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Case Number: TC09171

FIRST-TIER TRIBUNAL
TAX CHAMBER

Alexandra House, Manchester

Appeal reference: TC/2023/07674

INCOME TAX AND CAPITAL GAINS TAX – Discovery assessments – 20 year time limit – whether loss of tax attributable to negligent conduct – section 36(1A) Taxes Management Act 1970 – paragraph 7 of the Finance Act 2008, Schedule 39 (Appointed Day, Transitional Provision and Savings) Order 2009 - extent of deductions available in computing profits of the Appellant's property development trade – where the disposal of properties formed part of trading or investment activities – whether the Appellant failed to notify chargeability under section 7 Taxes Management Act 1970 – if so, the appropriate amount of any penalty under section 7(8) Taxes Management Act 1970 – appeal allowed in part

Heard on: 9 April 2024
Judgment date: 16 May 2024

Before

TRIBUNAL JUDGE ROBIN VOS
DEREK ROBERTSON

Between

KENNETH WILLIAMS

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: the Appellant appeared in person

For the Respondents: Ms Louise Hartstill and Mr Darren Bradley, litigators of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. Many people have entered the property market hoping to make significant profits. In 2004, Mr Williams was one of those people. However, things did not go well and he does not believe he made any profits at all.

2. Nonetheless, in 2014, HMRC started to make enquiries into his property dealings between 2004-2006. Eventually, in 2019, they concluded that Mr Williams had made taxable trading profits in the tax years ended 5 April 2005 and 5 April 2006 and issued assessments totalling a little over £14,000. They also assessed penalties of around £8,000 on the basis that Mr Williams had failed to notify HMRC that he was chargeable to tax for the relevant years.

3. Following a review which concluded in February 2023, HMRC accepted that their calculation of the profits was overstated and so they now say that the amount of tax due for the two years is just under £12,000 with the penalties correspondingly reduced to just under £6,500.

4. It is of course surprising that HMRC might be able to make assessments almost 15 years after the tax years in question in circumstances where they do not suggest that there has been any deliberate default by Mr Williams. However, where there has been a failure to notify chargeability to tax and the loss of tax is attributable to negligent conduct, HMRC are able to issue assessments going back 20 years.

5. Mr Williams has appealed both against the assessments and against the penalties. His position is that he did notify HMRC that he was starting to carry out a property business so that there was no failure to notify HMRC of his potential chargeability to tax.

6. In any event, he says that HMRC have not allowed all of the expenses he incurred as part of his business and that, if they did so, there would be no profit.

7. As far as the penalties are concerned, these of course fall away if Mr Williams is right in his primary arguments. However, if he is not and the penalties are, in principle, due, he complains that HMRC should have reduced the penalties by more than they have to reflect his co-operation during the course of HMRC's enquiries.

FURTHER SUBMISSIONS

8. The hearing lasted for a full day and, as a result of this, Mr Williams was short of time at the end of the day in replying to one of the points made by HMRC. This related to some detailed calculations of expenditure which HMRC had referred to in their submissions and which Mr Williams did not have time to verify. In addition, there were two small points where Mr Williams could not recollect exactly where particular references appeared in the bundle of documents. We therefore gave Mr Williams permission to make further written submissions in relation to these three points with a right for HMRC to make a response should they wish to do so. We have received submissions from Mr Williams and from HMRC and have taken these into account in reaching our decision.

9. We also note for completeness that, subject to being able to deal with these three points, Mr Williams confirmed at the end of the hearing that he had been able to make all of the points which he wished the Tribunal to take into account.

THE ISSUES TO BE DETERMINED

10. HMRC must first of all show that the discovery assessments which they issued were valid. The main issue here is whether they can rely on the 20 year time limit in section 36(1A) Taxes Management Act 1970 (TMA). This requires HMRC to satisfy the Tribunal

that Mr Williams failed to notify HMRC of his chargeability to tax in accordance with section 7 TMA and that any loss of tax resulted from his negligence.

11. However, the only issue we need to determine is whether Mr Williams did in fact notify HMRC of his chargeability in respect of the two tax years in question. His appeal is based on the fact that he did so. He does not seek to argue that if the Tribunal were to find that he did not notify HMRC of his chargeability the loss of tax did not result from his negligence.

12. Assuming the discovery assessments are valid, it is up to Mr Williams to demonstrate that he has been overcharged by the assessments. Based on the grounds of appeal put forward by Mr Williams, this requires the Tribunal to consider two points:

(1) Whether (and the extent to which) HMRC should have allowed deductions for expenses which Mr Williams claims he incurred in the course of his property business and which HMRC have not allowed.

(2) Whether, in relation to two particular properties which Mr Williams says he purchased as a long-term investment with the intention of renting them out, any profit (if there was one) should be subject to capital gains tax or whether the sale of those properties was also part of Mr Williams' property development trade.

13. Finally, if having considered all of this, we consider that there is a tax liability we need to look at the penalties which have been assessed. There is no suggestion from Mr Williams that a penalty is not properly due if he failed to notice his chargeability to tax and there is in fact tax due. The only issue we therefore need to consider is whether the penalties should be set at a lower amount than that assessed by HMRC.

THE EVIDENCE AND THE BACKGROUND FACTS

14. The Tribunal was provided with a large bundle of documents and correspondence. This included witness statements which had been prepared for these proceedings by the HMRC officer most recently dealing with the matter, Ms Kerry Smith and by Mr Williams. Mr Williams indicated that he did not wish to cross-examine Ms Smith and so, to the extent that her witness statement contains factual evidence rather than opinion, we accept it.

