



# BA(HONS) Accounting & Finance

## ACC-3530 Taxation

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### BY

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## 1. Introduction

### 1.1 Background

With reference to the Tax Journal “**Judgement Day**”, issue no 540, 20<sup>th</sup> March 2000, by Ian Somerville, this article reviews VAT implications for WHS of assumed thefts. The author analyses the consequences that company can face when working out its VAT liability where there is a danger of its staff taking the cash out after the sales are made or the stock stolen by shoplifters.

WH Smith Retail Ltd encompasses retailers such as Virgin, Our Price and Waterstones operate using either scheme J or F<sup>1</sup>.

Below the author has summarised the main points of this Tax case, highlighting the implication retailers can face regarding their VAT liability of unrecorded sales or theft of cash with reference to statutory provisions and relevant references to case law. This case has significant consequences for the future of retail industry in regards to adjustments of missing stock deficiencies.

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<sup>1</sup> WH Smith operated under Retail schemes J and F. Under these schemes there is no provision under the retail schemes for an adjustment to daily gross takings in respect of unrecorded takings as a result of cash theft. However under Scheme J adjustments are required to expected selling prices in respect of expected wastage, breakage, sell-by date reductions and any other anticipated price changes.

## 2. Summary of content

### 2.1 Main Concerns

The author in this article explains the case between WHS and Customs and describes the complications Customs face in calculating tax liability where cash has been received but no sales has been recorded. The author states that where the cash has been handled inappropriately, i.e. when payments have been made for the goods but the employees failed to record the sales properly, the company is liable to pay Tax on those transactions.

In author's opinion, Customs became concerned about the level of stock deficiencies in WHS and decided to investigate its VAT liability; they knew that this was either due to shoplifting, theft by employees or incorrect receipts of stock.

It was made clear that the VAT liability would not occur if the stock had been stolen by either shoplifters or its own employees; however where there is a situation where stock has been sold with no records of sales, then there would be a VAT liability. It was agreed that misappropriation of cash did happen however WHS did not believe that the calculation of the Tax liability was handled properly.

The judgement was made against WHS for the collection of VAT debt of missing cash but WHS appealed that VAT liability calculated by the commissioners' was not reflecting true amount.

### 2.2 Facts

The Customs used its powers under section **73(1)<sup>2</sup> of VAT act 1994** to exercise this recovery of VAT from WHS. The author explains the idea about the best judgment performed by the commissioners when there is little material available to assess. The question of best judgement was first discussed in case of "**Van Boeckel -v- Customs & Excise Commissioners**" by wolf J using Section 31(1) of the Finance Act 197.

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<sup>2</sup> 'Where a taxable person has failed to make any returns required under this Part of this Act or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect they may assess the amount of tax due from him to the best of their judgment and notify it to him.'

This case further described three conditions<sup>3</sup> which must be fulfilled as to complete the requirement of best judgment.

To calculate the WHS tax liability, the commissioners relied on the certain basis to come up with the final figure. The first basis of assessment to calculate the VAT liability was from the sales figures obtained from WHS's final annual accounts. The commissioners also relied on the Retail Crime Cost survey which said 27% was attributable to staff theft. However 20.45% of this, according to WHS security controllers report was attributable to unrecorded sales.

## **2.3 Arguments**

### **2.31 Arguments by WHS**

The author has summarised WH Smith's argument and their basis of appeal and arguments by Customs & Excise in response to its assessment. Firstly WHS argued that under either scheme there was no requirement to include adjustments for cash thefts and customs can only make assessment if there is proper material available to investigate.

According to the author, WHS also argued that their action was not deliberately suppressed and that customs didn't have any solid materials on which to base their action which makes their judgement not reasonable as per case of "**Wednesbury test**"<sup>3</sup>. (Associated provincial picture house Ltd v Wednesbury Corporation)

### **2.32 Arguments by HMCR**

The author however examines the arguments by Customs & Excise that there might be some mistakes but assessment was in good faith. It was clear to customs that unrecorded sales were there and assessment was therefore necessary as sufficient material did exist as per case of "**Van Boeckel**" on which commissioners can rely.

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<sup>3</sup> *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223, CA. the reasonableness of an inspector's decision as to whether the decision was made rationally and can be supported with evidence. This test is sometimes referred to as the "Wednesbury" reasonableness.

In response to WHS argument about unrecorded sales, customs argued that they should have carried out study to reveal such information and it was not Customs officer's duty to perform such tests. All figures and material used to judge the assessment were provided by WHS and Retail crime cost survey and that the commissioners acted in good faith.

#### **2.4 Decision**

The Tribunal rejected WHS appeal on the grounds that there was sufficient material to base the assessment in particular information from Retail Crime Costs Survey 1995/96 and figures provided by WHS.

