[2017] UKFTT 158 (TC)

TC05651

Appeal number: TC/2015/03827

CAPITAL GAINS TAX – claim for relief, subsequently withdrawn – penalty under Schedule 24 Finance Act 2007 for inaccuracy in return – whether taxpayer careless – yes – taxpayer moving abroad – whether "no reasonable prospect" of the balance of the loss claimed being used – yes – potential lost revenue recalculated and penalty reduced

FIRST-TIER TRIBUNAL
TAX CHAMBER

SIMON FRY **Appellant**

- and -

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

TRIBUNAL: JUDGE JANE BAILEY
MS JANET WILKINS

Sitting in public at Fox Court, London on 6 June 2016

Ms Zizhen Yang, of counsel, instructed by Legal Consult, for the Appellant

Mrs Gill Carwardine, presenting officer, for the Respondents

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DECISION

Introduction

1. By notice of appeal dated 17 June 2015 the Appellant appealed to this Tribunal against the Respondents' review decision, dated 19 May 2015, to impose a penalty under Schedule 24 of the Finance Act 2007 ("Schedule 24") upon the Appellant, in the sum of £163,192.65, for a careless inaccuracy in his tax return submitted for the tax year 2009/2010.

Background

2. The Appellant's tax return for the tax year 2009/10 contained a claim for relief under Section 253 Taxation of Capital Gains Act 1992 ("TCGA 1992"). This claim, in the sum of £10,736,038, was based upon a "loan of £10,736,038 to KXDNA Ltd which became irrecoverable with effect from December 2009". £202,071 of the relief claimed by the Appellant in his tax return was set against chargeable gains accruing to the Appellant in 2009/10; the Appellant carried forward the loss balance of £10,533,967.

3. In February 2013 the Respondents wrote to the Appellant's agent stating that they proposed to disallow the Appellant's claim for relief under Section 253 TGCA 1992. After correspondence between the parties, in May 2013 the Appellant withdrew his Section 253 TGCA 1992 claim. In February 2014 the Respondents issued an assessment under Section 29 Taxes Management Act 1970 to recover the tax of £34,554.78 which came into charge as a result of the claim being disallowed. The Appellant did not appeal against this assessment.

4. Following further correspondence and a formal information request, the Respondents concluded that the Appellant had been careless in submitting an incorrect tax return for 2009/10. On 27 February 2015 the Respondents issued the Appellant with a penalty under Schedule 24. The Appellant was given 95% reduction for the quality of his disclosure and so the penalty was calculated at 15.75% of the potential lost revenue. The Respondents calculated the potential lost revenue as all of the tax which came into charge as a result of the inaccuracy being corrected, plus 10% of the unused balance of the £10,736,038 relief claimed in the Appellant's tax return. The Appellant sought a review of this penalty.

5. On 19 May 2015 the Respondents upheld the decision to impose a penalty but reduced the percentage to 15% of the potential lost revenue and corrected a mathematical error in the original calculation. This reduced the penalty to £163,192.65. On 17 June 2015 the Appellant appealed to this Tribunal.

Appellant's submissions

6. In his Notice of Appeal the Appellant accepted that there was an inaccuracy in his tax return but he contended that he had taken reasonable care in completing his

return and so no penalty was due. In the alternative, the Appellant contended that the penalty was excessive and also that it was eligible for suspension.

7. Before us the Appellant did not contend that the penalty, if due, was eligible for suspension but he expanded upon his argument that the penalty imposed was excessive: arguing that the potential lost revenue (and hence the penalty) had been miscalculated, and also that if the penalty had not been miscalculated then the penalty was disproportionate to the carelessness alleged and so should be reduced, either because it was disproportionate or as a special reduction.

Respondents' submissions

8. The Respondents submitted that the Appellant had been careless in submitting his return for 2009/10. The Respondents had undertaken considerable investigation but the figures were still not completely clear.

9. The Respondents submitted that the potential lost revenue had been correctly calculated, that special reduction had been considered and that suspension would have been inappropriate in this case.