15. Mr Williams was cross-examined in relation to his evidence. We have to say that we found his approach to answering the questions put to him somewhat unhelpful. Instead of answering the questions in a straightforward way, he had a tendency to respond with questions of his own and to divert the focus away from the question which had actually been asked. This was particularly the case where points were raised which might be thought to cast doubt on the position he was taking in his own submissions.

16. We also observe that there are some significant inconsistencies in the evidence Mr Williams has given. For example, until the hearing he has been adamant that he submitted tax returns for each of the tax years ended 5 April 2005, 5 April 2006 and 5 April 2007. However, in response to questions put to him in cross-examination, he accepted that no tax return had been submitted for the tax year ended 5 April 2007 (although that is not in fact relevant to the issues we have to determine) but also conceded that he could not recall whether a tax return had been submitted for the year ended 5 April 2006 and, indeed, accepted that it was quite likely that it had not.

17. Whilst we commend Mr Williams for his frank response in relation to this, it does illustrate that, not surprisingly, after a period of almost 20 years, his recollection of events during the relevant period from 2004-2006 is somewhat hazy and is not reliable. We have therefore preferred, in relation to some issues, to draw inferences from the contemporaneous documentary evidence rather than relying on Mr Williams's uncorroborated recollections.

18. Although there are significant areas of factual dispute between the parties, it is helpful to summarise the background facts in respect of which there is no real disagreement.

19. Until February 2003, Mr Williams worked with a group of companies involved in debt management. Although his employer changed from time to time, it was always part of the same group and he was doing the same job in the same office.

20. After the end of his employment in February 2004, Mr Williams decided to get into the property business which was something he had been thinking about for some time. He initially purchased four properties in April and May 2004 and then purchased a further seven properties later in 2004 and in 2005. Of these properties, HMRC have accepted that two qualify for principal private residence relief as they were, at some point, occupied by Mr Williams. There are therefore nine properties which form the subject matter of this appeal.

21. Mr Williams renovated each of the properties and then sold them. The assessments are made by HMRC on the basis that six of the properties were sold in the tax year ended 5 April 2005 and the remaining three properties were sold in the tax year ended 5 April 2006. There is in fact some uncertainty as to whether one of the properties (24 Cutland Street) was sold in the tax year ended 5 April 2005 or the tax year 5 April 2006. The documentary evidence shows that it was sold at auction on 24 March 2005 but the documents also show that completion of the sale took place on 13 April 2005.

22. For the purposes of this decision, we have assumed that HMRC are correct in treating the disposal as having taking place in the tax year ended 5 April 2005. However, it makes no difference to the outcome of this appeal as, if Mr Williams is right and the disposal took place in the tax year ended 5 April 2006, the effect would simply be to increase the assessment for the year ended 5 April 2006 to the extent that there is in fact a profit on the sale.

23. On 22 June 2004, Mr Williams wrote a letter to HMRC enclosing his P60 forms for the tax year ended 5 April 2004. Neither party has a copy of the letter. Mr Williams says that the letter notified HMRC that he had commenced a property business as a sole trader and listed the four properties which he had purchased in April and May 2004. HMRC's self-assessment notes record that, as a result of the receipt of the letter, Mr Williams' self-assessment record was re-opened and that a manual self-assessment tax return for the year ended 5 April 2004 was issued to Mr Williams on 6 July 2004 as he was still a higher rate taxpayer.

24. There is a dispute as to whether the letter of 22 June 2004 notified HMRC of Mr Williams' chargeability to tax for the tax year ended 5 April 2005 and we deal with this further below.

25. Mr Williams' tax return for the year ended 5 April 2004 was filed on 15 July 2004. The only entries on the return related to his employment income and student loan deduction. The return was processed by HMRC on 28 July 2004. On the same day, HMRC's self-assessment notes show that Mr Williams' self-assessment record was closed "following automatic selection". The evidence of Ms Smith is that this would have been on the basis that, as a result of Mr Williams' tax return showing that his employment had ceased in February 2004, he would no longer be within the requirements for filing a self-assessment tax return.

26. Mr Williams says that he submitted a tax return for the tax year ended 5 April 2005 although he does not say exactly when this was done. HMRC have no record of receiving that tax return and suggest that no tax return was submitted. Again, we deal with this further below.

27. There was no further interaction between Mr Williams and HMRC until Mr Williams called HMRC in October 2012 asking for a UTR. This was followed in August 2013 by a

request from an accountant appointed by Mr Williams for a tax return for the year ended 5 April 2014. This was not followed up but in March 2014, Mr Williams called HMRC to say that he had been receiving income from property since October 2013. His self-assessment record was therefore re-opened.

28. At around this time, HMRC became aware of some of the property transactions which had taken place in 2005 and therefore opened a check into Mr Williams' tax position in respect of those properties.

29. A significant amount of correspondence passed between Mr Williams and HMRC over the next few years during the course of which Mr Williams noted that he had in fact purchased and renovated 11 properties rather than just the original seven identified by HMRC, HMRC issued two information notices to try and get information which thy had asked for (although these were ultimately withdrawn) and Mr Williams gradually provided more and more information about the property transactions and the expenses which he had incurred in relation to the properties.