It also rejected the argument of Wednesbury approach on the basis that material provided was reasonable and sufficient on which the judgement was based.

The article summarized the implications of this case for other retailers, concluding retailers handling cash sales need to be implementing systems to prevent such theft and that the records need to be maintained to calculate any deficiencies.

In author's view it would be unfair that company's maintaining stock deficiencies would be liable for such assessment whereas companies without any records would not be liable. This case confirms the powers of the customs to raise assessment on best judgement on the available information.

### 3. Statutory References

The main statutory provision which relates to this case is VAT Act 1994 and can be found in the Stationery Office Limited as the **Value Added Tax Act 1994**, ISBN 0105423947.

In particular the relevant section for this case is **part IV, Administration, Collection and Enforcement** of VAT tax act 1994 which deals with General administrative provisions, Default surcharges and other penalties and criminal offences, VAT evasion, Penalty for miss-declaration or neglect resulting in VAT loss for one accounting period equalling or exceeding certain amounts, Repeated miss-declarations, Inaccuracies in EC sales statements, Failure to submit EC sales statement, Failure to notify and unauthorised issue of invoices, Breaches of walking possession agreements, Breaches of regulatory provisions and Failure to make returns. As reference made in the case about **section 73 “Assessments of VAT and other payments due”**, it is concerned with employer’s failure to make Vat tax return.

Here it is crucial to turn our attention to **Section 73(1)** of the VAT Act 1994 as this the point which was used by Commissioners to backup their assessment decision for WHS. This section of the article deals with failure to pay the VAT payments. It reads: “Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.”

This article allows the commissioners to act in their best judgment to calculate the VAT due from a person, in this case, WHS, if the information provided to them is either incomplete or incorrect.

However this section rather doesn’t make clear as how the assessment should be made and has rather left it to Commissioners to use their knowledge about the entity and experience to consider if incorrect VAT return has been made. This raises the question to Commissioners whether they are acting too harshly just for the sake of getting some money from the company or do they have genuine reasons. Also the this

section is vague in defining what is meant by “best judgement” which leaves open grounds for custom officials to act in whatever way they want to. Subsequently even if we look at the relevant cases, courts don’t want much material from Commissioners to support their assessment, a little material is enough to penalise a firm like WHS, which was the case here.





## 4. Case Law

The article includes two case law references for and against WHS VAT liability. The case used by HM Customs to back its decision of assessing WHS liability to VAT reasonable correct is “**Van Boeckel v Commissioners of Customs and Excise, [1981] STC 290**”. This case was based on **Finance Act 1972, s. 31(1)**, which allows the commissioners for up to 3 years to assess the taxpayer liability on petty theft using the material provided by the taxpayer.

### 4.1 Main Issues:-

This case confirms the power of the commissioners and their rights as to make an assessment “to best of their judgement”. It sets out 3 principles which must be fulfilled in order to make an assessment to calculate Vat tax liability to “best Judgement”.

In the case of “**Van Boeckel v Commissioners of Customs and Excise**” commissioners visited the premises of the taxpayers and it appeared to them that VAT returns for the period 1 August 1973 to 31 July 1976 were incorrect. As a result commissioners took a trail test of 5 weeks and using powers of **Finance Act 1972, s. 31(1)** issued an assessment of Tax due. However taxpayer appealed that commissioners have not acted to their best judgement and they didn’t take into account the amount of pilferage.

Tribunal here held the decision that commissioners do not need to perform any test as to amount of assessment if they have sufficient material to rely on, but if they do, they have to take into account that. So therefore assessment is valid as far as sufficient material is their and commissioners don’t need to perform additions test etc.

### 4.2 Tax Payer Arguments:-

Taxpayers even appealed against the decision of the tribunal that “the commissioners made no sufficient attempt to investigate the possibility of

pilferage of stock and the assessment was based on an insufficiently long and representative period of the taxpayer's business". The right of appeal to taxpayer at that time was given by s 40 of the **Finance Act 1972 Section 40(1)**<sup>4</sup>.

#### **4.3 Court interpretation of "Judgment": -**

The court held that "best judgment" in the form of three principles firstly that they must perform that function honestly and bona fide. Secondly there must be some material before the commissioners on which they can base their judgment. And lastly 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 judgment, is due.

The judge here also referred to few other cases to support back tribunal decision of dismissing appeal as in case of "**Comr of Income Tax, United and Central Provinces v Badridas Ramrai Shop (1937) 64 LR Ind App 102**" judge put the view forward that work of commissioner will involve some guesswork which is fine as far as it is honest work. Secondly in the case of "**Argosy Co Ltd v Inland Revenue Comr [1971] 1 WLR 514**" the judge also said it is necessary that commissioners work will involve guesses but it must be made to best of commissioners judgment considering the material available to him.

