TC04117

Appeal number: TC/2013/09686

INCOME TAX – penalty under TMA s 95 – whether ebay and PayPal documents provided to accountant – whether difference between negligence and carelessness – whether negligent – record-keeping requirements in TMA s 12B considered – whether finding of negligence precludes a "reasonable excuse" defence – whether penalty should be capped at 30% in line with the new Sch 24 penalties for carelessness – level of co-operation and disclosure, consideration of gravity – 40% penalty upheld

FIRST-TIER TRIBUNAL
TAX CHAMBER

CATHERINE GRAINNE MARTIN **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE REDSTON
MR DUNCAN MCBRIDE

Sitting in public at the Tribunal Centre, Bedford Square on 14 October 2014

Mr John Martin, husband of the Appellant, for the Appellant

Mr Stephen Goulding of HM Revenue & Customs Appeals and Reviews Unit, for the Respondents

DECISION

1. This was Mrs Martin's appeal against a penalty of £1,643 charged under Taxes Management Act 1970 ("TMA") s 95(1)(a) for negligently filing her 2007-08 self-assessment ("SA") tax return. We decided that Mrs Martin had been negligent and confirmed the penalty.

The issues in the case and the legislation

2. The first issue was whether, on the basis of the evidence provided, Mrs Martin had acted negligently in delivering her 2007-08 return, so as to incur a penalty.

3. If we found that she had been negligent, our second task was to consider whether the penalty charged by HMRC was appropriate, excessive or insufficient, as we are required to do by TMA s 100B.

4. HMRC also charged penalties in relation to Mrs Martin's 2006-07 and 2008-09 SA returns. Mrs Martin appealed the 2006-07 penalty, but that appeal was withdrawn on the morning of the hearing, following settlement with HMRC. The 2008-09 penalty of £4,048.41 was originally appealed and notified to the Tribunal but was subsequently suspended under Finance Act 2007, Schedule 24, para 14 and that appeal was also withdrawn.

5. The legislation relevant to this decision is set out as an Appendix.

The evidence

6. The Tribunal was provided with a Bundle of documents. This included the correspondence between the parties and between the parties and the Tribunal. It also contained Mrs Martin's SA return for 2007-08 (unamended) and her return for 2006-07, both before and after HMRC's amendments.

7. In addition, Mrs Martin provided a witness statement, gave oral evidence on oath, was cross examined by Mr Goulding and answered questions from the Tribunal. As explained in more detail in the main body of the decision, we found her to be a unreliable witness in relation to many of the points at issue. For example, she gave implausibly vague evidence about companies in which she had significant shareholdings. Some of her evidence was impossible to reconcile with other material before the Tribunal, such as her statement that she had issued invoices for "almost everything."

8. Mr Cotton, the HMRC officer who handled the enquiries into Mrs Martin's case from April 2009, provided a witness statement, gave oral evidence on oath, was cross-examined by Mr Martin and answered questions from the Tribunal. His evidence summarised the course of the enquiry and the reasons why he had decided on the penalty abatements. It confirmed what had been set out in his correspondence. We found him to be an honest and credible witness.

Establishing the facts

9. Although this appeal relates only to 2007-08, the related discovery assessment was made after HMRC had opened an enquiry into Mrs Martin's 2006-07 return. As a result, some of the facts relating to that earlier year are relevant to this appeal.

10. HMRC's enquiries ran from January 2009 through to December 2013, a period of almost five years. A significant number of issues were involved. Rather than set out the correspondence chronologically, we decided it would be easier to follow the threads of each line of enquiry if we considered how the main issues developed over the enquiry period.

11. The next part of our decision therefore opens with some initial findings of fact. We then set out, for each of the main issues:

(1) the correspondence;

(2) Mrs Martin's witness evidence, where it expanded on and/or was different to the correspondence; and

(3) the Tribunal's findings of fact.

12. One of the key issues in dispute is whether Mrs Martin provided Christopher Hardern Limited ("CHL"), the firm of chartered accountants which had prepared and submitted Mrs Martin's 2006-07 and 2007-08 accounts and tax returns, with ebay and PayPal records relating to internet sales. We make findings of fact on that issue later in our decision.

13. The correspondence also covers a number of issues which have not been discussed in this decision either because they do not impact the 2007-08 tax year, and/or because they are not relevant to the imposition of the penalty. They include:

(1) Mrs Martin's treatment of sales of medals as within capital gains tax rather than as part of her business receipts;

(2) adjustments to her subsistence costs and entertaining expenses;

(3) costs for the improvement of her garage, which she used to store some of the ephemera, all of which had been claimed as revenue costs;

(4) an allowance for "home as office";

(5) Mrs Martin's use of her personal credit card for business purchases, and the extent to which purchases were double-claimed, once as a reimbursement and once as the actual cost;

(6) Mr Martin's inheritance from a Mr Taylor of a large quantity of ephemera, and his gifting of much of that ephemera to Mrs Martin;

(7) Mr Martin's wages, which were drawn from the business by Mrs Martin on the basis that he had agreed that they would be paid to her to help with the housekeeping;

(8) how Mr and Mrs Martin were able to support themselves, and pay the interest on their mortgage, which exceeded £700,000, given their declared income;

(9) Mrs Martin's correspondence with Mr Cotton, his manager Mrs Easton, and the HMRC Business Head, Mr Young, complaining that the enquiry was taking too long and that she was being "bullied" by Mr Cotton.

14. HMRC's enquiry into the 2006-07 return was opened on 6 January 2009 by Mr Mawkes. *Inter alia*, his early enquiries asked for Mrs Martin's VAT registration number. The response was that "Mrs Martin is not registered for VAT having applied for and been granted exemption." We clarified with Mr Cotton whether VAT had formed part of the enquiry and he said he had not looked at the VAT status of the business. It therefore has no bearing on this appeal.

Initial findings of fact

15. Mrs Martin runs a business selling ephemera, partly on the internet and partly via other outlets. She trades as "Mayfly Ephemera." Her stock includes books, maps, postcards, theatre memorabilia, and documents.

16. Her accounts are made up to 31 March each year, so the accounts for the year ended 31 March 2008 formed the basis for the 2007-08 tax year

17. Based on the accounts, the turnover figure for 2006-07 was £138,568 and the taxable profit was £5,689. The turnover figure for 2007-08 was £141,084; the taxable profit was £11,042. The stock figure at 31 March 2006 was £6,000, at 31 March 2007 it was £5,500 and at 31 March 2008 it was £4,500.

18. The dividend income included in Mrs Martin's 2006-07 and 2007-08 returns was £203.

19. Mr Martin is an employee of the business. He had practised as a lawyer but his practice had been affected by fraud and he finally went bankrupt in 2006. He and Mrs Martin spent some time caring for his mother, who was in a nursing home and died in January 2007.

The conduct of the enquiry

20. The enquiry correspondence was initially conducted on Mrs Martin's behalf by Mr Hardern of CHL. In April 2010, Mrs Martin took direct responsibility for the enquiry, because of the mounting costs. She wrote to Mr Cotton on 21 May 2010, saying "I have seen your letter of 26 April addressed to my accountants and I have retrieved my papers."

21. CHL was re-engaged to write a letter to HMRC in May 2011, but by that stage the employee who had actually carried out the detailed work on Mrs Martin's accounts had left CHL and was not available to answer any questions. Shortly after that, Mr Hardern became seriously ill and Mrs Martin reverted to dealing with the correspondence herself.

22. In February 2012 Mrs Martin instructed Michaelides Warner & Co, a firm of accountants and business advisers, to act for her. Mr Andrew Michaelides of that firm had conduct of the matter.

The business records generally and the turnover

The correspondence

23. On 30 April 2009, Mr Cotton asked CHL for "all prime records relating to the business receipts, ie sales invoices remittance advice slips, self-billing invoices and similar, together with details of how the figure of sales/business income of £135,568 was calculated."

24. He also requested the documentary evidence underlying the figures in the accounts, including all link papers, i.e., the documents prepared by an accountant which link between the client's records and the final accounts. Among other questions was "what records did you see?"

