TC04099

Appeal number: TC/2013/04463

Income tax - incorrect returns - penalties - expenditure included in Appellant doctor's accounts, which related to taxed foreign income - whether allowable - no - appeal disallowed and penalties confirmed

FIRST-TIER TRIBUNAL
TAX CHAMBER

DR SEETHAPPA MADHUSUDHAN **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL
MR DEREK ROBERTSON

Sitting in public at HMCTS, Civil & Family Court, 35 Vernon Street, Liverpool L2 2BX on 25 September 2014

The Appellant did not attend and was not represented

Mrs Catherine Douglas Officer of HM Revenue and Customs for the Respondents

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DECISION

The Appeal

1. This is an appeal by Dr. Seethappa Madhusudhan ("the Appellant") against closure notices and amendments to his self-assessment returns for the three tax years ended 5 April 2009.

2. The Appellant also appeals against penalties imposed for submission of the incorrect returns.

3. The points at issue are:

i. Whether, and if so, to what extent, expenses which it has been agreed were incorrectly claimed against the Appellant's self-employed income as a Doctor, may now be claimed as expenses against Foreign Income derived from an overseas property business, which the Appellant had originally omitted from his return in the three years, 2006-07, 2007-08 and 2008-09.

ii. Whether, penalties are payable by the Appellant in respect of additional duties arising from the incorrect returns and adjustments to those returns for the three years, 2006-07, 2007-08 and 2008-09.

4. The Appellant did not attend and was not represented. However, the Tribunal was satisfied that the Appellant had been given notification of the date, time and venue of the appeal and that it was in the interests of justice to proceed, with determination of the appeal in his absence.

Background

5. As a result of an enquiry into the Appellant's 2006-07 Tax Return, pursuant to s 9A Taxes Management Act 1970, HMRC established that expenses claimed against the Appellant's income as a Doctor had been overstated and that he had been in receipt of Foreign Income from, a property development and trading business registered and conducted in India which had not been declared.

6. The Appellant has a business in India, 'Sweet Homes Corporation' exact details of which are not known, but it is evident that the Foreign Income, which had not been declared had been included in audited accounts submitted to the Indian Tax Authorities and a certificate had been issued by the authorities relating to the net income and tax arising.

7. As a result of their findings, HMRC and the Appellant agreed the quantum of the adjustment required for the years 2004-05 and 2005-06. HMRC's assessment for each year included the Foreign Income reported to the Indian Tax authority of £154,092.00 and credit was given for the foreign tax paid.

8. Agreement could not be reached in respect of the adjustments due for 2006-07. The amounts in dispute for 2006-07 totalled £26,851 in respect of disallowed legal

consultancy fees, £4,258 “other finance” and £8,950 “business venture” interest, which made a total of £40,059. It was agreed that an adjustment was due in respect of expenses claimed against his UK income as a Doctor in a total amount of £45,374, but the Appellant contended that, although £40,059 of these were attributable to the Foreign income, which had originally not been declared, they were nonetheless allowable against his income.

9. The Appellant contends that although as a matter of law, a trade had been carried out in India and registered in that country, expenditure of £40,059 had not been included in the overseas accounts, and it was unlikely that this would now be possible, irrespective of that; HMRC do not accept that the expenses claimed against the Appellant’s self-employment as a Doctor could now be deducted from the net profit already reported to the Indian Tax authorities and included in the Appellant’s adjusted income.

10. HMRC subsequently extended their enquiries into the Appellant’s 2007-08 and 2008-09 Tax Returns and it was established the Appellant had also incorrectly claimed against his self-employment as a Doctor, his children's college fees of £5,756 in 2007-08 and £7,062 in 2008-09.

11. The Appellant’s accountant said that it was he, and not the Appellant, who was responsible for the errors and so it should follow that the Appellant cannot be considered to have failed to have taken reasonable care.

12. HMRC say that although there will be some circumstances where it could be argued that a person should not be charged a penalty because that person's accountant completed their return and there was nothing to suggest to that person that the accountant's figures might have been incorrect, HMRC do not accept that to be the situation in this appeal. The Appellant’s tax returns were completed incorrectly as a result of him failing to take reasonable care.

