[2015] UKFTT 0203 (TC)

# TC04395

**Appeal number: TC/2010/02313**

***INCOME TAX – discovery assessment – amount of appellant's profits from motor business – whether appellant carrying on a trade of operating a beach café – yes – amount of appellant's rental income – whether appellant negligent – yes – appeal dismissed***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**JOHN HERBERT** **Appellant**

**- and -**

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

**TRIBUNAL: JUDGE JONATHAN RICHARDS**
**TYM MARSH**

**Sitting in public at The Royal Courts of Justice on 27 March 2015**

**Christopher Lunn of The FTR Accountants Company Limited for the Appellant**

**Philip Shepherd, Officer of HM Revenue & Customs, for the Respondents**

DECISION

## Introduction

1. The appellant was made bankrupt in the tax year 1991/1992. Between 1992 and 2005, he submitted no income tax returns. However, on 31 January 2005, he submitted a tax return for the tax year 2003/2004. He subsequently submitted a number of other tax returns going back to the tax year 1996/1997 as well as a return for 2004/2005.

2. This appeal relates to the appellant's liability to income tax and Class 4 National Insurance Contributions ("Class 4 NIC"), together with associated penalties, arising out of three categories of income. Firstly, there is a dispute as to the amount of his tax liability in respect of his motor agency business. Secondly, there is a dispute as to whether he was the proprietor, or merely an employee, of a beach café business and the amount, if any, of his tax liability in respect of that business's profits. Finally, there is a dispute as to his tax liability associated with rents he received on certain properties.

3. From around 2004 or 2005, the appellant was advised by Christopher Lunn & Company ("CLAC"), a firm of accountants and tax advisers. In 2010, HMRC seized a number of CLAC's files. HMRC also refused to deal with CLAC as a tax agent and CLAC instigated procedures for judicial review of HMRC's actions in this regard. All of those factors have led to a delay in this appeal coming to a hearing and the unfortunate result is that the Tribunal now has to adjudicate on a dispute involving events taking place over 20 years ago.

## Points at issue

4. HMRC have issued the appellant with assessments to income tax, Class 4 NIC and related penalties in respect of each of the tax years from 1992/1993 to 2004/2005. The appellant disputes these liabilities for a variety of reasons:

(1) In the case of the beach café, he disputes liability altogether, stating that he was an employee of the business and not its proprietor. We refer to this category of dispute as a "dispute as to liability".

(2) With some of the assessments, and all of the penalties, he denies that requisite threshold conditions (such as a "discovery" of loss of tax, or his own negligence) are satisfied. Accordingly he denies that certain assessments are validly issued. We refer to this category of dispute as a "dispute as to validity".

(3) In some cases, he is disputing the amount of the assessments. We refer to this category of dispute as a "dispute as to amount".

5. Annex 1 contains a table summarising the various issues in dispute for the various tax years and the additional sources of profit that HMRC are seeking to tax.

**Evidence and procedural matters**

6. We heard evidence from the appellant in person and he was cross-examined.

7. HMRC produced no witness evidence. However, Mr Shepherd had produced a bundle of documents and referred us to a number of those documents in the course of his submissions. The appellant did not dispute the authenticity of these documents.

8. In the course of his submissions Mr Lunn made a number of references to a process whereby HMRC had seized, certain of CLAC's files. Mr Lunn also asserted that he had not received, in advance of the hearing, copies of the bundle of documents which HMRC had prepared for the hearing. Mr Shepherd was adamant that bundles had been sent to the appellant no later than 28 days before the hearing as required by the directions that the Tribunal had issued. Mr Lunn simply noted these issues as matters that had made it difficult for him to prepare for the hearing. He confirmed, in response to a question from the Tribunal, that he was not seeking an adjournment or postponement of the hearing on either of these grounds.

9. The Tribunal nevertheless noted that Rule 2 of the Tribunal Rules sets out the "overriding objective" of dealing with cases fairly and justly. A specific aspect of that overriding objective is stated to be:

> "ensuring, so far as practicable, that the parties are able to participate fully in the proceedings".

That is not an absolute requirement and needs to be balanced against other aspects of the overriding objective (for example the desirability of avoiding delay). Nevertheless, we considered whether the Tribunal should direct a postponement or adjournment of its own motion on the grounds that the difficulties articulated by Mr Lunn restricted the appellant's ability to participate fully in the proceedings.

We accepted that Mr Lunn had not received the bundles. However, neither he nor any of his colleagues appear to have contacted HMRC when they were not received by the due date. That suggested that they did not consider that a detailed examination of documents was a necessary part of the appellant's case.

10. We also accepted that the seizure of documents might have made it more difficult for the appellant's representatives to prepare for the hearing. However, we did not consider that this could be cured by an adjournment or postponement as there was no suggestion that there was a fixed date by which seized documents would be returned.

11. For both of those reasons, and noting that Mr Lunn was not himself requesting an adjournment or postponement we decided to give more weight to the importance of avoiding delay and decided to proceed with the hearing.

## Law

*The assessments*

12. HMRC rely on making assessments under s29 of the Taxes Management Act 1970 ("TMA 1970") in relation to the tax years from 1992/1993 to 1998/1999 and the appellant disputes that HMRC are entitled to do so. These assessments were made in February 2008. Assessments in relation to subsequent tax years are made in reliance on s9C TMA 1970 and s28A TMA 1970, but nothing turns on the precise terms of these statutory provisions since there is no dispute as to the validity of these assessments, although there is a dispute as to their amount.

13. At all material times, s16(1) of the Social Security Contributions and Benefits Act 1992 ("SSCBA") provided that all provisions of the Income Tax Acts, including in particular, provisions dealing with assessment, apply with the necessary modifications to Class 4 NIC. Therefore, we deal with the assessments in relation to Class 4 NIC in the same way as we deal with the assessments to income tax.

*The penalties*

14. HMRC seek penalties under s7 TMA 1970 in relation to tax years from, and including, 1992/1993 to, and including, tax year 1995/1996. For tax years starting with 1996/1997, HMRC seek penalties, instead, under s95 TMA 1970. The appellant disputes that HMRC are entitled to a penalty under either s7 or s95 TMA 1970.

*Ascertaining the statutory provisions in force for particular tax years*

15. The provisions of TMA 1970 have changed significantly over the years. In particular in Finance Act 1994, a number of changes to the tax assessment machinery were made to prepare for the "self-assessment" regime. In addition, Finance Act 2008 introduced the new concept of failures in tax compliance being brought about "carelessly or deliberately", whereas previously the relevant question was whether the conduct of the taxpayer (or a person acting on his behalf) was "fraudulent or negligent".

16. Therefore, some difficulties arise in identifying, in 2015, which version of the relevant statutory provisions applies in relation to different assessments dating back to the tax year 1992/1993. We heard no argument on this issue. Mr Shepherd's bundle of authorities simply included the legislation in its current form which did not assist matters. We have therefore had to ascertain the historic versions of the legislation without the benefit of submissions from either party. In order to set out our conclusions on this matter we have included, as Annex 2 to this decision, the relevant statutory provisions in the various forms in which we believe they apply in relation to different tax years in dispute.

*Burden of proof*

17. We consider that it is long-settled law that, where a "discovery assessment" is made under s29 TMA 1970, the burden is on HMRC to establish that the requisite

"discovery" has been made. Similarly, where HMRC's ability to raise an assessment depends on the satisfaction of a threshold condition (such as the taxpayer's "fraudulent or negligent conduct" and a loss of tax that is attributable to that conduct), the burden is on HMRC to establish that the relevant threshold requirement is satisfied. However, where a taxpayer is disputing the amount of an assessment, it is the taxpayer who has the burden of establishing what the correct amount of the assessment should be. The standard of proof is the ordinary civil standard. Although we were not referred to any authority on this issue, we believe that authority can be found in the cases of *Johnson v Scott (Inspector of Taxes)* [1978] STC 48 and *Hurley v Taylor (Inspector of Taxes)* [1999] STC 1.

18. The position with the penalties is different, however, from the position with the assessments themselves. The burden is on HMRC to prove that the default giving rise to the penalties occurred. Even though proceedings in relation to income tax penalties are "criminal" for the purposes of Article 6 of the European Convention on Human Rights, the standard of proof remains the ordinary civil standard (see *Khawaja v HMRC* [2008] STC 2880).

## The motor business

19. The assessments in relation to the motor business are the most significant in amount and, therefore, we deal with them first.

20. Profits of the motor business are included in assessments for tax years from, and including, 1997/1998 to, and including, 2004/2005. The appellant disputes the validity of the "discovery assessments" issued for 1997/1998 and 1998/1999 (but does not dispute the validity of the assessments for subsequent tax years). He disputes the amount of all of the assessments made in respect of the profits of the motor business.

