[2015] UKFTT 0603 (TC)

TC04747

Appeal number: TC/2014/05014

Income tax and national insurance– whether taxpayer had undeclared business income- application of s 29 and s 36 TMA 1970- penalties under s 7(8) and s 95 TMA and Schedule 24 FA 2007

FIRST-TIER TRIBUNAL
TAX CHAMBER

JOLANTA HARPER **Appellant**

- and -

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

TRIBUNAL: JUDGE SARAH FALK
JOHN COLES

Sitting in public at Fox Court, 30 Brooke Street London EC1N 7RS on 5 June and 3 November 2015

Ahmad Haddareh as representative for the Appellant

Dermot Ryder, Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against discovery assessments for each of the years 1997-98 to 2007-08, a closure notice for 2008-09 and penalties for each of those years. In summary, HMRC assert that the appellant had undeclared trading income for each year. The appellant claims that she only commenced business in October 2007 and that the tax returns she filed for 2007-08 and 2008-09 did not under declare her trading income and therefore her trading profit. The total amount of tax at stake is just under £72,000 (excluding interest) and the penalties in dispute total around £28,000. Full details of the amounts are set out in the Annex to this decision.

The assessments: relevant legal background

2. The legal background to the various assessments varies somewhat between different periods due to changes in law over the period in question, the fact that the appellant did not file tax returns before 2007-08 and the length of time elapsed before assessments were made. There are three categories, dealt with separately below. Common features are that all assessments (and the closure notice for 2008-09) and penalty determinations were issued on 28 May 2014 and were the subject of an HMRC review which concluded on 12 August 2014 and which upheld all the previous decisions. The appellant appealed to the tribunal on 8 September 2014. There was no dispute between the parties about the relevant legal principles to apply.

2008-09

3. The appellant's tax return for 2008-09 was subject to an enquiry pursuant to s 9A Taxes Management Act 1970 ("TMA") opened on 31 March 2010. HMRC issued a closure notice under s 28A TMA and assessed an inaccuracy penalty under Schedule 24 FA 2007 on the basis of deliberate behaviour.

4. Since the enquiry for 2008-09 was commenced within normal time limits HMRC does not need to rely on rules relating to discovery assessments or on any extended time limit in relation to this period.

2007-08

5. The appellant made a tax return for 2007-08 pursuant to s 8 TMA. However, HMRC did not open an enquiry in relation to this period pursuant to s 9A TMA. Instead, HMRC issued a discovery assessment under s 29 TMA (see below). Since this was issued more than six years after the end of the relevant tax year, HMRC must rely on s 36(1A) TMA in order for the assessment not to be out of time. Section 36(1A) can extend the time period for assessment to up to 20 years. Of the various sub paragraphs in s 36(1A) only paragraph (a) is relevant for 2007-08, and this

requires HMRC to demonstrate that the case involves a loss of income tax which is brought about deliberately.

6. HMRC also issued a penalty determination for 2007-08 under s 95(1)(a) TMA, on the basis that the appellant acted fraudulently or negligently in delivering an incorrect return. (The penalty regime changed between 2007-08 and 2008-09, which is why a different provision applied.) The effect of s 103(1) TMA is that, provided HMRC is in time to assess the tax in dispute, it will also be in time to determine a penalty.

1997-08 to 2006-07

7. The appellant neither notified chargeability to tax nor completed a tax return for any of these years. HMRC issued discovery assessments in respect of each year. Again, HMRC needs to rely on s 36(1A) TMA in order for the assessments not to be out of time, but in these cases s 36(1A)(b) is potentially relevant in addition: it provides for an extended period of up to 20 years in a case involving a loss of income tax attributable to a failure to comply with an obligation under s 7. Section 7 is the provision that requires a person who is chargeable to income tax for any year of assessment (and has not received a notice to file a return) to notify HMRC of that fact.

8. How s 36(1A)(b) applies in this case is also affected by some transitional rules. Section 36(1A) was inserted as part of amendments made to s 36 by Finance Act 2008 which were brought into force by a statutory instrument, SI 2009/403. The effect of article 7 of that SI is that s 36(1A)(b) does not apply to tax years 2008-09 or earlier except where the assessment is for the purposes of making good a loss of tax attributable to negligent conduct of the taxpayer or someone acting on their behalf. Accordingly, negligent conduct must be established under paragraph (b), or alternatively (and as with 2007-08) deliberate conduct under paragraph (a).

9. HMRC also issued a penalty determination in respect of each of the years 1997-98 to 2006-07 under s 7(8) TMA, for failure to comply with the duty to notify under s 7. Again, if HMRC is in time to assess tax for these years, it will also be in time to determine a penalty.

Discovery assessments: s 29 TMA

10. For all periods other than 2008-09, HMRC relies on the discovery assessment rules in s 29 TMA. In order for s 29 to apply in this case, HMRC or an officer of HMRC must “discover” that income which ought to have been assessed has not been assessed (s 29(1)). In addition, for the year 2007- 08 it must be shown either that the failure to assess was brought about by the appellant carelessly or deliberately, or that at the expiry of the self assessment enquiry period the officer in question could not reasonably be expected, on the basis of information made available before that time, to be aware of the under assessment. This is the effect of s 29(3) to (5), which apply where (as was the case for 2007-08) the taxpayer filed a return under s 8 TMA. For all relevant periods prior to 2007-08 s 29(3) to (5) do not apply since no return was filed under s 8 TMA.

National insurance

11. The assessments and penalty amounts charged all include amounts in respect of Class 4 national insurance contributions as well as income tax. HMRC's basis for treating them in an undifferentiated way is s 16 of the Social Security Contributions and Benefits Act 1992, which applies all the provisions of the Income Tax Acts, including assessment provisions, to Class 4 contributions as if they were income tax chargeable on trading profits. Section 16 does not expressly refer to penalties under s 7 TMA but does expressly refer to certain other penalties, in particular Part X TMA which includes s 95. However, the general wording is clear enough to cover penalties under s 7. In addition, in the case of penalties under Schedule 24 FA 2007 paragraph 5(3) of that Schedule expressly provides that tax includes national insurance contributions when calculating the amount by reference to which the penalty is charged. On this basis we have not considered the national insurance position separately, and references to tax below should be taken to include amounts charged in respect of Class 4 national insurance.

