TC03444

Appeal number: TC/2011/04188

VALUE ADDED TAX – civil evasion penalty – section 60 VATA 1994 – understatement of sales – whether dishonest – quantum of assessments to VAT and penalty – assessments excessive – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR SALAH MOHAMED HUSSEIN **Appellant**
t/a
EASTERN ORBIT

- and -

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

TRIBUNAL: JUDGE JONATHAN CANNAN
MR JOHN DAVISON

Sitting in public in Manchester on 25 and 26 November 2013

Mr N Khan of Kirtley Qureshi & Co Chartered Accountants for the Appellant

Mr B Haley of HM Revenue & Customs for the Respondents

DECISION

Background

1. This is the second appeal by the appellant in relation to a business he conducted importing a herbal stimulant known as *Khat* or *Chat* into the UK and selling it on a wholesale basis. Our decision on the first appeal was released on 5 April 2012 with reference [2012] UKFTT 248 (TC) ("the First Appeal").

2. The appellant is of Yemeni origin living in Sheffield. Over the years he has established a number of businesses in the UK. One such business involved the importation and sale of Khat which is widely used in East Africa. As will appear below, the shelf life of imported Khat is relatively short. In consequence the appellant would import quantities of Khat two or three times a week by air from Ethiopia.

3. The First Appeal was concerned with customs duty assessments on the importations, in particular the value of those importations in the period 24 December 2004 to 19 December 2007. More particularly it related to VAT on importation chargeable at the time of assessing customs duty.

4. The present appeal is concerned with assessments to VAT. The assessments in dispute comprise an assessment to output tax on supplies for the period 1 August 1999 to 30 April 2008 in the sum of £230,371. The original assessment was for a much higher amount but was subsequently reduced by the respondents. There is also a penalty assessment for alleged dishonest evasion of VAT covering the same periods in the sum of £172,764. It is the alleged dishonesty which, if made out, would entitle the respondents to make a VAT assessment going back further than 3 years from April 2008.

5. The issue on this appeal is whether the appellant understated for VAT purposes the sales value and quantities of Khat that he supplied to customers and if so whether there was dishonest evasion of VAT. The appellant accepts that there was some understatement, but not at the levels alleged by the respondents. He denies that he has been dishonest in any way. He further contends that the mitigation allowed by the respondents in calculating the penalty ought to have been greater.

Legal Framework

6. The penalties for dishonest evasion are said to arise under section 60 Value Added Tax Act 1994 ("VATA 1994"). Section 60 provides as follows:

" *(1) In any case where-*

(a) for the purpose of evading VAT, a person does any act or omits to take any action, and

(b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability),

he shall be liable, subject to subsection (6) below, to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded, by his conduct…"

7. Section 60(7) VATA 1994 provides that on an appeal against an assessment to a penalty "*… the burden of proof as to the matters specified in subsection (1) (a) and (b) above shall lie upon the Commissioners.*"

8. In the circumstances therefore it is for the respondents to establish both evasion of VAT and dishonesty. The test in relation to dishonesty is objective. Did the appellant have knowledge sufficient to render his conduct dishonest according to normally acceptable standards of honest behaviour? On the facts of this case the question is simply whether the appellant deliberately understated his takings in order to evade VAT.

9. The Court of Appeal in *Khan v Commissioners for Customs & Excise [2006] EWCA Civ 89* considered various issues in relation to assessments to VAT under section 73 VATA 1994 and civil evasion penalties under section 60. At [69] Lord Justice Carnwarth, as he then was, said as follows:

" *There is no problem so far as concerns the appeal against the VAT assessment. The position on an appeal against a "best of judgment" assessment is well-established. The burden lies on the taxpayer to establish the correct amount of tax due:*

> *'The element of guess-work 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).'*

That was confirmed by this court, after a detailed review of the authorities, in Customs and Excise Commissioners v Pegasus Birds Ltd [2004] EWCA Civ STC 1509; [2004] EWCA Civ 1015. We also cautioned against allowing such an appeal routinely to become an investigation of the bona fides or rationality of the "best of judgment" assessment made by Customs:

…

It should be noted that this burden of proof does not change merely because allegations of fraud may be involved …"

10. In relation to penalty assessments Lord Justice Carnwarth said the following at [73] and [74]:

> *" 73. The ordinary presumption, therefore, is that it is for the appellant to prove his case. That approach seems to me to be the correct starting-point in relation to the other categories of appeals with which we are concerned under section 83, including the appeal against a civil penalty. The burden rests with the appellant except where the statute has expressly or impliedly provided otherwise. Thus, the burden of proof clearly rests on Customs to prove intention to evade VAT and dishonesty. In addition, in most cases proof of intention to evade is likely to depend partly on proof of the fact of evasion, and for that purpose Customs will need to satisfy at least the tribunal that the threshold has been exceeded. But, as to the precise calculation of the amount of tax due, in my view, the burden rests on the appellant for all purposes.*
>
> *74. This view is reinforced by a number of considerations:*
>
> *i) It is the appellant who knows, or ought to know, the true facts.*
>
> *ii) Section 60(7) makes express provision placing the burden on Customs in relation to specified matters. This suggests that the draftsman saw it as an exception to the ordinary rule, and seems inconsistent with an implied burden on Customs in respect of other matters.*
>
> *iii) The distinction is also readily defensible as a matter of principle. Mr Young relied on "the presumption of innocence" under Article 6 of the Convention, but he was unable to refer us to any directly relevant authority. The presumption clearly justifies placing the burden of proof on Customs in respect of tax evasion and dishonesty; but once that burden has been satisfied, a different approach may properly be applied (compare R v Rezvi [2003] 1 AC 1099; [2002] UKHL1, in relation to confiscation orders in criminal proceedings).*
>
> *iv) In relation to the calculation of tax due the subject-matter of the assessment and penalty appeals is identical. This link is given specific recognition by section 76(5) (allowing combination in one assessment). It would be surprising if the Act required different rules to be applied in each case.*
>
> *v) Section 73(9) provides that the assessed amount, subject to any appeal, is "deemed to be an amount of VAT due…" In a case where either there was no appeal against the assessment, or the penalty proceedings followed the conclusion of any such appeal, this provision would appear to preclude any attempt to reopen the assessment for the purpose of assessing the penalty. The subsection does not apply directly where, as here, the penalty appeal is combined with an appeal against the assessment, and the assessment has not therefore become final, but it indicates another link between the two procedures. (I do not see the*

provision as necessarily confined to enforcement, as Mr Young argues. Nor in the present context do I need to spend time on his argument that this interpretation could cause unfairness in proceedings against a third party under section 61, although I note that under that provision there appears to be a general power to mitigate the penalty.)

vi) To reverse the burden of proof would make the penalty regime unworkable in many cases. In a case such as the present, a "best of judgment" assessment is needed precisely because the potential taxpayer has failed to keep proper records, so that positive proof in the sense required in the ordinary civil courts is not possible. The assessment may be no more than an exercise in informed guesswork. Indeed to put the burden on Customs would tend to favour those who have kept no records at all, as against those who have kept records, which are merely inadequate, but may be enough to give rise to an inference on the balance of probabilities."

11. If the respondents satisfy us that there has been dishonest evasion, it is then for the appellant to satisfy us that the penalty assessment is excessive. In the present case, as in Khan v CCE, proof of intention to evade is likely to depend partly on proof of the fact of evasion.

12. At one stage during the appeal Mr Khan on behalf of the appellant appeared to be questioning whether the assessments were made to best judgment, as required by section 73 VATA 1994. However it is clear from the Court of Appeal decision in *CCE v Pegasus Birds Limited [2004] EWCA Civ 1015* that such a challenge can only be made where there is a fully pleaded case put to the assessing officer. Further, if we were to find that the assessments were overstated in some way, the relevant question when considering best judgment is that endorsed by the Court of Appeal at [21]: "… *whether the mistake is consistent with an honest and genuine attempt to make a reasoned assessment of the VAT payable; or is of such a nature that it compels the conclusion that no officer seeking to exercise best judgment could have made it. Or there may be no explanation; in which case the proper inference may be that the assessment was indeed arbitrary.*"

13. In the light of *Pegasus Birds* Mr Khan did not pursue any submission that the assessments were not to best judgment.

14. In substance the issues which we must decide on this appeal are therefore as follows:

(1) Did the appellant understate his sales for VAT purposes in the period assessed or any part of that period?

(2) If so, was he evading VAT dishonestly?

(3) Are the assessments to VAT and a penalty excessive?

(4) Was an appropriate level of mitigation allowed by the respondents in calculating the penalty?

15. The respondents opened the appeal and adduced evidence from Mr Brendan Spranklen, a Higher Officer of HM Revenue & Customs. The appellant gave evidence himself. Both witnesses produced witness statements and were cross-examined.