Facts

10. We heard no witness evidence. On the basis of the documents in the bundle, we find the following:

a) KXDNA Limited was incorporated in October 1999. From its incorporation until December 2003 the Appellant was the sole director of KXDNA Limited. The Appellant was also the sole shareholder, holding 100 ordinary shares of £1 each. The accounts of KXDNA Limited for the year ended December 2003 show that in 2003 the Appellant loaned £9,968,753 to KXDNA Limited. These funds were required to finance the administrative and management costs in opening a related company, KX Gym UK Limited.

b) By 2004 KXDNA Limited required further funds to continue trading and the Appellant sought outside investment. As part of the agreement securing that outside investment, an additional director of KXDNA Limited was appointed and, on 23 December 2004, the Appellant was issued with 9,068,853 deferred shares of £0.000000001 each in KXDNA Limited. These shares were issued in conversion of the Appellant's 2003 loan to the company of £9,968,753.

c) In the year ended December 2009, the directors of KXDNA Limited agreed to waive an inter-company loan of £7,700,606 owed to it by KX Gym Limited. The Appellant was a director of KX Gym Limited at that time.

d) In January 2011 the Appellant's then tax advisor, Mr Offord, wrote to the Appellant, in connection with the Appellant's tax return for 2009/10. Mr

Offord requested further information from the Appellant in order to make a claim for a loss arising to the Appellant as a result of KXDNA Limited waiving its loan to KX Gym Limited. Mr Offord stated that the debt written off was £10,736,038 and that it "came from funds you had loaned to the company way back".

e) On 11 February 2011 the Appellant submitted his tax return for 2009/10. This return contained a claim for relief under Section 253 TCGA 1992 in the sum of £10,736,038. This claim for relief was said to arise upon the Appellant's loan to KXDNA Limited having become irrecoverable in December 2009.

f) In February 2013 the Respondents extended an already open enquiry into another tax return of the Appellant's into the Appellant's tax return for 2009/10. There was correspondence between the parties concerning various aspects of the Appellant's tax return including the Section 253 TCGA 1992 claim for relief. The Respondents informed the Appellant's agent that they intended to refuse the Appellant's Section 253 TCGA 1992 claim on the basis that the company accounts of KXDNA Limited showed that a loan of £9,968,753 from the Appellant to the company had been converted into shares in 2004. In May 2013 the Appellant withdrew his claim to relief under Section 253 TCGA 1992.

g) In May 2013 the Appellant's agent informed the Respondents that the Appellant was resident in the United States of America but working in Switzerland. The agent stated that the Appellant was unlikely to return to the UK.

h) From May 2013 the Respondents and the Appellant's agent corresponded regarding the imposition of a penalty upon the Appellant for submitting an inaccurate return. In October 2013 the Appellant submitted a P85 form to notify HMRC that he had left the UK in March 2013 and was no longer resident in the UK. The Appellant gave an address in Switzerland as his permanent address. In January 2014 the Appellant's agent informed the Respondents that the Appellant had been resident in Switzerland since March 2013 but would become resident in the United States from the end of March 2014.

i) In February 2014 the Respondents raised an assessment to tax in the sum of £34,554.78 on the Appellant, to recover the tax which came into charge as a result of the Appellant withdrawing his claim for relief under Section 253 TCGA 1992. The Appellant did not appeal against this assessment; he paid the tax and interest due.

j) Correspondence between the parties continued with regard to the imposition of a penalty for an inaccuracy in the Appellant's tax return. In September 2014 the Appellant's agent confirmed that the Appellant still resided in Switzerland. In December 2014 the Respondents issued the

Appellant with a formal notice under Schedule 36 of the Finance Act 2008 to provide documents and information. The Appellant did not provide the material requested.

k) In February 2015 the Respondents assessed the Appellant to a penalty under Schedule 24 in the sum of £168,806.24 on the basis of a careless inaccuracy in his tax return for 2009/10. The Appellant sought a review of this penalty. On 19 May 2015 the Respondents upheld the imposition of a penalty in the reduced sum of £163,192.65. The Appellant appealed.