Burden of proof

12. HMRC claimed that the burden of proof was on the appellant to show that she was overcharged by the assessments pursuant to s 50(6) TMA, following the well established principle demonstrated by cases such as *Jonas v Bamford* 51 TC 1 and *Nicholson v Morris* 51 TC 95. Whilst this is correct as far as it goes, there are a number of issues in this case in respect of which the burden of proof lies on HMRC. HMRC accepted that these are as follows:

> (1) Whether the conditions required to allow discovery assessments to be made were met (see for example *HMRC v Household Agents* [2007] EWHC 1684 (Ch), approved in *Hankinson v HM Revenue and Customs* [2011] EWCA Civ 1566). This was relevant to all years apart from 2008-09.
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> (2) Whether the conditions for s 36 TMA to apply were satisfied. (This is perhaps less clearly established by case law, at least in the context of the amended s 36, but is clearly right in this case given the need to establish deliberate or negligent conduct. See also for example *Rochester (UK) Ltd & another v Pickin* [1998] STC (SCD) 138 for a decision to this effect by the Special Commissioners in relation to s 36 in its unamended form which referred to fraudulent or negligent conduct, and earlier cases on assessments outside normal time limits such as *Brady v Group Lotus Car Companies Plc* 60 TC 359 at 386H.) Again this was relevant to all years apart from 2008-09.
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> (3) Whether the necessary level of culpable conduct was established to justify the imposition of the penalties sought by HMRC.

Evidence: the two hearings

13. For the initial hearing HMRC produced a bundle of documents comprising much of HMRC's correspondence with the appellant together with copies of the

assessments, closure notice, penalty determinations and review conclusions. We also had the appellant's notice of appeal and a limited number of other documents put forward by the appellant. HMRC produced a statement of case.

14. One witness appeared for HMRC. This was Mr Darryl Gray, an officer of HMRC who was the "case owner" throughout the period of HMRC's enquiry and at that time was a higher officer on the investigations team for the London and Anglia region.

15. HMRC's case relied to a significant extent on an analysis of entries in 10 different bank accounts held by the appellant at various times over the period, which HMRC claimed demonstrated undeclared trading income. (One additional Polish bank account was also analysed but HMRC did not argue that business income was deposited directly into it.) Unfortunately HMRC did not produce any of the relevant bank statements, or their analysis of them, at the initial hearing. All that was available was a one page summary that had been used in correspondence, showing what HMRC claimed was the total of the undeclared business receipts in each account for each of the years in dispute. In addition, HMRC failed to produce a cash expenditure survey completed by the appellant on which HMRC had also relied in reaching its conclusions. In addition, the correspondence in the original bundle turned out to be incomplete.

16. Although certain additional information relating to the bank statements and HMRC's analysis of them was produced by HMRC in accordance with directions made shortly after the initial hearing, we concluded that its nature and in some cases legibility, together with the absence of other important information including the cash expenditure survey, meant that a further hearing should be ordered. We considered that this was necessary to ensure that all relevant issues could be properly and fairly addressed, with the appellant being given an appropriate opportunity to challenge HMRC's approach and make any additional submissions that she wished to make.

17. We accordingly made further directions for additional evidence to be produced for a second hearing. In summary, the additional evidence comprised copy bank statements and HMRC's analysis of them for the years 2003-04, 2004-05, 2007-08 and 2008-09, the cash expenditure survey and other missing documents including the appellant's 2008-09 tax return and correspondence from the Polish tax authorities. We also required additional submissions from HMRC regarding burden of proof and the various legal tests to be satisfied as outlined above. Finally, we encouraged the appellant to consider giving oral evidence in relation to any of the years in dispute, bearing in mind that if HMRC discharged the burden of proof on them as regards discovery and s 36 TMA, the burden would fall on the appellant to demonstrate that the assessments were excessive.

18. The choice of years to consider further was, in the case of 2003-04, 2007-08 and 2008-09, agreed by both parties at the initial hearing. We subsequently added 2004-05 because missing bank statements for 2003-04 made the choice of that year sub-optimal. The intention in each case was to ensure that the tribunal and appellant could properly understand the methodology HMRC had adopted in its analysis of the accounts.

19. For the initial hearing Mr Gray produced a witness statement. He gave evidence at both hearings, took us through the additional evidence at the second hearing, answered additional questions and was cross examined. We accept Mr Gray's evidence so far as it relates to matters of fact rather than inferences or legal conclusions.

20. The appellant did not formally put herself forward as a witness but was present throughout the proceedings. At the tribunal's invitation she made some comments during and after her representative's submissions at each hearing and answered some questions from the tribunal.

21. We cannot leave this subject without criticism of HMRC's failure to produce adequate evidence for the first hearing. The bank statements in particular were the most significant documentary evidence available and it should have been clear that the tribunal would not be in a position to decide the case without reviewing at least some of them and understanding HMRC's approach to analysing them in detail.

The parties' arguments

22. The key question in dispute is whether the appellant had undeclared business income for each of the years in question. The appellant claims that she started a business of providing cleaning services only in October 2007, after completing a course on running a business. HMRC formed the view that the appellant had been receiving trading income from at least 1997, and that she continued to under declare her business income after notifying HMRC that the business had commenced.

23. As already indicated, HMRC relied primarily on bank account entries in certain of the appellant's bank accounts as demonstrating receipts that in their view comprised business income. In addition they relied on analysis they had undertaken to demonstrate a shortfall between cash withdrawals from the accounts and cash expenditure, arguing that a significant part of the shortfall must represent additional cash earnings. They also relied on information from the Polish tax authorities, including a statement made by the appellant to those authorities to the effect that funding for a property purchase in Poland had been derived from working in the UK since 1987.