25. On 28 May 2009, Mr Hardern replied, enclosing "all prime records relating to business receipts" and details of how the turnover figure was calculated. He also said:

> "we were provided with bank statements, business diaries, purchase/expense receipts/invoices and verbal explanations from the client."

26. In answer to a question about how the business was run, he said:

> "Mrs Martin's business is the sale of paper collectibles, eg books, maps, broadside archives [sic] Sales are a combination of (a) over-the-counter sales at fairs (nationwide)… and (b) auction and private consignments, and (c) quoting direct to collectors and institutions."

27. On 20 July 2009, Mr Cotton responded, saying:

> "I note from the sales ledger the breakdown of the turnover figure. It would appear from your letter that you have not seen any sales invoices and that the turnover figure appears to have been compiled from bankings and cash sales per the diary of £11,190 and a balancing figure of other cash sales of £6,342. Can you please confirm my assumption or otherwise advise of the correct position."

28. On 27 August 2009, CHL replied saying "sales were indeed compiled from banking and cash sales per the diary and other cash sales."

29. On 19 July 2010 Mr Cotton wrote to Mrs Martin, who was by now dealing with the enquiry herself, saying:

> "At an early stage in the enquiry, your agent advised that the turnover figure in your accounts had been arrived at from business bankings added to cash sales of £11,190, as recorded in our diary, and a balancing figure of other cash sales of £6,342. It seems it was necessary to arrive at the turnover in this manner because you had not made an accurate record of all your business takings. The total sales

> recorded in your diary add up to just over £65,000, less than half the figure in your accounts.
>
> The inclusion of additional cash sales by your accountant was necessary because the amount of cash you recorded as spent exceeded the amount of cash sales and the amount of cash withdrawn from your bank account when added together, by the sum of £6,342. The cash must have arisen from unrecorded business cash sales."

30. He went to say that every taxpayer has a responsibility to keep sufficient records so as to allow them to make a correct and complete return, but those running businesses have extra, more specific requirements. These include keeping:

(1) records of all receipts and expenses in the course of the trade;

(2) records of the matters in respect of which those receipts and expenditures take place;

(3) records of all sales and purchases made in the course of any trade involving dealing in goods; and

(4) supporting documents including accounts, books, deeds, contracts, vouchers and receipts.

31. On 14 September 2010 Mr Cotton repeated the comments about the need for a balancing figure in the accounts, saying that "these steps are only necessary when the business records do not fully support the sales or turnover figure in the accounts."

32. After further correspondence on other matters set out in the following sections of this decision, Mr Cotton wrote to Mrs Martin on 1 September 2011, asking her to arrange with CHL for him to be provided with the documents relating to the turnover figure in the 2007-08 accounts.

33. He reminded Mrs Martin of this request on 24 October 2011, acknowledging that Mr Hardern was by then seriously ill but saying:

> "the documents I have requested from your accountant ie the general ledger for sales…should have been created when the accounts for these years were drawn up. No additional work should be required and it would appear that it would only require a member of staff to forward the relevant documents."

34. On 21 December 2011 he reminded her again, saying that "the lack of business records is continuing to delay the progress of the enquiry." He also asked where the records are currently located, whether any were in Mrs Martin's possession, and whether she or another person could collect any records remaining with CHL and send them on to HMRC. He said that once he had received these records, he would "undertake to extract the information I need." No reply was given to these questions.

35. On 27 February 2012, Mr Michaelides confirmed to Mr Cotton that his firm was acting for Mrs Martin. On 23 March 2012, Mr Cotton wrote him a detailed letter setting out the position, and again saying that he had not seen the 2007-08 or 2008-09 business records.

36. On 2 July 2012, Mr Michaelides said that the 2007-08 and 2008-09 business records were at his office and asked Mr Cotton to arrange collection.

37. On 23 August 2012, Mr Cotton wrote back, referring to the documents recently received via Kensington Enquiry Centre, and saying that although he had not reviewed them in detail, they did not contain the general ledger for sales, purchases, drawings or the Trial Balance.

38. On 6 November 2012, Mr Michaelides wrote to HMRC saying that he had received the missing documents from CHL and adding "I hope the above are helpful to you because I have been told that unfortunately no other information is available from the accountant or from the client."

39. On 10 January 2013, Mr Cotton spoke to Mr Michaelides on the telephone, and followed it up with a letter. He said that for the year ended March 2008, the turnover figure had been based on the bankings into the A&L business account together with the cash sales in the diary of £11,796 and a balancing figure for petty cash of £2,683.

Mrs Martin's witness evidence on business records and turnover

40. In oral evidence, Mrs Martin said that she had issued invoices for "almost everything" she sold and that she had provided copies of those invoices to CHL.

Findings of fact on business records and turnover

41. We find it inconceivable that a firm of chartered accountants, who had been provided with invoices for "almost everything" would then have reconstructed the turnover by the painstaking method of adding up the income in the bank accounts and then adjusting for other cash received. We find that Mrs Martin's non-ebay sales records were significantly incomplete. We deal later in this decision with the ebay sales.

42. We further find that there was no good reason for the long delay before Mr Cotton received all the documents underlying the 2007-08 return, because:

(1) The underlying documents were held by Mrs Martin from April 2010, when she "retrieved" them from CHL, until they were finally provided to Mr Cotton in July or August 2012. CHL only retained Mr Hardern's working papers.

(2) Mr Hardern's illness therefore cannot be a reason for the delay in supplying the documents (as by the time he became ill the documents were already in Mrs Martin's possession).

(3) The working papers were not requested from CHL until after August 2012. Had Mrs Martin requested these from CHL before August 2012, they would have been provided to Mr Cotton in August 2012, with the other documents.

Purchases and stock

The correspondence

43. Mr Cotton's letter of 30 April 2009, referred to above, also asked for a full breakdown of stock on hand at 31 March 2007 of £5,500, together with:

> "all records relating to the business expenditure, whether capital or revenue, including delivery notes, bills, receipts, invoices and vouchers."

44. On 20 July 2009, he asked whether Mrs Martin kept a stock book or other record of her purchases, and that CHL also explain what paperwork/records she maintained to help her "control her trading stock and generate a profit."

45. In the letter of 27 August 2009, CHL responded saying that "customers have the option of a hand-written receipt for purchases although most do not request one" and "Mrs Martin does not keep any stock control sheets."

46. In his reply of 24 September 2009, Mr Cotton asked:

> "Please clarify: are you advising that stock records for that period have not been retained, or that no records of Mrs Martin's purchases are written up or kept. Considering the turnover figure, I assume that numerous items must be bought and sold each year…would your client please explain how does she know what price was paid for a particular purchase, how does she decide on the sale price of each item and how is she aware of whether she is operating at a profit or a loss."

47. CHL replied on 13 October 2009, saying:

> "the value of the business is in the mark-up that the owner can achieve based only on her specialist knowledge…the client will mostly try to acquire random and unsorted ephemera, sold at low value by a less learned individual in the calculated anticipation that there may only be one or two items of value in the eyes of a specialist…it could clearly be argued that until the application of the client's knowledge is applied, the intrinsic value of items should perhaps start with a base of nil, since to an untrained eye and under an immediate disposal they are simply boxes of papers, postcards and pamphlets. Any value until point of sale is largely in the 'speculator' value based on costs…Mrs Martin carried out a basic 'on site' stock check of the storage room and applied her valuation based on her intrinsic knowledge of the underlying costs of each item."

48. On 19 July 2010, after Mrs Martin had assumed responsibility for the correspondence, Mr Cotton wrote to her, saying:

> "I understand at one stage you had 'hundreds of storage boxes' and rented storage space costing £350 per month. [CHL] advised that you temporarily converted your garage into a storeroom to store your purchases. The accounts [for 2006-07] show that you make regular purchases throughout the year, totalling £93,000. These facts indicate

> that you have a large amount of stock passing through your business but no records to show how you paid for it or when…."

49. As already stated, Mr Cotton went on to set out the normal record-keeping requirements for a business, which include a requirement that traders keep records of purchases and supporting documents, sufficient to allow them to make a correct and complete return.