### *Background*

21. On 31 January 2005, the appellant submitted a tax return for the tax year 2003/2004 that included entries relating to a motor business known as "S&B Cars" that he conducted. That tax return was submitted within the applicable time limits for that tax year. Box 3.24 of the return showed that the motor business had a turnover of £12,520 in that tax year and that the appellant had incurred allowable expenses of £15,129. The appellant deducted expenses from turnover and claimed a trading loss of £2,609 for the year.

22. Tax returns for the years 1997/1998 to 2002/2003 were submitted later. Unlike the return for 2003/2004, they were not submitted within the requisite time limits, although the appellant's position is that he had no tax liability in those periods since he made a loss in the trade.

23. HMRC enquired into the appellant's 2003/2004 tax return and earlier returns with reference to the profits of the motor business. In due course, HMRC completed their enquiries and made assessments based on adjustments to the figures contained in those returns.

*The nature of the motor business*

24. The appellant gave evidence as to the general nature of the S&B Cars business in the years 1997/1998 to 2004/2005. There was no dispute as to the matters set out at [25] and [26] below.

25. In summary, the appellant would hold initial discussions with a customer who was interested in buying a car. The customer would explain to the appellant what his requirements were (as to, for example, make, model, colour and specification) and how much he or she would be prepared to spend. The appellant would then attend a car auction and seek to bid successfully for a car matching his customer's requirements. If he was unable to do this, for example if no suitable car was being sold in the auction, or if the winning bid on a suitable car would be more than the customer was prepared to spend, his customer would not pay him anything. However, if the appellant was able to bid successfully for a suitable car, he would write a cheque to the auctioneer for the purchase price, deliver the car to the customer and ask the customer to pay the appellant an amount equal to the purchase price of the car plus a "finder's fee" of £100 and compensation for the appellant's expenses, primarily petrol costs, in travelling to the auction and back. Given that the appellant had already written a cheque for the purchase price to the auctioneer, it was of crucial importance that his customer paid him in short order as, although the appellant had an overdraft facility of £15,000, this was insufficient for him to finance the cost of acquisition of many of the cars that he bought, even for a short time. Therefore, the appellant would typically ask his customer to arrange for the cheque to the appellant to be "speed cleared" by the customer's bank.

26. The appellant also operated a car collection business. That business involved the appellant agreeing to collect cars that a customer had bought, but which was located in a different part of the country. The appellant would, accordingly, travel to the vendor's premises, collect the car and deliver it to his customer. His fee for that would be a flat £100 plus compensation for travel expenses incurred.

*Was there a partnership?*

27. At one point in his evidence, the appellant suggested that the S&B Cars business was operated in partnership. That would potentially be relevant to the assessments as, if the appellant was simply a 50% partner in the S&B Cars business, it would follow that he could be assessed on only 50% of its profits. The appellant provided no evidence to support the existence of a partnership in the form of a partnership agreement or even the name of the other partner. In tax returns for the disputed tax years, the appellant had completed the "Self Employment" pages, but had not completed the "Partnership" pages. We find, therefore, that in the relevant years, the appellant ran the S&B Cars business as a sole trader and was not in partnership with any other person.

*The "S&B Cars account"*

28. The appellant said in his evidence that all cash flows associated with his motor business went through the bank account in his name referred to as the "S&B Cars

account". However, he later said that there might have been occasions, in what he referred to as "the old days", when he received cash in connection with the motor business and he spent that cash without first paying it into the bank.

29. It was not suggested in cross-examination that the appellant failed to pay significant sums that he received in connection with his motor business into the S&B Cars bank account. We therefore accepted that most receipts of the business were paid into that account. However, given the statement referred to at [28] above, we do find that it is more likely than not that the occasional £100 fee received was not paid into that account.

*HMRC's approach to the assessments for tax years from 1999/2000 to 2003/2004*

30. The table set out below was included in a number of letters HMRC sent to the appellant during the course of its investigations, and set out the adjustments proposed in relation to tax years from 1999/2000 to 2003/2004. The "original" figures are those that the appellant included in his tax return. The "revised" figures are figures that HMRC took into account when making their assessments. The "additions" figures show the difference between the "revised" and the "original" figures. HMRC based their assessments to income tax and Class 4 NIC on the "revised" figures they had calculated.

Tax Year: 1999/2000

| | | | |
|---|---|---|---|
| Sales (Revised) | £428,824.93 | Net Profit (Revised) | £29,810.67 |
| Sales (Original) | £ 12,000.00 | Net Loss (Original) | £ 4,521.00 |
| Additions | £416,824.93 | Additions | £34,331.67 |

Tax Year: 2000/2001

| | | | |
|---|---|---|---|
| Sales (Revised) | £459,842.77 | Net Profit (Revised) | £31,094.32 |
| Sales (Original) | £ 12,000.00 | Net Loss (Original) | £ 6,240.00 |
| Additions | £447,842.77 | Additions | £37,334.32 |

Tax Year: 2001/2002

| | | | |
|---|---|---|---|
| Sales (Revised) | £338,147.13 | Net Profit (Revised) | £40,404.83 |
| Sales (Original) | £ 13,000.00 | Net Loss (Original) | £ 2,623.00 |
| Additions | £325,147.13 | Additions | £43,027.83 |

Tax Year: 2002/2003

| | | | |
|---|---|---|---|
| Sales (Revised) | £565,604.94 | Net Profit (Revised) | £40,126.21 |
| Sales (Original) | £ 12,500.00 | Net Loss (Original) | £ 3,635.00 |
| Additions | £553,104.94 | Additions | £43,761.21 |

Tax Year: 2003/2004

| | | | |
|---|---|---|---|
| Sales (Revised) | £583,486.12 | Net Profit (Revised) | £30,343.42 |
| Sales (Original) | £ 12,520.00 | Net Loss (Original) | £ 2,609.00 |
| Additions | £570,966.12 | Additions | £32,952.42 |

31. HMRC's position, which they explained to the appellant in a letter of 30 June 2006 was that, in view of what they regarded as the inadequacy of supporting information that the appellant had provided during the course of the HMRC enquiries, HMRC had derived "revised" figures for these tax years from the bank statements for S&B Cars which the appellant had supplied. Those bank statements covered a period from September 1998 to April 2004. HMRC had assumed that all receipts into the S&B Cars account in excess of £1,000 were business receipts (unless the description of the payment on the face of the bank statement made it clear that it could not relate to the business). They had similarly assumed that any payments out of the account of £900 or more were business expenses. Finally, HMRC maintained that they had adopted the appellant's own calculation of expenses, as set out in the tax returns that the appellant had submitted when calculating profits.

*HMRC's approach to the assessments for tax years 1997/1998, 1998/1999 and 2004/2005*

32. The approach summarised in the previous section depended on HMRC having sight of full bank statements. However, they did not have these for all tax years and they therefore adapted their approach for particular tax years.

33. For tax year 1998/1999, the appellant supplied bank statements covering only the period from 28 September 1998 to 31 March 1999. HMRC applied the method described at [31] to estimate profits for that period and then multiplied the resulting figure by a factor so as to produce estimated profits of the motor business for the entire tax year. HMRC then allowed a deduction for the expenses as shown in the appellant's actual tax return for the year. The amount of additional profit so calculated for this tax year was included in a "discovery assessment" under s29 TMA 1970.

34. For the tax year 1997/1998, HMRC had no bank statements at all. They therefore determined the profits of the motor business by taking the profits determined for 1998/1999 and reducing them by a factor related to the Retail Prices Index. They issued a "discovery assessment" based on these figures.

35. The appellant did not provide HMRC with bank statements covering the tax year 2004/2005. Therefore, for that tax year, HMRC estimated profit by averaging the profit of the previous two tax years.

*The nature of the appellant's challenge to the assessments*

36. In addition to disputing the validity of the discovery assessments for the years 1997/1998 and 1998/1999, the appellant disputes the amount of all of the assessments. In particular, he criticises the methodology that HMRC used in their calculation noting that its effect is to include sums received by way of reimbursement of the purchase price of a car as receipts of the business. This, Mr Lunn submitted, is "ludicrous" as the only receipts of the business are the £100 "finder's fees" and delivery fees that the appellant received. More generally, Mr Lunn criticised the assessments as being nothing more than estimates of the amount due.

37. There was no dispute that HMRC had in fact followed their stated methodology as set out at [31] to [35] above.

*The appellant's approach to calculating his tax liabilities and keeping books and records*

38. The appellant gave evidence, and was cross-examined, as to the way in which he calculated the figures included in his tax returns. We accepted the appellant's evidence that this had started with a meeting with Mr Lunn (who then worked for CLAC) at a hotel in Colchester to go through what the appellant described as "everything I had been doing and not doing" with a view to preparing an "estimate of the tax due". The appellant's evidence was that the main components of that calculation were the amount of commission that the appellant received per car and the number of cars with which he was involved. Given the nature of the business he operated, we accepted that these would be important elements in the calculation of profit.