24. The appellant's arguments at the first hearing can be summarised as follows:

> (1) During the 1990s and up to 2007 the appellant allowed Polish ladies who came to the UK and had no bank accounts, to use her bank account to receive funds. The appellant then reimbursed them in cash on a pound for pound basis. The appellant was not responsible for tax payable by those other individuals.
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> (2) In 1997 the appellant's daughter was only six years old and, as a single mother with full childcare and household responsibilities, there would not have been time available to earn the income HMRC were claiming she had. Instead she had to wait until her daughter turned 16 in 2007 to start a business.

(3) It was just not possible for a cleaner to make the kind of money that HMRC were alleging: there were not enough hours in the day.

(4) It was impossible for any business to generate income at the level claimed based on the level of expenses allowed by HMRC, and the ratio of income to expense also varied significantly between years.

(5) The appellant had family cash available in in the form of a "family bond". The chief source of this was land sold for a proposed motorway by the appellant's late grandmother in around 2004, although funds generated by the appellant's parents' work were also mentioned. Cash from the family bond was regularly brought to the UK from Poland. The existence of these resources was demonstrated by the fact that they had been used to pay most of the tax and penalties in dispute.

(6) HMRC's claim that the appellant had several non-UK properties was wrong: she had only one property in Poland purchased in December 2006 and financed by a flat that she previously owned in Poland plus funding from her grandmother's estate.

(7) HMRC's claim that the appellant had had up to 11 bank accounts failed to take account of the fact that she opened new accounts at various times to get the benefit of better interest rates.

25. At the later hearing the appellant's position appeared to have shifted in some respects. Although still maintaining that the business only commenced in October 2007, the emphasis was more on an argument that the profit margin indicated by HMRC's figures for three years, 2006-07, 2007-08 and 2008-09, was unrealistically high and could not be correct, and an argument that before that date the appellant did not know how to run a business and was simply helping people out where they required cleaning services or were available to provide them. The appellant also maintained that girls were paid in cash in Poland as well as in the UK.

Findings of fact

Background

26. The appellant is of Polish origin but has been living in the UK since around 1987. Her parents still live in Poland and she has a brother who has also lived in the UK. The appellant has one daughter, born in 1991. The appellant told us that she originally trained as a teacher. She was employed in the UK until her daughter was born.

27. In 2007 the appellant attended a Government sponsored course on how to run a business, and later in the same year notified HMRC that she had started a business. She filed tax returns for 2007-08 and 2008-09 showing the profits set out in Part B of the Annex.

28. By a letter dated 2 October 2009 the Polish tax authorities contacted HMRC under exchange of information arrangements. They informed HMRC that the appellant had purchased a property in Poland in 2006 and that she had explained to them that she

had funded this in part from the sale of her flat and as to the balance from income from working in Great Britain since 1987. The information received by HMRC was passed to Mr Gray's team and Mr Gray wrote to the appellant on 31 March 2010. The letter explained that HMRC had received information about an offshore account and properties and were seeking information with a view to raising an assessment under s 29 TMA, and also opened an enquiry into the appellant's 2008-09 return.

29. Initially the enquiry into the appellant's business activities focused on 2008-09 but as it progressed Mr Gary widened its scope to earlier years, ultimately back to 1997-98 which was the earliest year for which HMRC was able to obtain bank statements.

The bank accounts

30. A number of the appellant's bank accounts show receipts for one or more of the tax years in question which we consider can only be explained as being in the nature of business income. Based on the four sample years we considered we do not think HMRC's approach to identifying these receipts, and excluding non-business items, was unreasonable. We also do not understand the appellant to challenge any of the specific items identified. Instead the appellant's argument was that the unreported income represented by the bank account entries was not hers but belonged to others.

31. Although a number of accounts were used at different times, it is worth comparing one particular account used throughout the period, referred to as the Barclays (4) account in HMRC's analysis, with another one opened in October 2007 and referred to as Lloyds (1). The opening date for Lloyds (1) corresponds to the date the appellant claimed her business commenced. It was also not disputed that only the deposit entries in Lloyds (1) were used to determine the turnover reflected in the appellant's tax returns for 2007-08 and 2008-09.

32. A comparison between the deposits shown in Barclays (4) and Lloyds (1) indicates entries of a similar nature. In each case there are regular or reasonably regular deposits and (where payers can be identified) a pattern of receipts from the same individuals or entities. The amounts involved vary but in our view are consistent with cleaning services being provided throughout the period. In a few instances there is also an overlap in names between the two accounts. A review of the information and analysis relied on by HMRC for other accounts also demonstrates receipts which are similarly consistent with business income, although the scale of entries in Barclays (4) is generally more significant and continued throughout the period in dispute.

33. At the initial hearing the appellant produced some extracts of bank statements for the Barclays (4) account for certain periods between March 2005 and June 2006. The appellant's representative referred to entries which he said demonstrated that some of the payments into the account were specifically labelled with the name of the individual who was entitled to the income and who the appellant would therefore reimburse. We do not accept this. On proper scrutiny of the entries referred to they actually relate not to receipts but to payments out of the account to the individuals in question, one of whom corresponds to the name of an individual who the appellant

accepts cleaned the premises of a regular payer, the Bridgeman Art Library. They are also not payments in cash. We also note that each of the entries includes both the name of the individual and the name "Jolanta". This is both the appellant's first name and the first name of the business, Jolanta Domestic Services. We think the most likely explanation is that these were business related payments for services supplied.

34. We should say a bit more about the Bridgeman Art Library. This organisation made payments into the Barclays (4) account throughout the period. Our review of the sample years indicated that it paid on a regular and consistent basis as to both time and amount. The appellant claimed that a particular individual provided cleaning services there and that, as in other cases, the appellant reimbursed that individual for the amounts paid into her bank account by the library. HMRC made various enquiries of the library. The initial response confirmed that the library did have a business relationship with Jolanta Domestic Services which commenced in October 2007. An undated copy of the terms and conditions of service was enclosed to demonstrate the relationship. After the accuracy of the initial response was queried the library confirmed that they had not used their records to answer the questions, because they were off site and hard to obtain.