50. Correspondence continued. On 10 October 2010 Mrs Martin said in particular that given the many different items she acquired, the fact that some had no value, and the fact that they were often purchased and sold in bundles meant that it was unrealistic for her to track them item by item. She said:

> "concerning values, no item I handle has any intrinsic value at all. My business is based on my self-belief and skill at placing the right item at the right time to secure a sale; sometimes this works, sometimes it does not. The value I give to the stock is my valuation, as an expert, of what its net realisable value is. My understanding of accounting rules is that stock should be valued at the lower of cost and net realisable value."

Findings of fact on purchases and stock

51. On the basis of the correspondence, we find as facts that there are few primary records for purchases: in preparing the statutory accounts, reliance was again placed on bankings and the cash diary.

52. We further find that the process for valuing stock is casual and does not appear to relate either to the purchase costs of the items or to their net realisable value. Rather, it appears that most items are effectively written down to nil on purchase: the accounts stated that the stock figure for the year ended 31 March 2006 was £6,000, that for the year ended 31 March 2007 was £5,500 and that for the year ended 31 March 2008 was £4,500.

53. We also observe in passing that we found it difficult to understand how the stock could be of such a low value at the end of each year, given the amount being stored and the scale of the operation as reflected in the value of purchases and sales. This however goes to the quantum of the profits, and thus the assessment itself, which was not under appeal. Whether the stock held at 31 March 2008 had been correctly valued is therefore not a matter we have taken into account.

The bank accounts

The correspondence

54. On 30 April 2009, Mr Cotton asked CHL to provide him with statements or passbooks for all Mrs Martin's business bank/building society accounts. He included a blank certificate of bank accounts for Mrs Martin to complete. On 28 May CHL sent him the business bank account statements which had been used to complete Mrs Martin's SA return.

55. On 24 September 2009 Mr Cotton reminded CHL that he had not yet received the certificate. He also asked for the statements or passbooks for all the private bank and building society accounts in sole or joint names.

56. On 13 October 2009, CHL returned the certificate completed by Mrs Martin. It is headed with the words:

> "I confirm that the following is a complete list of all banking accounts, savings and loan accounts, deposit receipts, building society and co-operative Society accounts, including credit cards and budget accounts, in my own, name, in the name of any child of mine [and] in any other name or names in which I am or have been interested (whether solely or jointly with any other person) and which are in existence now or which have existed at any time during the year ended April 2007."

57. The bank and building society accounts listed were an Alliance and Leicester ("A&L") business account XXX322, an Abbey Savings account, and three Lloyds TSB accounts: a personal current account, a savings account and a joint account with Mr Martin.

58. On 19 November 2009, Mr Cotton wrote again, saying that he had the bank statements for the Lloyds current account and savings account, but not the Abbey savings account or the TSB account jointly held with Mr Martin. Furthermore, there were some deposits in the Lloyds TSB personal accounts which he could not link to Mrs Martin's business account.

59. On 31 March 2010, Mr Cotton sent CHL a list of unexplained deposits, which totalled £24,137. He also asked CHL to identify the source of a transfer into the joint account of £3,852.01.

60. At this point Mrs Martin took over dealing with the enquiry herself and replied to Mr Cotton's letter on 15 April 2010. Under the heading "Joint Lloyds TSB account with my husband Mr J Martin" she first responded to some queries from Mr Cotton and then ends with this sentence, in bold "the suggestion that I have an additional account is clearly erroneous."

61. Mr Cotton pressed on with various enquiries seeking to find the source of certain receipts into the bank accounts. On 10 October 2010, she mentioned trading on ebay, and we return to this in the next part of this decision.

62. On 15 March 2011 Mr Cotton again sent Mrs Martin a spreadsheet with outstanding deposits highlighted. In his letter of 3 June 2011, he gave a great deal of detail as to why he did not agree that Mrs Martin had successfully explained all the deposits. In his letter of 4 August 2011 he again asked for details of the bank account into which a particular transfer had been made.

63. On 17 August 2011, Mrs Martin informed Mr Cotton that the ebay account was operated using a bank account originally opened by her son and previously operated by her husband. However, she did not supply either the account name, its reference

number or copies of the statements. On 1 September 2011, Mr Cotton wrote again, asking for the relevant bank account statements. Later correspondence established that this was a NatWest Bank account.

64. On 24 October 2011, Mr Cotton asked for details of her personal and business bank accounts for the 2007-08 and 2008-09 tax years. On 23 November 2011she provided the same list of private bank accounts as she had supplied in relation to 2006-07, along with relevant documentation for these accounts.

65. At some date between then and 10 January 2013, although the date is not clear from the correspondence, Mrs Martin provided details of a further private A&L account XXX709.

66. As already stated, on 10 January 2013, Mr Cotton spoke to Mr Michaelides on the telephone. He said that deposits into A&L account XXX709 of £20,223 had not been included in the turnover figures. In addition, he said, that account also contained a further £23,281, the source of which was not yet established.

67. On the same day, Mr Cotton wrote to Mr Michaelides, asking for the NatWest Bank statements for 2007-08 and 2008-09. He also says:

> "I understand that Mrs Martin also has an ISA account with the Nationwide. I need to see the statements for all bank accounts in her name solely or jointly with others, in someone else's name but which may receive income under the control of Mr and Mrs Martin. Please let me have the statements covering the two year period 6 April 2007 to 5 April 2009."

68. On 23 April 2013 Mr Cotton wrote reminding Mr Michaelides of this and other requests. He attached an Information Notice under FA 2008, Schedule 36, para 1 ("a Sch 36 Notice"). In so far as relevant to this appeal (and not to other tax years), the Sch 36 Notice required Mrs Martin to produce:

(1) the NatWest bank statements in Mrs Martin's son's name for the years 2007-08;

(2) the statements for all bank accounts in her name solely or jointly with others, in someone else's name but which may receive income under the control of Mr and Mrs Martin covering 2007-08; and

(3) the source of all deposits.

69. Mr Michaelides responded to the Notice on 14 May 2013 and later that year the enquiry was concluded on the basis set out later in this decision.

Mrs Martin's witness evidence on bank accounts

70. In oral evidence, Mrs Martin said that CHL were not provided with statements for the NatWest bank account into which the PayPal monies were paid. Further, they were not told about this account.

71. In her witness statement, she said (her emphasis) that "PayPal is a bank. PayPal monthly bank statements were given to CHL. Ebay sales were included in the PayPal bank statements and also included in the A&L deposit books." She repeated this in her oral evidence, saying that PayPal was "a second bank account."

72. When asked whether she had provided the PayPal documents to HMRC when she was required to provide details of all bank accounts, she said that "the PayPal accounts were in my husband's name so they were not included."

73. She said that the reason why her son's account was used for the PayPal money was because it was Mr Martin who had begun selling things on ebay; he could not have a bank account because he was bankrupt at the time and so borrowed one of his son's.

74. In her oral evidence, Mrs Martin accepted that she had not informed HMRC of her ISA account, and said this was because it was tax free.

Findings of fact on bank accounts

75. CHL were not aware of the NatWest bank account and were not provided with the statements.

76. The confirmation certificate signed by Mrs Martin on 13 October 2009 did not include the NatWest account, the second private A&L account XXX709 or her ISA account. The certificate was therefore materially incomplete.

77. Mrs Martin clearly regarded PayPal as a second bank account. Given that the money in PayPal formed part of her business receipts (and not her husband's), on her own case she made a further incomplete disclosure to HMRC when she signed the confirmation document, by not including the PayPal details.

78. When Mrs Martin said, on 15 April 2010, that "the suggestion that I have an additional account is clearly erroneous" this statement was not correct. The NatWest account was being used to hold her business income.

EBay and PayPal

The correspondence

79. EBay and PayPal are first referred to in Mrs Martin's letter to Mr Cotton of 10 October 2010. This said that she used ebay and:

> "the sales proceeds thereof would be received via PayPal and PayPal receipts are included in my records as sales. This process is self-policing and listing PayPal receipts ensures I maintain proper records of these sales."