13. Other adjustments were agreed in respect of motoring costs, mobile phone costs and capital allowances. Agreement was also reached on the Foreign Income reported to the Indian Tax authority in 2007-08 and in 2008-09. However agreement was not reached that an adjustment was due to allow overseas travel and telephone calls amounting to £7,713 in 2007-08 and £1,295 in respect of overseas travel in 2008-09.

14. As a result of the above HMRC concluded that the Appellant had claimed against his UK self-employed income as a Doctor, expenses incurred in connection with the business in India. These are summarised as follows:

	2006/07	**2007/08**	**2008/09**
Legal Fees	£22,811	-	-
Loan interest	£8,950	-	-
Loan to brother	£4,258	-	-
Overseas Phone	-	£6,103	-
Overseas Travel	£4,050	£1,610	£1,295
Total	£40,059	£7,713	£1,295

15. The expenses were denied against the UK self-employment pursuant to s 34 Income Tax (Trading and other income) Act 2005 as they were not wholly and exclusively for the purposes of the trade in the UK, that trade being a Doctor in the UK.

16. An impasse was reached with regard to the items not agreed. Pursuant to s 28A TMA, an enquiry is completed by service of a closure notice, following which, amendments were made to Appellant's return. on 10 September 2012

Year	Date Assessment/ Amendment Made	Additional Income Assessed	Additional Tax/NIC Charged	Additional Tax/NIC Disputed	Legislation
2006-2007	10 Sept 2012	£60,866	£20,241.20	£16,424.19	S28A TMA 70
2007-2008	10 Sept 2012	£20,470	£6,687.86	£3,162.33	S28A TMA 70
2008-2009	10 Sept 2012	£12,248	£4,637.13	£530.95	S28A TMA 70
Total				**£20,117.47**	

17. HMRC maintained that the Appellant had negligently submitted an incorrect return for 2004-05 to 2007-08 inclusive and that penalties under s 95 TMA 1970 were due. The penalties for the two years ended 5 April 2008 were imposed under s 95 TMA 1970 and the penalty for the one year ended 5 April 2009 was imposed under Schedule 24 FA 2007. The former says a penalty may be charged if an incorrect return was submitted negligently and the latter if the inaccuracy in a return was careless. The penalties issued were as follows :-

Year	Date Penalty Determination Issued	Penalty	Penalty Disputed	Legislation
2006-2007	12 Sept 2012	£3,036.00	£2,463.63	S95 TMA 70
2007-2008	12 Sept 2012	£1,189.00	£828.33	S95 TMA 70
2008-2009	12 Sept 2012	£873.49	£513.95	Sch 24 FA 2007
Total			**£3,805.91**	

18. The maximum statutory penalty under s 95 TMA 1970 is 100% of the additional duties arising from the omissions and understatements. Mitigation was considered and a penalty of 15% imposed.

19. Regarding the adjustments made in respect of the disallowed overseas expenses, the issue to be decided is whether the returns for 2006-07 and 2007-08 were submitted negligently. If negligence is established the onus is then on the Appellant to demonstrate that the amount of the penalty is excessive. For 2008-09, the issue to be decided is whether the return was submitted carelessly. If carelessness is established, the onus is similarly on the Appellant to demonstrate the amount of the penalty is excessive.

20. In respect of the 2008-09 tax year only, HMRC have explained their intention to suspend the penalty and detailed the suspension conditions. The suspension conditions are themselves appealable, but this does not form part of the appeal.

Legislation relating to penalties

21. Penalties are calculated under s 95(2) TMA as the difference between:

> "(a) the amount of income tax and capital gains tax payable for the relevant years of assessment by the said person (including any amount of income tax deducted at source and not repayable), and
>
> (b) the amount which would have been the amount so payable if the return, statement, declaration or accounts as made or submitted by him had been correct."

22. Section 100 TMA 1970 allows an authorised Officer of the Board in making a penalty determination to set it at such an amount as in his opinion is correct or appropriate.