35. We agree with HMRC that the information from the library about the date the business relationship commenced cannot be accepted. The Barclays (4) account entries directly contradict this and show numerous payments from this source before October 2007. In addition, it is clear from the library's response that it was a client of the business at least by the date of the correspondence in 2012 and for some time before that, and that the same named individual was at least one of the people who did the cleaning. It seems highly implausible that there would have been a sudden shift in October 2007 from the appellant reimbursing that individual in full for the amounts paid by the library, to a conventional business model under which the business generated income and paid staff working for it at a lower rate.

36. In certain instances the bank statements available to HMRC were incomplete. In some cases, including for the period before 1997-98, HMRC made no adjustment for this. In others it made some adjustment. In particular, the Barclays (4) account was incomplete by seven months for 1997-98 and HMRC included an amount for those months based on the level of what it considered to be business receipts for the remaining five months. Two other Barclays accounts were also incomplete for later periods. For one, referred to as Barclays (7), 2007-08 was incomplete and 2008-09 was missing entirely. HMRC uplifted the 2007-08 deposits by reference to the level of deposits in the available months, and applied an RPI adjustment to the resulting annual total to provide a figure for 2008-09. The other, Barclays (11), was opened in July 2004 with an opening balance of around £8,000 which could not be identified as a non-business source, and HMRC treated 4/12ths of that amount as 2004-05 income and the remainder as income of the previous year. The appellant did not raise any specific comment about HMRC's approach to the missing bank statements and we think it was reasonable in the circumstances.

The "cash deficit"- HMRC's methodology

37. We also accept HMRC's analysis of withdrawals made from the accounts. The cash withdrawals made were clearly insufficient to match the receipts which the appellant argued belonged to others, and which she said had been reimbursed to them in cash. The shortfall is marked and ranges from around £6,000 to £9,000 for each of the years up to 2003-04, over £20,000 for 2004-05 and 2005-06, and over £50,000 for 2006-07: all years before the period in which the appellant claimed her business commenced.

38. We considered the cash expenditure survey completed by the appellant during the enquiry. It showed personal cash expenditure of around £12,000 per year as at the time of preparation in 2011. HMRC used this figure, adjusted for RPI changes, as the basis for determining the appellant's personal cash requirements for the years in dispute. The appellant did not seek to dispute any of the entries in the survey or HMRC's approach of using it as a basis to estimate private cash expenditure for earlier years, and we accept both the survey and HMRC's approach.

39. HMRC used a similar approach to calculate cash expenditure for business purposes. Cash business expenditure for 2008-09 could be determined from the information obtained during the enquiry, and this was scaled back using RPI for each of the other years.

40. The appellant claimed that some of the cash shortfall was explained by contributions received both from her brother, who was living with her from 2004, and from her daughter's father. No specific details were provided but the appellant did not dispute HMRC's approach of making an allowance for contributions from the daughter's father for each of the years in question based on 50% of childcare costs, together with an allowance from 2004 onwards for contributions from the appellant's brother equivalent to 50% of household costs. We accept that this was reasonable.

41. HMRC calculated "cash deficit" amounts for each year, namely the amounts by which private and business cash expenditure exceeded cash withdrawn from the accounts and the contributions accepted as made from the appellant's brother and former partner. Cash expenditure was calculated as described above. Since HMRC had not accepted any other explanation for how the cash deficit had been met, they treated the amount of the cash deficit as representing undeclared business income received in cash.

Business expenses- profit calculation

42. HMRC's analysis made allowance for business expenses as follows. For 2008-09 the amount allowed was based on business records and wage slips provided by the appellant as part of the enquiry. Mr Gray said he suspected that these had not been prepared contemporaneously but instead had been constructed using the Lloyds (1) account subsequently. This was not challenged and we accept it. For 2007-08 and 2003-04 no business records were available and HMRC used numbers produced by the appellant's then agent during the enquiry. For other years HMRC estimated business expenses by applying the ratio of expenses to gross turnover derived from

the figures they had arrived at by that point for 2007-08 and 2003-04, applying the former ratio to the years 2004-05 to 2006-07 and the latter in relation to earlier years. (In the final numbers the ratios vary to a greater extent than this would suggest, but the chronology indicates that was due to subsequent adjustments being made for the allowances referred to at [40] above.) Mr Gray explained that he had accepted all amounts claimed in respect of staff expenses in full in the interests of trying to arrive at a settlement, despite having some doubts. The appellant produced no specific evidence either to challenge HMRC's approach or to claim any additional expenses (although the level of turnover and profit was challenged). She also confirmed that her business expenses comprised largely staff costs.

43. For each year, HMRC calculated gross business income by adding together the entries from the bank accounts that HMRC had concluded represented business income and the cash deficit amount for each year, and then deducting business expenses calculated as described above to arrive at a net profit figure. The net profit figure produced for each year is shown in the Annex, which also includes a comparison with the profits returned for 2007-08 and 2008-09.

Other cash resources?

44. The appellant's primary explanation for the apparent cash deficit was that funds were available in Poland and regularly brought to the UK in cash. She would bring around £2,000 in cash to the UK each time she returned from Poland. Her brother made similar trips as did other family members. At the second hearing the appellant also indicated that girls were sometimes paid in cash in Poland, for example if they were returning there for a holiday. The appellant said that she kept cash in a safe at her London home for her use and also to assist her mother's transport business, which required her to pay drivers.