16. Based on the evidence we make the following findings of fact. Firstly in relation to various background matters and then in relation to more contentious matters. We make these findings of fact applying the balance of probabilities as the relevant standard of proof.

Background Findings of Fact

17. The appellant was born on 27 December 1935 and was 78 at the time of the hearing. He came to the UK from Yemen in 1956 at the age of 21. He has had no formal education either in his mother tongue or in English and had no vocational skills. He originally worked as a labourer in Sheffield and then became self-employed setting up a small shop selling women's clothing. By the late 1990s he had a business letting rooms to the elderly Yemeni community, a café and a sideline booking airline tickets. He had also established a wholesale business importing Khat from Ethiopia. Chewing Khat is a social aspect of life in the Yemeni community particularly amongst older residents.

18. There was some suggestion on the part of the respondents that the appellant was also retailing Khat. It may be that referred to the business prior to 1999. In any event, Mr Haley accepted that in the period we are concerned with the appellant operated solely in the wholesale market.

19. Khat is a plant which is imported in bunches. It has a tough stem with green leaves. A narcotic effect is obtained by chewing the leaves. Bunches of Khat are graded with the best being described as "Grade 1" or "Normal". Below that there is Grade 3. In addition the appellant explained that people who could not afford to do otherwise would chew what he described as the "mid-cuts" or "unchewable" parts of the plant which have few if any leaves. The narcotic effect is best obtained by chewing fresh leaves and it is for this reason that it is imported by air. It is wrapped in banana leaves to help keep it fresh, although the unchewable is simply tied together without banana leaves. The Khat is packed and transported in cardboard boxes which are loosely tied with a thin rope.

20. The "chewing time" is traditionally between noon and 2pm. If a shipment is delayed then Khat may be wasted. Only if the plane is more than 24 hours late is the supplier liable to compensate the appellant. Compensation would take the form of boxes of Khat on a later shipment. Ideally the Khat must be chewed on the day of arrival, or at the latest the following day. The main day for chewing is Saturday. Whilst some Khat would be chewed during weekdays, the price is always higher on Saturday.

21. By 1998 the appellant's businesses were trading at a level which required VAT registration and he became registered for VAT as a sole proprietor with effect from 1 February 1998. On that date the VAT treatment of Khat was altered and rather than being zero rated as a food it became standard rated for VAT purposes. The appellant continued to trade as a VAT registered business until February 2008 when he de-registered. At that time the business was transferred to a company operated by the appellant's son.

22. At all material times the appellant had one supplier which was a business in Ethiopia called Yohannes Afework, based in Addis Ababa. The appellant would place an order with this supplier depending on the requirements of his customers. He had several wholesale customers at any one time. Orders would be placed 3 or 4 days prior to delivery. The appellant might also add a few boxes "just in case". He would fax a list of his order to the supplier.

23. Yohannes Afework would send the appellant a packing list by fax, which included numbered boxes. The packing list would indentify which numbered boxes contained Grade 1 Khat, Grade 3 Khat, a mixture of the two or unchewable. The appellant said that if he ordered 6 or 7 Kg of Grade 1 Khat that would all be shipped in one box. If he only ordered 2 or 3 Kg then it would be shipped with Grade 3 Khat. The appellant maintained that he did not often order Grade 1 Khat because most users could not afford it. We accept that the packing list indentified what was contained in each box, however the extent to which the appellant ordered Grade 1 Khat is one of the factual issues in this appeal and we deal with it below.

24. The appellant would send a driver down to Heathrow airport to collect the Khat and to transport it to Sheffield for distribution.

25. The appellant told us that customers might not actually take what they had ordered, depending on what was at the market on a Friday night. We took this to mean that if there was a good supply and prices were more competitive his customers might source from elsewhere. However the appellant said that it worked both ways. If there was little supply in the market then the appellant could sell more Khat. Hence the ordering of additional boxes. We have no reason to doubt this description of the market.

26. The issue of wastage is controversial and we deal with it below. Having said that, there was no suggestion that otherwise saleable Khat would go to waste simply because there was an oversupply in the market. Rather we infer that it would be sold but at a lower price than might otherwise be obtained.

27. The appellant purchased Khat in US dollars whilst the sales were conducted in pounds sterling. Occasionally it appears that Khat would also be sold in bundles rather than by weight or boxes but both parties accepted that such sales were minimal and we could ignore them for the purposes of this appeal.

28. Based on the appellant's evidence, we find that boxes on average weighed 10 Kg, including the weight of the box and banana leaves. The weight of Khat in a box

could be between 8 and 10 Kg. Any particular box might contain only Grade 1 or Grade 3 Khat or a mixture of the two. Unchewable Khat would be packed in separate boxes.

29. At an interview on 7 November 2011 the appellant stated that he imported Grade 1 and Grade 3 Khat. He stated that had paid $15/kg for Grade 1 and $5/kg for Grade 3, selling them for £14/kg and £5/kg respectively. These figures were not in dispute although both parties accepted that Grade 1 Khat was in fact sold for £15/kg. At the same interview the appellant also identified that with effect from 1 November 2005 half of the Khat imported was for Mr Hamood trading as Ben Ly and based in Birmingham. Eventually HMRC accepted this was the case. The appellant also provided to HMRC an account book for the period April 2005 to March 2006 ("the Account Book"). We understand that the appellant produced other account books to HMRC however these were not in evidence before us.

30. The appellant kept no record of sales apart from his account books. In particular he did not issue or retain copies of any sales invoices. The boxes of Khat once they had been received in Sheffield were kept in a cooler behind the appellant's shop. Customers would come and collect their boxes and pay cash.

31. The appellant would also receive documents from its shipping agent, GNK Freight Services Ltd ("GNK"). The appellant did not retain copies of his orders or the packing lists sent by Yohannes Afework. He did however retain invoices from Yohannes Afework.

32. The appellant paid Yohannes Afework in advance. The sums paid on account, often $25,000, would be transferred from the appellant's bank to the bank of Yohannes Afework.

33. From 1 November 2005 onwards Mr Hamood would also send a driver to Heathrow to collect his share of the Khat. He would place his own order with Yohannes Afework and receive his own packing list identifying which boxes were his.

Customs Duty Enquiry

34. In Mid-2007 the importation of Khat from Ethiopia was indentified as an area of potential high tax loss by the respondent's freight intelligence team. The appellant was selected for a joint enquiry in relation to direct taxes, indirect taxes and by the Customs, International Trade and Excise team ("CITEX").

35. The CITEX enquiry started in 2007. Officers noted that the appellant had occasionally imported Khat using incorrect commodity codes resulting in a zero rating for VAT purposes. In due course the appellant acknowledged these errors and they were corrected. The respondents in the present appeal do not suggest that these errors were anything other than innocent errors by the appellant or its customs' agent.

36. The CITEX officers also had concerns about the valuation of Khat imported. Those concerns resulted in a post-clearance demand to the appellant seeking to

recover as customs duty the VAT due on importation. The original demand was subsequently reduced to £73,858.32 during the course of enquiries. This sum related to imports of Khat by the appellant in the period 24 December 2004 to 19 December 2007 and used an import value of $5/kg. This was the subject of the First Appeal.

37. In the First Appeal HMRC maintained the value of imported Khat for VAT purposes was at least $5/kg. The appellant contended that the value for VAT purposes was $2.20/kg. The evidence before us on that occasion was not exactly the same as that before us in this appeal. However, we stated our conclusion on the valuation issue at [41] in the following terms:

> " *Taking all the evidence into account, including our assessment of the appellant's oral evidence and the absence of any corroborating evidence, we are not satisfied that the customs value of the imports is any less than $5 per kg.*"

38. The respondents' case in the First Appeal was that we should not take the invoices from Yohannes Afework at face value. Notwithstanding the invoices suggested a price of $2.20/Kg we were not satisfied that they reflected the true cost price of Khat imported by the appellant.

VAT Enquiry

39. In May 2009 Mr Spranklen initiated a VAT civil evasion enquiry and invited the appellant to attend an opening meeting with his accountant. The purpose of an opening meeting is for HMRC to gather further information to that already held, and also to give the taxpayer an opportunity to make relevant disclosures and give assistance so as to mitigate a penalty for civil evasion if one is later imposed.

40. On 28 May 2009 Mr Khan of Kirtley Qureshi &Co spoke with Mr Spranklen on the phone to say that he considered any civil evasion enquiry should await the outcome of the customs duty enquiry. On that basis he was going to advise the appellant not to attend a meeting. In a letter of the same date Mr Khan also indicated that Mr Hussein was aged and frail and suffering from ill health. In the circumstances he would not be attending the meeting.

41. In the event there was no meeting. On 27 November 2009 Mr Spranklen gave Mr Hussein another opportunity to attend a meeting. Mr Hussein responded in writing both personally and through Mr Khan to the effect that he was still very ill and that Mr Khan would offer every cooperation. Again, there was no meeting.

