[2018] UKFTT 97 (TC)

TC06355

Appeal number: TC/2016/04512

INCOME TAX – COP9 investigation – whether deficits identified in calculations of appellant's known and estimated expenditure and known income taxable as "miscellaneous income" under s 687 ITTOIA – UK tax system as schedular, not global system – doctrine of 'source' – appeals against discovery assessments and penalties allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MOHAMMED ASHRAF **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD THOMAS
DEREK ROBERTSON

Sitting in public at Alexandra House, Manchester on 7 December 2017 with further written submissions received on 5, 18 and 26 January 2018

Mr Con Kelley for the Appellant

Mr Brian Horton of HMRC Solicitor's Office and Legal Services for the Respondents

DECISION

1. This decision is about appeals by Mr Mohammed Ashraf ("the appellant") against

(1) assessments made under s 29 Taxes Management Act 1970 ("TMA") on him for the tax years 2005-06 to 2013-14 inclusive

(2) determinations of penalties under s 95 TMA for the tax years 2005-06 to 2007-08 inclusive

(3) assessments of penalties made under Schedule 24 Finance Act ("FA") 2007 on him for the tax years 2008-09 to 2014-15 inclusive.

The hearing & the evidence

2. This hearing was listed for one day. Unfortunately that was an underestimate – given the number of witnesses, the amount of evidence and the number of years involved it should have been at least a one and a half, probably two, day hearing.

3. At 4.30 pm the appellant was in the witness box and about half way through cross-examination by Mr Horton. Given that the appellant was due to undergo a difficult surgical procedure in the near future we thought it would be inadvisable to adjourn for what might be many weeks when the appellant was still in the witness box and unable to discuss the case with his advisers. We therefore decided to continue until we could discharge the appellant, which we did at about 5.15pm.

4. We then directed, as we had intimated to the parties, that they make their closing submissions on the evidence in writing. We also directed that HMRC could make such comments as they thought fit on the witness statement of Mr Mehta, the appellant's accountant, whose evidence we had not had time to hear, and that Mr Kelley could respond.

5. We have, after considering all the submissions and the evidence, decided to cancel all the assessments and determinations of tax and penalties for reasons unconnected with the evidence given by the appellant and his accountant. For that reason we do not go into the factual evidence in the amount of detail we would otherwise have done.

6. The evidence we did have from HMRC was given by Mr Mark Shaw, the officer of HMRC who carried out the investigation. He gave a witness statement which referred to a large number of documents which he had exhibited. He was cross-examined by Mr Kelley.

7. For the appellant we had a witness statement from the appellant on which he was cross-examined by Mr Horton. The appellant also produced a number of witness statements from other persons which he maintained evidenced the explanations that he put forward in his witness statement about the "deficits" in his finances that Mr Shaw had shown in a schedule he had produced. The witnesses themselves were not present,

and in other circumstances we would have had to decide what weight to put on the statements.

8. As we have said there was a witness statement from Mr Mehta, the appellant's accountants. Mr Mehta was present and was assisting Mr Kelley. Had the hearing been set for longer he would have been called to give evidence and been cross-examined by Mr Horton. In the event his evidence has become irrelevant but we have considered it and Mr Horton's comments on it. We add that we accept Mr Horton's complaints that in post-hearing submissions Mr Mehta was trying to introduce new evidence, indeed evidence of matters that happened after the hearing, including his notes of a telephone conversation with a witness who was not present at the hearing. We would, even if matters had turned out differently, have regarded that evidence as inadmissible.

Facts

9. Because of what we said about the outcome of this case we set out here only some basic facts we find about the investigation which we take primarily from Mr Shaw's statement. We do not think that anything we say here is contested.

10. In December 2012 Mr Shaw, an investigator in HMRC's team investigating civil (ie not criminal) fraud, received a report from a VAT Compliance Officer dealing with Zonehead Ltd, a company controlled by the appellant. The report related to claims by Zonehead Ltd for input tax on imports which were not evidenced by Forms C79, a form which is issued to an importer when they pay customs duty and import VAT.

11. As a result of this report Mr Shaw reviewed the case for potential investigation under HMRC's Code of Practice (COP) 9.

12. Mr Shaw opened his investigation on 21 February 2013 inviting the appellant to make full disclosure under the Contractual Disclosure Facility. The appellant declined to make any admission but agreed to co-operate.

13. At a meeting on 26 June 2013 attended by the appellant and Mr Mehta who had been appointed as his accountant, the appellant answered the standard five questions denying any errors or inaccuracies in his own returns and those of businesses he was concerned with (including companies).

