

Taxation – judgement day



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With reference to the Tax Journal "Judgement Day", issue no 540, 20th 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 F1.

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.

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)2 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. This case further described three conditions³ 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" 3. (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. 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 warehousing 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

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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 <https://assignbuster.com/taxation-judgement-day/>

assessing VAT 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

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right of appeal to taxpayer at that time was given by s 40 of the Finance Act 1972 Section 40(1)4.

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.

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 form 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.