42. We accept that the appellant was unable to attend these meetings due to ongoing health issues and that this is a matter to be taken into account when considering the appellant's co-operation in relation to any penalty.

43. We also accept Mr Spranklen's evidence that during 2010 his enquiries continued, including enquiries with Mr Hamood who had initially denied any sharing arrangement with the appellant.

44. On 15 December 2010 Mr Spranklen wrote to the appellant to say that he intended to issue a VAT assessment and setting out the basis on which he proposed to make that assessment. He also indicated that if the appellant provided further relevant information then he would re-consider the assessment.

45. On 6 January 2011 Mr Spranklen issued a VAT assessment in the sum of £619,212 covering the period 1 August 1999 to 24 November 2008. Following a review of that assessment it was reduced to £504,288 for the same period. The reason for this reduction was firstly to make allowance by way of input tax for VAT on importation assessed by CITEX. Secondly to reflect acceptance on the part of the respondents that the appellant's business ceased in February 2008.

46. On 23 May 2011 Mr Spranklen issued a civil evasion penalty in the sum of £453,843 which gave the benefit of a 10% reduction by way of mitigation. The civil evasion penalty was upheld on a review notified to the appellant on 22 July 2011. However there was a subsequent meeting between Mr Spranklen, the appellant and others on 17 November 2011.

47. On 3 April 2012 Mr Spranklen wrote to Kirtley Qureshi & Co reducing the VAT assessment to £268,788 to reflect information provided at the meeting. This included a reduction to reflect the fact that 50% of Khat imported was for Mr Hamood and was to be treated as sold to Mr Hamood at cost price. At this time Mr Spranklen was not aware that the hearing of the First Appeal had taken place on 19 March 2012. The decision in the First Appeal was then released on 5 April 2012.

48. There was further discussion between the parties and further material was provided by the appellant. This resulted in a reduction in the VAT assessment to £230,371 notified on 25 October 2012, and an amended penalty assessment of £172,764. The amended penalty assessment was notified on 4 December 2012, reflecting the reduced VAT assessment and also an increase in the mitigation allowed to 25% to reflect further co-operation.

49. In his oral evidence Mr Spranklen described the basis upon which the respondents will mitigate a civil evasion penalty. There are 2 heads of mitigation – co-operation and disclosure. There can be mitigation of up to 40% of the penalty under each head. He had given no reduction for disclosure because he considered that there had been no disclosure of any evasion. He had allowed 25% for co-operation in quantifying the amount of VAT evaded.

50. Mr Spranklen maintained that the appellant had not given access to all information that would help to quantify the arrears. For example to support the appellant's claim that some of the Khat was purchased and transported to his nephew which we consider below.

Further Findings of Fact

51. In this section of our decision we consider firstly the appellant's accounting records which formed the basis of his VAT returns. We then consider the facts and matters which shed light on whether those records are correct or whether they understate the true sales. In doing so we consider the explanations offered by the appellant in relation to those facts and matters.

52. The evidence of the appellant was in some respects vague and confused. In other respects it was quite clear. We take into account that he was 78 years old at the time of the hearing and recalling events going back up to 14 years in relation to some aspects of his evidence.

53. The hearing bundle contained a large volume of documentation, including numerous calculations to which we were not referred and which were not explained. We have limited our consideration principally to the documents to which we were referred during the course of the hearing, either in evidence or submissions, together with the evidence of Mr Spranklen and the appellant.

(1) Accounting Records

54. The Account Book took the form of a diary in which the appellant recorded in manuscript each importation of Khat with figures including the date, weight, purchase cost in US $ then converted into sterling, various costs incurred and the sales value. For example an entry for 15 November 2005 included the following details:

Date	15/11/05
Weight	66.6 kg
Purchase Cost ($)	$ 1,000.00
Purchase Cost (£)	588.33
Agent Charges (£)	118.50
Import VAT (£)	117.22
Petrol (£)	84.00
Car Hire (£)	45.00
Sales Value (£)	999.00

55. The weight was not always recorded in the Account Book.

56. Agents charges were the sums paid to GNK, the appellant's customs agent. Import VAT was the sum due by way of VAT on importation.

57. Petrol and care hire were the costs associated with picking up the Khat from Heathrow Airport and transporting it to Sheffield.

58. The total expenditure including the sterling cost of the Khat was totalled and noted as £953.05

59. The figures noted as "Sales Value" for each date were added together and declared in the VAT returns. Output tax was accounted for on the total recorded sales in each quarter.

60. The Account Book did not split the Khat imported between different grades. The appellant did not issue invoices to his customers so there was no record of what was bought or by which customer.

61. The appellant was initially unable to explain in his oral evidence how he arrived at the weight of Khat entered in the Account Book. He said "*I have no idea how I got [the figure in the Account Book]. If you asked me at the time I could tell you*". We take into account the difficulties of recollection experienced by the appellant and also the fact that he was 78 years old at the time of giving his evidence. Mr Khan suggested that the appellant was generally confused when giving evidence. We do not accept that was the case.

62. At the close of his evidence, in answer to questions from us, the appellant was able to recall that he entered the equivalent weight of what he had purchased in Grade 1 Khat, based on his purchase price. Hence, in terms of purchase price, 3 Kg of Grade 3 Khat was equivalent to 1 Kg of Grade 1 Khat. 3 boxes of Unchewable Khat was equivalent to 1 Kg of Grade 1 Khat. This was the same explanation as the appellant had given at the meeting on 17 November 2011 when a discrepancy between the import declarations and the Accounts Book was put to him.

63. It was common ground that Grade 1 Khat cost the appellant $15 /Kg. The appellant said that he entered the cost price of Khat he had purchased in the Account Book. In every case it is clear that the weight in the Account Book multiplied by $15 gave the cost price recorded in the Account Book. Hence on 15 November 2005 multiplying 66.6 Kg by $15 gives $999 against a cost price recorded of $1,000. There were no invoices in evidence from which we could verify whether the appellant was actually recording the cost as invoiced by Yohannes Afework.

64. It seems to us that there is little sense in the appellant's alleged formula for recording the weight of Khat imported, especially if, as the appellant contends, he did not import much Grade 1 Khat. We do not discount the possibility that this was an idiosyncrasy of the appellant, but to record everything in terms of Grade 1 Khat seems an unlikely explanation. It is also inconsistent with our findings, described in more detail below, that in 1999 the appellant was recording the actual weight of Khat imported. It is unlikely that he would later change to recording weight by reference to a formula.

65. The appellant was initially clear in his oral evidence that the entries in his Account Book included the weight of Khat imported for Mr Hamood. He said that on 15 November 2005 the 66.6 kg included Mr Hamood's Khat and Mr Hamood would tell the appellant what he had ordered from Yohannes Afework.

66. The appellant was also initially clear that the Account Book included money he received from Mr Hamood in the figure for sales. Hence on 15 November 2005 he

said that the sales value of £999 included sums paid by Mr Hamood to the appellant. Mr Hamood would pay his share of the cost of the Khat, together with half the agents charges and half the import VAT.

67. The appellant later corrected himself to say that the Account Book weights did not include Mr Hamood's Khat and that Mr Hamood would pay Yohannes Afework direct. The only sum Mr Hamood paid to the appellant was his share of the agent's charges and half the VAT which was not included in the Account Book.

68. The notes of a meeting on 15 April 2008, the accuracy of which we have no reason to doubt and which were not specifically challenged, record the appellant as saying that Mr Hamood paid for his share of importations from November 2005 onwards by cheque which was paid into the appellant's bank account. In a letter dated 11 February 2011 the appellant's adviser stated that Mr Hamood paid the exporter, Yohannes Afework, for his share of the consignment. This echoes the confusion in the appellant's oral evidence mentioned above. It suggests to us that the confusion in the appellant's account of his dealings with Mr Hamood in oral evidence does not stem from his age or from any difficulty in remembering details from 2008.

69. On 15 November 2005 therefore, according to the Account Book and the appellant's later explanation, he received £999 from wholesale customers in respect of what he identified as 66.6 Kg of Khat, together with £117.86 from Mr Hamood. The sales value recorded by the appellant reflected his case that 1Kg of Grade 1 Khat would be sold for £15. We would therefore expect the sales value in £ to be the same as the purchase cost in $. However that was not always the case and there was at least some variation on some entries.

70. In the period from 1 April 2005 to 30 October 2005 the sales value in £ in the Account Book was always slightly more than the purchase cost in $. For example on 1 July 2005 the purchase cost was $850 and the sales value was £904. It is notable however that from 1 November 2005 onwards the sales value in £ is, to within a matter of pence, the same as the purchase price in $. That can be seen in the figures for 15 November 2005 set out above.