14. Mr Shaw's investigation concentrated on the appellant's personal affairs and included an investigation of his bank accounts as disclosed and a Spanish property purchase which the appellant had also disclosed at the opening meeting. Schedules of his findings were given to the appellant and explanations for certain large credits sought.

15. On 10 March 2015 Mr Shaw sent a schedule of his calculations of the appellant's personal income and expenditure over a period beginning in 2005. This schedule he said showed a shortfall of approximately £258,000 in the appellant's declared income, without taking into account personal expenditure such as food and clothing.

16. Following further correspondence in which explanations for the shortfall were put forward, on 9 October 2015 Mr Shaw sent a letter outlining HMRC's current position. He accepted some of the explanations, but after adding in expenditure based on ONS research about household expenditure, the shortfall, or deficit, was now "approximately [sic] £276,709". Mr Shaw noted that it appeared the appellant was disclosing a deficit of £12,292.

17. On 14 October 2015 Mr Shaw caused assessments under s 29 TMA to be made and notified to the appellant, based on the deficit for each year from 2004-05 to 2013-14. They were appealed.

18. Further correspondence and meetings about the explanations for the deficit ensured, but there was no change in Mr Shaw's view. On 11 June 2016 a penalty explanation letter was sent to the appellant and on 5 May 2016 penalty determinations and assessments were made and notified for the same tax years as the s 29 assessments. They were also appealed.

19. On 27 July 2016 a reviewing officer gave her consideration of a review requested by the appellant. With the exception of an amount of £50,000 the explanation for which she accepted, the reviewing officer upheld Mr Shaw's decisions to assess in the amounts he did, though she considered that further mitigation of the penalties was justified.

20. More correspondence and meetings took place. On 3 June 2017 Mr Shaw again set out his current view of the matter which was again unchanged.

21. On 26 August 2016 the appellant notified his appeals to the Tribunal.

Discussion

What income was assessed?

22. Income tax systems throughout the world are divided by academic commentators into two types, global and schedular, or synthetic and analytic[1]. A global system in its pure form taxes all income in the same way at the same rate and allows reliefs from tax to be set against the totality of the income. A pure schedular systems identifies separate types of income and applies different computational rules and rates of tax to each and allows no set off.

23. Of course few if any income tax systems in the world are purely global or purely schedular. The UK system, which in 1803 was a pure schedular system, has evolved over the years so that now, by and large, the rates are the same and set off of reliefs such as losses is to some extent allowed between one type of income and another. But the UK still identifies separate types of income for computational purposes, even if they

[1] See eg Thuronyi, Comparative Tax Law.

are no longer set out in actual schedules to an Act of Parliament, as they were from 1803 to 2005[2].

24. As is put with characteristic clarity in the authoritative textbook "Revenue Law[3]" ("*Tiley*"), the original sole author of which was the late lamented Professor John Tiley

> "A schedular system like that of the UK has four[4] features which differentiate it from a pure global system:
>
> (1) *Income*. If an income receipt does not fall within any Part or Schedule, it is not taxable; there is no need to seek a general definition of 'income'. [as to which *Graham v Green*[5] is cited]
>
> (2) *Rules exclusive*. Where income falls within a Part/Schedule, it falls to be computed in accordance with the rules in that Part/Schedule and no other. As Lord Radcliffe has said:
>
> > Before you can assess a profit to tax you must be sure that you have properly identified its source or other description according to the correct Schedule: but, once you have done that, it is obligatory that it should be charged, if at all, under that Schedule and strictly in accordance with the Rules that are there laid down for assessments under it." [*Mitchell & Edon v Ross (HM Inspector of Taxes)*[6]]

25. The "Parts" referred to in the extract above are Parts 2 to 5 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") and Parts 2, 9 and 10 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA") which between them include all the main charging provisions for income tax in the tax years concerned.

26. The concept of 'source' referred to by Lord Radcliffe is further considered in *Tiley* under the heading "The UK concept of income". There he says that the UK has two important principles limiting the scope of [income] tax, "Capital is not income" and "The Source".

27. Capital receipts not included as income include gambling winnings, gifts and loans. As to the source doctrine, *Tiley* points out that

> "the courts have held that every piece of income must have a source[7], and reports abound with reference to 'fruit and tree'.

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[2] The well known Schedules A, B, C, D and E. Schedule F was added by FA 1965.

[3] Revenue Law 7th Edn, John Tiley and Glen Loutzenhiser, Oxford (2012).

[4] The other two, 'losses' and 'choice of schedule' need not concern us here.

[5] 9 TC 309.

[6] 40 TC 11 @ 61.

[7] For which proposition Tiley cites inter alia *Brown v National Provident Institution* 8 TC 57 and *Leeming v Jones* 15 TC 333.

> ITTOIA 2005 *reinforces* [my emphasis] this notion by identifying the source of the particular head of income."