#### **4.4 Decision: -**

Therefore by citing these cases and relevant statutory provision judge decided that commissioners fully acted within their rights of section s.31 and the tribunal decision as to reducing the assessment to take account of pilferage did not invalidate the assessment. Overall this case clearly backs the customs decision in case of WHS assessment that it was made to their best judgment and that they were within their rights/powers to impose such liability on them.

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<sup>4</sup> 'An appeal shall lie to a value added tax tribunal ... against the decision of the Commissioners with respect to ... (b) an assessment under section 31 of this Act or the amount of such an assessment.'

## 5. HMRC Manuals

These manuals are mainly produced for the guidance of HMRC staff to guide them in making correct vat assessments. They set out the basic record keeping and accounting requirements that a trader is expected to comply with. These manuals back the decision of the commissioners to the assessment of WH Smith who not only failed to maintain the record of the missing the cash from the till but also didn't comply with legal obligation to supply all the relevant material to the commissioners.

Here it is crucial to highlight the relevant manuals relating to commissioners power of making assessment of pre till cash theft. The manuals relating to this issue are "V1-24B: Officers powers", this provides the officers assurance of their legal powers and obligations e.g. when the records are not kept accurately due to pre till cash theft etc. Secondly the manual "V1-24A: Traders Records" makes it a legal obligation for the retailers to keep and maintain their records for the tax liability assessment. These manuals can be found in the HMRC's VAT guidance for commissioners.

### 5.1 V1-24A: Traders Records

#### **The obligation to keep records: -**

This can be found under Section 2 of "V1-24A: Traders Records". Under the VAT Act 1994, Schedule 11 paragraph 6(1) all taxable persons must keep such records as [VAT Regulations 1995, Regulation 31(1) ] the Commissioners may by regulations require. The VAT Regulations 1995 set out, in broad terms, the records that are required to be kept for the purposes of accounting for tax.

According to HMRC, a trader is not required to keep his records in any set way. Section V1-24B provides guidance on the action to be taken by officers in events where the required records have not been kept, which was the case with WH Smith as they didn't provide all the documents relevant to trace the cash sales which were missing in order to calculate correct VAT liability.

## 5.2 V-24B: Officers powers

### **Trader's obligation to produce documents: -**

This can be found under the section 6 of this manual. The VAT Act 1994 Schedule 11 paragraph 7(2) gives commissioners the power to require the production of documents relating to supplies of goods or services, and acquisitions or importations that are made in the course or furtherance of business. If we notice WHS in this case didn't provided all the relevant documents to the commissioners which could help them make fair assessment which they are obliged to acquire by law, as a result even if assessment is higher they only got to blame themselves for that.

## 6. Conclusion

### 6.1 Overall View

We consider that the author by elucidating these articles highlights momentous aspects in terms of obligations which can affect retailers vigorously regarding their VAT liability, where there might be risk of pre till theft on company's gross daily taking.

The article brings the awareness of the matter which many retailers wouldn't be aware and by presenting the problem in a very explanatory way. The author has done a very good job by collecting the relevant material to the case law as well as statue law in reference to retailer's liability to pay VAT

By reading this we can also get a good insight as to the powers of the commissioners which they can use to enforce tax liability on customers like WHS where they have been negligent to keep records of cash transactions, where amounts were missing from tills. This not only confirms the powers of the customs officials to the assessment of liability but also clears that if company doesn't keep records of missing cash transactions, the commissioners would be free to take a generous view of what they think might be reasonable liability due, using best judgement principle.

Therefore one thing retailers should understand that by not providing complete information to the commissioners would only be helping Customs to get more generous tax liability from them as long as they think its reasonable and later making appeals as WHS did, wont help to invalidate the assessment.

We consider that it might not be company's fault entirely to the missing cash involved but it may be due to some dishonest staff it have employed. Therefore it is crucial for any retailers or such business to introduce strict internal control systems which would help eliminate such staff and would put them under pressure to act honestly.

The only exemption to this rule might be to business where there is little room for pre-till cash theft and even if it does happen; the amounts involved are significantly immaterial to be of any relevance.

## **6.2 Need for new Legislation**

Overall we think that some people might view this case to be judged unfairly on the basis that commissioners are allowed too much freedom without being under any pressure to make the assessment reasonable and not over-stating the amount. As we have already seen in one of the cases that court does accepts that commissioner's work involves guesswork where information is not complete and in those circumstances they are free to make an assessment of what they think is reasonable amount. Some might argue that commissioners, if want to act unfair, they can under their powers given by this case and statue law, enforce the incorrect assessment of VAT liability.

Therefore this particular area has to be clearly described by either introducing more statues or providing more strict guidelines to put more pressure on commissioner to make judgement more accurately and reasonably.

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