Decision

11. In an appeal against the imposition of a penalty the onus of proof is first upon the Respondents to establish that a penalty may, on the face of it, be imposed. The onus then shifts to the Appellant to satisfy us that he is entitled to any defence which may be available.

12. For a Schedule 24 penalty the Respondents must demonstrate that there is an inaccuracy in a document submitted by the Appellant, that the inaccuracy has led to a false statement of a loss, and that the inaccuracy was careless. The parties are agreed that there is an inaccuracy in the Appellant's tax return for the tax year 2009/10 in that a loss of £10,736,038 was incorrectly claimed in that year. The first issue for us to determine is whether that inaccuracy was due to carelessness on the part of the Appellant. As we set out above, with regard to this aspect of the appeal the onus of proof is upon the Respondents. The standard of proof is the balance of probabilities.

Carelessness

13. The incorrect claim made in the Appellant's 2009/10 tax return relates to events which happened a few years before the claim was submitted but in respect of companies of which the Appellant was a director. The trigger for the Appellant making his claim for relief under Section 253 TCGA 1992 appears to have been the suggestion from Mr Offord, the Appellant's previous agent, that KXDNA Limited's decision in 2009 to waive an intercompany loan to KX Gym Limited would give rise to a capital loss of the Appellant. It is clear from his letter of 13 January 2011 that Mr Offord required further information from the Appellant to check this claim. We do not know what response the Appellant gave to Mr Offord but there are handwritten notes on the copy of the letter we have in our bundle indicating that the Appellant provided Mr Offord with some of the information requested.

14. In correspondence the Appellant's agent made the point that the notes on Mr Offord's letter suggested that the Appellant had given honest answers to the questions asked by Mr Offord. However, it ought to have been clear, to both Mr Offord and to the Appellant, that more checking was required in order to be confident that a loan waived by KXDNA Limited did result in the Appellant suffering a capital loss. The securing of outside investment in 2004 was a significant event for the Appellant, requiring him to convert his loan to KXDNA Limited, of more than £9.9 million, into shares in KXDNA Limited with a nominal value of less than £1. We do not expect

the Appellant to recall the finer details, some six years later, but we would expect the Appellant to remember that a restructuring of this magnitude took place. This is particularly so given the Appellant's submission – see below – that the business was in financial difficulty at that time and the conversion was necessary to secure outside funding. A check of the KXDNA Limited accounts would have confirmed that the Appellant's loan was converted to shares in 2004. We consider that a prudent taxpayer would have undertaken these checks to establish the loan history before submitting his tax return. We consider that the Appellant was careless to submit a tax return which claimed a substantial amount of relief to which he, or his agent, had not checked he was entitled.

15. Ms Yang sought to persuade us that there was a genuine loan which became irrecoverable in 2004 and so the Appellant was entitled to make a claim for relief; the only error was simply that the Appellant's claim for relief had been made outside the four year period permitted for making claims. We do not agree that this analysis is correct. Quite apart from it being clear that the Appellant's loan of £9,968,753 to KXDNA Limited was converted into shares in KXDNA Limited, the amount of relief claimed by the Appellant was £10,736,038. There is no explanation for why this claim was £767,285 in excess of the loan converted. Ms Yang submitted that, in 2004, the Appellant was obliged either to give up the business altogether or to give up his loan in exchange for what were effectively worthless shares. We take the view that for the purposes of making a claim for relief under Section 253 TCGA 1992 there is a clear difference between a loan conversion and a loan becoming irrecoverable but, even if the Appellant took the view that his receipt of shares in 2004 was analogous to a loan becoming irrecoverable and that this entitled him to make a claim for relief, we would have expected the Appellant to have checked that he was claiming the correct amount of relief and that he was still in time to make such a claim before he submitted his tax return. We consider a taxpayer's failure to check, either that he was still in time to make a claim for relief under Section 253 or that he was claiming the correct sum by way of relief, would amount to carelessness.