80. The enquiry was then delayed as Mrs Martin made a formal complaint about Mr Cotton. A meeting was suggested, but Mrs Martin objected to the length of the agenda and it was aborted. On 15 March 2011, Mr Cotton finally replied to Mrs Martin's October 2010 letter, saying this had been the first mention of ebay trading

and PayPal. He cited the letter from CHL dated 28 May 2009, cited earlier in this decision and said "it appears from your agent's comments that he may not be aware that you were trading on ebay. Please let me know if your trading on ebay has been included in your turnover."

81. CHL were re-engaged to write the letter dated 19 May 2011. It says:

> "our client was surprised at this level of activity as this was before she opened her 'ebay shop' in March 2007. Since opening the shop all transactions have been incorporated in to the trading records…our client is adamant that no profit was made from ebay at that this time."

82. Enclosed with the letter were the PayPal printouts relating to 2006-07. On 4 August 2011, Mr Cotton asked for ebay trading records for 2007-08.

83. On 17 August 2011, Mrs Martin told Mr Cotton that the ebay account was operated originally by her husband and taken over by her in February 2007. On 2 July 2012, she told Mr Cotton, via Mr Michaealides, that "if there were any ebay sales towards the end of the year ended 5 April 2007, then these were included in the accounts for the year ended 5 April 2008."

84. On 6 November 2012, Mr Cotton finally received the business records for 2007-08. He wrote to Mr Michaelides on 10 January 2013, saying:

> "Despite Mrs Martin's earlier assurances that ebay trading had been included in the accounts, there is no evidence that it has. The PayPal account has sales amounting to £35,859 in the year."

85. On 14 May 2013, Mr Michaelides sent Mr Cotton two spreadsheets of the ebay trading income for the 2007-08 and 2008-09 tax years.

86. On 23 July 2013, Mr Cotton and Mr Michaelides had two telephone conversations. Mr Michaelides confirmed that the ebay income had been omitted from the accounts. The ebay sales for 2007-08 were later agreed at £36,216. This figure was used in the assessment, which has not been appealed.

Mrs Martin's witness evidence

87. Mrs Martin said in her witness statement, and reiterated at the hearing, that some cheques received for ebay sales had been paid into the A&L bank account XXX322. The list of cheques attached to the witness statement appears to have been produced for this hearing and not at an earlier stage. Those for 2007-08 total £2,407 out of ebay sales for that year of £36,216, being 6.6%.

88. Mrs Martin did not appeal the assessment of her liability, so we are unable to consider whether or not cheques totalling £2,407 have been taken into account twice, once in the original turnover figure, and once as part of the ebay adjustment. We observe only that the list of cheques has not been reviewed by HMRC, and also that the assessment brought an extensive and long-running enquiry to an end, and so closed down a number of other issues which might have otherwise been more fully explored.

Initial findings of fact on PayPal and ebay

89. Given that the assessment has not been appealed, we find as a fact that ebay sales of £36,216 were omitted from the return.

90. As already stated, a key issue in the appeal is whether or not the ebay and PayPal statements were given to CHL, and we make further findings of fact on that issue later in this decision.

The dividends

The correspondence

91. On 1 September 2011, Mr Cotton asked Mrs Martin for a breakdown of her dividend income for 2007-08 and the following year, together with information about "the capital investment to produce the dividend." He repeated this request on 24 October 2011. On 23 November 2011, she provided what she said were "tax vouchers for any shares' dividends which I own." She went on to say that she had owned these "since the last century and these were mainly 1980s shareholdings."

92. On 21 December 2011, Mr Cotton challenged this statement, drawing Mrs Martin's attention to the dividends shown in her 2008-09 return, which at £13,183 was significantly more than those declared for 2007-08. On 23 March 2012 Mr Cotton set this out in more detail for Mr Michaelides.

93. On 2 July 2012, Mr Michaelides said that the £13,183 came from Mrs Martin's shareholding in a company called "Mayflower Books and Periodicals Limited." Mr Cotton said in his reply of 23 August 2012:

> "despite the fact that the enquiry has been running since January 2009, I note that it is only in your letter dated 2 July 2012 and after the company has been struck off, is it mentioned that Mrs Martin was a shareholder in a 'sister' limited company business, Mayfly Books and Periodicals Ltd. Would Mrs Martin please let me know of any other shareholding she has by letting me have a statement of assets and liabilities…"

94. On 6 November 2012, Mr Michaelides responded, enclosing the accounts of that company and stating "I can confirm that according to Mrs Martin, she has no other shareholding."

95. Meanwhile, on 15 March 2011, Mr Cotton had asked for information about certain deposits, one of which was a sum of £3,591. On 19 May 2011, CHL said that the sum was "believed to be a refund for nursing home fees for Mrs Martin's mother-in-law." Mr Cotton asked for more details. On 30 June 2011, Mrs Martin reiterated that "my husband and I are convinced" that this related to the nursing home fees. On 13 September 2011, Mr Cotton asked six questions about this payment. On 23 November 2011, having received the cheque back from the bank, Mrs Martin informed HMRC that the deposit related to "the net payment due to me…in respect of the sale of a small freehold commercial unit in North London." Mr Cotton again asked for more details.

96. On 2 July 2012, Mr Michaelides said he had "not been able to get to the bottom of this figure and at the moment I am still awaiting some information from Mrs Martin's solicitors." On 6 November 2012, he promised he would "have a full reply" for Mr Cotton in relation to this amount, by the following week.

97. On 10 January 2013, Mr Michaelides told Mr Cotton that he had been informed that the £3,591 related to a dividend from another limited company. On 11 January he said that Mrs Martin had received dividends totalling £3,785 from Rusthall Estates Limited, a company in which Mrs Martin was a 50% shareholder with her former brother-in-law. Of this total, she had paid £3,591 into her Lloyds account; the balance was "a deduction for expenses agreed to be borne by Mrs Martin."

98. Mr Michaelides said that Mrs Martin declared £1,029 of these dividends in her 2007-08 returns, and that the incomplete disclosure was because she had been "misinformed" by CHL.

99. HMRC included the full Rusthall Estates Limited dividend in the assessment (which has not been appealed).

Mrs Martin's witness evidence on the dividends

100. Mrs Martin said, in her witness statement, that she had been misinformed by CHL and that was the reason she omitted the dividend income from Rusthall Estates Limited.

101. When asked by the Tribunal why she did not include all her dividends, Mrs Martin said (a) she had not received a dividend voucher, and (b) she had thought companies dealt with their own tax.

Findings of fact on the dividends

102. The dividend figure in the accounts is only £203, the same as the previous year. Mr Michaelides' statement that £1,029 of the Rusthall Estates dividend had been included in the 2007-08 return was therefore incorrect.

103. We find that the £203 declared in the 2007-08 SA return arises from Mrs Martin's historic holdings of 1980s shares and that none of the Rusthall Estates Limited dividends was disclosed in Mrs Martin's 2007-08 return.

104. Mrs Martin's statement on 23 November 2011, that she was supplying "tax vouchers for any shares' dividends which I own" was at best an incomplete answer to Mr Cotton's request for a breakdown of her dividend income.

105. Her statement, made via Mr Michaelides on 6 November 2012, that she had "no other shareholding" was not true: she held shares in Rusthall Estates Limited.

106. Her witness statement, and Mr Michaelides' letter of 11 January 2013, said that she had failed to disclose the Rusthall Estates dividend because of "misinformation" given by CHL. We do not accept this, because:

(1) Mrs Martin had been a shareholder in other companies since the 1980s, and had included those dividends in her tax returns, so knew that dividends were disclosable;

(2) she continued to provide incorrect and incomplete responses to Mr Cotton about her dividends, at a time when CHL were no longer acting for her; and

(3) when asked by the Tribunal why she had not disclosed the dividends, she did not blame CHL.

107. We therefore find as a fact that Mrs Martin's omission of dividend income did not come about because she had been misinformed by CHL. We consider at §134 of this decision, her submissions that she failed to include the dividend income because (a) she had not received a dividend voucher, and (b) she thought companies dealt with their own tax.