30. In January 2017, HMRC decided that any profit from the sale of the properties should be taxed as trading income rather than as a capital gain. HMRC, however, also accepted, as mentioned above, that two of the properties should be treated as Mr Williams' main residence and would not therefore be within the scope of any potential tax liabilities.

31. It was not until 2 September 2018 that Mr Williams finally provided HMRC with detailed calculations of the expenses which he said had been incurred in relation to each of the properties. This included renovation expenses totalling approximately £150,000. Mr Williams accepts that the figures set out in this letter are estimates but, having based them to some extent on payments made out of his bank account, believes they are reasonably accurate. We will return to this aspect in due course.

32. It is apparent that part of the reason the correspondence was so protracted is that there were a number of changes of personnel on the part of HMRC. However, we are also in no doubt that Mr Williams' approach to the compliance check was to drip feed information to HMRC, in particular providing further information each time HMRC indicated an intention to issue assessments.

33. Again, there followed a significant amount of correspondence between HMRC and Mr Williams in relation to the expenses which Mr Williams claimed he had incurred in relation to his property business but no agreement could be reached. Eventually, on 31 October 2019, HMRC issued discovery assessments under section 29 TMA for the tax years ending 5 April 2005 and 5 April 2006. The amount of tax due for the year ending 5 April 2005 was £6,050.40. For the year ended 5 April 2006, the tax due was £8,360.47. As far as renovation expenses were concerned, these figures were based on an allowance over both years of a total amount of just under £55,000.

34. At the same time as issuing the discovery assessments, HMRC assessed penalties for failure to notify chargeability under section 7 TMA. The penalties were reduced from the maximum of 100% of the tax due to 55% of the tax due.

35. Mr Williams appealed to HMRC against all these assessments.

36. The correspondence between HMRC and Mr Williams continued after the assessments had been issued with the focus very much on the amount allowed by HMRC in respect of the renovation costs. However, in addition, on 3 March 2020, Mr Williams raised for the first time the suggestion that two properties at 7 Dollond Street and 13 Dollond Street (two of the properties purchased in April/May 2004) had been purchased as long-term investments with the intention of renting them out with the result that any profit in respect of those properties

should be subject to capital gains tax and not income tax as they were not part of the property development trade.

37. HMRC increased the amount of the renovation costs allowed to £55,199 as a result of Mr Williams' appeal against the assessments.

38. Ultimately, HMRC offered a review in August 2022 which Mr Williams accepted. The review conclusion letter was issued on 28 February 2023. As a result of the review, additional renovation costs were allowed reducing the tax due for the year ended 5 April 2005 to £5,827.50 and for the year ended 5 April 2006 to £5,904.90. In calculating these figures, the total renovation costs now allowed by HMRC totalled £62,182. The penalties were correspondingly reduced but remained 55% of the tax.

39. Mr Williams was still not satisfied with the result of the review and so notified his appeal to the Tribunal on 19 March 2023, primarily on the basis that HMRC should have allowed more of the expenses which he had claimed and also that the two properties at Dollond Street were not part of his trading business so that any profits should be within the scope of the capital gains tax rather than income tax.

40. With that background in mind, we turn now to consider the issues which we have to determine.

VALIDITY OF THE DISCOVERY ASSESSMENTS

41. There is no suggestion from Mr Williams that the basic conditions set out in section 29 TMA are not satisfied. We accept that HMRC made a discovery as a result of their compliance check which commenced in 2014 and that the relevant assessments were intended to make good the loss of tax which, in HMRC's opinion, had occurred.

42. HMRC's position in relation to the discovery assessment it is based on Mr Williams not having submitted tax returns for the tax years ended 5 April 2005 and 5 April 2006. If they are right in relation to this, there are no other requirements which need to be satisfied under section 29 TMA.

43. The only question we therefore need to address is whether the assessments were made within the relevant time limit. As we have said, HMRC rely on the 20 year time limit set out in section 36(1A) TMA which applies where the loss of tax is attributable to a failure by the tax payer to comply with the obligation to notify chargeability to tax under section 7 TMA.

44. Section 36 (1A) TMA was introduced with effect from 1 April 2010. However, due to a transitional provision contained in the Finance Act 2008, Schedule 39 (Appointed Day, Transitional Provisions and Savings) Order 2009, the 20 year time limit where there has been a failure to notify only applies where the year of assessment is 2008-09 or earlier if the loss of tax is attributable to the taxpayers' negligent conduct.

45. HMRC therefore have to satisfy us both that there has been a failure to notify chargeability which has resulted in a loss of tax and that the loss of tax is attributable to Mr Williams' negligent conduct.

46. Section 7(1) TMA provides as follows:

> "Every person who –
>
> (a) is chargeable to income tax or capital gains tax for any year of assessment, and
>
> (b) has not received a notice under section 8 of this Act requiring a return for that year of this total income and chargeable gains,

shall, subject to sub-section (3) below, within six months from the end of that year, give notice to an officer of the board that he is so chargeable."

47. Mr Williams accepts that HMRC did not give him a notice under section 8 TMA requiring him to file a tax return for either of the tax years in question. As can be seen, the requirement in section 7 TMA to notify chargeability applies for "any year of assessment". This means that we must consider separately whether Mr Williams notified chargeability for the tax year ended 5 April 2005 and, even if he did, whether he notified chargeability for the tax year ended 5 April 2006.

48. HMRC's position is that Mr Williams did not notify chargeability for either tax year. They do not accept that the letter dated 22 June 2004 contained details of his new property business and they have a record of Mr Williams having submitted tax returns either for the year ended 5 April 2005 or the year ended 5 April 2006.