23. For the year 2008-09 Schedule 24 FA 2007 replaces s 95 TMA 1970. Section 1 Part 1 provides the conditions for imposing a penalty:

> Condition 1 is that the document contains an inaccuracy which amounts to, or leads to-
>
> (a) an understatement of [a] liability to tax,
>
> (b) a false or inflated statement of a loss, or
>
> (c) a false or inflated claim to repayment of tax.
>
> Condition 2 is that the inaccuracy was [careless (within the meaning of paragraph 3) or deliberate on P's part]

24. Section 2 Part 2 provides for the maximum amount of the penalty.

> (2) If the inaccuracy is in category 1, the penalty is -
>
> (a) for careless action, 30% of the potential lost revenue,
>
> (b) for deliberate but not concealed action, 70% of the potential lost revenue, and
>
> (c) for deliberate and concealed action, 100% of the potential lost revenue.

25. Section 5 Part 2 provides the amount on which the penalty should be based.

> (1) "The potential lost revenue" in respect of an inaccuracy in a document [(including an inaccuracy attributable to a supply of false information or withholding of information)] or a failure to notify an under-assessment is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment.

The Appellant's case

26. The Appellant appeals the discounted amount of £40,059 in respect of 2006-07, on the grounds that if it had been offset against his overseas income, it would create overseas losses, and that would bring the liabilities back to the figures not disputed.

27. The business, which generated the foreign income was controlled from the UK and therefore the expenses on air fares and telephone costs should be allowed.

HMRC's submissions

28. Under UK domestic legislation all income arising to a UK resident is chargeable to UK tax, - Income Tax (Trading and Other Income) Act 2005:

> 'Part 2 Trading Income
>
> 6. Territorial scope of charge to tax
>
> (1) Profits of a trade arising to a UK resident are chargeable to tax under this Chapter wherever the trade is carried on.'

29. Therefore even though the Appellant's trade was not carried out in the UK, the profit so arising from it is chargeable to UK tax.

30. The Appellant says that the expenses were wholly and exclusively for the purposes of the overseas trade and that they were not taken into account when audited accounts were prepared in India. However, no evidence of this has been provided, and no legislation in support of his contention that those expenses may now be off set against his UK income has been deferred to.

31. The profit and loss account for the Indian business have been provided to HMRC, but the Appellant has not provided any evidence that the disputed expenses have not already been included. There has been no explanation why, if the expenses were incurred wholly and exclusively in connection with the Indian business, an attempt was not made to amend the accounts.

32. Many countries have the same model of taxation as the UK, the UK taxing its residents on the whole of their income, wherever in the world it arises. However so that tax is not paid on the same income in more than one country, many countries provide for relief, to avoid double taxation.

33. There is a Double Taxation Agreement between the UK and India and so, whilst the income from the Indian business is to be included in the self-assessment of tax for a particular year, foreign tax credit relief is given.

34. HMRC therefore submit that they have done what they are required to do. They contend that the Appellant has not provided the evidence required to show that he has been overcharged in the 2006-07, 2007-08 and 2008-09 years

35. Regarding the penalties, HMRC must first establish that the Appellant submitted the return negligently for 2006-07 and 2007-08, and carelessly for 2008-09.

36. In the case of *Julie Ashton* [2013] UKFTT 140(TC), Judge Staker commenting on the definition of 'careless', stated at Para 35:

> "The Tribunal considers that a prudent and reasonable taxpayer must at the very least be expected to take prudent and reasonable steps to ascertain what his or her tax obligations are."

and at Para 37 he agrees "With what was said in *Verma* at {13}":

> "An omission may be innocent, in the sense of not having been deliberate, but such an innocent omission may still be the result of a failure to take reasonable care."

37. Taking the ordinary every day meaning of the word negligent that is - lack of proper care and attention or carelessness, HMRC suggest the comments by Judge Staker in the *Ashton* case, as above, support their view that by failing to take steps to obtain all the information needed to enable his agent to prepare his UK tax return the Appellant was negligent. A prudent and reasonable taxpayer would not have claimed expenses pertaining to an overseas business against his income as a Doctor in the UK.