39. The appellant was, however, not clear or consistent in his evidence on the subject of books and records of the business. At first he maintained that he had handed over books and records to his accountants in order to enable them to prepare his tax returns for the years in question, but had not kept copies of these himself. Mr Shepherd put to him HMRC's assertion that at no point had the appellant or his advisers provided any books or records to support the position taken in the tax returns and the appellant initially attributed this to HMRC's seizure of documents from CLAC.

40. Mr Shepherd also referred the appellant to an extract from a letter written by CLAC on 31 October 2005, which stated as follows:

> "As regards point i – iii [of a letter written by HMRC requiring documents and information], Mr Herbert did not keep business books for the year. He has also informed me that he has not kept the relevant bank statements."

41. Ultimately in cross examination, the appellant accepted that he may not have kept adequate books and records and may not have submitted such records as he had to HMRC. Nevertheless, Mr Lunn submitted that this was not a wholesale failure and

pointed out that the letter of 31 October 2005 referred to above stated only that the appellant did not keep business books "for the year", leaving open the possibility that he kept business books for other years.

42. Despite Mr Lunn's submissions to the contrary, we have concluded that the appellant did not keep proper books or records of the motor business for any of the tax years in question.

43. We reach this conclusion firstly because of the contemporaneous evidence in the form of the letter from CLAC of 31 October 2005. That letter needs to be read in conjunction with a letter from HMRC dated 2 August 2005 giving the appellant a notice under s9A TMA 1970 of their intention to enquire into his tax returns for 2001/2002, 2002/2003 and 2003/2004. While the letter of 2 August stated the "initial focus" would be on the return for 2001/2002, it was clear that all of the returns were being enquired into. It was this letter to which CLAC were replying in their letter of 31 October. As professional tax advisers, they would have realised the significance of an admission that their client did not keep business books. If they were maintaining that the appellant had only failed to keep books for a single year, we would expect them to have made that clear given that they were responding to enquiries covering a number of tax years.

44. The letter of 31 October 2005 was also not the only occasion on which CLAC indicated to HMRC that the appellant did not keep books and records. Mr Drury of HMRC wrote in a letter dated 30 June 2006:

> "No evidence has been provided as to how turnover was calculated and my understanding from our telephone conversations is that the figures are verbal information provided by Mr Herbert".
>
> and
>
> "No records of trading activity have been provided or apparently retained and the only tangible guide we have are bank statements".

45. Mr Drury did not produce a witness statement and was not cross-examined. We have therefore treated these statements with the caution appropriate to hearsay evidence. However, we have accepted that what Mr Drury wrote in this letter was true, not least since it is consistent with what the appellant's own advisers were saying. Moreover, if the appellant had maintained proper books and records (for any tax year), we would have expected him to supply them to his accountant and, when it became clear that HMRC were enquiring into the appellant's tax position, we would have expected them to be supplied to HMRC. It is clear to us that HMRC did not receive any such books or records since, if they had, there would have been no need for the process of seeking to determine profits of the motor business from bank statements.

46. Finally, we do not believe that the appellant provided books and records to his accountants but that, owing to HMRC's seizure of CLAC's documents, these could not be passed on. The seizure of documents took place in 2010 whereas the enquiry into the appellant's tax position was ongoing between 2006 and 2008.

47. We find that the appellant calculated the figures for inclusion in his tax returns by seeking to identify the number of cars with which he was involved and the fee he received per car. If the appellant had kept careful records of each fee he received, that process could have produced accurate figures. However, in the absence of such records, and given the appellant's own admission that there were occasions on which he received payments in cash and spent that cash before it was paid into a bank account, we find that the process amounted to nothing more than an educated guess as to his level of taxable income.

*Dispute as to amount of assessments - discussion*

48. For the reasons set out in this section, the appellant has failed to discharge the burden of proving that HMRC's assessments in relation to profits of the motor business were wrong. In fact, we have concluded that the appellant has understated his tax liability in relation to profits of the motor business in all of the tax years in dispute.

49. As a general matter, HMRC have followed an approach of calculating profit by reference to figures contained in bank statements. By contrast, as we have found, the appellant's approach was no more than an educated guess. The HMRC approach is therefore, we find, inherently more reliable than that adopted by the appellant and has resulted in a higher calculation of taxable profit.

50. We have nevertheless gone on to consider whether there are reasons why the HMRC approach has not produced the right result. Mr Lunn suggested that HMRC's approach was wrong as it included sums that the appellant received by way of reimbursement of the cost of cars within the calculation, whereas it should have taken into account only finders' fees and other commissions that the appellant received. We have also considered whether HMRC's approach has included items which, although paid into the S&B Cars account, were not actually receipts of the business or has failed to include expenses of the business that are not paid out of the S&B Cars account.

51. Subject to different considerations that would apply to low value cars, as discussed below, HMRC's approach did, as Mr Lunn says, involve the cost of a car entering the calculation as a receipt (contributing to "sales"). However, it also enters as an expense (taken into account in calculating "profit"). For example, if the appellant wrote a cheque to an auction house for £15,000 on purchasing a car and received £15,150 from his customer (comprising £15,000 for the car, his "finder's fee" of £100 and £50 of expenses), the £15,150 would, on HMRC's approach, be regarded as a "sale" and the £15,000 as an expense. The appellant suggested that this was "ludicrous" since the essence of his business was that he received a flat rate of £100 for each car that he acquired for a customer, or delivered to him, together with compensation for his expenses. In those circumstances, he considered the true figure for "sales" should be calculated by reference only to his "finder's fees" or commissions.

52. We do not accept Mr Lunn's criticism of HMRC's method. In the example above, HMRC's approach would produce net income of £150 (£15,150 less £15,000). Therefore, including the cost of the car within the calculation did not of itself result in profit being overstated since that cost entered both as a receipt and an expense.

53. There is a question on the treatment of expenses. Continuing with the above example, the appellant's true profit could fairly be described as £100 (not £150), since the £50 he received in relation to expenses was merely reimbursing a cost that he had incurred. Even if paid out of the S&B Cars account, HMRC's method would ignore the payment of £50 that the appellant made when incurring the expense (as it fell below the £900 threshold at which payments out of the S&B Cars account were included in the calculation). However, HMRC's method also involved adopting the appellant's own calculation of expenses by reference to the figures he included in his tax returns. Therefore, for cars costing in excess of £900, we do not accept Mr Lunn's primary criticism of HMRC's approach.

54. However, we find that HMRC's approach could produce unusual results for low value cars. For example, if the appellant incurred £51 of expenses in buying a car at auction for £899 and received £1,050 from his customer (being the cost of the car, a "finder's fee" of £100 and reimbursement of £51 of expenses incurred), HMRC's methodology would ignore the payment of £899 as being below the £900 threshold. However the full receipt of £1,051 would be taken into account (as it is more than £1000) resulting in the conclusion that the appellant's taxable income from this transaction in isolation was £1,051. While HMRC's method involved taking into account the appellant's own calculation of expenses, it would still overstate the appellant's true profit.

55. In addition, HMRC's method could produce favourable results for the appellant as well. For example, if the appellant received a payment of £100 for collecting a car for a customer and paid it into the S&B Cars account, it would clearly represent income of the motor business. However, it would be ignored on HMRC's methodology as it would fall below the £1,000 threshold. If the £100 was not paid into the S&B Cars account (as the appellant's suggested might occasionally be the case) it would similarly be ignored by HMRC's calculation.

56. HMRC's methodology was not perfect, therefore, and it could produce counter-intuitive results. However, for periods where HMRC had been provided with bank statements, those counter-intuitive results applied primarily to cars costing less than £900. We heard no evidence on the value of cars with which the appellant was concerned, but even in the late 1990s we think that £900 would be a low price to pay for a car. Moreover, some of the counter-intuitive results we have identified would operate to the advantage of the appellant.

57. There were some periods for which the appellant had provided HMRC with no bank statements at all. In those circumstances, we accept that HMRC have "estimated" profits. However, we find that the process they have adopted is reasonable and sensible. We do not believe that HMRC could have done better given

that the appellant had not provided proper information, proper figures or even bank statements for the period.

58. It is not enough for Mr Lunn to make general criticisms of the methodology that HMRC have applied. In order to establish that HMRC's assessments were excessive, he would need to demonstrate what the correct, lower, amount of the assessments should be. At no point in his submissions did he do so. He did not, for example, take us to particular entries derived from the S&B Cars account and demonstrate that they were not receipts of the motor business. He did not establish particular deductible expenses that had not been taken into account in HMRC's calculation, but which should have been.

59. Overall, therefore, we concluded that HMRC's method of estimating profit was more reliable than that advanced by the appellant and that HMRC's figures are to be preferred. Since HMRC are calculating a higher level of taxable profit than the appellant did, it follows that we have concluded that the appellant has not reported, or has under-reported, taxable income from his motor business in his tax returns from 1997/1998 to 2004/2005.