The assessments

28. With this as background I turn to the returns and assessments in this case.

29. The appellant made tax returns for the years 2005-06 to 2011-12. We do not have printouts of the entries in the returns but we do have copies of the tax calculations created by HMRC from the entries in the returns.

30. The income and the source disclosed on them are

(1) Income from employments – all years 2005-06 to 2011-12 (Pt 2 ITEPA)

(2) Profits from UK land and property – 2008-09 to 2011-12 (Pt 3 ITTOIA)

(3) Dividends from UK company shares 2010-11 and 2011-12 (Pt 4 ITTOIA)

31. There are assessments made for 2012-13 and 2013-14, but we have no details of any returns made.

32. We have copies of notices of further assessments. On each the "total amount now assessed" is shown, followed by "Previous assessment" and the result of subtracting the latter from the former "Amount charged by this assessment". "Previous assessment" refers to the amount of tax on the self-assessment in the return. Each of these is an amount of tax.

33. Each notice says it is accompanied by a calculation of the amount charged by this assessment. We do not have any copies of these calculations, but we note that the further assessments for 2012-13 and 2013-14 do have "previous assessment" figures not out of line with the earlier years.

34. We are therefore unable to see what the description is of the amounts of income charged by the further assessment. We asked HMRC to tell us in their post-hearing submissions. They did so, and we quote

> "HMRC contend they have not been able to identify an income source and so have not allocated it to trading income as in Johnson [v] Scott. HMRC have allocated the amounts to other income is the self-assessment calculations sent to Mr Ashraf with the discovery assessments"

35. We assume that by "self-assessment calculations" is meant the calculations referred to in the notices of assessment (not self-assessment).

36. The appellant's post-hearing submissions, by Mr Kelley and Mr Mehta, refer to the source issue and to HMRC's Business Income Manual at BIM15035, and to the reference there to "casual or occasional payments" which "may in some circumstances be liable as miscellaneous income." The submissions go on to refer to s 687 ITTOIA.

37. In reply to the appellant's post-hearing submissions HMRC pick up the reference to s 688, but it is worth quoting earlier parts

> "12 HMRC submit that they have attempted throughout the compliance check to identify a source of income. Furthermore HMRC submit the appellant was unable to assist the Tribunal in the identification of a source.
>
> 13 HMRC submit that during cross-examination Mr Shaw advised the Tribunal that the appellant had not advised him that he was trading and that Mr Shaw wasn't aware that the appellant was trading as a sole trader or as a property developer.
>
> 14 HMRC submit that the appellant did not declare a self-employment on his return.
>
> 15 HMRC submit as there was not a clearly identifiable source it was reasonable to describe it as "other income"
>
> 16 HMRC submit that the Miscellaneous Income charging provisions in Part 5 [ITTOIA] are appropriate as the appellant has received income not otherwise charged.
>
> 17 HMRC submit that the assessments issued to the appellant have been made under a charging provision in ITTOIA and are valid.
>
> 18 HMRC submit that section 687 ITTOIA charges Tax on income sources not otherwise charged."

38. To be fair to HMRC I add that in their skeleton of 23 November 2017 there is a section headed "Relevant Legislation/Case Law" which mentions "Section 667 [sic – 687 is meant] - Charge to tax on income not otherwise charged" and "Section 688 - miscellaneous income". But nothing is said as to how they were relevant to this case[8]. Part 5 ITTOIA as a whole is headed "Miscellaneous income" and contains 7 Chapters covering a range of different types of income, of which Chapter 8 is "Income not otherwise charged".

39. And in his witness statement of 29 August 2017 Mr Mehta says:

> "23. … the onus is on HMRC to establish a trading source …
>
> 24 However, HMRC in this case have not identified a particular source of trading … This differs from Johnson-v-Scott case".

40. The question for the Tribunal then is can section 687 cover the amounts which the appellant is said to have received in this case? We say "said to have received" because HMRC's case relied on Mr Shaw's income and expenditure calculations which take known outgoings and known incomings and assume the difference, the deficit is taxable income. The appellant has sought to explain the deficits as arising from non-taxable sources, some of which have been accepted by HMRC on review, but most have been rejected as unsatisfactorily evidenced or the subject of conflicting statements.

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[8] In any case, section 688 is not headed "miscellaneous income": it is headed "Income charged".

41. Chapter 8 Part 5 ITTOIA provides relevantly

> 687 Charge to tax on income not otherwise charged
>
> (1) Income tax is charged under this Chapter on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act.