38. HMRC assumes that a reasonable person would amongst other things:

- make a complete and correct return of their income
- keep such records as are necessary to enable them to make an accurate return
- supply to HMRC accurate information during the course of an enquiry

39. The Appellant has accepted that he submitted incorrect returns in respect of expenses over claimed. He has also agreed that he failed to include Foreign Income in each year. It is the Appellant alone who is responsible for the accuracy of his return. HMRC contend that, based on the evidence and explanation provided during the course of the enquiry, the conclusions reached by the Inspector were fair.

40. Section 100 TMA 1970 allows an authorised Officer of the Board in making a penalty determination to set it at such an amount as in his opinion is correct or appropriate. In practice any penalty is usually abated from the 100% maximum to reflect the level of disclosure and co-operation during an enquiry and also the seriousness of the offence. In the Appellant's case abatements of 20% were made for disclosure, 35% for co-operation and 30% for seriousness, leaving a penalty chargeable at the rate of 15%. HMRC submit that a penalty of 15% is reasonable and the Appellant has not discharged the onus upon him to demonstrate that the penalty is excessive.

41. In respect of the 2008-09 year, the penalty legislation changed. Under Schedule 24 Finance Act 2007, a penalty can be charged where an understatement of tax arises from an inaccuracy in a document that was careless on that person's part. The Appellant has been given full reduction for quality of disclosure and has been charged the minimum penalty under the legislation of 15% for a prompted disclosure.

42. HMRC submit that the Appellant has not discharged the onus upon him to demonstrate that the penalty has been calculated incorrectly.

Conclusion

43. The issues for determination by the Tribunal are, whether the expenses incurred by the Appellant in relation to his overseas business in India, in 2006-07, 2007-08 and 2008-09, which he had originally incorrectly claimed as a deduction in his profit and loss accounts for his earnings as a Doctor in the UK, are allowable as expenses in the adjustments of his returns for those years, and if not, whether the penalties have been correctly applied.

44. In respect of 2006-07 the Appellant asserts that the amount of £40,059 should be allowed against his UK income on the grounds that if it had been offset against the taxed overseas income, it would create overseas losses, and that would bring the liabilities back to the figures not disputed.

45. There has been no explanation as to why the expenses should be deemed to be a business expense or allowable against the Appellant's UK income. There has been no explanation as to what paperwork was available or what checks the Appellant's advisors made with regard to the expenditure in preparing the accounts. The Foreign Income itself was not included on the Appellant's tax returns, therefore a question must arise as to whether the Appellant made a full disclosure to his agent.

46. In respect of the years 2007-08 and 2008-09, the issue is whether the Appellant was negligent when he incorrectly claimed a deduction in his profit and loss accounts for training expenses in respect of payments for his children's university fees. The Appellant has now accepted that these expenses were incorrectly included in his accounts. Other expenses, which were also incorrectly claimed have been adjusted by agreement.

47. Although not defined in statute, negligence includes the omission to do something which a prudent and reasonable person would do. A prudent taxpayer exercising reasonable diligence would only claim deductions in their accounts for expenditure that has been incurred wholly and exclusively for the purpose of the business in respect of which a return is made.

48. The Appellant made mistakes on his returns. A person taking reasonable care with regard to their tax affairs would ensure they had all the relevant information they needed when completing the return. The claims for deductions in the Appellant's accounts arose from a failure to take reasonable care in completing his accounts.

49. The Tribunal finds that the Appellant has not discharged the onus upon him to show he has been overcharged by the amendment to his Self-Assessment in 2006-07, 2007-08 and 2008-09. He was negligent when he submitted an inaccurate return for 2006-07 and 2007-08. The inaccuracy in his 2008-09 return was careless.

50. For the above reasons the HMRC assessments and penalties are confirmed and we dismiss the appeal.

51. 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.

MICHAEL S CONNELL
TRIBUNAL JUDGE

RELEASE DATE: 29 October 2014