71. Based on the evidence we have heard we accept that the weights and sales figures in the Account Book related only to the Appellant's Khat. However neither party adduced any evidence to show how Mr Hamood paid for his share of the Khat, whether to the appellant or to Yohannes Afework direct.

72. In the light of all the evidence we do not accept that the Account Book reflects accurate sales values. It is clear that the appellant used a cost price of $15/Kg and generally a sales value of £15/Kg rather than actual purchase costs and sales values. It is inconceivable that there would be such a close relationship between cost price and sales value in the light of the market described by the appellant.

(2) Mr Hamood t/a Ben Ly

73. The appellant stated in evidence that in 2005 he was approached by a Mr Hamood trading as Ben Ly with a view to importing from Yohannes Afework on a

joint basis. The real benefit of such an arrangement was a reduction in transport costs because as the weight increased the cost of shipping became more advantageous. The appellant therefore entered into an arrangement with Mr Hamood with effect from 1 November 2005.

74. In the First Appeal the appellant sought to persuade us that the effect of his agreement with Mr Hamood was to reduce the appellant's liability to customs duty based on the quantity imported by removing Khat which was imported for Mr Hamood. We rejected that argument. In doing so we made the following finding of fact at [45]:

> " *As a matter of fact we find that the appellant did have an agreement with a business trading as Ben Ly based in Birmingham. We accept that approximately half the Khat imported was destined for this trader. When the cases of Khat arrived at Heathrow they were marked with a red pen to indicate they were destined for Ben Ly or a black/blue pen to indicate that they were destined for the appellant. The appellant would pay the full price to Yohannes Afework and was reimbursed by Ben Ly for their share. The GKN invoices [ie the Customs Agent] would be split equally between the appellant and Ben Ly.*"

75. As we have said, the appellant's evidence, eventually, was that Mr Hamood ordered from and paid Yohannes Afework directly. However neither party specifically sought to disturb the findings of fact made in the First Appeal.

(3) Discrepancies with Import Records

76. Mr Spranklen was provided with a copy of the Account Book. He identified that for each importation the weight of Khat apparently imported was much less than the customs duty declarations made on importation. For example the weight recorded on the import entry for 15 November 2005 was 525 Kg. There was a significant discrepancy even taking into account the fact that half the Khat was for Mr Hamood.

77. The discrepancies also appear prior to November 2005 when all Khat imported was for the appellant. For example on 1 July 2005 the appellant records sales of £904 and a weight of 56.5 Kg. The customs declaration was 456 Kg of Khat imported on that date. There was no evidence, and the appellant was unable to recall how he applied his formula to give an entry of 56.5 Kg in the Account Book. Hence there was no evidence to reconcile the weight recorded in the Account Book to the import declarations. There were similar discrepancies throughout 2005-06 for each importation.

78. The appellant did say in evidence that an importation may include compensation from Yohannes Afework for a previously delayed consignment. However the weight identified in the Account Book was consistently much less than the customs declaration. It was not suggested during the hearing that the discrepancy might be accounted for by such compensation, or by the weight of packaging. In any event that would not account for such large discrepancies.

79. Mr Khan on behalf of the appellant accepted that the amount of unchewable Khat imported could be taken as 60 boxes per month, each box weighing on average 7.5 Kg. Hence unchewable Khat would not explain the discrepancies.

80. Both parties agreed that the customs declaration values were not correct. We dealt with this in the First Appeal but for the purposes of that decision we did not need to consider why the declarations were not correct. No explanation was offered by the appellant during the present appeal.

81. The evidence before us as to the purchase price and sales price for the appellant's dealings in Khat was very confusing. Some of that confusion arises because at various stages in the enquiry and appeal process the discussion of these matters has been conducted on the basis of a cost or sales price per box, and at other stages on the basis of a cost or sales price per Kg. This was compounded by the absence of accounting records.

82. The fact that the respondents worked in Kg for the purposes of their calculations does not reflect any assumption on their part that the appellant was retailing Khat. They have accepted that he was a wholesaler. There may have been some bunches of Khat sold to individuals but they would not be significant and for the purposes of calculation they can be ignored.

83. Overall we are left with no credible explanation for the discrepancy between the Account Book and the import declarations. The appellant's evidence as to use of a formula is, as we have said, an unlikely explanation.

(4) Wastage

84. Undoubtedly there was wastage where Khat leaves were not sufficiently fresh to be saleable. The appellant said in evidence that an entire consignment may be wasted or there may be no wastage in a consignment. He suggested that it was more likely that there would be some level of wastage in most consignments.

85. The appellant said that he had to pay to send wastage to a refuse tip and we have no reason to doubt that evidence. The nature of the product meant that it was likely there would be some wastage and the respondents have always accepted as much. The appellant stated in his evidence that in November 2007, when a Mr Hunt of HMRC visited the appellant's café, he was shown nearly 500 Kg of wasted Khat. Even if that is right, and the uncorroborated evidence of the appellant does not satisfy us that it is, we do not know over what period it accumulated and so it does not help in assessing an average figure for wastage on any particular importation.

86. Initially Mr Spranklen assumed that there would be 5% wastage. Later in his calculations he allowed 13.5% wastage. Mr Spranklen accepted that his figure for wastage was arbitrary. At the hearing the appellant maintained that wastage would be approximately 25%, although previously in correspondence he had suggested a figure of 35%.

87. We can see no reliable basis on which to estimate the extent of wastage. None of the figures mentioned is supported by any evidence, save that the appellant's figure is at least an estimate in the light of his experience. However, in the light of all the evidence we cannot accept the appellant's evidence on this point without any corroboration and there is no corroboration.

(5) Payments to Yohannes Afework

88. The appellant made bank payments totalling £223,623 to Yohannes Afework in the period 1 April 2005 to 31 March 2006.

89. The appellant's evidence was that his nephew in Saudi Arabia sent him money to purchase Khat from Yohannes Afework on behalf of his nephew. This was said to be because of regulations which restricted the importation of Khat into Saudi Arabia. The appellant therefore argued that the sum of £223,623 paid to Yohannes Afework should be reduced by payments made on behalf of his nephew.

90. Mr Khan in his opening said that all the invoices from Yohannes Afework were available and had been presented to HMRC. We were not shown any invoices during the hearing, although we identified one invoice in the hearing bundle. We saw at least one invoice in the First Appeal which, for the reasons given, we did not accept at face value.

91. The evidence before us included 15 advices from HSBC Bank, each transferring $25,000 from the appellant's HSBC account to Yohannes Afework. They were dated between 19 January 2005 and 20 October 2008. On each advice the details of payment were noted as "*FOR EXPORT OF FRESH CHAT TO YEMEN*" or "*ADVANCE PAYMENT FOR FUTURE EXPORT TO YEMEN*". The total amount transferred was equivalent to £199,966. In the period 1 April 2005 to 31 March 2006 the amount transferred was £26,512.

92. In addition, the evidence included HSBC advices showing 9 credits to the appellant's HSBC bank account in the period 10 October 2005 to 12 February 2008. The total amount credited was £79,287. In the period 1 April 2005 to 31 March 2006 the total amount credited was £22,651. Various senders were identified, although we were not told the name of the appellant's nephew. The advices contain no reference as to what the payments relate to.

93. There was no reconciliation between the debits and the credits to the appellant's HSBC account in respect of these sums.

94. In letters dated 17 November 2011 and 28 August 2012 the appellant's representative offered an explanation of the appellant's alleged dealings on behalf of his nephew. It was suggested by Mr Khan in opening that the appellant could show a paper trial for the money.

95. The documentation in evidence was at best an incomplete paper trail. On the face of the HSBC advices it appears that some money paid to Yohannes Afework was for the purpose of purchasing Khat for shipping to Yemen. However we have no

evidence from either Yohannes Afework or from the appellant's nephew to substantiate that Khat was shipped to Yemen

96. On balance we are satisfied that all the payments identified as being transfers between the appellant's HSBC account and Yohannes Afework were for the purpose of the appellant's business in the UK.

(6) The Respondents' Estimate of True Sales

97. Mr Spranklen made a number of calculations of what he considered were undeclared sales during the course of his enquiries. We will refer in detail only to the basis on which the final assessment was made.

98. Mr Spranklen did not accept the appellant's explanations for discrepancies in the records and considered that there had been a deliberate understatement of sales. However he faced considerable difficulty when it came to quantifying the amount of VAT sought to be evaded. He had the Account Book, which was apparently inconsistent with the customs declarations. The invoices from Yohannes Afework did not appear to be reliable. There was no documentary evidence of the sales made or the split in sales between Grade 1 Khat, Grade 3 Khat and Unchewable Khat.

99. Early on in the enquiry the appellant said that about 5% of his purchases were Grade 1 Khat. Later in the enquiry he said it was no more than 10%. We do not accept that evidence at face value.