Findings of fact on the assessment and the penalty

108. On 5 December 2013, Mr Cotton raised a formal assessment for 2006-07, 2007-08 and 2008-09.

109. For 2007-08, the profit was increased by £14,393 as a result of adding extra ebay income. Adjustments were then made by disallowing certain sums claimed as subsistence (£500) and allowing a claim for use of home as office (£1,200). The net effect was an overall increase in profits from £11,042 to £24,735. The extra tax was £4,107.

110. The penalty for 2007-08 was assessed as follows:

(1) *Disclosure*: Mr Cotton took into account the fact that "disclosure or agreement to the omitted ebay income was only given after a breakdown of the 2007-08 turnover had been received and the omission was apparent." Of the 20% maximum reduction, a 10% abatement has been given.

(2) *Co-operation*: Mr Cotton said that "certain information had not been provided quickly, requiring the information powers to be used and some of the information provide was not accurate. There was an improvement following the appointment of a new agent." Of the 40% maximum reduction, a 25% abatement was given.

(3) *Seriousness*: Mr Cotton said that "the ebay profits were diverted to an account in another person's name and inaccurate information was given about the inclusion of ebay income. The omitted ebay profits were more than 100% of the declared profit figure." Of the 40% maximum reduction, an abatement of 25% was given.

111. The penalty was therefore 40% of £4,107, being £1,643.

Submissions by and on behalf of Mrs Martin

PayPal and ebay

112. Mr Martin said that Mrs Martin had provided the PayPal and ebay documents to CHL, and the firm had failed properly to incorporate the information in her tax return. In his submission, Mrs Martin could not be negligent when she had reasonably relied on a firm of chartered accountants.

113. Mrs Martin's evidence, contained within her witness statement and expanded at the Tribunal, was that:

(1) She had printed off the PayPal transactions and handed them to CHL along with all the ebay invoices, and "as far as I knew they were in the accounts" and she "had no idea they were not included."

(2) When asked by the Tribunal whether she had checked whether all the income had in fact been included in the accounts, she expressed surprise, saying "how could I check that all the income was included?"

(3) Some of the ebay sales were settled by cheque and some via PayPal; those settled via cheque were included in her bank accounts, with the result that they were included in her turnover, whereas those paid via PayPal had been omitted from the turnover.

(4) Despite CHL having been supplied with all the ebay invoices, they included only those which had been paid into the bank account and not those settled via PayPal. She said she did not know why CHL would have done this. It was put to her that she had not provided the ebay or PayPal documents to CHL, but she reiterated her evidence.

Other submissions

114. Mrs Martin submitted that this had been a stressful time for her and her family; that neither she nor Mr Martin were very computer literate and that she had had no training in accountancy and so relied on CHL.

115. Mr and Mrs Martin said that if, contrary to their main submission, Mrs Martin had been negligent or careless, 15% would be a more appropriate penalty, rather than 40%. Mr Martin also said that "negligence" was a higher threshold than "careless" and that that the (suspended) penalty for the following year had been reduced, because it was classified as careless under the new penalty rules which came into force that year.

Submissions of Mr Goulding on HMRC's behalf

116. Mr Goulding said *Blyth v Birmingham Waterworks Co* [1856] 11 Ex 781 provided the definition of negligence:

> "Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do."

117. He said Mrs Martin had clearly been negligent. She had omitted the ebay income from her turnover. Its inclusion had the effect of more than doubling her profits. He said (a) that HMRC did not accept that she had given the PayPal and ebay records to CHL, but (b) even if she had, it was negligent of her not realise, when she saw the draft accounts, that both turnover and profits were significantly understated. There were also the dividend omissions.

118. He said that one underlying problem was Mrs Martin's failure to keep proper books and records, so that the accounts had to be constructed from bankings and diary entries. A reasonable person would keep proper books and records.

119. Finally, he submitted that no further abatement was appropriate, for the reasons given by Mr Cotton earlier in this decision.

What is negligence?

120. We first set out our understanding of the meaning of negligence, and then consider Mr Martin's submission that it is more heinous than "carelessness."

The law on negligence

121. Mr Goulding relied on *Blyth v Birmingham Waterworks,* a nineteenth century case about tort liability. The test has been more recently formulated by Judge Berner in *Anderson v HMRC* [2009] UKFTT 206 at [22]:

> "The test to be applied, in my view, is to consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done."

122. This summary was cited with approval by Judge Bishopp in the Upper Tribunal in *Colin Moore v HMRC* [2011] UKUT 239 (TCC) at [13] and we too respectfully adopt it.

123. The reference to "a reasonable taxpayer" means that the test is objective: we are required to consider how the hypothetical reasonable taxpayer would have completed her return.

Does negligence differ from carelessness?

124. The new rules, referred to by Mr Martin in his submissions, are contained in Finance Act 2007, Schedule 24 ("Sch 24"), and take effect from 2008-09. They set out a codified table of penalties, so that each penalty falls into a fixed band, unlike the TMA s 95 penalties in this appeal. Sch 24, para 4(2) specifies that the maximum penalty for carelessness is 30%.

125. Sch 24, para 3 defines "careless" as "a failure…to take reasonable care." That this was intended to be negligence in modern dress rather than introducing a fundamental change in meaning is indicated by the Notes to the 2007 Finance Bill, which say that the new definitions use "more accessible language." The consultation which preceded the Finance Bill provisions, entitled "A new approach for penalties for incorrect tax returns" said explicitly at ¶5.6 that the term "failure to take

reasonable care" would "incorporate the terms 'negligent conduct' and 'negligence.'" We note that cases such as *Duke v GEC Reliance Ltd* [1988] AC 618 at 637, *per* Lord Templeman, have relied on pre-enacting documents as a guide to Parliament's intention.

126. However, in *Hanson v HMRC* [2012] UKFTT 314(TC), Judge Cannan said at [21]:

> "What is reasonable care in any particular case will depend on all the circumstances. In my view this will include the nature of the matters being dealt with in the return, the identity and experience of the agent, the experience of the taxpayer and the nature of the professional relationship between the taxpayer and the agent."

127. This includes an element of subjectivity, which would not be permissible when measuring a taxpayer's behaviour against the objective standard of the reasonable man. It is similar to the approach taken on "reasonable excuse," which we discuss further at §162 below, and so differs from the strictly objective meaning of negligence.

128. In *Harding v HMRC* [2013] UKUT 575(TC) Judges Bishop and Sadler at [35] took a similar approach to the meaning of carelessness: they say:

> "we do not accept that the Appellant, who admits that he considered that the 'severance payment' was possibly liable to tax in October 2008, could, by August 2009, reasonably have reached the conclusion that it was definitely not liable to tax. The Appellant is an intelligent person, and held a senior position (such as made him eligible to participate in his employer's profit share and bonus plans reserved for directors) in a company which forms part of a leading accountancy practice."

129. The same conclusion is also indicated by the absence of any "reasonable excuse" provision in Sch 24. Instead, para 18 says that a person who submits "a document which contains a careless inaccuracy" is not penalised if he "took reasonable care to avoid inaccuracy." This is merely the flipside of para 3, which says that an inaccuracy is only "careless" if it is due to a person's failure to take reasonable care.

130. If failure to take reasonable care were to be an objective test, Sch 24 would be much harsher than the TMA penalty provisions, because the objective test of negligence at TMA s 95 can be mitigated by the reasonable excuse provisions at TMA 118(2). Sch 24 would also be harsher than the other new compliance rules in FA 2008 Sch 36; FA 2009 Sch 55 and 56: all of these other provisions allow for reasonable excuse.

131. We thus agree with Mr Martin that "negligence" under TMA s 95 is different to "careless" under the new rules. The former is objective, the latter includes an element of subjectivity. But the difference is more apparent than real: a taxpayer who has been found objectively negligent under TMA s 95, may then satisfy the reasonable

excuse provision at TMA s 118(2) and so escape a penalty. We consider at §167 whether Mrs Martin has a reasonable excuse.

132. We also return at §175 to Mr Martin's submission that we should reduce the penalty, given the new 30% cap on such penalties.