45. At the hearing and during the later stages of the enquiry the appellant claimed that the main source of the cash in Poland was a "family bond" available to herself, her brother and mother. This had derived from her late grandmother's estate and in particular a sale of property located on the site of a planned motorway. It was family funds, together with the sale of a flat, that had also enabled her to purchase a property in Poland in 2006. She had given a different explanation to the Polish tax authorities because it was the "first thing that had come into her mind" to avoid being involved in "lengthy bureaucratic procedures" in Poland. The appellant also claimed that she had received financial help from her parents over the years. However, no documentary evidence was produced to demonstrate the existence of the bond, other than bank account entries showing the payment of £79,000 into a Metro Bank account in 2014, which was used towards payment of the amount claimed by HMRC. We accept that this statement shows that the payment was from a joint account in the names of the appellant, her brother and mother and whilst it is not clear on the face of the statement we accept that this was a transfer of funds from Poland.

46. The position in relation to contributions from the appellant's parents changed during the enquiry. At one stage the appellant's mother provided details to the Polish tax authorities of funds she had provided to her daughter, but this was later retracted.

The Polish tax authorities also provided information indicating that the appellant's mother's declared income in Poland did not support the level of contribution that had initially been indicated. The appellant's explanation for her mother's change of story was that she did not want to give her mother any further concerns by continuing to involve her in the case and so asked her to retract what she had said.

47. A review of entries in a Polish bank account held by the appellant does in fact demonstrate receipts that are broadly consistent with the details originally provided by the appellant's mother and later retracted. The original source of these receipts is unclear. However, neither side relied on these deposits either being made or not being made, and we are satisfied that HMRC's approach to analysing the entries in the UK bank accounts it relied on excluded any transfers of funds from Polish to UK bank accounts from the calculation of business income.

48. Whilst we accept that the appellant may well have resources available to her in Poland, we are not persuaded that these resources provided the cash the appellant needed either for her personal requirements or to reimburse the people whose income the appellant claims appears in her accounts. The amounts involved are very significant. For example, for 1997-98 the amount identified as banked undeclared business income is around £9,500 and the cash deficit is around £5,000. For 2006-07 the numbers are around £60,000 and £1,500. Even in the first of these years that would suggest at least seven trips to Poland to collect £2,000 a time. For 2006-07 it would need around 30 trips. For the later year at least this seems wholly unrealistic.

49. Moreover, we do not accept the appellant's explanation of why she did not do what to us would be the obvious thing, namely withdraw cash from her UK accounts both to meet her personal expenditure and to reimburse the individuals she claims to have reimbursed: the income went into these accounts so the obvious thing to do would be to withdraw it from the same accounts. Indeed the appellant's initial explanation to HMRC was that she had withdrawn funds from the accounts to pay the individuals concerned. The effort and risk involved in transferring significant sums of cash from Poland into the UK on a regular basis when funds were readily available in UK accounts requires some explanation. The appellant's answer to this was that she preferred to use money from the family bond so that she could demonstrate to her mother that she was being careful with money by not spending all her money in the UK. We do not accept this as an adequate explanation. The appellant's mother was said to be interested in the family bond and so seems to us to be more likely to be aware of expenditure from that source than from the appellant's own accounts, to which the mother would be unlikely to have access.

Other points raised

50. The appellant claimed that, before she went on a course in 2007, she did not know how to run a business- indeed she was still learning. She also claimed at the initial hearing that as a single mother she had no time, although at the second hearing she maintained that she was just "helping people out" rather than running a business. She was on income support and also relied on family help.

51. We do not accept the appellant's assertion that she did not run a business before October 2007. An absence of knowledge about how to run a business properly does not preclude a business being carried on. Furthermore, it is clear that this was not a case of the appellant doing all of the cleaning work herself, in which case her claim that there were not enough hours in the day to generate the alleged revenue would have had some substance. The appellant accepted that she had a number of girls on her books at any one time. She thought they totalled around 60 over the whole period (it was not clear what this period was), and accepted that there might be up to around 10 at any one time. She also indicated that a typical working day might comprise two three hour cleaning slots, so around 30 hours a week.

52. There was some dispute at the hearings about rates charged to clients and paid to staff. Mr Gray said, and we accept, that the pay rate used in the records produced during the enquiry into 2008-09 showed a staff rate of £6 per hour, whereas during the enquiry the appellant's charge rate to clients was shown as £13 per hour on her website. The appellant said at the hearing that £13 was an introductory rate and she thought the relevant rate was probably £12 for clients (which she said was also the current rate), although there was also a suggestion during the enquiry by the appellant's then agent that the rate was £10 up to some point in 2008-09. Whilst we do not think it necessary to decide the precise rate, we note that at the £6 per hour staff costs claimed for 2008-09 and a charge out rate of £12 the profit margin would be 50% in the absence of other costs, and would be higher if the appellant did any of the work herself.

53. The appellant also claimed that although there were a number of accounts she did not operate them all at one time, and new ones were opened to obtain the benefit of better interest rates. We accept that they were not all open at the same time and that the appellant may well have been motivated to open accounts to benefit from a higher interest rate, but that does not explain why a number of the accounts were used to receive deposits of what we have concluded was business income, and why all accounts other than the Lloyds (1) account were disregarded in preparing the appellant's tax returns. Furthermore, it is clear from the course the enquiry took that the existence of a number of these accounts was not readily volunteered, and it was only around April 2013 that full details of all the accounts had been disclosed.

54. We should also mention the tax treatment of staff. The appellant relied on the fact that HMRC had considered whether the appellant was liable for tax and national insurance in respect of staff and had concluded that she was not. On the basis of our review of the relevant correspondence (which relates to 2008-09 and later years) we do not consider that this is relevant to the appellant's case. HMRC had considered whether the appellant was liable for PAYE and national insurance under the "agency worker" rules in s 44 Income Tax (Earnings and Pensions) Act 2003 and their national insurance equivalent, but on review had concluded that this should not be pursued since the position was "borderline". This view was expressly reached on a without prejudice basis, but in any event it does not demonstrate that the income was not the appellant's. It is simply a decision about the agency worker rules. We also note that the papers produced in connection with this aspect and relied on by the appellant

suggest that the appellant had 13 individuals on her books for 2008-09, including the individual who cleaned the Bridgeman Art Library.

Deliberate/negligent behaviour?