49. Mr Williams says that he notified HMRC about his new property business in the letter dated 26 June 2004 (which HMRC accept was received by them). Up until the date of the hearing he was also adamant that he had submitted tax returns both for the year ended 5 April 2005 and the year ended 5 April 2006. However, as we have mentioned, he accepted in cross examination that he could not recall whether a tax return was submitted for the year ended 5 April 2006 and concluded that it was quite likely that it had not been.

50. HMRC also say that, even if Mr Williams referred to his new property business in the letter dated 22 June 2004, this does not satisfy the requirements of section 7(1) TMA as a notification must be given "within six months from the end of [the relevant tax] year". Ms Hartstill submits that this means the notification must be given at some point between 6 April – 5 October after the end of the relevant tax year. As the letter was written before the end of the tax year which ended on 5 April 2005, it does not therefore satisfy the relevant requirement.

51. Ms Hartstill did not refer to any authority in support of this submission. In the absence of any such authority, we do not accept it. We cannot believe that Parliament could have intended that a person who notifies HMRC that they will be liable to tax before the end of the relevant tax year but does not then repeat the notification after the end of the tax year should be in breach of the requirement in section 7(1) TMA to give notice to HMRC that they are chargeable to tax for the relevant tax year.

52. Ms Hartstill accepted that the purpose of section 7 TMA is to enable HMRC to issue a tax return should it be appropriate for them to do so. If they are notified before the end of a tax year that a person will be chargeable to tax, they are of course able to issue a tax return at the end of the tax year in question. The purpose of section 7 will have been fulfilled. In our view, the phrase "within six months from the end of that year" must therefore only been intended to set a deadline for the provision of the relevant notice. It cannot have been intended to prevent a taxpayer from giving notice of chargeability before the end of the tax year.

53. We therefore need to consider on the balance probabilities whether the letter of 22 June 2004 included a notification to HMRC that Mr Williams had commenced a new property business and that he would be chargeable to tax for the tax year ended 5 April 2005.

54. Mr Williams' evidence is that he has a clear recollection that the letter notified HMRC that he had started a new property business and, indeed, listed the properties which he had purchased in April/May 2004. He asks why he would have bothered to write to HMRC if it was not to notify them about his change in circumstances.

55. HMRC however draw attention to the fact that, whilst their self-assessment records acknowledge receipt of the letter and the accompanying P60s, no mention is made in those records of a new sole trader property business.

56. The self-assessment records also show that HMRC's response to the letter was to issue Mr Williams with a self-assessment tax return for the year ended 5 April 2004 as the P60s showed that, for that tax year, he was a higher rate taxpayer. Once the tax return for the year ended 5 April 2004 had been received, Mr Williams' self-assessment record was closed.

57. Ms Hartstill submits that, had the letter of 22 June 2004 referred to the fact that Mr Williams had started to carry on a new property business as a sole trader, the self-assessment record would not have been closed as it would have been clear to HMRC that he would have needed to file a tax return for the year ended 5 April 2005.

58. Despite Mr Williams' recollection of the contents of the letter, for the reasons we have already explained, we do not think that his memory alone is sufficiently reliable when weighed against the evidence of HMRC's self-assessment notes.

59. As Ms Hartstill says, the clear inference from the self-assessment notes is that no mention was made in Mr Williams' letter of June 2004 of his new property business as the likelihood is that this would have otherwise been mentioned in the self-assessment notes and his self-assessment record would not have been closed.

60. Whilst it is of course possible that HMRC simply overlooked the reference to the new property business, we consider this to be unlikely given that somebody at HMRC clearly read the letter and reviewed the P60s which were enclosed with it. This is evident from the fact that, as a result of this, a self-assessment tax return for the year ended 5 April 2004 was sent to Mr Williams for him to complete

61. There does of course remain the question as to why Mr Williams would write to HMRC with the P60 forms if it was not to notify HMRC of the commencement of his new property business. There are two points to make in relation to this. The first is that, if the main purpose of the letter was to notify HMRC of the commencement of the new property business, there would be no need to attach the form P60s to the letter.

62. The second point is that it is clear from the evidence before us that Mr Williams received a tax repayment of just over £3,000 in respect of the year ended 5 April 2003. An alternative explanation for his letter to HMRC enclosing the P60s is that he may have thought that, if he completed a tax return for the year ended 5 April 2004, he would similarly be entitled to a tax refund. As it turns out, he would have been right in relation to this as, having completed the tax return, he received a refund of approximately £1,900.

63. We did ask Mr Williams about this at the hearing. His recollection was that he had no reason to think that he might be entitled to a tax refund and that this therefore could not have been the reason for the letter dated 22 June 2004. However, given what we have said above about the reliability of Mr Williams' recollection and the fact that he had recently received a tax refund for the previous year, coupled with the evidence of HMRC's self-assessment note, we think that, on the balance of probabilities, this is a more likely explanation for the letter.

64. Our conclusion therefore is that the letter dated 22 June 2004 did not notify HMRC about the commencement of a new property business and did not therefore constitute a notification of chargeability to tax for the year ended 5 April 2005.

65. We therefore need to consider whether Mr Williams submitted a tax return either for the year ended 5 April 2005 or for the year ended 5 April 2006 as this is the only other basis

on which Mr Williams suggests that he might have notified HMRC of his chargeability to tax for each of the two relevant tax years.