The burden of proof

133. As this is a penalty appeal, it was accepted that the burden of proof was on HMRC and that the standard of proof was the civil standard of the balance of probabilities (*HMRC v Khawaja* [2008] STC 2880 at [25] and [29]).

Did Mrs Martin negligently omit the dividend income from her return?

134. When asked by the Tribunal why she did not include all her dividends, Mrs Martin said (a) that she had not received a dividend voucher, and (b) had thought companies dealt with their own tax.

135. We find that a reasonable person, in receipt of a dividend from a company in which she is a 50% shareholder, would not think that she could omit those dividends from her tax return, simply because she had not received a voucher.

136. Mrs Martin's statement that she thought companies paid their own tax cannot be reconciled with the inclusion of other dividends on her return.

137. We have already found at §107 that Mrs Martin's omission of dividend income did not come about because she had been misinformed by CHL.

138. We find that her failure to include the Rusthall Estates Limited dividends in her SA return was negligent.

Were CHL provided with the ebay and PayPal records?

139. This is a key issue in dispute, because Mrs Martin contended that CHL had been provided with these documents but failed to include the related figures in the turnover. She said she does not know why CHL failed to use this information.

The 2006-07 year

140. We first consider the 2006-07 year, for which the enquiry was opened. Mr Cotton asked CHL for details of how the turnover figure had been calculated. Mr Hardern's reply of 28 May 2009 refers only to "bank statements, business diaries, purchase/expenses receipts/invoices and verbal explanations from the client" and he provided these documents to Mr Cotton. On 27 August 2009, he confirmed that the turnover figure was established using "banking and cash sales per the diary and other cash sales." There is no mention of ebay or PayPal, and we find that for 2006-07, Mr Hardern was not provided with any ebay or PayPal documents.

141. This, however, does not solve the problem for 2007-08. This is because Mrs Martin has said that ebay sales before February 2007 were not part of the business,

and that ebay sales from February 2007 through to March 2008 were included in her 2007-08 accounts. Thus, even on Mrs Martin's case, CHL would not have been given any ebay or PayPal documents for the 2006-07 accounts.

The 2007-08 year

142. Mrs Martin's evidence is that she supplied the ebay and PayPal documents to CHL, along with all the other papers, but that she does not know why they were not used by CHL.

143. One possibility is that Mrs Martin did not, in fact, gave these documents to CHL. Her evidence was challenged at the Tribunal, so this is not a case where we are precluded by the rules of natural justice from disbelieving her (see *Okolo v HMRC* [2013] STC 906 *per* Arnold J at [34]). We have also already found that:

(1) She made an untrue statement about not having any more shareholdings, when in fact she owned 50% of Rusthall Estates Limited.

(2) She signed a bank confirmation document saying she had disclosed all her bank accounts, but omitted the NatWest bank account. She told us only that the NatWest arrangement had been set up in that manner because her husband was bankrupt. That does not explain why it was not disclosed to HMRC.

(3) She also omitted the ISA account. She told us that this was because it was tax free. But the certificate makes no such exclusion, and it was clear from the whole tenor of the correspondence that what was in issue were deposits, not the taxability of the interest arising.

(4) Although she regarded the PayPal account as a second bank account, she did not disclose it to HMRC. She told us this was because it was in Mr Martin's name, but it contained her business income and the certificate was inclusive of all accounts in which she had an interest.

(5) The second personal A&L account was also not disclosed.

144. Mrs Martin therefore made untrue statements in relation to her shareholdings and bank accounts. However, this does not of itself mean that her evidence in relation to the provision of ebay and PayPal documents to CHL should be disbelieved. We respectfully agree with Langstaff J when he said, in *Clements v Shawcross* [2014] UKEAT/0474/13/JOJ at [19]:

> "The fact that a witness is untruthful in respect of one matter does not carry as a necessary implication that the witness is untruthful as to others. It raises the possibility that he might be, but it is always likely to be too cavalier an approach for a fact-finder to reject all of that which a witness says merely because on one point he is thought clearly to be telling an untruth. What is required is a careful and conscientious examination of all the facts."

145. In carrying out that "careful and conscientious examination," we take into account the following:

(1) The 2007-08 turnover, like that for the previous year, was calculated by extrapolation from the bank accounts and diary records, with a balancing figure because withdrawals exceeded business income. We find it improbable that a firm of chartered accountants who had received the ebay and PayPal documents would have ignored these documents and instead only relied on the business bank account, cash book and a balancing figure.

(2) One possibility is that CHL lost the ebay and PayPal documents before any work could be done. However, we consider this to be an unlikely scenario, given that all the other papers were safely retained.

(3) A firm of accountants in receipt of the PayPal documents would have been unable to reconcile the PayPal transfers to the bank account Mrs Martin had provided, and would have been likely to ask for the missing bank statements in order to draw up the accounts. We have found as a fact, based on Mrs Martin's own evidence, that CHL was not provided with the NatWest bank statements which received the PayPal receipts; neither was it informed that the account existed. The missing bank statements were clearly never raised as an issue.

(4) Although Mrs Martin's other untrue statements do not mean that we should necessarily disbelieve her on this matter, our findings on credibility are nevertheless relevant facts.

146. The above findings point to the conclusion that Mrs Martin did not provide the ebay and PayPal documents to CHL. But why then did Mr Hardern tell Mr Cotton, in May 2011, that "since opening the [ebay] shop all transactions have been incorporated in to the trading records"?

147. We do not have the benefit of witness evidence from Mr Hardern. On the basis of the facts so far established, we find that:

(1) Mr Hardern is unlikely to have checked the underlying documents, because in May 2011 they were held by Mrs Martin.

(2) He had not carried out the detailed work on the documents himself, but delegated it to another member of staff, so is unlikely to have remembered what documents were actually provided.

(3) He cannot have asked that staff member, because she had left CHL and was unavailable for questions.

148. It is also possible that Mr Hardern simply accepted what Mrs Martin had told him. We find that this possibility is the most likely, given the findings in the previous paragraph.

149. Taking all these factors into account, we find that the ebay and PayPal documents were not provided to CHL by Mrs Martin and that her failure to provide those documents was negligent.

The position if CHL had lost the records

150. For completeness, we considered what the position would be, had we found that CHL were provided with the ebay and PayPal documents, but then lost them, or failed to include them in the accounts for some other reason.

151. As a result of the omission of the ebay income, Mrs Martin's taxable profits were £11,042; with the ebay income included, her profit increased by £14,393, becoming £25,435 before other disallowances and adjustments consequent upon the enquiry. The profit declared on the tax return was thus only 43% of the profit which would have been disclosed had the ebay figures been included.

152. The turnover for 2007-08, before the inclusion of the ebay figures, was £141,084. The ebay figure was £36,216 – an increase of over 25%, making a total of £177,300.

153. We find that the reasonable taxpayer, who was approving her tax return for delivery to HMRC, would at least review the figures being submitted and check that they reflect what she understood the position to be, in broad terms. Here, Mrs Martin was apparently presented with a tax return showing only 43% of the true profit and only 75% of the turnover.

154. On the witness stand, Mrs Martin seemed astonished by the suggestion that she should have been able to detect whether the turnover or profit was incorrect, saying she relied entirely on her accountants. HMRC's case is that Mrs Martin should have been aware that the accounts and tax return significantly understated the profit, and that if she was unaware, part of the reason for this was her failure to comply with her statutory record-keeping requirements.

155. Mr Cotton several times referred to these obligations, which are set out at TMA s 12B. These include (at s 12B(3)(a)) the requirement that a person running a business must keep records of:

> (i) all amounts received and expended in the course of the trade, profession or business and the matters in respect of which the receipts and expenditure take place, and
>
> (ii) in the case of a trade involving dealing in goods, all sales and purchases of goods made in the course of the trade.

156. There is a further duty to preserve "all supporting documents relating to such items as are mentioned in paragraph (a)(i) or (ii) above" for five years from 31 January after the end of the tax year, so broadly for six years. There is no specific list of the supporting documents required, but they must be sufficient to enable the person to make and deliver a correct and complete SA return, see TMA s 12B(1)(a).