55. We have concluded that HMRC has discharged the burden of proving that the appellant's behaviour in failing to report her income accurately for 2007-08 and 2008-09 was deliberate. For earlier years it is not necessary for HMRC to prove deliberate behaviour, and we agree that the appellant's behaviour for those periods was at least negligent. Our conclusions are inferred from the following:

(1) The evidence from the bank accounts is stark and the appellant's explanations as to the income being those of others whom she reimbursed do not make sense. They also changed over the course of the enquiry when it became clear that withdrawals from the accounts did not fit with the initial explanation that individuals had been reimbursed in cash from the accounts. The appellant had sole control of the accounts and must have been aware, and indeed in control, of the transactions going through the accounts.

(2) It is also clear that the appellant had dealings with a relatively large number of individuals who performed services. At the hearing she suggested around 60 in total, although the numbers provided varied during the enquiry, ranging from "two or three girls" on her books to around 50. 50 or 60 not only suggests a significant scale of operation but also makes it very difficult to accept the appellant's explanation that she was just letting people use her bank account because they did not have accounts of their own. It is credible that someone would allow that for close family members or perhaps one or two people well known to them, but not for a large number of people.

(3) Both the appellant and the Bridgeman Art Library accepted that the library was a business customer. The library made regular deposits into the Barclays (4) account which the appellant claimed not to be a business account and which had been ignored in preparing the appellant's tax returns.

(4) The appellant was slow to disclose various bank accounts over the course of the enquiry. Some of these had received significant deposits and it seems very unlikely that the appellant had genuinely overlooked all of them. For example, HMRC requested full details of all accounts relevant to 2008-09 in September 2010 and was provided only with details of Lloyds accounts. Disclosure of the Barclays (4) account, in which around £27,000 of what HMRC analysed to be business income had been deposited in that tax year, was disclosed only when specifically prompted by HMRC in March 2011. In May 2011 HMRC widened their request to cover earlier years but full disclosure was still not made, and at a meeting in November 2011 the appellant was claiming she had no recollection of holding a Halifax account: in fact there were two Halifax accounts over the

period, one of which received deposits which HMRC identified as business income totalling about £10,000 in 2007-08.

(5) Information given to the Polish tax authorities was consistent with the appellant having UK source business income, and later explanations and retractions of this information do not appear to us to be reliable.

(6) The appellant's cash expenditure was significantly in excess of drawings from the accounts. This is strongly indicative of other cash resources being readily available. The appellant must have been well aware of these funds and their source.

(7) The appellant has consistently refused to provide any details of the alleged cash bond. The Polish tax authorities also appear to be unaware of it. Whilst it may exist we do not accept the appellant's attribution of unexplained cash to it. The amount of cash that would need to be brought into the UK to meet the appellant's personal expenditure and the amounts she claims were reimbursed to others is simply unrealistic in circumstances where funds were readily available in UK accounts, or could if needed have been moved to the UK by bank transfer. The only evidence we have seen of funds being used in the UK that may have originated from the bond was to pay tax and penalties, and that was clearly done by bank transfer.

(8) A number of other inconsistencies also lead us to doubt the appellant's version of events. For example, the appellant's Polish property was at one stage said to be part funded by the appellant's mother, and only later by the family bond. At one stage in the enquiry the appellant signed meeting notes confirming a statement that the appellant's former partner never contributed to their daughter's upkeep, but that was subsequently changed.

(9) At the hearing the appellant confirmed that the only material business costs related to staff. If they were paid £6 per hour as reported for 2008-09, then even if the rate charged to clients was the £10 an hour suggested in the enquiry rather than the £12 discussed at the hearing the profit margin would be around 40% (ignoring any work the appellant did herself). This is significantly out of line with the reported figures for that year, which show turnover of £30,745 and staff costs of £25,444 (out of total expenses of £28,136), a profit margin of 17% based on staff costs or around 8% based on total costs. We do not accept that the appellant can have genuinely believed that the reported figures were accurate. For 2007-08 reported income was £17,706 and staff costs £11,022 out of total expenses of £12,004. This profit margin of 38% based on staff costs and 32% based on total costs is more plausible, but ignores a significant amount of business income, including around £40,000 of deposits into the Barclays (4) account in that year alone.

Discussion

Discovery

56. The first question to determine for all years apart from 2008-09 is whether an officer of HMRC made a “discovery” within s 29(1) TMA. This means that an officer “finds” or “satisfies himself” or that it “newly appears” that there has been a loss of tax, see for example *Hargreaves v HMRC* [2015] STC 905 at [21] and *Charlton v HMRC* [2013] STC 866 at [37]. In our view this test is clearly satisfied.

57. HMRC was originally alerted to the possibility of undeclared income when it received information from the Polish tax authorities in October 2009. The enquiry was opened on 31 March 2010 but proceeded slowly, clearly in large part due to a lack of prompt and complete co-operation from the appellant. Having reviewed the correspondence we do not consider that the assessments raised in May 2014 were unduly delayed beyond what was required to gather the information and attempt to reach an agreed resolution. As explained in *Charlton* at [37], the requirement for “newness” in a discovery relates to the conclusion that a discovery assessment should be issued, not to any underlying reason or information that led to it.

58. In addition, we are satisfied that for 2007-08 HMRC could not reasonably have been expected to be aware of the under assessment at the time the enquiry window closed. The 2007-08 return was filed during April 2008, so the self assessment enquiry period would have expired 12 months later in April 2009, before HMRC received information from the Polish tax authorities. The alternative of careless or deliberate behaviour (see [10] above) does not therefore need to be considered in the context of discovery, although as discussed above we are also satisfied that this test would be met.

Section 36 (1A) TMA

59. As discussed at [5], [7] and [8] above HMRC must establish that, for 2007-08, the case involves a loss of income tax which is brought about deliberately. For earlier years HMRC must establish either that the same test is satisfied or that (a) the case involves a loss of income tax attributable to a failure to comply with s 7 TMA and (b) the assessments are made for the purpose of making good a loss of tax attributable to negligent conduct of the taxpayer or someone acting on their behalf.