*Dispute as to validity of assessments for 1997/1998 and 1998/1999 - discussion*

60. The assessments for the tax years 1997/1998 and 1998/1999 were "discovery assessments" under s29 TMA 1970. In relation to those assessments, HMRC have the burden of establishing:

(1) that an officer of HMRC has "discovered" that income of the appellant that should have been assessed has not in fact been assessed;

(2) that situation is attributable to the appellant's fraudulent or negligent conduct; and

(3) that the assessments were issued within the applicable time limits.

61. *Charlton and another v Revenue and Customs Commissioners* [2012] UKUT 770 is authority for the proposition that the condition as to "discovery" is satisfied if:

> "… it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment."

62. In the hearing, Mr Shepherd made no submissions as to what constituted the "discovery" in question for these tax years. We have found at [59] above that the appellant had understated taxable income of the motor business for the tax years 1997/1998 and 1998/1999 (and indeed for all tax years up to 2004/2005). The bundle of documents that Mr Shepherd prepared contains a letter written by Mr Drury of HMRC dated 19 December 2007, explaining how he had calculated the assessments relating to the motor business. That letter was written precisely because HMRC had become aware that the appellant had taxable income that had not been assessed to tax. The authenticity of that letter was not in dispute and we find that it demonstrated that there had been the requisite "discovery" for the purposes of s29 TMA 1970.

63. As to the question of "negligence", Mr Shepherd relied on *Blyth v The Company of Proprietors of the Birmingham Waterworks* (1856) 11 Exch 781, in which Alderson B stated that:

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

64. Although Mr Shepherd did not rely on this decision, 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."

65. As we note at [47] above, the process by which the appellant calculated profits of his motor business in all tax years amounted to nothing more than an educated guess given the inadequacy of the books and records that he kept. We consider that to be a negligent course of conduct and that the shortfall in the amount of the appellant's income assessed to tax was attributable to that negligent conduct. Therefore, the condition set out in s29(4) TMA 1970 is satisfied.

66. In addition, our finding as to negligence means that the "extended time limit" in s36 TMA 1970 applied and that the assessments for 1997/1998 and 1998/1999 were issued within the applicable time limits.

67. In conclusion, we find that the appellant's challenge to the validity of these assessments fails.

**The café**

68. HMRC assessed the appellant under s29 TMA 1970 in relation to profits of a beach café business for tax years from, and including, 1992/1993 to, and including, 1997/1998. The appellant disputes that he is liable to tax on those profits at all as he asserts that the trade in question was carried on by his mother, and not by him. He also disputes both the validity and the amount of those assessments.

*Facts not in dispute*

69. The following facts were not in dispute:

(1) The appellant and his mother were involved in a beach café business. The café closed from 1995 to 1998 due to repairs to the sea wall and in 1996 or 1997 the local authority paid approximately £50,000 as compensation to the owner of the café as a result of the café having to close.

(2) The appellant was made bankrupt in the tax year 1991/1992 and was discharged from bankruptcy some time in 1996.

(3) None of the appellant's tax returns included any profit attributable to the café business.

(4) On 6 December 2006 CLAC stated in correspondence with HMRC that the appellant had "run a beach café until 1994".

*HMRC's position*

70. HMRC's position is that the appellant carried on the café trade but that at no point has the appellant told them exactly when he commenced it. In the absence of any information relating to the café, HMRC have concluded that the £50,000 receipt in 1996 or 1997 was compensation for the loss of three years' profits and was itself taxable income. They have spread that receipt over three tax years and have therefore assessed the appellant to tax on an additional £16,667 of income in each of the tax years from 1995/1996 to 1997/1998.

71. They have also concluded that the compensation receipt demonstrates that the café business made £16,667 of profit each year and that, since they consider that the appellant operated the café from the tax year 1992/1993, they are entitled to assess annual profits of £16,667 going back to that tax year.

72. HMRC accept that the appellant did not carry on the trade after the 1997/1998 tax year. Therefore, the result of HMRC's approach is to produce additional taxable income of £16,667 in the tax years from, and including, 1992/1993 to, and including, 1997/1998.

*The appellant's position*

73. The appellant disputes HMRC's approach on three grounds:

(1) He disputes liability, asserting that he was an employee of the business and not its proprietor. In support of this argument, he asserts that he could not have been the proprietor of the business prior to 1996 as he was then an undischarged bankrupt.

(2) He disputes the amount of the assessments. He submits that HMRC's approach does not take into account expenses that would be incurred in earning that income. Therefore, he argues that the £16,667 annual figure on which HMRC bases its estimates should be reduced by an allocation of expenses.

(3) He disputes the validity of the assessments and puts HMRC to proof that all of the conditions of s29 TMA 1970 were satisfied and that the assessments were issued in time.

*Determining ownership of the business– consideration of evidence*

74. We concluded that HMRC have the burden of proving that the appellant was indeed the proprietor of the business.

75. On 9 October 2006, HMRC sent a letter to the appellant. In that letter, HMRC reminded the appellant that they had the power to make assessments reaching back up to twenty years in cases of fraud or negligence. HMRC noted that it seemed clear from bank statements that the appellant had provided that the motor business had been carried on at least as far back as the 1998/1999 tax year. HMRC wanted, however, to ascertain whether the business had been carried on even earlier than that. HMRC therefore invoked formal powers requiring the appellant to give information on the actual date on which the motor business commenced, a request that had been made informally in an earlier letter of 31 August 2006. The letter included the following paragraphs:

> "The quickest way to make progress with 1998-99, and any earlier years of trading, is if you now provide the information for those years voluntarily. The information requested in the first instance is the date the trading started, the month and the year if you cannot give a specific date, and the bank statements for the account or accounts through which trading was conducted"
>
> and
>
> "I told Miss Sweeney [an employee of CLAC] when I spoke to her on 3 October that prior to your current business, the latest trace I can find of you is when you sold C J's [a hair salon] to your mother in August 1991 and mention this to you now so that you realise we are aware of the possibility that your motor trading goes back to 1991. Indeed, motor trading could run in tandem with management of another business and it is feasible that the disposal of the salon was to enable to you to concentrate on the alternative existing venture".

76. On 6 December 2006, CLAC wrote to HMRC. That letter began by referring to an HMRC letter of 13 November, but is clear from the context, and we find, that the letter was concerned primarily with answering some of the points contained in HMRC's letter of 9 October 2006 addressed to the appellant. CLAC's letter was headed "Re: Mr John Herbert" and included the following:

> "Our Client ran a café on the beach until 1994, this was then shut for 3 years from 1995 to 1998 because of the Council with regards to the sea wall defence work. The shop was then sold in 1997/8. You may see on our Client's Bank Statements around 1996/1997 Income of around £50,000 was received, which was paid by the Council with regards to the closure of the shop. Our Client cannot remember if this was paid in one lump sum or whether it was paid in instalments over a 2-year period".

77. HMRC rely on this letter as evidence that the appellant himself, and not his mother, carried on the beach café trade. However, the appellant maintained in his evidence and cross-examination that he was merely an employee and had not received the £50,000. He also asserted that his mother had been the subject of an HMRC enquiry into her own tax position that had revealed no problems and should therefore be accepted as evidence that profits of the beach café were correctly reported on her return. Mr Lunn submitted that CLAC's letter was consistent with the appellant's

status as an employee as the letter stated only that the appellant "ran" a café and did not state that he was the owner of that business.

78. We did not accept that a natural reading of the 6 December 2006 letter suggests that the appellant was only an employee of the café business. Viewed in isolation, the statement that he "ran" a business could be read as a statement that he "managed" it. However, the statement needs to be read in context. HMRC's letter of 9 October 2006 was, we find, clearly pressing for information on the appellant's trading income with a view to making assessments dating back to tax years prior to 1998/1999. HMRC's letter makes no reference to employment income and indeed, since employment income would be paid under deduction of tax through the PAYE system, it would be unlikely to justify the making of the additional assessments which HMRC were clearly considering. Therefore, we find that the normal meaning of the letter of 6 December 2006, particularly when we note that it was written by a firm of tax professionals, was that the appellant was himself carrying on the café trade and was not merely an employee of it.

79. We also find that the 6 December 2006 letter suggests, albeit indirectly, that the business commenced in 1991 or 1992. On its face the letter states only that the business was carried on "until 1994" without stating when it started. However, again the letter needs to be understood in its context. It was written by a firm of accountants in response to a letter that mentioned the possibility of assessments being made going back to 1991. The letter does not seek to explain that there was a hiatus between the closing of "CJ's" and the start of the café business, a point that would have been highly relevant given HMRC were threatening to make assessments going back to 1991.

80. HMRC responded to CLAC's letter of 6 December 2006 in a letter of 13 December 2006. Having been made aware of the café business HMRC asked whether it was conducted as a sole trade or a partnership. HMRC also stated that they looked forward to seeing how the compensation payment of £50,000 was treated in the appellant's tax returns.