100. Mr Spranklen used the information he did have to estimate the true sales. For the purpose of his calculations he assumed wastage of 13.5% as described above. He accepted the appellant's evidence that Grade 1 Khat was purchased at $15 / Kg and Grade 3 Khat at $5 / Kg. He assumed that the appellant would purchase 60 boxes of unchewable Khat per month. Each box weighed approximately 7.5 Kg and cost $5. It would be sold for £5.50. Mr Khan did not take issue with this treatment of unchewable Khat although it is not clear where the figure of £5.50 per box of unchewable Khat comes from. The appellant estimated the sales value as £5 per box and in the absence of any other evidence we accept that figure.

101. Apart from wastage the appellant did not dispute Mr Spranklen's estimates and assumptions. It is fair to say that Mr Spranklen's approach involved an element of the "*guesswork*" and "*unavoidable inaccuracy*" referred to by the Privy Council in Bi-Flex Caribbean Limited. We accept that it was in the nature of an "*exercise in informed guesswork*" as referred to by the Court of Appeal in Khan v CCE.

102. We attach at Appendix 1 a copy of Mr Spranklen's letter to Kirtley Qureshi & Co dated 3 April 2012 in which Mr Spranklen set out the calculations he used to estimate the true sales made by the appellant in the period 1 February 2004 to 29 February 2008. This was the period for which the respondents had evidence of customs duty declarations.

103. The cost to the appellant of Khat supplied by Yohannes Afework was £223,623 in the period 1 April 2005 to 31 March 2006.

104. Mr Spranklen proceeded on the basis that these payments related to all the Khat imported, including that belonging to Mr Hamood. The appellant did not challenge that assumption and did not suggest that the £223,623 included payments from Mr Hamood. On the basis that the assumption operates in favour of the appellant for the purpose of calculating the proportion of Grade 1 Khat purchased we shall adopt it.

105. There was no issue in relation to the average exchange rate at this time ($1.797), so the cost price was $401,850. The cost of unchewable Khat was estimated at $5 per 7.5 Kg box so that 60 boxes per month for a year amounts to $3,600. The total cost of Grade 1 and Grade 3 Khat was therefore $398,250.

106. The weight of goods imported into the UK in 2005/06 was 60,041, including the weight of packaging. Of this, both parties accepted that 5,400 Kg was unchewable Khat, leaving 54,641 Kg of Grade 1 and Grade 3 Khat.

107. Both parties then agreed that it was necessary to use simultaneous equations to identify the relative quantities of Grade 1 and Grade 3 Khat imported. On the facts as we have found them to be the equations are solved as follows:

$$X + Y = 54{,}641$$

$$15X + 5Y = 398{,}250$$

Where: X is the weight of Grade 1 Khat, and

Y is the weight of Grade 3 Khat

108. In other words the total weight is 54,641 Kg and the total cost was $398,250.

109. Solving those equations, 12,504 Kg of Grade 1 Khat was imported and 42,137 Kg of Grade 3 Khat was imported. Hence, for 2005-06 the following proportions of Khat were imported:

	Weight (Kg)	Proportion	Proportion (Excluding Unchewable Khat
Grade 1	12,504	20.83	22.88
Grade 3	42,137	70.18	77.12
Unchewable	5,400	8.99	
Total	60,041	100.00	100.00

110. Mr Spranklen had insufficient information to calculate the proportion of Grade 1 Khat and Grade 3 Khat imported in 2006-07. He carried out a similar exercise for

2007-08 but both parties limited their submissions to the year 2005-06 and we shall do likewise.

111. We find as a fact that these figures reflect the best estimate of the appellant's imports of Khat in 2005-06.

112. Mr Spranklen then applied the proportions he had calculated for Grade 1 and Grade 3 Khat to the appellant's imports in the period 1 February 2004 to 29 February 2008. We consider that calculation further in our decision below.

(7) Previous VAT Enquiry

113. The appellant's evidence was that an enquiry by HM Customs & Excise commenced in 1999 and was not concluded until 2003. At that time HMC&E were satisfied that the appellant was properly declaring all his takings from sales of Khat.

114. In oral evidence the appellant stated that the visit lasted about 1 ½ to 2 hours and that the officer found that everything was fine. A visit report of Officer Proctor in evidence does not indicate that the appellant was present. The person interviewed is identified as Mr Tomlinson, the appellant's then accountant. The appellant in his oral evidence thought that he was present.

115. The visit report shows and we find as a fact that in 1999 the appellant maintained a record of takings and no invoices were issued. A record was kept of the weight, distribution and proceeds of each importation. It seems likely that this was similar to the Account Book. What is notable is that the officer in 1999 records the following:

> "*Compared weights of Khat consignments as per import documents to those entered on sheets by trader – all agreed.*"

116. There is no suggestion that the officer required any explanation from the accountant or the appellant in order to make that comparison. The officer made detailed notes of the visit. If he had required any explanation to reconcile the accounting record to the import entries it is likely he would have recorded that fact. We find as a fact that the appellant's records in 1999 could be easily reconciled to the import entries without any explanation and without applying any formula.

117. Finally the officer recorded that the business appeared profitable "*and on the evidence presented credible*". There is no indication at all of any ongoing queries and Mr Spranklen told us that there was nothing to suggest an ongoing enquiry to 2003. We find that the 1999 visit was concluded shortly after 29 October 1999 and there was no ongoing enquiry. We are satisfied on the evidence we have that there was no dishonest evasion of VAT in the period up to October 1999.

118. Mr Khan also suggested during the course of submissions that HMRC gave guidance to the appellant at the conclusion of the enquiry and that the appellant

followed that guidance. There was no evidence from either party from which we could infer what guidance, if any, was given or followed.

Submissions

119. Mr Khan submitted that the main issue for determination was the amount, grade and cost of Khat imported by the appellant and the sales value of that Khat. He relied on the Account Book as an accurate record of the appellant's sales, although he accepted that there had been some understatement of takings. He estimated this as £27,406 over the period from 1 February 2004 to 24 February 2008. In part he said this reflected funds paid by Mr Hamood in relation to agents charges and his share of VAT. In part it reflected a greater proportion of Grade 1 Khat than the 5% estimated by the appellant.

120. Mr Khan invited us to accept the appellant's evidence as to the weight of Khat imported, in particular the appellant's formula for recording weight in the Account Book. He also invited us to accept that approximately 10% of Khat imported and sold was Grade 1 Khat. As we have said, he accepted that some 60 boxes of unchewable Khat was imported per month.

121. He further submitted that there was no evidence of dishonesty and that the appellant had been consistent in his explanations in relation to the business throughout the enquiry.

122. We take into account these submissions and Mr Khan's further submissions below when giving reasons for our decision.

123. Mr Khan drew our attention to what we had found in the First Appeal. Initially HMRC had assessed customs duty on the basis that Mr Hussein imported equal amounts of Grade 1 and Grade 3 Khat. However in May 2008 HMRC reduced the assessment to customs duty on the basis that in the absence of direct evidence as to the quality of Khat being imported they would charge duty based on Grade 3 Khat.

124. Ideally we would expect HMRC to adopt a consistent approach to both customs duty enquiries and VAT enquiries. However in a case such as this, if there is dishonesty on the part of the appellant, we do not consider that the approach taken by HMRC for customs duty purposes binds the respondents in their consideration of the proper amount of output tax payable. Dishonesty was not an issue in the First Appeal.

125. The present appeal was lodged with the Tribunal on 3 May 2011. There was no suggestion at the hearing of the First Appeal that it was in any way binding as to the approach the tribunal should take in this appeal. Nor do we consider that there is any estoppel to prevent the respondents putting their case as they have done on this appeal. The issues we were concerned with on the First Appeal were firstly whether a purchase price of $5 per Kg was excessive and secondly whether there was any agreement with Mr Hamood.

126. Mr Khan submitted that the weight of Khat imported included the weight of the box and packaging. Hence a 10 Kg box would contain only 8 Kg of Khat. Even then

there would be considerable wastage. However he did not put forward any alternative calculations to reflect that submission. Indeed his alternative calculations took the same approach as Mr Spranklen in this regard.

127. Mr Haley submitted that the appellant had not produced any evidence to dislodge the assessments. The respondents' calculations were to be preferred and the appellant had not put forward any reasonable or reliable alternative. The respondents calculations were based on the declared weights imported but were also consistent with the payments made by the appellant to Yohannes Afework. He acknowledged that there was a difficulty in calculating the understatement, in particular the amount of wastage.

128. In relation to dishonesty, Mr Haley relied in particular on the discrepancy between the appellant's Account Book and the import declarations and the absence of any cogent explanation for the discrepancy. He also pointed to the appellant's poor record keeping as consistent with dishonesty.