157. TMA s 12B(5) says that a failure to comply with these provisions can incur a penalty of £3,000. No such penalty has been charged in this case, but we agree with Mr Cotton that the reasonable person running a business would be aware of, and adhere to, these statutory requirements.

158. On the basis of our findings of fact, made earlier in this decision, we find that Mrs Martin ran the business with no proper systems, a casual attitude to the recording of sales and purchases, and with little or no regard to her statutory obligations to keep proper books and records.

159. The test for negligence is objective. The reasonable business person, who conducted her business in accordance with her statutory obligations, would have realise that the turnover and profit figures included on her SA return were too low.

160. Therefore, even had CHL had been provided with the ebay and PayPal records, and failed to take them into account, we would still have found that Mrs Martin had been negligent in delivering to HMRC an SA return which contained such significantly incorrect trading and profit figures.

Conclusion on negligence

161. We therefore agree with HMRC that Mrs Martin negligently delivered her 2007-08 SA return, so as to come within TMA s 95, for the following reasons:

(1) she negligently omitted dividend income from her return;

(2) she did not provide CHL with the ebay or PayPal information, or the NatWest Bank statements, with the result that the turnover and profit for the year were significantly understated.

(3) even had the ebay and PayPal documents been provided to CHL, but were lost or otherwise omitted from the returns, it would have been negligent of Mrs Martin to submit a return without making reasonable checks, which would have identified that her profits and turnover were significantly understated.

Reasonable excuse

162. TMA s 118(2) provides, *inter alia* that:

> "where a person had a reasonable excuse for not doing anything required to be done he shall be deemed not to have failed to do it unless the excuse ceased and, after the excuse ceased, he shall be deemed not to have failed to do it if he did it without unreasonable delay after the excuse had ceased."

163. The effect of having a "reasonable excuse" is that the penalty is cancelled. As we have already said at §123, negligence is an objective concept, but the test for reasonable excuse contains elements of subjectivity. Because the tests are different, a finding of negligence does not exclude the possibility of a reasonable excuse.

164. The test was set out in *The Clean Car Co Ltd v C&E Comrs* [1991] VATTR 234 where Judge Medd QC said:

> "the test of whether or not there is a reasonable excuse is an objective one. In my judgment it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of

> the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?…It seems to me that Parliament in passing this legislation must have intended that the question of whether a particular trader had a reasonable excuse should be judged by the standards of reasonableness which one would expect to be exhibited by a taxpayer who had a responsible attitude to his duties as a taxpayer, but who in other respects shared such attributes of the particular appellant as the tribunal considered relevant to the situation being considered. Thus though such a taxpayer would give a reasonable priority to complying with his duties in regard to tax and would conscientiously seek to ensure that his returns were accurate and made timeously, his age and experience, his health or the incidence of some particular difficulty or misfortune and, doubtless, many other facts, may all have a bearing on whether, in acting as he did, he acted reasonably and so had a reasonable excuse. Such a way of interpreting a statue which requires a court to decide an issue by judging the standards of the reasonable man is not without precedent of the highest authority, though in a very different field of the law. (See *DPP v Camplin* ([1978] 2 All ER 168)

165. The case last listed, *Camplin,* shows that the roots of this approach are not in the objective standards of *Blyth* and the law of tort, but in the criminal law. The approach set out by Judge Medd QC has, however, been widely accepted by this Tribunal as providing correct guidance when deciding whether a taxpayer has a reasonable excuse.

166. As we have already said, and as can be seen from the extract set out above from *The Clean Car Company,* the reasonable excuse test imports an element of subjectivity and so differs from the objective test we have to apply for negligence. We therefore considered whether there were any factors which had a bearing on Mrs Martin's actions, so as to provide her with a reasonable excuse.

Whether Mrs Martin had a reasonable excuse

167. Mrs Martin said, and we find as a fact, that in the period from 2004-2006 Mr Martin faced serious work-related difficulties, ending in his bankruptcy, and we accept this will have caused stress to Mrs Martin. Further, Mr Martin's mother had died in January 2007.

168. However, by 2007-08 Mrs Martin managed to run a business with an annual turnover of some £177,000, made up of numerous individual transactions. It is not credible that a person can do this on the one hand, but be prevented by stress from delivering a complete and correct SA return on the other. There is no basis here for a reasonable excuse defence.

169. We also considered Mrs Martin's submission on computer literacy. We find, first, that computer expertise is not required in order to submit an SA return. Second, there were no technical problems with the submission of the return, the issues were with omissions from the return. Third, although Mrs Martin was not an expert, she

was nevertheless able to conduct over £36,000 of business on ebay. Mrs Martin's level of computer expertise does not provide her with a reasonable excuse.

170. Finally, we considered whether she had a reasonable excuse because she relied on CHL. However, we have already found that she was not misadvised by CHL so as to cause her to under-declare her dividends. We have also found as a fact that she did not provide the ebay and PayPal records to CHL, so she cannot have relied on that firm in relation to that issue.

171. Even had Mrs Martin provided the ebay and PayPal records to CHL, we would still have found that she did not have a reasonable excuse. Appointing an agent does not absolve a taxpayer of responsibility; Mrs Martin remained responsible for her return and should have realised that such large sums were missing from the turnover and profits.

172. Her position is different from that of the taxpayer in *Rowland v HMRC* [2006] STC (SCD) 536, which involved a "difficult and complex area of tax law," including "the arcane matters of film finance partnerships." Mrs Martin's case turns on the simple and straightforward issue as to whether the accounts correctly showed the turnover and profit for a year, or were significantly understated.

173. We find that Mrs Martin does not have a reasonable excuse for delivering an incorrect SA return.

Is the quantum of the penalty appropriate?

174. We next consider whether the quantum of the penalty is appropriate, excessive or insufficient, as we are required to do by TMA s 100B.

Whether we should consider the cap on penalties in Sch 24

175. We first considered the matter raised by Mr Martin. Under the new penalty rules contained in FA 2007, Sch 24, the maximum penalty for carelessness is 30%. Should we therefore restrict Mrs Martin's penalty to 30%?

176. Sch 24 is a new, free-standing code which applies to most parts of the tax system. It replaced a complex network of inaccuracy penalties with a single framework. It contains brand new provisions, including the possibly for a "special reduction" at para 11 and for suspension at para 14. It sets minimum as well as maximum penalties – for example, the minimum penalty for prompted disclosure in a carelessness case is 15%. It also allows for penalties of up to 200% of the "potential lost revenue" in the most serious cases.

177. Our starting point is that we should not use Sch 24 to impose a cap on the penalty charged on Mrs Martin, any more than we should (on different facts) use it to increase a penalty, for instance by bringing it up to the minimum prescribed for a prompted disclosure. We must apply the law which is actually in force for the period in question, not a completely different set of provisions.

178. That this is the right approach can be seen when the Commencement Order[1] is considered. That Order sets out when the Sch 24 provisions come into force for different parts of the tax system. It would have been an easy matter for Parliament to provide, by that Order, that all direct tax penalties *raised after* 1 April 2008 came within Sch 24. Had this happened, all Mrs Martin's penalties would have been dealt with under the new rules. However, the Order instead provides that Sch 24 applies only where the assessment is for *tax periods beginning after* 1 April 2008. It is not for us to approach Mrs Martin's penalty as if the Order had otherwise provided.

Disclosure, co-operation and gravity

179. We move on to considering the three headings under which HMRC assess TMA s 95 penalties. We are not bound to follow the same approach, but it is a sensible one and we see no reason to depart from it. In so doing we bear in mind that we have a wide discretion and can take into account matters not before Mr Cotton when he set the penalties originally, see *Willey v HMRC* [1985] STC 56 *per* Scott J at page 61.

180. First, disclosure. Mr Cotton gave a 10% rebate out of a possible 20%. He took into account the belated acceptance that the ebay sales had not been included in turnover. We have also considered other matters. Mr Cotton first began asking about the receipt which turned out to be the Rusthall Estates dividend, in 15 March 2011. It was not until 11 January 2013, almost two years later, and after significant efforts on Mr Cotton's part, that the true facts emerged. Mr Cotton first asked for details of Mrs Martin's bank accounts in 30 April 2009, but it was not until August 2011 that the NatWest account was disclosed, over two years later, again after repeated questions from Mr Cotton. In our judgment, 10% is too generous, and we have reduced it to 5%.