81. On 26 April 2007, HMRC noted that they had no reply to their letter of 13 December 2006 and that the compensation receipt was not reflected on the appellant's tax returns at all.

82. On 19 December 2007, HMRC wrote to the appellant noting, among other matters, that they still had no further information on the café and explaining that they had made assessments on the appellant in respect of profits of the beach café business going back to the tax year 1991/1992. HMRC justified this by noting that:

> "The last record we have for you is ceasing trading at C J's in August 1991 and the Café is therefore assumed to have traded for the summer seasons of 1992,1993 and 1994".

The bundle of documents does not contain any challenge from the appellant or his advisers to the assumed start date of the business.

83. As late as 30 September 2009, Mr Drury of HMRC noted in a letter to CLAC that no further information on the beach café had been supplied since the letter of 6 December 2006 mentioning its existence. Since Mr Drury did not provide witness evidence and was not cross-examined, that is hearsay evidence which we have treated with caution. However, we have accepted that the statement he made is true as the appellant has not produced any correspondence giving information on the beach café. In addition, if the appellant had supplied "further information" as referred to in Mr Drury's letter, we do not consider that HMRC would have sought to determine the profits of the café business by deducing it from the compensation payment received.

84. Therefore, in the period from 13 December 2006 to 30 September 2009, the bundle of documents produced at the hearing contains no evidence of a communication from the appellant or his advisers suggesting that HMRC were under any misapprehension as to the ownership of the business. The appellant did not produce evidence that any such communication was made. Therefore, we concluded that there was strong evidence that neither the appellant nor CLAC considered that there was any misapprehension to correct because the appellant was indeed the proprietor of the café.

85. The appellant has not produced any witness statement from his mother confirming that she was the proprietor of the café; nor has he produced pay-slips confirming he received employment income from his mother. We considered his evidence that his mother had been through a tax enquiry and no adjustments had been made to her tax liability, but found that it was of little weight. Firstly, that evidence was hearsay evidence only and the strength of it was not tested by his mother being cross-examined. Secondly, we had no evidence before us as to whether the tax returns of his mother that were investigated contained any mention of the beach café or not.

86. We consider the evidence set out at [75] to [85] above pointed firmly to a conclusion that the appellant was proprietor of the café. We have, however, gone on to consider whether that strong evidence was outweighed by the undisputed fact that, between 1992 and 1996, the appellant was an undischarged bankrupt.

87. We heard no submissions from either party on whether the fact that the appellant was bankrupt made it impossible for him to be proprietor of the café between 1992 and 1996. Nor did we hear any evidence as to whether the beach café was dealt with as an asset of the appellant in his bankruptcy. If the appellant did own the beach café, we would certainly expect it to be sold as part of the bankruptcy process. However, while we heard no submissions on any aspect of bankruptcy law, we considered that this would not be inevitable. It occurred to us that if, for example, the appellant held the café under a lease that prohibited assignment, it might not be possible to sell the business at all. In that case, we considered that a trustee in bankruptcy might properly conclude that the appellant could continue to run the business as a means of providing funds to pay creditors and that there would be no legal impediment to the appellant doing this. We also noted that the case of *Armitage v Moore* 4 TC 199 (to which we were not referred at the hearing) suggests that there would be no legal impediment to assessing the appellant to income tax on profits of a business carried on while he was bankrupt.

88. In conclusion, beyond the agreed fact that the appellant was an undischarged bankrupt from some point in the tax year 1991/1992 to some point in 1996, we heard no evidence or submission on what effect this had on the café business. We therefore concluded that there was nothing to contradict the other evidence we had heard which pointed firmly to the conclusion that the appellant was the proprietor of the café.

*Conclusion on ownership of the cafe*

89. Overall, we concluded that the statement of CLAC in their letter of 6 December 2006 was correct and that HMRC had demonstrated that the appellant, and not his mother, owned the beach café. We also concluded that HMRC demonstrated that he had owned that business since the tax year 1992/1993.

*Dispute as to amount of assessment – consideration of evidence*

*(a) Taxability of the £50,000 compensation receipt in tax years 1995/1996 to 1997/1998*

90. Given the conclusion we reach at [89], we have concluded that the appellant received this sum, some time in 1996 or 1997, from the local council. For tax years from, and including, 1995/1996 to, and including, 1997/1998, HMRC are seeking to impose tax on that receipt.

91. We were not referred to any authorities on the income tax liability associated with compensation payments. We have ourselves referred to the judgment of the Court of Appeal in *Deeny (and others) v Gooda Walker Ltd* [1996] STC 39 and concluded that, insofar as the compensation receipt was intended to compensate the appellant for loss of profit of his business, it would be subject to income tax.

92. CLAC's letter of 6 December 2006 suggests that the £50,000 compensation was paid "with regards to the closure of the shop". That statement suggests that it was intended as compensation for lost profit. The appellant produced no evidence to suggest that the payment compensation for anything other than interruption to the beach café business. If we had seen evidence to the effect that the payment was made to compensate for damage to the fabric of the café building, for example, we might have accepted that it is not subject to income tax. However, in the absence of any such evidence, and noting that the burden is on the appellant to prove the amount of his liability to tax, we have accepted HMRC's assertion that the £50,000 represented compensation for lost profit of the business and was, accordingly, subject to income tax.

93. Mr Lunn submitted that, even while the café was closed, the proprietor of the business would have had to incur expenses and that these expenses should be taken into account in reducing profit. The appellant in his evidence referred to a burglar alarm at the premises and stated that it needed to be maintained even while the café was closed. However, we received no evidence on the precise amount of these additional expenses. We therefore concluded that the appellant has not discharged the

burden of proving that a lower amount should be substituted for the amount contained in the assessments.

*(b) Estimate of profits for 1992/3 to 1994/1995*

94. For tax years 1992/1993 to 1994/1995, HMRC are not seeking to tax the compensation payment itself. Rather, they have concluded, based on the amount of compensation payment received, that the taxable profits of the beach café were £16,667 per year and it is this profit figure that they seek to assess.

95. Mr Lunn criticised this approach as involving mere guesswork. While we were not referred to the decision during the hearing, we have concluded that *Momin & Others v HMRC* [2007] EWHC 1400 (Ch), is authority for the proposition that, where a taxpayer has over a number of years denied the true facts, he will not succeed in overturning assessments simply by demonstrating that they contain an element of guesswork and perhaps even inaccuracy. To discharge the burden of proof, the appellant would have needed to put forward evidence of what the profits of the beach café business actually were. He did not do so and therefore we had no evidence before us to justify a conclusion that a lower figure should be substituted for the amounts contained in the assessments HMRC have made.

*Dispute as to validity of assessments – tax years 1996/1997 and 1997/1998*

96. For these tax years, the law in force was the same as that considered in relation to the motor business at [60] above. HMRC therefore have the same burden of proof as is considered at [60].

*(a) "Discovery"*

97. We heard no submissions from either party on the question of "discovery". However, we have concluded that there is ample evidence that a "discovery" was made in the form of documents included in the hearing bundle as well as the facts we have found at [89] above.

98. We have found, at [89] above, that the appellant was proprietor of the café from the tax year 1992/1993 to the tax year 1997/1998. It was common ground that the appellant made no reference to the beach café in any of his tax returns. We conclude that, on 6 December 2006, when HMRC learned of the existence of the beach café, it newly appeared to Mr Drury of HMRC, acting reasonably and honestly that the appellant had not paid sufficient tax in relation to profits of the beach café. Therefore, we conclude HMRC have discharged its burden of proving the requisite "discovery" for the purposes of section 29 TMA 1970.

*(b) "Negligence"*

99. We had no detailed submissions from Mr Shepherd on what the precise nature of the appellant's negligence was, although he did submit that he had been negligent.

100. Having concluded that the appellant was the proprietor of the beach café business from the tax year 1992/1993, we conclude that his failure to include any profits from that business in any tax return was a negligent course of conduct. That conduct resulted in income of the appellant that should have been assessed to income tax not being so assessed. We therefore hold that the condition in s29(4) TMA 1970 is satisfied.

*(c) Time limit*

101. Given our conclusion at [100] above, it follows that, the extended time limit in s36 TMA 1970 applied and we conclude that HMRC were in time to issue the assessment for this tax year.

*Dispute as to validity of assessments – tax years 1992/1993 to 1995/1996*

102. For tax years 1992/1993 to 1995/1996, the provisions of section 29 TMA 1970 were different from those considered at [97] to [101] above. We heard no submissions as to the detailed statutory provisions for those tax years and have therefore considered that issue as best we can in the light of our conclusions as to the nature of those statutory provisions set out in Annex 2.