66. Looking first at the position for the year ended 5 April 2006, the position is straight forward. Mr Williams accepted in his evidence that it was quite likely that no tax return for that year was submitted. In addition, HMRC have no record of having received a tax return from Mr Williams for the tax year ended 5 April 2006. There is therefore no doubt that, based on the evidence available to us it is more likely than not that no tax return was submitted for the year ended 2006. Mr Williams was therefore in breach of his obligations under section 7(1) TMA as he failed to notify HMRC of his chargeability to tax for that year.

67. As far as the year ended 5 April 2005 is concerned, Mr Williams' evidence is that his conveyancing solicitor, a Mr Boucher, assisted him to prepare a tax return for that year and that Mr Williams then posted the tax return to HMRC. Unfortunately, Mr Boucher died in 2006 and his firm ceased trading a couple of years later and so it has not been possible to obtain any evidence corroborating Mr Williams' recollection of events.

68. We do however consider it somewhat implausible that Mr Boucher, being a conveyancing solicitor would have prepared a tax return on behalf of Mr Williams. This is not something which would normally be done by a conveyancing solicitor and it seems very unlikely that such an individual would consider themselves to be qualified to do so.

69. In addition, as we have already noted there are, unsurprisingly, problems with Mr Williams' recollection of the events which took place in 2004-2006, not least his insistence until the date of the hearing that he had not only submitted a tax return for the year ended 5 April 2005 but also a tax return for the year ended 5 April 2006, only to accept that, as far as the tax year ended 5 April 2006 was concerned, he may well be mistaken.

70. HMRC once again pointed to the fact that their records show no trace of a tax return having been submitted for the tax year ended 5 April 2005. Based on this, we consider it more likely than not that no tax return was in fact submitted and that Mr Williams did not therefore notify HMRC of his chargeability to tax for the year ended 5 April 2005 in accordance with section 7 TMA.

71. Based on our findings, HMRC is able to rely on the 20 year time limit for making the discovery assessments if the loss of tax was attributable to Mr Williams' negligence.

72. HMRC's position is that, based on Mr Williams' own statements in his correspondence with HMRC, he was aware of the need to submit tax returns for the relevant tax years and to tell HMRC that he was liable to tax and that, if he had failed to do so, he must therefore have been negligent. Ms Hartstill submits that a reasonable taxpayer, knowing about such requirements, would have filed tax returns and there would therefore have been no loss of tax.

73. We accept HMRC's submissions in relation to this given that Mr Williams accepted that, should the Tribunal find that he had not in fact notified HMRC of his chargeability to tax, he would have been negligent as his case has always been that he did notify HMRC about his new property business.

74. We therefore conclude that HMRC's discovery assessments are valid. The requirements of section 29 TMA are satisfied. The assessments were made within the 20 year time limit which applies because the loss of tax arises as a result of Mr Williams' failure to notify HMRC of his chargeability for each of the relevant tax years in accordance with section 7(1) TMA and was also caused by his negligence.

75. We therefore now go on to consider whether Mr Williams has been overcharged by the assessments.

THE AMOUNT OF THE ASSESSMENTS

76. As we have said, Mr Williams' complaints in relation to the amount of the assessments focuses on two areas. The first (and by far the most significant) is the amount allowed by HMRC by way of a deduction for expenses incurred in relation to his property business.

77. The second is the question as to whether the disposals of 7 Dollond Street and 13 Dollond Street formed part of his property development trade or whether, on the basis that these properties were purchased with a view to letting them out and retaining them in the long-term, this formed part of a separate investment business so that the disposals are subject to capital gains tax rather than income tax.

78. Based on the expenses which HMRC have allowed, the combined profit for both of these properties is only just over £2,000. However, HMRC make the point that, if the disposals are subject to capital gains tax and are not part of the trade, the expenses which can be deducted will be different and that a separate calculation of the gain will be required.

79. Given that we did not hear any submissions as to what expenses (particularly renovation costs) could be deducted for capital gains tax purposes, we accept this, although we note that the capital gains tax annual exempt amount for the year ended 5 April 2005 was £8,200 and so it may well be that there is no taxable gain even if not all of the expenses which have been allowed by HMRC for the purposes of calculating the profit for trading purposes are deductible for capital gains tax purposes.

Deduction for expenses

80. The expenses claimed by Mr Williams fall into three categories. The first is the sale and purchase costs for each property, the second is the renovation costs for each property and the third relates to home office expenses and mileage expenses during each of the two relevant tax years.

81. The home office and mileage expenses claims have been allowed in full and so there is no dispute in relation to this.

82. Although HMRC have not allowed all of the sale and purchase costs (and, in particular, have refused to allow the costs of any surveys as there is no evidence that these costs were in fact incurred), Mr Williams did not dispute the amounts which had been allowed in relation to the sale and purchase costs. Again, we do not therefore need to address this aspect.

83. The real dispute therefore relates to the renovation costs which have been disallowed by HMRC.

84. In his initial response to HMRC's questions, Mr Williams stated that he spent over £35,000 renovating each property. This would give total renovation costs of over £300,000.

85. However, when Mr Williams eventually provided more detailed estimates in September 2018, the total claimed was approximately £150,000 in respect of the nine properties which are the subject of this appeal.

86. Mr Williams has provided bank statements for the bank account which he says was his only bank account at the time. The parties have agreed that the total payments out of this account (ignoring payments which are not relevant such as transfers to a connected savings account and payments for the purchase of the relevant properties) is just over £89,000.

