which has been developed as a result of feedback from small businesses suggested such a tool would be helpful to show when turnover could require businesses to register for VAT and its effect on profits. The tool allows businesses to input relevant data and experiment with different input and output figures. HMRC does not record these details.

In order to use the tool, businesses are advised to have information about their income and costs, and the VAT rates that apply to them, to hand.

They will be asked to:

- state whether the business is, or will be, based in the UK;
- input the approximate income and costs for the time period to estimate, up to 12 months (this can also be used if a person is considering setting up a new business);
- use the guidance links provided to choose the VAT rate(s) for the income and costs (as an estimated percentage of zero, reduced or standard rated, or VAT exempt, goods and services);
- state if the business would prefer to add VAT to, or absorb VAT into, the current or estimated selling price;
- check the answers and complete the form to review the results, which can be saved and printed.

Neil Warren, independent tax consultant, feels more work and testing needs to be done to improve the usefulness of the tool:

'I have just done a walkthrough test based on a builder who has sales of £5,000 a month and then had a one-off good sale in month 12 that involved labour and materials for £60,000, i.e. sales of £115,000 for the year. The tool rightly said: "As the taxable income is more than £90,000 you would need to register for VAT.'

The disappointing fact is that it did not ask me questions about my estimated future sales, which would have revealed turnover of £60,000 in the next 12 months, meaning that I am eligible to apply for an exception to being registered.

My other observation is that the entries I made when completing the various boxes kept changing between percentages and actual numbers – I found that confusing. For example, instead of just entering annual exempt rental income of £2,000, I had to enter the percentage of my total income that related to exempt income and then round it up. It worked out at 0.17%, which I rounded to 1%, producing a figure that was not £2,000.'

<https://www.gov.uk/guidance/check-what-registering-for-vat-may-mean-for-your-business>

Adapted from the article in Taxation 18 July 2024