*(a) "Best judgement"*

103. For tax years 1992/1993 to 1995/1996, HMRC had, by virtue of s29(1)(b) TMA 1970 as it applied to those tax years, the power to make assessments to the "best of its judgment". It also had the power under s29(3) TMA 1970 to make "discovery assessments".

104. In the case of *MH Rahman (t/a Khayam Restaurant) v C & E Commissioners* [1998] STC 826, Carnwath J, as he then was, considered circumstances in which an assessment to VAT would fail the "best judgment" test. He concluded that this would be the case only where the assessment had been made "dishonestly, or capriciously or vindictively". We find that is not the case here and that HMRC have made a reasonable and genuine attempt, based on the limited information with which they have been provided, to assess the profits of the appellant's beach café business in the relevant tax years. Therefore, we find that the assessments made satisfy the "best judgment" test.

*(b) "Discovery"*

105. For reasons set out at [98], we consider that HMRC have made the requisite "discovery".

*(c) "Negligence" and time limits*

106. By contrast with the law in force for later tax years, there was no link between the question of whether a taxpayer had engaged in "negligent conduct" and HMRC's ability to issue a "discovery assessment".

107. However, the question of "negligence" was relevant to the time limits within which assessments could be made set out in s36 TMA 1970. For reasons set out at [100] above, we have concluded that the appellant's conduct was "negligent" with the result that the extended time limit in s36 TMA 1970 applied. Accordingly, we find that the assessments for tax years 1992/1993 were issued within applicable time limits.

*Overall conclusion on beach café*

108. Our conclusion, therefore, was that the assessments to both income tax and Class 4 NIC insofar as relating to profits of the beach café, should be upheld.

## Letting income

*Agreed facts*

109. There was no dispute on any of the facts set out at [110] to [114] below.

110. In his tax return for the tax year 2003/4, the appellant included rent receivable on two properties, one at "4 Kings Road" and the other at "22 Almond Close". These properties were owned jointly by the appellant and his wife. The relevant computation of taxable profit was as follows:

| | 4 Kings Road | 22 Almond Close |
|---|---|---|
| Rent received | £2,550 | £6,848 |
| Mortgage interest paid | (£2,218) | (£5,186) |
| Other expenses | (£499) | (£900) |
| Taxable profit (loss) | (£167) | £762 |

111. The appellant did not include taxable rental income on any other tax return for the tax years in dispute. Nevertheless, in a letter dated 31 October 2005, CLAC informed HMRC that letting of the 4 Kings Road property had begun on 19 March 2001.

112. By letter dated 2 December 2005, CLAC informed HMRC that the appellant had also owned another property, 1 Andover Close, that was purchased on 25 July 2002 and sold on 7 October 2003.

113. Some of the tenants to whom the appellant and his wife let properties were entitled to housing benefit from Tendring District Council. The council paid this housing benefit to the appellant and his wife in or towards discharge of the tenants' obligations to pay rent. In the course of enquiring into the appellant's tax position, HMRC contacted Tendring District Council and obtained the following information regarding payments made to the appellant and his wife.

| | 4 Kings Road | 1 Andover Close | 22 Almond Close |
|---|---|---|---|
| Tax year 2001/2002 | £4,098.05 | - | - |
| Tax year 2002/2003 | £4,728.04 | £2,373.25 | - |
| Tax year 2003/2004 | £5,230.85 | - | £6,294.23 |

*HMRC's position*

114. HMRC concluded that rental income should have been declared for tax years other than 2003/2004 and that the rental income declared for 2003/2004 had been understated. HMRC issued assessments accordingly and explained that the additional taxable income had been calculated as follows:

(1) For the tax years 2001/2002 and 2002/2003 HMRC took the housing benefit figures as supplied by Tendring District Council reduced those by half (to reflect the fact that the appellant and his wife owned the property jointly) and rounded down for expenses.

(2) For the tax year 2000/2001, HMRC assessed only a proportion of a full year's rent to reflect their understanding that the letting began on 19 March 2001, just 17 days before the end of a tax year.

(3) For the tax year 2003/2004, HMRC followed the approach in (1) above, but took into account the profit that the appellant had included in his own self-assessment for the year.

(4) For the tax year 2004/2005, HMRC had no figures available to them supplied by Tendring District Council and made an assessment in respect of what they described as a "general increase in letting income".

115. That resulted in HMRC taking the following additional rental income into account:

(1) £200 for tax year 2000/2001

(2) £2,000 for tax year 2001/2002

(3) £3,000 for tax year 2002/2003

(4) £4,000 for tax year 2003/2004

(5) £5,000 for tax year 2004/2005

*Appellant's position*

116. Mr Lunn criticised HMRC's approach in the following respects:

(1) He said that HMRC should have included a much more generous allowance for expenses (primarily mortgage interest) in all of the relevant tax years. He said the figures that were included in the 2003/2004 tax return demonstrated the level of mortgage interest that the appellant was paying and should have been followed.

(2) He said that HMRC was wrong to assess the appellant on the basis of a "general increase in letting income" in 2004/2005. Rather, he said that HMRC should have ascertained accurate figures by making enquiries of Tendring District Council and, after making due allowance for expenses such as mortgage interest, based the amount of the 2004/2005 assessment on those figures.

(3) For 2003/2004, he said that HMRC was wrong to assess the appellant on amounts in addition to those contained in the 2003/2004 tax return. A property can only be let to one household at a time and therefore he submitted that the 2003/2004 contained an accurate return of all of the appellant's rental profit for that year.

(4) More generally he pointed to the fact that all the additional assessments were for "round number" amounts as evidence that they were mere estimates and had not been produced in a rigorous fashion.

*Facts*

117. The appellant offered no evidence as to what he regarded as either the true level of rental income or expenses for the years in question. It follows that we have been able to find comparatively few facts in this regard.

118. It is clear from the agreed facts at [111], and we find, that the appellant had received rental income from the 4 Kings Road property that he had not declared.

119. We find that HMRC have indeed followed the approach outlined at [115] above in making their assessments in relation to the appellant's rental profits. We also find that, if one accepts that all of the rent that the appellant received was paid on tenants' behalf by Tendring District Council (an assumption whose validity we consider at [124] below), the level of allowance that HMRC have given for expenses in its calculation, is much lower than the deductions that the appellant claimed in his 2003/2004 tax return. For example, for 2001/2002, the Tendring District Council figures show a payment of £4,098.05. The appellant's half share of those payments would be just over £2,049. HMRC have treated the appellant as receiving an additional taxable income of £2,000 for that period. Therefore, if all of the rent received on the property was paid on tenants' behalf by Tendring District Council, HMRC have made an allowance of just £49 for expenses. By contrast, in his 2003/2004 tax return, the appellant claimed a deduction for expenses (including mortgage interest) of £2,717.

120. We heard no detailed evidence on how the appellant had derived the figures that were included in the tax return for 2003/2004. However, there were some oddities in those figures. For example, the appellant included rent received in respect of 22 Almond Close of £6,900 in that tax return. That presumably was half of the total rent

paid for the letting of that property for the tax year (given that the appellant owned the property jointly with his wife). However, the figures supplied by Tendring District Council suggested that total payments (and not just the appellant's half share of those payments) in respect of 22 Almond Close amounted to £6,294.23. The appellant's half share of rent payable in respect of 22 Almond Close as shown on his tax return was therefore more than the total paid by Tendring District Council. By contrast, for 4 King's Road, the appellant reported gross rents on his tax return of £2,550 which is slightly less than half of the amount of housing benefit that Tendring District Council paid in relation to that property. In short, the figures on the 2003/2004 tax return do not appear to match the housing benefit paid by Tendring District Council.

121. Another oddity relates to the deduction that is claimed for mortgage interest in the tax return for 2003/2004. A document prepared by Groom Davies & Company, the solicitors acting on the purchase of 4 Kings Road, indicates that the property was purchased for £45,000 of which £30,000 was borrowed and secured by mortgage. As noted above, the appellant has claimed a deduction of £2,218 in respect of his half share of mortgage interest paid in relation to 4 Kings Road. That would appear to suggest that the total annual interest payable was £4,436 which, by reference to an original loan of £30,000 would represent an annual interest rate of nearly 15 per cent.

*Discussion*

122. The dispute in relation to the rental income relates purely to the amount of the assessments.

123. We have not accepted Mr Lunn's submission that the figures as to expenses in the tax return for 2003/2004 should have been followed. It is clear from the discussion at [121] above that there are some questions as to whether the deduction for mortgage interest in the 2003/2004 return has been correctly calculated. We put the point no higher than that and are not finding that the interest expense was overstated. However, the existence of the uncertainty has caused us to conclude that the appellant has not satisfied us as to the amount of mortgage interest that was paid in any of the tax years in dispute.