87. A large proportion of these payments are cash withdrawals either from cash machines or as a result of Mr Williams going into the bank and withdrawing cash upon presenting his

bank card to the cashier. The cash withdrawals made in the bank are usually larger amounts which exceed the maximum daily limit for cash machines.

88. As HMRC point out, it is clear from the bank statements that some of the payments out of the account relate to personal expenses such as mobile phone operators, car expenses, entertainment and betting. This can be identified from card transactions where the payee is named. We accept Ms Hartstill's submission that it must be inferred from this that some of the cash withdrawals would have been used for personal expenses as well.

89. Mr Williams' explanation for the shortfall between the payments out of his bank account (approximately £89,000) and the total amount of the renovation costs he has claimed (around £150,000) is that his parents and his partner provided him with cash as and when required in order to pay contractors in addition to the amounts withdrawn by him from his bank account. In effect, he is saying that his parents and his partner provided him with a total of over £60,000 in cash (possibly more if allowance is made for the fact that some of the withdrawals from the bank account relate to personal expenses) over the two year period during which he was carrying on his property business.

90. During the course of HMRC's enquiries, Mr Williams provided them with a statement from his partner confirming that she had taken out two loans of £25,000 and £15,000 respectively to support Mr Williams' business. Mr Williams identified that the initial £25,000 had been paid into his bank account and so must therefore have been included as part of the £89,000 of withdrawals from that account rather than representing separate cash payments to Mr Williams.

91. There is no evidence of any payments made by Mr Williams' parents other than statements by Mr Williams to the effect that his parents helped him out financially. Mr Williams accepted at the hearing that the evidence in relation to any payments of expenses which were not payments out of his bank account was relatively weak.

92. As we have said, the total allowed by HMRC in respect of renovation costs (following the review) is just over £62,000. They have carefully analysed the claims made by Mr Williams (which have been broken down into specific items of work on particular dates in respect of each property) and have tried to marry up the amounts claimed with payments out of Mr Williams bank account.

93. Where there is a payment out of the bank account within a day or two of a particular expense which has been claimed, HMRC have allowed it to the extent of the payment out of the bank account. So, for example, if an expense of £500 is claimed on a particular date and there is a cash withdrawal from the bank account of £300 on or around the same date, HMRC have allowed an expense of £300. In addition, HMRC have allowed many of the cash withdrawals from the account even where there is no corresponding claim by Mr Williams for an expense incurred on the relevant date of the cash withdrawal.

94. HMRC accept however that they have not allowed any cash withdrawals where cash was withdrawn by Mr Williams in the branch using his card rather than through a cash machine. On a review of his bank accounts, it appears that approximately £23,500 was withdrawn in cash using this method. Of this, £3,000 has been allowed by HMRC in respect of a kitchen at one of the properties, leaving £20,500 which has not been allowed.

95. Mr Williams submits that these amounts should be allowed as, in principle, they are no different to withdrawals via a cash machine; it is just that the amounts are larger. In support of this, he showed an example of an expense claimed by him for which he had obtained a duplicate invoice from the builder and which HMRC had not allowed in full despite the fact

that there was an in-branch withdrawal of cash within a day or two of the relevant invoice date.

96. We do therefore accept, on the balance of probabilities, that there are likely to be some expenses which Mr Williams has claimed and which HMRC have rejected as a result of not taking into account the cash withdrawals which were made in the branches rather than through cash machines.

97. Mr Williams also draws attention to the fact that HMRC have made no allowance for the fact that contractors would be paid in stages rather than the whole amount for any particular job being paid in one go. Based on this, he submits that HMRC's methodology of only allowing an expense if there is a payment out of the bank account on around the same date is flawed and that some payments out of the bank account which have not been allowed on the basis that they do not coincide with the date of an expense has been claimed should have been allowed.

98. Ms Hartstill accepts that there may be some force in this argument but submits that, even if it were taken into account, it would, at best, only make a minimal difference. We do not however accept this. Mr Williams drew attention to a number of significant expenses (for items such as central heating, a new kitchen and double glazing) where HMRC had only allowed relatively small amounts based on the cash withdrawals which had been made within a day or two of the date of the date of the expense which had been claimed.

99. On behalf of HMRC, Ms Hartstill questioned the reliability of the schedule of expenses produced by Mr Williams in September 2018. She identified a number of periods during which the expenses claimed by Mr Williams significantly exceeded the amounts paid out of his bank account.

100. For example, Ms Hartstill notes that, during the period from 31 January 2005 to 2 April 2005, Mr Williams claims expenses of £7,210 in relation to one property (24 Cutland Street), but the total withdrawn from the bank account during this period is only just over £2,400. Similarly, in the period from 5 May 2005 to 12 September 2005, Ms Hartstill says that the total expenses claimed in relation to two properties (15 Fram Street and 53 Toxteth Street) is just over £50,000 whilst, during the same period, the amounts withdrawn from the bank account are just under £20,000.

101. In his further submissions, Mr Williams suggests that the amount withdrawn from his bank account during the period relevant to Cutland Street (which he says is 31 January 2005-13 April 2005) was in fact £5,862. He also says that the amount withdrawn between 5 May 2005-20 October 2005 (the period he says is relevant to Fram Street was £22,641. In relation to Toxteth Street, he notes that the withdrawals between 17 May 2005-16 September 2005 were £14,264. However, this covers the same period as Fram Street so the total for both properties is, in our view, only £22,641 at most.