16. We are satisfied that the inaccuracy in the Appellant's tax return for 2009/10 arose as a result of the Appellant's carelessness. We agree with the Respondents that the conditions are met for a penalty to be imposed under Schedule 24.

The size of the penalty imposed

17. In his notice of Appeal the Appellant argued that there was no carelessness but that if it was correct to impose a penalty then the penalty imposed was excessive and should also be suspended. Before us the Appellant did not make any submissions in respect of suspension but raised three arguments in relation to the size of the penalty imposed by the Respondents. The Appellant's first point was that the amount of the penalty was disproportionate to the Appellant's carelessness, the Appellant's second point was that special reduction should be given, and the third point was that the penalty had been miscalculated as the Appellant was entitled to the reduction set out in paragraph 7(5) of Schedule 24. We consider this third point first.

The potential lost revenue

18. In order to determine the amount of a penalty imposed under Schedule 24, it is necessary to calculate the potential lost revenue (or PLR). This is usually calculated in accordance with Paragraph 5 of Schedule 24 but where the inaccuracy has led to the taxpayer claiming a loss then the PLR is calculated in accordance with Paragraph 7. We set out the relevant parts of each of these paragraphs below.

Potential lost revenue: normal rule

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

(2) The reference in sub-paragraph (1) to the additional amount due or payable includes a reference to-

(a) an amount payable to HMRC having been erroneously paid by way of repayment of tax, and

(b) an amount which would have been repayable by HMRC had the inaccuracy or assessment not been corrected.

Potential lost revenue: losses

7 (1) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has been wholly used to reduce the amount due or payable in respect of tax, the potential lost revenue is calculated in accordance with paragraph 5.

(2) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has not been wholly used to reduce the amount due or payable in respect of tax, the potential lost revenue is-

(a) the potential lost revenue calculated in accordance with paragraph 5 in respect of any part of the loss that has been used to reduce the amount due or payable in respect of tax, plus

(b) 10% of any part that has not.

(3) Sub-paragraphs (1) and (2) apply both-

(a) to a case where no loss would have been recorded but for the inaccuracy, and

(b) to a case where a loss of a different amount would have been recorded (but in that case sub-paragraphs (1) and (2) apply only to the difference between the amount recorded and the true amount).

…

> (5) The potential lost revenue in respect of a loss is nil where, because of the nature of the loss or P's circumstances, there is no reasonable prospect of the loss being used to support a claim to reduce a tax liability (of any person).

19. In this case the loss claimed was a capital loss, and capital losses may be carried forward to any future tax years in order to reduce liability to capital gains tax. The Respondents took the view that, although the Appellant left the UK in March 2013, there was insufficient evidence that the Appellant would not return to the UK at a future date and (had the inaccuracy not been discovered) the Appellant would be in a position to carry forward the loss to reduce any future capital gains occurring after such a future return to the UK. Therefore the Respondents calculated the PLR as 100% of the additional tax which came into charge (under paragraph 5) and 10% of the unused loss claimed (under paragraph 7(2)). The Appellant's submission is that paragraph 7(5) applies so that the PLR to be taken into account is only the additional tax brought into charge of £34,554.78.

20. In considering this point, both parties were agreed that we should consider the position as at the date of the imposition of the penalty. The penalty was imposed on 27 February 2015 and upheld (with a slight variation) in the review decision of 19 May 2015. Therefore we consider the position at 19 May 2015.

21. We did not hear evidence from the Appellant but we have evidence of his intentions from the correspondence between the parties until 19 May 2015. In November 2013 the Appellant's agent submitted a completed form P85 informing the Respondents that the Appellant had ceased to be resident in the UK. On his P85 the Appellant provided an address in Switzerland as his new address. The Appellant stated that he had left the UK on 15 March 2013. The covering letter states that the Appellant had taken up full time employment in Switzerland. On 30 January 2014 the Appellant's agent emailed the Respondents stating that the Appellant's wife, an American citizen, and their son had moved to the USA, the Appellant's son (at that time aged 14) had been enrolled in a school in California, the Appellant and his wife had sold their home in the UK, and they were negotiating the purchase of a property in California.