60. We are satisfied that these tests are met. The appellant was clearly chargeable to tax in respect of each year in dispute but only notified chargeability during 2007-08. When she did so the income returned related to only one of several bank accounts into which business income was deposited. We are satisfied that the appellant’s behaviour for 2007-08 was deliberate and that it was at least negligent for earlier years. The appellant was receiving significant sums from 1997 onwards and should have taken steps to ensure that these were correctly reported. We have not accepted that the appellant was reimbursing the individuals whose income she said it was in full, and the appellant must therefore have been aware that she was making a profit and that this would have tax implications. If she was not aware of the tax implications before 2007-08 then that was clearly at least negligent. As Judge Berner said in *Anderson v*

HMRC [2009] UKFTT 206 at [22] (and cited with approval by the Upper Tribunal in *Colin Moore v HMRC* [2011] UKUT 239 (TCC) at [13]), the test for negligence is to consider what a reasonable taxpayer would have done. The appellant was clearly negligent by that standard.

The amounts assessed and profit margin

61. At the second hearing in particular the appellant's representative focused his submissions on what he argued was a wholly unrealistic profit ratio produced by HMRC's profit calculations in respect of three years, 2006-07, 2007-08 and 2008-09. He argued that the best ratio that might reasonably be expected for a small business was in the region of 25% (calculated as profit/turnover x 100). On HMRC's numbers, the same calculation produced ratios of approximately 75% for 2006-07, 80% for 2007-08 and 63% for 2008-09. (The turnover numbers on which these are based were around £62,000, £83,500 and £77,000 respectively.) Although these three years were discussed, we will assume that they were intended as illustrations since earlier years also produce higher profit ratios than 25%, for example 2003-04 at around 70%, albeit that turnover was significantly lower for years before 2006-07.

62. As we explained to the appellant at both hearings and in the written directions given prior to the second hearing in which we invited additional evidence and submissions, the onus is on the appellant to demonstrate that she is overcharged by the assessments. Provided HMRC has discharged its burden of proof as regards discovery and s 36 TMA (as we have concluded is the case), the burden of proof shifts to the appellant and it is up to her to demonstrate either that turnover is too high or expenses are too low. This cannot be done by generalised assertions. Unfortunately the appellant has not produced any evidence that demonstrates to us, on a balance of probability, that there is turnover we should exclude or additional expenses we should include.

63. There are many case law examples which illustrate this. The starting point is that HMRC should have had some sensible basis for their approach and cannot pluck numbers from thin air: see for example *MacEachern v Carr* [1996] STC 282 at 286. Before self assessment this would have followed from the express requirement to assess to the best of the inspector's judgment. In the legislation relevant to this appeal a similar result follows from s 29(1) TMA which requires the inspector making the discovery assessments (relevant for years up to 2007-08) to assess the amount which in his opinion makes good the loss of tax discovered, and in respect of 2008-09 follows from the point that the closure notice must give effect to the conclusions the officer has reached. Beyond that it is up to the appellant to disprove the assessments. A number of the cases include comments to the effect that if no evidence is given then the appellant needs to accept the negative consequences of that, and indeed that the absence of evidence may itself be cogent evidence that an assessment should not be displaced- see for example *Rouf v HMRC* [2009] STC 1307 at [31] and 32], referring to *T Haythornthwaite & Sons Ltd v Kelly* 11 TC 657 at 672 and *Nicholson v Morris* 51 TC 95 at 110. The cases also make clear that the fact that HMRC's numbers may be estimates or guesses, and might be a poor approximation of the truth, does not mean that they should be discharged: see *Rouf* at [36], citing *Nicholson v Morris*.

64. Having reviewed HMRC's methodology in some detail we have concluded that HMRC did have a reasonable basis for their calculation of both turnover and expenses, and the appellant has not produced any evidence that has persuaded us that the appellant has been overcharged. HMRC's approach to determining both turnover and expenses is discussed above and in each case is reasonable: turnover numbers derive mainly from a detailed analysis of the bank accounts and the appellant's own cash expenditure numbers, and expenses are derived from numbers discussed with the appellant's former representative during the enquiry. No alternative numbers have been suggested, other than general submissions about profit ratios.

65. We do not agree that we can simply adopt the suggestion of a 25% profit ratio put forward by the appellant's representative. Profit ratios vary widely between different businesses, and indeed the suggestion made appears to have reflected the representative's personal experience in retail and restaurant businesses rather than a business of the kind in question here which has limited overheads apart from staff. It can also readily be seen that the appellant could achieve profit margins in excess of 50% if (for example) she charged £12 and hour, paid £6 per hour in staff costs and did some work herself (see [52] above).

66. We accept that even if the appellant worked herself for (say) 30 hours a week that would not fully explain the profit margins produced by HMRC's numbers. However, no evidence has been produced as to the number of hours she worked and the evidence as to what staff were paid and what hourly rates were charged throughout the period is also unclear.

67. In addition we are conscious that there is another potential explanation for the apparently high profit margins. This is that there could have been additional cash takings that are not reflected in HMRC's numbers, and which were used to pay staff in cash. Using simplified numbers, if HMRC's figures for a particular year showed £80,000 turnover and £20,000 expenses, and therefore £60,000 of profit and a 75% profit margin, that margin would reduce to 50% if there were additional unreported takings of £40,000 which were used to pay additional cash expenses: the numbers would then be £120,000 of turnover and £60,000 of expenses, with the same profit of £60,000. Given the appellant's insistence that a number of the individuals involved did not have (and she said could not obtain) bank accounts, combined with the fact that it is extremely common to pay for cleaning services in cash, this would not be surprising.

68. The appellant also indicated that she had had a total of 60 individuals on her books, and perhaps 10 at any one time. If 10 staff worked 30 hours a week for 46 weeks at £12 an hour that would produce an annual turnover of around £165,000, well in excess of the amount determined by HMRC for any of the years.