Reasons

129. In deciding this appeal we consider the issues previously identified, namely:

(1) Did the appellant understate his sales for VAT purposes in the period assessed or any part of that period?

(2) If so, was he evading VAT dishonestly?

(3) Are the assessments to VAT and a penalty excessive?

(4) Was an appropriate level of mitigation allowed by the respondents in calculating the penalty?

130. In the light of our findings of fact we can answer those issues as follows.

Did the Appellant Understate his Sales?

131. We have found that the Account Book did not reflect the true weight of Khat purchased and sold or the true sales value of Khat sold. In the light of all the evidence we are also satisfied that it did not reflect the true purchase cost of Khat. The appellant recorded in his Account Book what he intended a reader of the Account Book to think was the total amount of Khat imported for re-sale.

132. The true weight of Khat purchased for re-sale was recorded in the customs duty declarations. The discrepancies between those declarations and the weights recorded in the Account Book establishes in all the circumstances that the appellant was understating the weight of Khat sold and therefore the sales value of the Khat.

133. We are satisfied that the appellant did understate his sales in the period 1 April 2005 to 31 March 2006. There was no apparent change in the appellant's business after 31 March 2006. We are also satisfied therefore that the appellant continued to understate his sales in the period after 31 March 2006 until the business ceased on 29 February 2008.

134. As to the period prior to 1 April 2005, the only evidence before us was the customs duty declarations covering the period from June 2004 onwards. For the reasons given below we are not satisfied that the presumption of continuity applies to fill that void.

Dishonesty

135. The appellant maintains that it is a sign of his honesty that he registered for VAT, when most if not all of his competitors selling wholesale Khat were not VAT registered. However there was no evidence before us to substantiate the VAT position of his competitors, or whether they were trading over the VAT threshold requiring registration.

136. Similarly the appellant suggested that if he was dishonest he could have operated through a limited company or moved his assets out of the jurisdiction.

137. We do not accept that these matters are cogent indicators of the appellant's honesty. It is not evidence of the appellant's honesty to suggest that he might have been more effectively dishonest in a different way.

138. In the First Appeal we also said the following in relation to dishonesty at [35] and [36] in the context of the value of imported Khat:

> "*35. Mr Khan submitted that the appellant was an honest and sincere person who had been consistent in telling HMRC that the price he paid was $1 per kg. For his part, Mr Chapman made a particular point that he was not making any submission that the appellant was dishonest. He relied on the lack of any clear explanation of the difference between the $5 identified in the correspondence referred to above and the $1 claimed by the appellant.*
>
> *36. We do not find that the appellant has been dishonest in his evidence. However we are unable to accept his evidence … at face value.*"

139. In the light of the way in which the respondents put their case in the First Appeal it would not have been right for us to approach the appellant's evidence in that appeal on any basis other than that he was an honest witness. The respondents did not need to establish dishonesty in the First Appeal. The issue was whether we were satisfied on the basis of the evidence before us that the value of Khat being imported was less than $5/kg. The appellant failed to satisfy us that was the case.

140. The appellant also pointed out his generosity to the Yemeni community in Sheffield, including bestowing a building for a mosque. He said that he was well respected in the Yemeni community and found it insulting and degrading to be labelled as a dishonest person. We have taken into account in assessing the evidence that the appellant is a person of previous good character and the respondents have not suggested otherwise.

141. The only plausible reason that the appellant would consistently understate his sales in the Account Book would be to dishonestly evade tax, in particular VAT. The

circumstantial evidence supports that conclusion. In particular the following facts and matters are consistent with an intention to evade VAT:

(1) The appellant kept no record of sales and issued no invoices to his customers.

(2) The appellant's evidence was confused and inconsistent in the manner described above. We would have expected the appellant to have a clear recollection of the basis on which he completed the Account Book, even taking into account his age and the period of time over which he was recalling matters.

(3) There was no credible explanation to explain the difference between payments made to Yohannes Afework and the purchase costs recorded in the Account Book. Even the explanation that some of the Khat was for the appellant's nephew, which we have rejected, would not have fully explained the difference.

(4) No explanation was put forward for the undervaluation of imports found in the First Decision.

142. We are satisfied therefore that the appellant was dishonestly seeking to evade VAT in the period from 1 April 2005 to 28 February 2008.

143. The respondents have produced no evidence of dishonesty prior to 1 April 2005. Instead they rely on the presumption of continuity, namely that a particular state of affairs is presumed to continue in the absence of a change in circumstances.

144. In applying the presumption, HMRC rely on the fact that the appellant said at a meeting that he had always used his formula to record the weight of Khat purchased. That cannot be right because, as we have found, he was not using a formula at the time of the previous visit in October 1999.

145. Mr Khan submitted that the presumption of continuity works looking forwards rather than backwards. If sales were understated at one point in time then in the absence of evidence to the contrary it could be assumed that they were understated from that point onwards.

146. In making this submission Mr Khan relied on a decision of the First-tier Tribunal in *Barkham v Commissioners for HM Revenue & Customs [2012] UKFTT 499 (TC)* where at [40] the tribunal said:

> " *For these years, the Inspector has applied a presumption of continuity to conclude that the under declaration for the year 2004/05 can be taken to point to under declaration in earlier years and discovery assessments were accordingly made. In such a case it is up to the Appellant to displace the assessments with evidence. The presumption of continuity alone does not justify increases in assessments; the initial onus is on HMRC to show evidence in support of the making of the assessments. This would therefore be a limitation on the use of the presumption of continuity where previous year's accounts are sought to be reopened.*"

147. In Barkham there was evidence from the appellant that he had used a similar methodology to calculate his turnover as he had done in the later year. Hence the tribunal was satisfied that a discovery assessment for income tax purposes could in principle be made, not because of the principle of continuity but on the basis of the evidence before it.

148. Mr Khan also relied on what was said in *Jonas v Bamford [1973] STC 519*. That case appears to be the first judicial recognition of a presumption of continuity, at least in the context of tax disputes. Walton J said at p540:

> " *But, so far as the discovery point is concerned once the inspector comes to the conclusion that, on the facts which he has discovered, Mr Jonas has additional income beyond that which he has so far declared to the Inspector, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer.*"

149. In *Chapman v Commissioners for HM Revenue & Customs [2011] UKFTT 756 (TC)* the First tier Tribunal considered Jonas v Bamford and said at [104]:

> " *The presumption goes on until there is some change. The presumption as expressed in that case looks to the future and not the past. It is difficult to see how one can apply such a presumption based on the Enquiry Year to the earlier years.*"

150. The respondents maintain that the level of declarations has been consistent since 1999, including 2005-06 in which they say dishonesty has been established. They say that justifies an inference that the appellant was dishonest throughout the period.

151. In fact it appears to us that there is very little consistency or identifiable pattern in the appellant's declarations. In the periods 10/99 to 01/04 the output tax declared varied between £2,257 and £7,250. In the period 04/04 to the cessation of business on 29 February 2008 it varied between £2,048 and £8,202.

152. We recognise that the presumption of continuity is simply a presumption and it may be rebutted by the evidence in any particular case. See *Dr Syed v Commissioners for HM Revenue & Customs [2011] UKFTT 315 (TC)* and *Guide Dogs for the Blind v Commissioners for HM Revenue & Customs [2012] UKFTT 687 (TC).*

153. If there is a presumption of continuity then on the facts of this case it could work either in favour of the respondents or in favour of the appellants. The respondents could say that there was dishonesty in 2005 and in the absence of any evidence to the contrary suppression of takings can be taken to go back to 1999. Alternatively, the appellant could say that there was no suppression of takings in 1999 and in the absence of any evidence to the contrary there was no suppression of takings until 2005.

154. It is difficult to see why the presumption of continuity should apply in favour of the respondents in a case which depends on establishing dishonesty. The respondents

must satisfy us that there was dishonest evasion. The burden is on them to establish dishonesty. In part they rely on a presumption, in the absence of evidence to the contrary, that the appellant was dishonest in periods prior to 2005. In effect they are shifting the burden to the appellant to establish that he was not dishonest in the prior periods. In our view that is inconsistent with section 60(7) VATA 1994.

155. Further, if a presumption is to operate it is difficult to see why the appellant should not be able to rely on a presumption of continuity from 1999 onwards. At that time the respondents accept that he was properly declaring his takings. There is no reason to think that the appellant immediately sought to evade VAT once that visit was completed. Nor is there any evidence of a change in circumstances until April 2005 when we have found that there was dishonesty.

156. The respondents have not relied in this appeal on accounting records prior to 1 April 2005. The only evidence we have in relation to the period between October 1999 and April 2005 is the import declarations for the period from June 2004 onwards. On their own they are not sufficient to establish dishonesty. We cannot identify any evidence of understated weights, purchases or sales for the earlier period. In our view the respondents have not discharged the burden of establishing dishonesty in the period October 1999 to 1 April 2005.