124. Mr Lunn also criticised the 2003/2004 assessment for including sums received from Tendring District Council in addition to those set out in the appellant's own tax return. We have not accepted that criticism firstly because, given our findings at [120] above, we are not confident of the accuracy of the figures in the appellant's tax return. We have also concluded that it is more likely than not that the appellant received amounts of rent that are in addition to payments of housing benefit made by Tendring District Council. We have noted that a letter from the appellant to Trish Scarlett at HMRC dated 19 February 2010 which includes the following paragraph:

> "With regard to the rental income from the properties in this country, I do not agree with My [sic] Drury's figures as I receive housing benefit payments from the local authority (copies of which I will supply) and any top up rent payments to be made by the tenants are paid directly into the bank. Each tenant has a tenancy agreement which states the amount of rent due each month (copies of which I will supply)"

This letter expressly contemplates the existence of other "top up" payments from tenants. We note in passing that no tenancy agreements appear to have been supplied.

125. The finding that the appellant was more likely than not to have received "top up" payments directly from tenants is also indirectly relevant to the determination of expenses associated with the properties. If it were certain that all rent on all of the properties was paid by Tendring District Council, then the calculation at [119] would be giving relief for only £49 of expenses in 2001/2002 and that might seem harsh. However, it becomes much less harsh once it is appreciated that the appellant was more likely than not to have received "top up" payments that have not been taken into account in HMRC's assessment at all.

126. Finally, Mr Lunn criticised the assessments as "round number" estimates and submitted that this was particularly true of the assessment to a "general increase in letting income" for 2004/2005. He submitted that HMRC should have sought accurate information from Tendring District Council and based assessments on this information. We do not, accept these arguments. Firstly, we have concluded that the appellant was receiving "top up" payments direct from tenants in addition to receipts from Tendring District Council. In any event, we do not agree with Mr Lunn's assertion that HMRC were under a duty to obtain accurate information from Tendring District Council. On the contrary, the obligation to produce accurate information lay squarely with the appellant.

127. It is true that there is an element of estimate, and perhaps guesswork, involved in HMRC's assessments. However, on the authority of *Momin & Others v HMRC* [2007] EWHC 1400 (Ch), the appellant cannot succeed in his appeal simply by criticising the assessments for this reason. Rather, the appellant must discharge the burden of proving that the assessments should be of a lower amount. He has not done so. We therefore uphold the assessments insofar as they relate to the letting income in dispute.

**The penalties**

128. As will be seen from Annex 3, the provisions of s7 TMA 1970 changed over the course of the tax years that are in dispute.

*Penalties under s7 TMA 1970 – Tax years 1992/1993 to 1994/1995*

129. For the tax years 1992/1993 to 1994/1995, we find that the appellant did not submit any tax return. We also find that he did not receive a notice under s8 TMA 1970 requiring him to submit a return firstly as no copy of such a notice was presented to us and secondly because if HMRC had required the appellant to submit a return, Mr Drury would not have stated that that the last record HMRC had of the appellant was in 1991 in his letter of 19 December 2007 referred to at [82] above. As noted at [89] above, we have concluded that the appellant did have a liability to income tax for those tax years arising out of his café business. Finally, we find that the appellant did not give notice of that liability to HMRC within the period specified in s7(1) TMA 1970. On the contrary, it was only CLAC's letter of 6 December 2006

(sent several years after the period referred to in s7(1) TMA 1970 had expired) that alerted HMRC to the existence of the beach café.

130. Therefore, we consider that the conditions of s7(1) TMA 1970 were satisfied for tax years 1992/1993 to 1994/1995. No exception to s7(1) is applicable and, accordingly, a penalty is chargeable for these tax years under s7(6) TMA 1970.

131. Mr Lunn sought to excuse the appellant's failure to deliver tax returns, or to give notice of his liability to income tax by reference to a letter dated 8 March 2005 from HMRC to the appellant. That letter was written in response to the appellant's submission of a tax return for the 2003/2004 tax year. It included the following paragraph:

> "Normally, a person need only complete a Tax Return when required to do so by the Inland Revenue. However, I have no record of asking you to complete a Tax Return. In the circumstances, I shall assume that you wish the return you have sent me to be treated as if it were in response to such a request."

132. Mr Lunn suggested that this letter could be read as confirmation that HMRC did not require the appellant to submit a tax return for previous periods and that, accordingly, the appellant should not be criticised for failing to do so. We do not accept that submission. The paragraph is simply stating that a tax return for 2003/2004 had not been requested. It cannot be read as stating that a tax return for 2003/2004 (or indeed any other tax year) was not required.

*Penalties under s7 TMA 1970 – Tax year 1995/1996*

133. For the tax year 1995/1996, s7 TMA 1970 was in slightly different terms. For that tax year, s7 TMA 1970 does not require it to be demonstrated that no tax return has been submitted. As discussed at [89] above, we have concluded that the appellant did have an income liability for that tax year arising out of his café business. We also find, for the same reasons as outlined at [128] above that he had not received a notice under s8 TMA 1970 requiring him to submit a tax return. Finally, for the same reasons, we find that he had not notified HMRC of his chargeability to income tax by the expiry of the period specified in s7 TMA 1970. Since no exception set out in s7 was on point, we find that HMRC were entitled to issue penalty notices under s7(8) TMA 1970 for that tax year.

*The penalty notice under s7 TMA 1970*

134. We have concluded that for tax years from 1992/1993 to 1994/1995, penalties could be charged under s7(6) TMA 1970 as then in force. For the tax year 1995/1996, we have concluded that penalties can be charged under s7(8) TMA 1970 as it applied for that tax year.

135. However, we have ourselves noted that HMRC issued a single penalty notice (expressed to be under s7(8) TMA 1970) for all of the above tax years. This point

was not drawn to our attention during the hearing and we heard no argument on it. We have, nevertheless, considered whether it suggests that HMRC have applied the wrong basis for assessing penalties for the tax years 1992/1993 to 1994/1995, or at least given the burden of proof, whether HMRC have failed to demonstrate that the penalties for those years were correctly issued.

136. We have concluded that the penalties should stand as, even if penalties for tax years 1992/1993 to 1994/1995 were calculated on the basis set out in s7(8) TMA 1970 (which applied only to the tax year 1995/1996), there is no difference in overall result.

137. Firstly, as we have noted, we consider that the conditions necessary to issue a penalty are satisfied for all of the tax years from 1992/1993 to 1995/1996. We do not consider, for example, that the conditions necessary to issue a penalty under s7(8) TMA 1970 were satisfied, but those necessary to issue a penalty under s7(6) TMA 1970 were not.

138. Having reached that conclusion, we have considered whether the amount of penalty would be affected if HMRC applied a "s7(8) methodology" in order to calculate a penalty under s7(6) for the tax years 1992/1993 to 1994/1995. We do not consider that it would.

139. The "s7(8) methodology" states that the penalty is not to exceed the amount of tax (a) in which the taxpayer is assessed under s9 or s29 TMA 1970 in respect of that year and (b) which is not paid on or before the 31st of January next following that year. For the tax years 1992/1993 to 1994/1995, the appellant's additional tax liability related entirely to his beach café trade and was assessed under s29 TMA 1970. None of that tax liability was paid by the 31st January next following the applicable tax year. Therefore, applying a "s7(8) methodology" to these tax years leads to the result that the maximum penalty was the amount of additional tax due on profits of the beach café.

140. The "s7(6) methodology" (which should have been applied to the tax years 1992/1993 to 1994/1995) would have led to the result that the maximum penalty would be the amount of tax for which the appellant is liable in respect of income from the relevant undeclared "source", under assessments made more than 12 months from the end of the tax year in question. For these tax years, there was a single undeclared "source" (being the beach café trade) and all of the assessments seeking to assess tax on income from that source were made more than 12 months after the end of the relevant tax year.

141. Therefore, in the circumstances of this appeal, the application of a "s7(8) methodology" to the tax years 1992/1993 to 1994/1995 would not produce any different maximum penalty from that that would be produced under a "s7(6) methodology". In addition, will be seen, HMRC have applied the same approach to mitigation of all penalties under s7 TMA 1970 (whether arising in relation to the 1995/1996 tax year or earlier years). Therefore, although the reference to s7(8) TMA 1970 in the penalty notice is wrong (at least in so far as it relates to penalties for tax years 1992/1993 to 1994/1995), it has not affected the amount of penalty due. We

have not seen any provision that requires a valid penalty notice to state with absolute precision the exact statutory provision under which it is issued. We have therefore concluded that the incorrect reference has not rendered penalties for 1992/1993 to 1994/1995 invalid.

*Penalties under s95 TMA 1970*

142. For subsequent tax years, penalties are charged under s95 TMA 1970. For tax years from, and including, 1996/1997 onwards, the appellant had submitted tax returns. We have found that every single one of those tax returns understated the appellant's liability to tax. It follows that they were all "incorrect" for the purposes of s95 TMA 1970. Therefore, a penalty can be charged under s95 TMA 1970 if those returns were delivered "fraudulently or negligently".