42. *Tiley* says of s 687 that it is the successor of Case VI of Schedule D where that section acted to charge any annual profits or gains not falling under any other Case or Schedule. He notes the explicit reference to "source" in the rewritten section and refers to the Explanatory Notes to the Bill. These say, on the Chapter generally:

> 1187. The charge under this Chapter is restricted to amounts that are "income" on first principles. That is, they are "annual profits or gains" under section 18(1) of ICTA, as that phrase has been interpreted by case law, and are not profits or gains of a capital nature (although some amounts of that nature have been treated as income charged to income tax, whether under a Case of Schedule D or otherwise). This is indicated by the use in section 687(1) of the words "from any source" and by the disapplication of the definition of "income" in section 878(1) of this Act by section 687(4). (For the significance of the reference to "any source", see the commentary on the overview to Part 8 of this Act on recent judicial remarks on "source".)

43. *Tiley* also refers to the established case law on Case VI which suggests four principles that apply also to Chapter 8 Part 5 ("the Chapter") – the profit must be annual, it must be of an income nature, it must not be gratuitous and it must be analogous to some other head of Schedule D. The first adds nothing and is omitted in the Chapter. To be so analogous a receipt must have a source to be within Case VI, and this is explicitly the rule in s 687[9]. The typical source for Case VI/s 687 ITTOIA is a contract for services rendered (eg *Alloway v Phillips*[10], the Great Train Robber's wife's case). Sale of an asset is not within Case VI/s 687 – it is trading or capital. A sum or receipt cannot be its own source.

44. Applying these features to what HMRC say is the case here it is clear to us that s 687 does not apply to the deficit as such. HMRC have not identified any sources – indeed they positively assert there are none outside those admitted by the appellant in his returns. HMRC's post-hearing submission (§37) at [16] is wrong in this case as there is no 'income', so the question whether it has been otherwise charged is irrelevant.

45. The appellant rightly says that there can be no analogy between this case and the decided cases on investigation or back duty enquiries such as *Johnson v Scott*[11]. We have been unable to identify any cases of this sort that have reached the courts where a Case VI charge has been upheld on the basis of either the simple income and expenditure statements of the type produced here or proper double entry capital

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[9] *Leeming v Jones* (see fn 7) was about Case VI and discussed the question of source.

[10] 53 TC 372.

[11] 52 TC 383.

statements of the type produced in cases like *Jonas v Bamford*[12]. In all the decided cases we have considered a source has been identified which it is possible on the evidence to attribute to the taxpayer, usually either trading or where a body corporate is involved, remuneration derived from omitted profits of the company.

46. At the hearing we asked Mr Shaw to explain to us what taxable source there might be. Given the many references to Spanish property we queried whether he was saying that there was omitted foreign rental income or property dealing profits, but he eschewed any such suggestion. Nor did he accept that the appellant was trading in the type of goods his companies operated in. HMRC have not suggested that there were any omitted profits of companies like Zonehead Ltd which he had diverted to himself to provide additional remuneration.

47. HMRC relied solely on s 687 when they realised they needed to show a taxable source, but s 687 cannot apply. There was no dispute that even for in date years (2012-13 and 2013-14 – see s 34 TMA) the burden of proof is on HMRC to show that one or other of the conditions in s 29(4) and (5) TMA had to be met and since there was no loss of tax shown for any year that burden had not, and was not on the evidence capable of being, discharged.

48. We therefore hold that the further assessments so far as they seek to charge income under s 687 ITTOIA cannot stand and must be cancelled.

49. As a result all penalties fall away and must be cancelled. There is no potential lost revenue within Schedule 24 FA 2007 nor its s 95 TMA equivalent.

50. We wish to make it clear that this decision does not by any means represent a clean bill of health for the appellant and his companies. Mr Mehta was prepared to admit, in an effort to settle the case, to a deficit of outgoings over explained incomings of around £70,000, though the appellant himself was wholly unable to say in cross-examination from what source the deficit arose, and we would have found there were substantial inconsistencies and difficulties with timing and credibility of many of the explanations for the deficit. But that by itself is insufficient in the absence of a source, whether belonging to the appellant or one or more of his companies.

Decision

51. Under s 50(6) TMA we decide that the appellant was overcharged to income tax for each of the tax years 2005-06 to 2013-14 by 9 assessments which are not self-assessments and we reduce them accordingly to nil.

52. Under s 100(2)(b) TMA it appears to us that no penalty under s 95 TMA has been incurred for the tax years 2005-06 to 2007-08 and we set the determinations aside.

53. Under paragraph 15(1) Schedule 24 FA 2007 we cancel HMRC's decision to assess penalties under that Schedule for the tax years 2008-09 to 2013-14.

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[12] 51 TC 1.

54. 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.

RICHARD THOMAS
TRIBUNAL JUDGE

RELEASE DATE: 22 FEBRUARY 2018