Are the Assessments Excessive?

157. We have found as a fact that once the unchewable Khat is taken out, 22.88% of the Khat imported was Grade 1 and 77.12% was Grade 3.

158. In the period 1 April 2005 to 29 February 2008 the appellant had the following amounts of Khat available for re-sale, with basis figures being taken from the customs duty declarations:

1/4/05 to 31/10/05	26,771 Kg
1/11/05 to 29/2/08	92,536 Kg
Total	119,307 Kg
Less:	
Unchewable at 450 Kg/month	15,750 Kg
Total Grade 1, 3	103,557 Kg
Less Wastage at 13.5%	13,980 Kg
Total Khat Sold (Grade 1, 3)	**89,577 Kg**

159. As far as cost is concerned, Mr Khan submitted that in the First Appeal the tribunal had decided that the cost of Khat imported was $5/Kg and that we must respect that decision. However the finding in the First Appeal was not that the cost was $5 per Kg, but that it was at least $5 per Kg. In any event, the cost of Khat does

not form part of the calculation which we have adopted to estimate the appellant's sales.

160. Mr Khan submitted that the appellant had always maintained that he imported only a small amount of Grade 1. At the first meeting on 15 April 2008 the appellant estimated only 5% of a shipment or 10 Kg was Grade 1. He later estimated 10%. We cannot accept the appellant's evidence at face value. We prefer the estimate in our findings of fact.

161. The sale proceeds of Khat can then be calculated as follows:

Grade 1 (22.88%)	20,495 Kg @ £15/Kg	307,425
Grade 3 (77.12%)	69,082 Kg @ £5 / Kg	345,410
Unchewable	£300 / month	10,500
Total Sales		**£ 663,335**

162. The output tax payable on sales of £663,335 is £98,795. The output tax declared in the period was £61,564. The appellant therefore sought to evade VAT of £37,231. This amounts to a suppression rate of 37.7% as opposed to 61.5 % calculated by Mr Spranklen. Whilst that amount is much less than the figure assessed by Mr Spranklen we do not consider that such a reduction raises the best judgment issues considered by the Court of Appeal in *CCE v Pegasus Birds Ltd*. The reason we have come to a different suppression rate is because:

(1) We are looking at the period 1 April 2005 to 29 February 2008.

(2) We have found that the proportion of Grade 1 Khat was 22.88% compared to Mr Spranklen's proportion of 23.97%.

(3) We have used the sale price of unchewable Khat as £5 per box.

(4) Most significantly, we have come to a different view as to the treatment of the appellant's dealings with Mr Hamood.

163. It can be seen from Appendix 1 that Mr Spranklen calculated the total sales of Grade 1 Khat, Grade 3 Khat and unchewable Khat in the period he was looking at. He then added to this agents fees and VAT recovered from Mr Hamood, together with the cost of boxes imported for Mr Hamood at cost.

164. Mr Spranklen included in his estimate of sales £37,178 recovered from Mr Hamood in relation to agents fees and VAT on importation He also included a sum of £296,148 in relation to goods imported for Mr Hamood. Mr Hamood's goods were treated as being sold by the appellant at cost price to Mr Hamood.

165. The appellant was certainly the declarant for customs duty purposes – see our decision in the First Appeal. As such he became liable for the VAT on importation. However that does not mean that the appellant made any supply to Mr Hamood. The

goods themselves belonged to Mr Hamood. He had ordered them separately from Yohannes Afework and they were separately identified on shipment. Either Mr Hamood paid Yohannes Afework direct or payment was made through the appellant as his paying agent. Either way, in our view there was no supply by the appellant to Mr Hamood.

166. On that basis no output tax was due from the appellant in relation to Mr Hamood's goods and the appellant would not be entitled to the full input tax credit for import VAT. Only half the goods imported since 1 November 2005 were for use in the appellant's business and his input tax credit should be restricted accordingly.

167. When the original assessment of £619,212 was reviewed the appellant was given credit for an input tax deduction of £73,859 being the VAT assessed by way of post-clearance demand. It does not appear that Mr Spranklen's later amended assessment gave credit for that sum. It may be that is because it is an assessment to output tax and the credit for input tax has been given elsewhere. It will be necessary for the respondents to confirm that an appropriate adjustment has been given elsewhere, albeit restricted, for the reasons outlined above, to input tax on the appellant's own goods.

168. Mr Spranklen calculated the suppression rate mentioned above for the period 1 February 2004 to 29 February 2008. He did that because he intended to uplift the sales in the period prior to 1 February 2004 applying a presumption of continuity.

169. For the reasons given above we are not satisfied that there was any dishonesty prior to 1 April 2005. In any event we should record our view that it would not be appropriate to include Mr Hamood's goods in calculating a suppression rate to be applied to earlier periods.

170. We are satisfied that the assessment for the shorter period from 1 April 2005 to 29 February 2008 is excessive and ought to be reduced to £37,231. The assessment for periods prior to 1 April 2005 should be reduced to nil.

The Penalty Assessment

171. We are satisfied in the light of all the circumstances that the penalty assessment was properly mitigated by 25%. The penalty assessment should therefore be reduced to £27,923 to reflect the reduction in the VAT assessment.

Conclusion

172. For the reasons given above we reduce the assessment and the penalty assessment and allow the appeal in part.

173. By way of postscript we should record that in his written submissions, presented on the last day of the hearing and for the first time, Mr Khan submitted that the assessments were out of time. In particular he relied on section 73(6) VAT Act 1994. He submitted that HMRC had all the evidence necessary to justify making an assessment more than one year prior to making the assessment in January 2011.

174. We have found above that during 2010 Mr Spranklen's enquiries were continuing. There is no evidence to suggest that the respondents had sufficient evidence to make an earlier assessment. We are satisfied that the assessments were in time.

175. 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.

JONATHAN CANNAN
TRIBUNAL JUDGE

RELEASE DATE: 28 March 2014

Annex 1

Letter from Mr Spranklen of HMRC to Kirtley Qureshi & Co dated 3 April 2012

Dear Sir(s),

Re: Mr Salah Mohammed Hussein

In response to your letter of 3rd February 2012, and after due consultation with Mr Hunt, I would now like to clarify my position as follows.

Dealings with Mr S Hamood

The facts are that there is evidence from the bankings records that Mr Hamood did reimburse Mr Hussein for half and not 55% of the clearing agent's charges. From this, it is therefore reasonable to assume that half of the imports were sold to Mr Hamood. In terms of the value of the sale, I will accept that it would have been at 'cost' value for each box.

In determining the cost value, a number of examples have been put forward but the most credible is the acknowledgement by Mr Hussein, that having consolidated the various costs involved in the import process, it results in a cost per box of approx £40 inclusive.

Naturally, if Mr Hamood is actually reimbursing Mr Hussein for half of the agent's charges, then this element within the costings will need to be removed to arrive at an actual value net of such charges which is reasonable for Mr Hussein to have charged on.

I have considered the financial year to 31/03/06 to assess costs etc as shown in the Accounts Book and to compare this record against the bank statements showing payments to Yohannes Afework and also to the import data which we hold:

Imported 60041 Kilos
Average size per box agreed as approx 10 Kilos = 6004 boxes approx.
Costs for clearance, petrol, motor expenses (Accounts Book) = £21,405 approx.
Payments to Yohannes Afework = £223,000 approx.
(Import VAT is excluded as it is reclaimed)

From this it can be seen that against a total cost value of £244,405 ÷ 6004 boxes, a consolidated value per box agrees with Mr Hussein's contention of £40 approx. Therefore, the actual cost of the boxes will follow the value paid to Yohannes Afework and results in £223,000 ÷ 6004 = £37 approx.

Now, for all the values to come together to prove Mr Hussein's contention to be correct, it must reasonably follow that all payments to Afework from Mr Hussein's

bank accounts were for his own imports i.e. he was solely responsible for paying Afework for imports, whether for his own onward trading or the 50% which he sold at cost to Mr Hamood. There is no evidence that Mr Hamood has paid for his share, directly to Afework. It is reasonable therefore to assume that Mr Hamood paid Mr Hussein, who was then responsible for paying Afework.

This scenario is supported by comparing the payments to Afework for the year 2007/08, against the import data which we hold:

Payments to Afework = £203,072 approx (we do not have the bank statements after 08/02/08 for account 31828193, so there is likely to be at least one more payment to Afework from this account).
Imported 58863 (to 29.02.08) ÷ 10 kilos = 5886 boxes approx.
If we assume that the cost per box is £37 approx = £217,782 approx will be due to Afework (close enough with the presumption that at least one more payment would have been added to the £203k paid).

In further support of this is the fact that Mr Hussein enters the costs of the <u>total</u> consignments in his Account Books, to which he applies his 'Formula', without before deducting the element which is 'passed' over to Mr Hamood.