143. We have found at [65] that the appellant's preparation of his tax return insofar as it related to his motor business was negligent owing to his failure to maintain any, or any proper, books or records. We have also concluded that the appellant negligently failed to report taxable income of the beach café trade in any of his tax returns.

144. Finally, as regards the letting income, as noted at [111] there is no dispute that the appellant failed to make any mention of rental income in any of his tax returns other than for 2003/2004 despite his own admission that letting of the 4 Kings Road property had begun in 2001. In addition, in upholding HMRC's determination of taxable rental income we have found that material receipts had not been included on those tax returns.

145. We have concluded that all of the above failures were negligent applying the tests set out at [63] to [64] above. These failures infected all of the tax returns that the appellant submitted for tax years from, and including 1996/1997 to, and including, 2004/2005. We find, therefore, that all of those returns were delivered negligently. It follows that penalties under s95 TMA 1970 are due for those tax years.

146. HMRC exercised their discretion to abate the penalties. On 30 September 2009 they set out their reasons for applying a 45% abatement in relation to the penalties under s7 TMA 1970 and a 40% abatement in relation to the penalties under s95 TMA 1970. The appellant put forward no argument to suggest that a higher level of abatement should have been applied and therefore we find that HMRC have applied the correct approach.

**Conclusion**

147. For reasons set out above, we uphold the assessments. We note that HMRC have made no accusations of fraud against the appellant and we make no such finding. However, we do consider that the appellant has shown a disregard of his obligations to make full, accurate and timely returns of his liability to income tax. We also find that he has been less than forthcoming in his dealings with HMRC and that he has ignored repeated invitations from HMRC to give a full account of his tax affairs. Had

he taken up those invitations, it may well be that he would not be in a position where HMRC have been compelled to issue figures based on, for example, figures shown in bank statements or hypotheses as to the nature of the £50,000 compensation payment. The appellant has only himself to blame if he feels that he has been overcharged by these assessments.

148. This contains full findings of facts and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**JONATHAN RICHARDS**

**TRIBUNAL JUDGE**
**RELEASE DATE: 7 April 2015**

## ANNEX 1 – SUMMARY OF MATTERS IN DISPUTE

| Tax Year | Sources of Profit | Assessment provision of TMA 1970 relied on by HMRC | Penalty provision relied on by HMRC | Amount of Assessment | Amount of Penalty | Validity of assessment disputed? |
|---|---|---|---|---|---|---|
| 1992/1993 | Café | s29 | s7 | £3,786.91 | £2,083.00 | Yes |
| 1993/1994 | Café | s29 | s7 | £3,749.60 | £2,062.00 | Yes |
| 1994/1995 | Café | s29 | s7 | £3,805.42 | £2,093.00 | Yes |
| 1995/1996 | Café | s29 | s7 | £3,765.97 | £2,071.00 | Yes |
| 1996/1997 | Café | s29 | s95 | £4,601.70 | £2,761.00 | Yes |
| 1997/1998 | Café, Motor Business | s29 | s95 | £14,725.79 | £8,835.00 | Yes |
| 1998/1999 | Motor Business | s29 | s95 | £8,269.00 | £4,961.00 | Yes |
| 1999/2000 | Motor Business | s9C/28A* | s95 | £6,575.45 | £3,945.00 | No |
| 2000/2001 | Motor Business, Rent | s9C/28A* | s95 | £7,378.03 | £4,427.00 | No |
| 2001/2002 | Motor Business, Rent | s9C/28A* | s95 | £11,405.95 | £6,843.00 | No |
| 2001/2002 | Motor Business, Rent | s9C/28A* | S95 | £11,598.00 | £6,959.00 | No |
| 2003/2004 | Motor Business, Rent | s9C/28A* | s95 | £8,363.20 | £5,018.00 | No |
| 2004/2005 | Motor Business, Rent | s9C/28A* | s95 | £10,494.34 | £6,296.00 | No |

*For these tax years, HMRC initially made assessments under s9C TMA 1970 and subsequently confirmed these assessments in "closure notices" issued under s28A TMA 1970. Since the validity of these assessments (as opposed to their amount), is not in dispute, these provisions are not considered in detail in this decision.

## ANNEX 2 – RELEVANT STATUTORY PROVISIONS RELATING TO ASSESSMENTS

### Relevant provisions of s29 , s34 and s36 TMA 1970 as applicable for tax years 1992/1993 to 1995/1996

*S29 TMA 1970*

**29 Assessing procedure**

(1) Except as otherwise provided, all assessments to tax shall be made by an inspector , and –

(a) if the inspector is satisfied that any return under the Taxes Acts affords correct and complete action concerning the profits in respect of which tax is chargeable, he shall make an assessment accordingly,

(b) if it appears to the inspector that there are any profits in respect of which tax is chargeable and which have not been included in a return under Part II of this Act, or if the inspector is dissatisfied with any return under Part II of this Act, he may make an assessment to tax to the best of his judgment….

(3) If an inspector or the Board discover –

(a) that any profits which ought to have been assessed to tax have not been assessed, or

(b) that any assessment to tax is or has become insufficient….

the inspector, or as the case may be, the Board, may make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged.

*S34 TMA 1970*

**34 Ordinary time limit of six years**

(1) Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case, an assessment to tax may be made at any time not later than six years after the end of the chargeable period to which the assessment relates.

*S36 TMA 1970*

**36 Fraudulent or negligent conduct**

(1) An assessment on any person (in this section referred to as "the person in default") for the purpose of making good to the Crown a loss of income tax… attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf

may be made at any time not later than 20 years after the 31st January next following the year of assessment to which it relates.—

## Relevant provisions of s29, s34 and s36 TMA 1970 as applicable for tax years 1996/1997 to 1998/1999

*S29 TMA 1970*

**29 Assessment where loss of tax discovered**

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment—

(a) that any income which ought to have been assessed to income tax …have not been assessed …

the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax …

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—

(a) in respect of the year of assessment mentioned in that subsection …

unless one of the two conditions mentioned below is fulfilled.

(4) The first condition is that the situation mentioned in subsection (1) above is attributable to fraudulent or negligent conduct on the part of the taxpayer or a person acting on his behalf….

*S34 TMA 1970*

**34 Ordinary time limit of six years**

(1) Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case, an assessment to tax may be made at any time not later than

(a) in the case of an assessment to income tax… five years after the 31st January next following the year of assessment to which it relates…

*S36 TMA 1970*

**36 Fraudulent or negligent conduct**

(1) An assessment on any person (in this section referred to as "the person in default") for the purpose of making good to the Crown a loss of income tax… attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf may be made at any time not later than 20 years after the 31st January next following the year of assessment to which it relates.—

## ANNEX 3 – RELEVANT STATUTORY PROVISIONS RELATING TO PENALTIES

### Relevant provisions of s7 TMA 1970 for tax years 1992/1993 to 1994/1995

**7 Notice of liability to income tax**

(1) Every person who is chargeable to income tax for any year of assessment and has neither –

(a) delivered a return of his profits or gains or his total income for that year, nor

(b) received a notice under section 8 of this Act requiring such a return

shall, subject to subsections (2) to (5) below, within twelve months from the end of that year, give notice to the inspector that he is so chargeable, specifying each separate source of income….

[Subsections (2) to (5) set out sources of income which are excluded for the purposes of subsection (1) which are not relevant to this appeal]

(6) If any person, for any year of assessment, fails to comply with subsection (1) above as respects any source of income, he shall be liable to a penalty not exceeding the amount of the tax for which he is liable, in respect of income from that source for that year, under assessments made more than twelve months after the end of the year.

### Relevant provisions of s7 TMA 1970 for tax year 1995/1996

**7 Notice of liability to income tax and capital gains tax**

(1) Every person who -

(a) is chargeable to income tax or capital gains tax for any year of assessment, and

(b) has not received a notice under section 8 of this Act requiring a return for that year of his total income and chargeable gains

shall, subject to subsection (3) below, within six months from the end of that year, give notice to an officer of the Board that he is so chargeable.

[Subsections (3) to (7) set out exceptions to the obligation in subsection (1) which are not relevant to this appeal]

(8) If any person, for any year of assessment, fails to comply with subsection (1), he shall be liable to a penalty not exceeding the amount of the tax -

(a) in which he is assessed under section 9 or 29 of this Act in respect of that year, and

(b) which is not paid on or before the 31st January next following that year.

for which he is liable, in respect of income from that source for that year, under assessments made more than twelve months after the end of the year.

## Relevant provisions of s95 TMA 1970 for tax years 1996/1997 to 2004/2005

**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 or 8A 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) submits to an inspector or the Board or any Commissioners any incorrect accounts in connection with the ascertainment of his liability to income tax or capital gains tax

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 amounts 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) The relevant years of assessment for the purposes of this section are, in relation to anything delivered, made or submitted in any year of assessment, that, the next following and any preceding year of assessment.