102. In her response to Mr Williams' further submissions, Ms Hartstill draws our attention to the fact that, during these periods, many of the withdrawals were apparently for personal expenses (approximately £9,000 for the period relevant to Toxteth Street/Fram Street and £2,750 for the period relevant to Cutland Street).

103. In our view, the precise figures do not matter. The point is that the claimed expenses do significantly exceed the payments out of Mr Williams bank account and that the excess can only be explained by the payments Mr Williams says were made by his parents/partner but in respect of which, even he accepts, there is little evidence.

104. Ms Hartstill also cast doubt on the accuracy of the September 2018 schedule based on the time which has passed since the events in question and the previous statements made by

Mr Williams in his correspondence with HMRC - for example, his first suggestion in 2014 that he had spent over £35,000 renovating each property. Clearly this was wildly inaccurate compared to his 2018 schedule which totalled less than half of this amount.

105. In addition, Ms Hartstill draws attention to the fact that Mr Williams stated on a number of occasions that he could not recollect whether or not he owned particular properties and also stated in numerous of his letters that he could not guarantee that all the information he was providing was correct or accurate.

106. Mr Williams' explanation for this was that, following the issue of an information notice early on in HMRC's enquiries and HMRC's warning that penalties of up to £3,000 could be charged if Mr Williams did not provide the relevant information, he was nervous about saying anything to HMRC which they might later suggest was incorrect or inaccurate and that this was why he had said in his subsequent letters that he could not guarantee the accuracy of the information. We accept this explanation.

107. It is however clear to us (and accepted by Mr Williams) that the figures he put forward in September 2018 were estimates. Mr Williams says that he believes the estimates were reasonably accurate (although not precise to the last penny) but we accept Ms Hartstill's submission that, not having provided any detailed figures for four years after HMRC started their investigation (which was by then 12-14 years after the events in question) it is simply not credible that Mr Williams could have had such a detailed recollection of the amounts, dates and nature of the relevant expenses, particularly expenses which could not be linked to payments out of his bank account and which can only be explained by cash payments which might have been made to him by his parents or his partner and in respect of which there is no evidence as to the individual amounts which were provided or the dates on which they were provided.

108. We do therefore consider that the schedules produced by Mr Williams on 2 September 2018 cannot be relied on and are likely to represent a significant overestimate of the expenses incurred.

109. Having said that, for the reasons set out above, we are persuaded that there are some expenses incurred by Mr Williams for which no allowance has been made as a result of HMRC's failure to take into account cash withdrawals made in a branch rather than through a cash machine and also as a result of some contractors being paid by way of staged payments rather than the entirety of a particular project being paid in one go.

110. We also bear in mind that the burden of proof is on Mr Williams to establish that he has been overcharged by the assessments.

111. These conclusions leave us in a somewhat difficult position as we are satisfied that Mr Williams has been overcharged but there is no way for us to calculate precisely what renovation costs should be allowed. We indicated to the parties at the hearing that, in these circumstances, we may need to take a rough and ready approach looking at the evidence in the round and applying the balance of probabilities and that is what we intend to do.

112. As we have identified, the amount of the cash withdrawals which have not been taken into account by HMRC because they were made in a branch rather than through a cash machine total £20,500. Based on the incomplete evidence we have, we think this is the most reliable indicator of the expenses which Mr Williams has incurred in relation to the renovation of the properties and which have not yet been allowed. We therefore intend to allow this amount by way of a deduction for additional expenses. We reach this conclusion taking into account the following:

(1) The cash withdrawals made in a branch rather than through a cash machine are all larger amounts and, based on Mr Williams' evidence are likely to have been used for major expenses identified by Mr Williams such as central heating, new kitchens, double glazing etc.

(2) These larger projects are the items Mr Williams says may have been paid for in stages so the effect of allowing an amount equal to the larger cash withdrawals also allows for the fact that some of these items may have been paid for in stages.

113. We have not made any additional allowance for expenses which Mr Williams says were met by funds which might have been provided by Mr Williams' parents or by his partner as, by Mr Williams' own admission, the evidence in relation to this is weak.

114. Based on the limited evidence available to us, and bearing in mind our conclusion as the lack of reliability of the statement produced by Mr Williams in 2018, we think it is more likely than not that these additional expenses were not incurred by him. It is perhaps telling that the first time Mr Williams mentioned any financial support from his parents was in his statement of case prepared in July 2023. He did not mention it at all during the previous nine years of correspondence with HMRC.

115. We do not propose to go through each individual expense which has been disallowed and marry this up with cash payments which have been withdrawn within a branch or consider whether the particular expense is likely to have been met by staged payments as this would be disproportionality time consuming. Instead, we direct that the amount of the renovation costs allowed for each property should be increased proportionately to take account of the additional £20,500 of expenses which we are allowing.

7 Dollond Street and 13 Dollond Street

116. 7 Dollond Street was bought on 6 April 2004 and sold on 30 November 2004. 13 Dollond Street was bought on 4 May 2004 and was sold on 30 November 2004.

117. Mr Williams' case is that he purchased these two properties with the intention of renovating them and then letting them out on a long-term basis. He says that they were renovated to a higher standard that than the other properties, that they were furnished and that he found tenants. He explains that he tried to get a buy-to-let mortgage but was unable to do so. As a result of this he was forced to sell the properties to provide funding for his property development business. On this basis, he submits that the properties were not part of his property development trade and so any profit on sale is subject to capital gains tax.