22. As at 19 May 2015, when the Respondents came to review the penalty, the Appellant had been resident in Switzerland for a little over two years. He was still residing at the address provided on the P85. It appears that the Appellant was endeavouring to secure employment in the USA so as to be able to join his family. By May 2015 the Appellant's wife and son had been resident in the USA for more than a year, and the Appellant's son was in school in the USA. Although the point was not made explicitly in the agent's email of 30 January 2014, we consider it implicit that the Appellant's wife and son would not move from the USA while the son remained in school. While it would have been possible for the Appellant to return to the UK without his family, we consider that there was no reason for him to do so and this was clearly not his intention.

23. We also bear in mind that the test is whether there is "no reasonable prospect of the loss being used". While he remained non-resident (either in Switzerland or in the USA), the Appellant was very much less likely to become liable to capital gains tax in the UK. In any situation where, due to his non residence, the Appellant was not liable to capital gains tax on any gain made then the Appellant would have no need of a carried forward capital loss. So, even if the Appellant were to consider a return to the UK after his son had completed his education, it is likely that the Appellant could manage his affairs in such a way that no gains which he made would give rise to a liability to capital gains tax. Therefore the Appellant would have no need of the loss which he had erroneously claimed.

24. The Appellant addressed us on what amounted to "no reasonable prospect", referring us to *Trustees of the Weld Tennis Club v McCarthy & Stone (Developments) Ltd* [2000] L & TR 249. We agree with the Appellant that "no reasonable prospect" does not amount to no prospect at all.

25. In the circumstances of the Appellant's case, we conclude that as at 19 May 2015 there was no reasonable prospect of the remainder of the loss being used. The Appellant was not resident in the UK, he was unlikely to return to the UK in the foreseeable future and, even if a return to the UK were contemplated at some point in the more distant future, it was unlikely that the Appellant would wait until that point to realise capital gains.

26. Therefore we consider that there was no reasonable prospect of the remainder of the loss being used to reduce the Appellant's liability to capital gains tax. As a result the unused part of the loss which had been claimed should be reduced to nil in accordance with Paragraph 7(5).

27. It follows that the PLR, correctly calculated, is solely the additional tax of £34,554.78 which came into charge as a result of the Appellant withdrawing his claim for relief. Applying the same penalty percentage as the Respondents of 15%, we calculate the penalty to be £5,183.21.

Disproportionality and special reduction

28. As we noted above, the Appellant's second submission on the size of the penalty was that a penalty of £163,192.65 was disproportionate to the carelessness which had occurred. In making this submission Ms Yang accepted that a penalty of about £5,000 would not be disproportionate to the carelessness alleged. Therefore, given our decision in relation to paragraph 7(5) and the revised calculation of the PLR, we do not intend to consider the proportionality arguments raised.

29. The Appellant also submitted that we should set aside the Respondents' decision not to grant a special reduction (under paragraph 11 of Schedule 24) and ourselves grant a special reduction. Ms Yang submitted that, if we decided to grant a special reduction, this should reduce the penalty to the size it would be if the PLR was calculated without reference to the unutilised losses. Therefore we do not intend to consider this point given our decision in respect of the PLR – even if we had

concluded that we were able to set aside the Respondents decision not to grant a special reduction, we do not consider that there are any special circumstances which would make it right to further reduce the penalty below £5,183.21.

Summary of conclusions

5 30. We agree with the Respondents that the inaccuracy in the Appellant's tax return for 2009/10 was occasioned by the Appellant's carelessness and that a penalty may be imposed under Schedule24. In calculating the penalty we consider that there is no reasonable likelihood of the unused portion of the claimed loss being used, and so we calculate the penalty upon the used portion of the loss only. Therefore the potential 10 lost revenue is £34,554.78, and the penalty, at 15% of the PLR, is confirmed at £5,183.21.

31. 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 15 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.

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JANE BAILEY

TRIBUNAL JUDGE
RELEASE DATE: 9 FEBRUARY 2017

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