69. In our view both these points reinforce the conclusion we have reached that HMRC's conclusions are not unreasonable and that the appellant has not demonstrated that the profits assessed are excessive.

Penalties

70. As previously explained, three different penalty regimes applied. We have reviewed HMRC's approach to the application of each regime and do not propose to make any adjustment to the penalties imposed.

71. For the years 1997-98 to 2006-07 the maximum penalty under s 7(8) TMA for failure to notify chargeability is 100% of the tax assessed. HMRC applied a 10% reduction for disclosure, 35% for co-operation and 15% for seriousness, resulting in a 40% penalty. Bearing in mind the extent of the delays in the appellant providing information during the enquiry, the need for continued prompting and various changes of story we consider this to be very reasonable in the circumstances, with HMRC making full allowance for the fact that some level of co-operation was provided.

72. For 2007-08 HMRC must show that the appellant fraudulently or negligently delivered an incorrect return, s 95 TMA. The maximum penalty is the difference between the tax payable under the return and the amount that would have been payable if the return was correct.

73. HMRC approached the penalty under s 95 on the basis of negligence rather than fraud and applied a penalty of 30% by taking a similar approach to that taken for earlier years but adding additional 5% reductions for disclosure and co-operation. Again, we consider this to be very reasonable. Whilst it is arguably overly generous given our conclusion that the appellant acted deliberately, we have not reached a conclusion that it is insufficient (and were not invited to do so by HMRC) and therefore do not propose to increase it under s 100B TMA. The officer imposing the penalty, Mr Gray, was involved throughout the enquiry so was clearly well placed to form a view of the appellant's behaviour, and we do not consider that any new information has come to light since the penalty decision was made that would justify disturbing it.

74. The penalty for 2008-09 was charged under Schedule 24 FA 2007. The legislation is more prescriptive than its predecessors and sets different percentage amounts depending on the type of behaviour, with reductions allowed within specified limits for "disclosure", described as telling HMRC, giving them reasonable help and allowing them access to records. HMRC assessed a penalty on the basis that the appellant's action was "deliberate but not concealed" and that disclosure was prompted rather than unprompted. This resulted in a 70% penalty under paragraph 4 of Schedule 24 and power to reduce it to a minimum of 35% under paragraph 10(4). HMRC applied the approach in their published guidance to determine the extent of the reduction, allowing 10% for telling, 20% for helping and 30% for giving access, and applying the resulting 60% to the maximum reduction of 35% to reduce the penalty by 21% to 49%. Again, we consider HMRC's approach to be reasonable and the categorisation of the appellant's behaviour as deliberate, with disclosure being made only on a prompted basis, is correct. We also do not think there is any basis for a reduction under paragraph 11 by reference to any special circumstances.

75. We have considered whether the fact that the penalties are calculated by reference to what can only be estimated amounts of tax makes any difference, bearing in mind

that the burden of proof is on HMRC to demonstrate that the penalties are correctly charged (in contrast to the quantum of the assessments themselves, where the burden is on the appellant). We have concluded that it does not. In the case of s 7 TMA this is because the penalty is calculated by reference to the tax assessed under s 29 TMA. In the case of s 95 TMA the penalty is charged by reference to what would have been the "correct" amount of tax, which at first sight presents a difficulty. However s 101 TMA provides that an assessment that can no longer be varied by the FTT is sufficient evidence that the amounts in respect of which tax is charged are as stated in the assessment. As discussed in *King v Walden* [2001] STC 822 this is amounts to a rebuttable presumption for penalty purposes, which in this case the appellant has not rebutted. Although the draftsman of s 101 may have had in mind a situation where separate penalty proceedings are brought after an assessment becomes final, we do not think it can sensibly make any difference if a penalty appeal is heard alongside an appeal against the assessment: our decision on the assessment means that (absent an appeal) it is final.

76. There is no equivalent to s 101 TMA in Schedule 24 FA 2007. Penalties are charged by reference to "potential lost revenue", defined as "the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment". In our view this is a reference to the tax that actually becomes chargeable as a result of the process of HMRC's enquiry, closure notice and the effect of any appeal on the amount of that tax. It is not necessary for HMRC to show that the amount charged is "correct" in absolute terms.

Decision

77. In conclusion, we confirm each of the assessments and penalty determinations in the amounts set out in Part A of the Annex. The appeal is accordingly dismissed.

78. 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.

SARAH FALK

TRIBUNAL JUDGE
RELEASE DATE: 24 NOVEMBER 2015

Annex

Part A: Details of assessments

Year	**(Additional) profits £**	**(Additional) income tax £**	**(Additional) Class 4 NI £**	**Total (additional) tax and NI assessed £**	**Penalty £**
1997-98	11,602	1,615.11	275.52	1,890.63	756
1998-99	11,593	1,572.54	256.98	1,829.52	731
1999-00	11,211	1,386.48	220.86	1,607.34	642
2000-01	12,335	1,566.60	556.50	2,123.10	849
2001-02	13,640	1,777.50	637.35	2,414.85	965
2002-03	12,664	1,540.38	563.43	2,103.81	841
2003-04	9,972	943.34	428.56	1,371.90	548
2004-05	24,553	4,115.36	1,584.64	5,700.00	2,280
2005-06	23,000	3,732.30	1,448.40	5,180.70	2,072
2006-07	49,378	11,485.20	2,438.78	13,923.98	5,569
2007-08	61,198	18,126.70	2,651.64	20,778.34	6,233
2008-09	45,997	10,068.40	2,854.06	12,922.46	6,332
			Totals	**71,846.63**	**27,818**

Part B: Comparison to amounts previously returned

Year	**Profits returned £**	**Income tax £**	**Class 4 NI £**	**Total tax and NI previously paid £**	**Total revised profits (previously self assessed plus additionally assessed)**	**Total revised tax and NI (previously paid plus additionally assessed)**
2007-08	5,702	47.70	38.16	85.86	66,900	20,864.20
2008-09	2,609	0	0	0	48,606	12,922.46