181. Second, co-operation. Mr Cotton gave a 25% rebate against a possible 40%, saying that it improved following the appointment of Mr Michaelides. We note the frequent and often unexplained delays in providing information. For example, it took almost 18 months before Mr Cotton was provided with all the necessary papers relating to the turnover. No reason was given for this. Even after Mr Michaelides' firm was appointed to act, Mr Cotton had to resort to a Sch 36 Notice when other information was not provided. We again thought that a 25% discount was generous, but have not reduced it.

182. Third, gravity. Mr Cotton gave a 25% rebate out of a possible 40%. He took into account the routing of the ebay money via Mrs Martin's son's account, and the inaccurate information about the nursing home fees, which turned out to be a dividend. We considered that the second of these matters was more properly dealt with under disclosure. Our understanding of gravity in the context of negligence is that the abatement should also take into account the seriousness of the failure – ie the size of the understatement in the context of the case itself, and absolutely. The dividend income was relatively small in value compared to the overall size of the business. On the other hand, the profit more than doubled as a result of the add-back

[1] Finance Act 2007, Schedule 24 (Commencement and Transitional Provision) Order SI2008/568

of the ebay income, and turnover went up by at least 24%. We decided that an appropriate discount was 30% out of a possible 40%.

183. As a result of the foregoing, the penalty remains at 40%, although its make-up is different: the abatements are 5%, 25% and 30%, making a total of 60%.

Overall conclusion

184. We dismiss Mrs Martin's appeal and confirm the penalty of £1,643, being 40% of the extra tax.

Appeal rights

185. 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.

ANNE REDSTON
TRIBUNAL JUDGE

RELEASE DATE: 10 November 2014

APPENDIX: LEGISLATION

TAXES MANAGEMENT ACT

12B Records to be kept for purposes of returns

(1) Any person who may be required by a notice under section 8…of this Act to make and deliver a return for a year of assessment or other period shall—

(a) keep all such records as may be requisite for the purpose of enabling him to make and deliver a correct and complete return for the year or period; and

(b) preserve those records until the end of the relevant day, that is to say, the day mentioned in subsection (2) below or, where a return is required by a notice given on or before that day, whichever of that day and the following is the latest, namely—

(i) where enquiries into the return are made by an officer of the Board, the day on which, by virtue of section 28A(1) or 28B(1) of this Act, those enquiries are completed; and

(ii) where no enquiries into the return are so made, the day on which such an officer no longer has power to make such enquiries.

(2) The day referred to in subsection (1) above is—

(a) in the case of a person carrying on a trade, profession or business alone or in partnership or a company, the fifth anniversary of the 31st January next following the year of assessment or (as the case may be) the sixth anniversary of the end of the period;

(b) in any other case, the first anniversary of the 31st January next following the year of assessment.

(2A) Any person who—

(a) is required, by such a notice as is mentioned in subsection (1) above given at any time after the end of the day mentioned in subsection (2) above, to make and deliver a return for a year of assessment or other period; and

(b) has in his possession at that time any records which may be requisite for the purpose of enabling him to make and deliver a correct and complete return for the year or period,

shall preserve those records until the end of the relevant day, that is to say, the day which, if the notice had been given on or before the day mentioned in subsection (2) above, would have been the relevant day for the purposes of subsection (1) above.

(3) In the case of a person carrying on a trade, profession or business alone or in partnership—

(a) the records required to be kept and preserved under subsection (1) or (2A) above shall include records of the following, namely—

(i) all amounts received and expended in the course of the trade, profession or business and the matters in respect of which the receipts and expenditure take place, and

(ii) in the case of a trade involving dealing in goods, all sales and purchases of goods made in the course of the trade;

(b) the duty under that subsection shall include a duty to preserve until the end of the relevant day all supporting documents relating to such items as are mentioned in paragraph (a)(i) or (ii) above

(4) Except in the case of records falling within subsection (4A) below, The duty under subsection (1) or (2A) above, the duty under subsection (1) or (2A) to preserve records may be discharged by the preservation of the information contained in them; and where information is so preserved a copy of any document forming part of the records shall be admissible in evidence in any proceedings before the Tribunal to the same extent as the records themselves

(4A) The records which fall within this subsection are:

(a) any statement in writing such as is mentioned in—

(i) subsection (1) of section 234 of the principal Act (amount of qualifying distribution and tax credit), or

(ii) section 495(1) or 975(2) or (4) of ITA 2007 (statements about deduction of income tax),

which is furnished by the company or person there mentioned, whether after the making of a request or otherwise;

(b)-(c) …

(5) Subject to subsections (5A) and (5B) below, any person who fails to comply with subsection (1) [or (2A) above in relation to a year of assessment or accounting period shall be liable to a penalty not exceeding £3,000.

(5A) Subsection (5) above does not apply where the records which the person fails to keep or preserve are records which might have been requisite only for the purposes of claims, elections or notices which are not included in the return.

(5B) Subsection (5) above also does not apply where—

(a) the records which the person fails to keep or preserve are records falling within paragraph (a) of subsection (4A) above; and

(b) an officer of the Board is satisfied that any facts which he reasonably requires to be proved, and which would have been proved by the records, are proved by other documentary evidence furnished to him.

(6) For the purposes of this section—

(a) a person engaged in the letting of property shall be treated as carrying on a trade; and

(b) "supporting documents" includes accounts, books, deeds, contracts, vouchers and receipts.

95 Incorrect return or accounts for income tax or capital gains tax

(1) Where a person fraudulently or negligently--

(a) delivers any incorrect return of a kind mentioned in section 8…of this Act, or

(b) makes any incorrect return, statement or declaration in connection with any claim for any allowance, deduction or relief in respect of income tax or capital gains tax, or

(c) …

he shall be liable to a penalty not exceeding the amount of the difference specified in subsection (2) below.

(2) The difference is that 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.

(3) ...

100 Determination of penalties by officer of Board

(1) …an officer of the Board authorised by the Board for the purposes of this section may make a determination imposing a penalty under any provision of the Taxes Acts and setting it at such amount as, in his opinion, is correct or appropriate.

(2) …

(3) Notice of a determination of a penalty under this section shall be served on the person liable to the penalty and shall state the date on which it is issued and the time within which an appeal against the determination may be made.

(4) After the notice of a determination under this section has been served the determination shall not be altered except in accordance with this section or on appeal.

100B Appeals against penalty determinations

(1) An appeal may be brought against the determination of a penalty under section 100 above and subject to…the following provisions of this section, the provisions of this Act relating to appeals shall have effect in relation to an appeal against such a determination as they have effect in relation to an appeal against an assessment to tax.

(2) …on an appeal against the determination of a penalty under section 100 above section 50(6) to (8) of this Act shall not apply but–

(a) in the case of a penalty which is required to be of a particular amount, the First-tier Tribunal may

(i) if it appears to it that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears to it to be correct, confirm the determination, or

(iii) if the amount determined appears to it to be incorrect, increase or reduce it to the correct amount,

(b) in the case of any other penalty, the First-tier Tribunal may–

(i) if it appears to them that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears to it to be appropriate, confirm the determination,

(iii) if the amount determined appears to it to be excessive, reduce it to such other amount (including nil) as they consider appropriate, or

(iv) if the amount determined appears to it to be insufficient, increase it to such amount not exceeding the permitted maximum as they consider appropriate.

118 Interpretation

(1) …

(2) For the purposes of this Act, a person shall be deemed not to have failed to do anything required to be done within a limited time if he did it within such further time, if any, as the Board or the tribunal or officer concerned may have allowed; and where a person had a reasonable excuse for not doing anything required to be done he shall be deemed not to have failed to do it unless the excuse ceased and, after the excuse ceased, he shall be deemed not to have failed to do it if he did it without unreasonable delay after the excuse had ceased.