Also, the accounts presented for tax purposes, reflect the full costs (as shown on the importation documentation and invoices issued by GNK Freight Services) in the 'cost of sales' value.

<u>Element of 'Dishonesty'</u>

From the evidence above, which demonstrates the consistency in payment levels to Afework when linked to the amount of boxes being imported, the conclusion to be drawn is that the true value of imports has been significantly understated. To demonstrate this fact, the Accounts Book for 2005/06 records the total cost value based on import declarations as approx £67,764 but the reality is that payments to Afework totalled approx £223,000 which as we have seen, equates with boxes being imported at a net cost of approx £37 a box, which in turn is a realistic value when compared to an overall approx box value of £40 as stated by Mr Hussein when including other costs.

As discussed, Mr Hussein then applied his 'Formula' to this undervalued cost, which will naturally result in an understated sales value. His argument therefore that he doesn't even adjust for 'wastage' is immaterial in these circumstances.

For this reason I maintain that there has been dishonesty involved in Mr Hussein's actions and that the imposition of a penalty for this behaviour is justified.

<u>Recalculation of debt</u>

Following the various comments provided by Mr Hussein, in which he has discussed how the different strands of his business come together, I am prepared to make adjustment to my original assessment.

Wastage

It has been claimed that levels of wastage have ranged from entire consignments, to none at all but in the main it exists to affect most consignments. I feel that it is reasonable to expect wastage due to various factors but I am also mindful that it is, at the end of the day, a business activity by Mr Hussein and that if wastage levels were consistently very high, then it would not be a business that he may have continued to involve himself in for so long.

Against the total consignments recorded on our systems, I am prepared to allow:

5% wholly wasted
10% no wastage
10% wasted of remaining 85%
This actually works out to an overall and across the board wastage level of 13.5%, which is an increase of 170% against the level of 5% originally allowed.

Actual values:

Total imported between 01/02/04 to 29/02/08 = 257328 kilos
5% wholly wasted = 12,867
10% no wastage = 25,732
Remaining = 218,729 X 10% wastage = 21,873
Therefore the total wastage amount is 34,740 which represents approx **13.5%** of total consignment.

Grade of Khat sold

Given the above scenario, which would appear to discredit the documentation produced by the supplier Yohannes Afework in regard to the true import valuation of goods, I intend to consider the following principles to determine a more accurate split of consignments between Grade A and B (Grades 1 and 3 respectively):

- Have established that the payments made to Afework is consistent with the cost per box confirmed by Mr Hussein and against the volume imported.
- Mr Hussein has confirmed that he buys Grade A @ $15 a kilo // Grade B @ $5 a kilo.
- For 'unchewable' Khat, I will allow 60 boxes a month @ an average weight of approx 7.5 kilos (5400 a year) and with a cost price of approx $5 (say £2.50 or £1800 a year) a box as confirmed by Mr Hussein.

Year 2005/06
Payments made to Afework = £223,623
Less cost of 'unchewable' Khat @ (£1800) = £221,823

Convert to Dollars using average exchange rate for year = $1.797
Therefore, £221,823 X $1.797 = $398,615 covers payment for Grades A/B
MSS import weight = 60041 kilos
Less weight of 'unchewable' Khat @ 5400 kilos = 54,641 kilos to represent grades A/B

- Grade A is said to cost $15 a kilo
- Grade B is said to cost $5 a kilo

Logically, in order to arrive at the imported kilos by using the costings provided by Mr Hussein, Grade A must have averaged approx 47.2% of the costs of the consignments:
$398,615 X 47.2% = $188,146 ÷ $15 = 12,543 kilos approx (Grade A)
Therefore $210,469 ÷ $5 = 42,093 kilos approx (Grade B)
(5 kilos difference).

Therefore, 12543 ÷ 54636 (total kilos) = 22.95% @ Grade A kilos imported.

Year 2006/07 – Not all information known.

Year 2007/08 (To 29/02/08)
Paid to Afework = £203,072
Less 'unchewable' (£1650 (11 months)) = £201,422
Exchange Rate average for year = $2.008
Therefore, £201,422 X $2.008 = $404,455 for Grades A/B
MSS import weight = 58863 kilos
Less weight of 'unchewable' Khat @ 4950 (11 months) kilos = 53,913 kilos at A/B
Therefore Grade A must have averaged approx 50% of consignments costs:
$404,455 X 50% = $202,227 ÷ $15 = 13481 kilos approx (Grade A)
Therefore, $202,228 ÷ $5 = 40,445 kilos approx (Grade B)
(13 kilos difference).

Therefore, 13481 ÷ 53926 (total kilos) = 24.99% @ Grade A kilos imported.

Weighted split = 26024 ÷ 108562 (total kilos) = **23.97% @ Grade A overall.**

Workings (01/02/04 – 29/02/08 – 49 months)

Between 01/02/04 – 31/10/05 imported 72,256 kilos (All for Mr Hussein).
Between 01/11/05 – 29/02/08 imported 185,072 kilos (Period with Mr Hamood), therefore take 50% split = 92,536 belonging to Mr Hussein.

Mr Hussein's element in total = 164,792
Less allow 'unchewable' volume (22,050) – *450 kilos a month x 49*
= 142,742
Less wastage @ 13.5% (19,271) = 123,471 kilos sold @ Grades A/B

123,471 X 23.97% (A) = 29,595 X £15 selling price = £443,925 sales of A
Therefore, 93,876 (B) X £5 selling price = £469,380 sales of B

Plus 'Unchewable' sales @ 60 boxes a month x £5.50 average sales value (i.e. £2 x 3 bunches or £5 a box) = £330 p/month
X 49 months = £16,170 total.

Plus recovery of charges from Mr Hamood of agent's fees:
From records we hold, between 01/11/05 – y/e 31/03/08 = £74,357
Of this, 50% is recovered = £37,178 recovered.
(These charges are not 'Disbursements' for VAT purposes as the charges were made to Mr Hussein by the agent GNK and Mr Hussein entered into a personal arrangement with Mr Hamood to recover half)

Plus sale of boxes at cost to Mr Hamood @ £37 approx per box.
Therefore, 92,536 kilos (50% split), less allow 13.5% wastage (12,493) = 80,043 kilos sold
80,043 ÷ 10 kilos per box = 8004 boxes approx sold to Mr Hamood.
8004 x £37 a box = £296,148 sales.

From the above, a total income of approx £1, 262,801 was deemed to be received.
Therefore, £1, 262,801 x 7/47 vat = £188,076 Output Tax applicable.
Declared O/Tax for Periods 04/04 to Final Period = £72,400.
The under-declared amount is therefore £115,676.
This reflects a suppressed rate of approx 61.5%.

As before, this suppressed rate will be applied to earlier periods as follows:

Period 10/99 to 01/04 – Declared O/Tax = £75,012 or approx 38.5% of true amount.
Therefore, 75,012 ÷ 38.5% = £194,836 True O/Tax.
The under-declared amount is therefore £119,824

In summary, the amount of VAT deemed to have been under-paid is approx **£235,500**

Final Comment

In arriving at this amount, I feel that I have considered and acted upon all the key areas which Mr Hussein has brought to our attention since the original assessment, including an increase of 170% for wastage allowance, from 5% to 13.5%. Furthermore, I believe that the recalculations are based on agreed principles in terms of costings, selling prices etc which were then applied logically to records of payments made and received and against departmental import data.

The reconsidered amount reflects a reduction of £268,788 from the amount of £504,288 notified in my letter of 19/04/11.
It is my belief that Mr Hussein has misrepresented a number of areas especially in regard to true import values and related payments to Yohannes Afework, which logically has lead to an understatement of sales when applying his 'formula'. This justifies the imposition of a penalty for dishonest behaviour.

Mr Hussein chose not to keep an actual record of his sales which is a legal requirement of any vat registered business and a straightforward process, instead he decided to estimate the sales values which is not permitted. I believe that the issue of misrepresentation is also supported by action taken by International Trade colleagues, who have raised assessments for undervalued imports. They also found that a large number of Khat imports were incorrectly entered under zero-rate codes, thereby avoiding import VAT.

In terms of the penalty, it currently stands at a rate of 90% due to the perceived lack of co-operation in regard to any acknowledgement by Mr Hussein, that he had underdeclared any amount of VAT. I am however prepared to reconsider whether any further mitigation of the penalty might be allowed but this will be dependent on Mr Hussein's response to this letter.

Should this case be pursued at tribunal, I believe that I have demonstrated that I have acted on the key issues raised and applied a reasonable level of adjustment to have arrived at a significantly reduced liability.

Would you please confirm the action that Mr Hussein now wishes to pursue.

Yours faithfully

B I Spranklen
Officer of HM Revenue & Customs