118. HMRC question whether Mr Williams genuinely intended to rent the properties out when he purchased them. However, even if this is correct, their position is that the properties were in fact dealt with in a broadly similar way to all the other properties (which are accepted to be part of a property development trade) in the sense that they were purchased, renovated and then sold within a relatively short period of time.

119. In support of this, Ms Hartstill relies on the decision of the court of session in Scotland in *Commissioners of Inland Revenue v Livingston* (1926) 11 TC 538 in which Lord Clyde concluded at [542] that the test to be applied in determining whether a venture constitutes a trade "is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made …"

120. It should however be noted that the issue in *Livingston* related to a one-off transaction and so Lord Clyde's comments were made in the context of whether a single transaction could amount to a trade. The comparison with ordinary trading was to see whether the single

transaction had the characteristics of an ordinary trading venture and not whether the particular transaction was similar to other transactions carried on by the same person.

121. In our view, *Livingston* therefore has little relevance and the real question is whether Mr Williams did indeed intend to renovate the two properties and then keep them on a long-term basis as rental properties (which HMRC, rightly, do not suggest amounts to a trade) or whether they were, in reality, always going to be part of his property development trade.

122. HMRC note that, during the course of their investigation, it became clear that Mr Williams' recollection of events in 2004-2006 was somewhat hazy and that he made inconsistent statements. They note for example that, at the outset of the investigation, he told HMRC that none of the properties had tenants.

123. In 2019 when HMRC identified entries on Mr Williams' bank statements which appeared to be rent, he denied that this was the case. However, he later accepted that he had received rental income. HMRC in fact identified £2,660 of rental income although they have only charged £630 of this as this was a figure which Mr Williams had earlier accepted was rental income. Given that there was in fact rental income (as Mr Williams eventually accepted), Mr Williams' initial denial that there any rental income is not, in our view, a reliable indication as to whether Mr Williams did in fact intend to rent the properties out.

124. In addition, Ms Hartstill draws attention to the fact that Mr Williams did not suggest that these two properties were intended to be long term rental properties until 2020. Mr Williams' explanation for this is that HMRC only decided his profits were trading profits and not capital gains in 2017 and that it was only when he took advice from an accountant in early 2020 that he appreciated that the profit on these two properties would still be within capital gains tax rather than trading profits. Based on this explanation, we do not draw any adverse inference from the fact that Mr Williams did not make this point to HMRC any sooner than he did.

125. HMRC also refer to a witness statement provided by one of Mr Williams' builders, Michael Samuels who notes that he was present when the surveyor on behalf of the mortgage companies inspected the buildings and said that no mortgage could be granted due to the condition of the properties. HMRC infer that this visit took place in March 2004 (before the properties were purchased) and, based on this, Ms Hartstill submits that when the properties were in fact purchased a month or so later, the intention must have been to sell them on relatively quickly.

126. However, it is clear to us that this is not what Mr Samuels is saying. He notes that he was approached by Mr Williams in March 2004 to get a quote for refurbishing the properties. Later in his statement he mentions the visit with the surveyor but he does not say when this took place. Mr Williams' evidence is that it took place in August 2004.

127. Mr Williams has been able to provide invoices for furniture which he says were used to furnish the two properties at Dollond Street. We do not place much weight on this as it is impossible to tell from the invoices when the items were purchased and whether they related to Dollond Street or not.

128. However, given HMRC's identification of rental income from Mr Williams' bank statements and Mr Williams' acceptance that he received rental income, there seems little doubt that the properties were in fact tenanted. We find as a fact that they were.

129. As Mr Williams points out, if he intended simply to renovate the properties and sell them, why would he put tenants into the properties as this would simply make them more difficult to sell?

130. Mr Williams has provided some evidence which shows that a tenanted property sells at a discount to a property with vacant possession. However, the evidence which has been provided relates to properties which have sitting tenants and not tenants who are occupying under the terms of an assured shorthold tenancy where the landlord can obtain possession relatively quickly. There is no suggestion that any tenants which were occupying Dollond Street were sitting tenants.

131. However, even if the discount for vacant possession value is minimal, it seems to us highly unlikely that a property developer would put tenants into a property before selling it. This does therefore provide strong support for Mr Williams' evidence that, when he purchased the properties, he intended to let them out and that it was only the inability to obtain a buy to let mortgage which forced him to sell the properties.

132. As to the failure to obtain a mortgage, there is, again, some inconsistency in the evidence. Mr Williams states that the reason he could not get a mortgage was that the properties were in an area where there had been mining. However, Mr Samuels' statement explains that the reason the surveyor gave for not being able to recommend the properties for a mortgage was "damp, wood rot to the structure" and "other issues".

133. However, given that Mr Williams' recollection of events in 2004 is, understandably, somewhat unreliable, we do not consider that this inconsistency casts significant doubt on his evidence that he tried to get a buy-to-let mortgage but was unable to do so.

134. Based on all of the above, we find as a fact that, when Mr Williams purchased the two properties at Dollond Street, he intended to keep them on a longer term basis to rent them out and that the only reason they were sold was because he could not obtain buy-to-let mortgage.

135. In these circumstances, we do not consider the purchase and sale of those properties to constitute a trading transaction. Even if the comments of Lord Clyde in *Livingston* were relevant, the fact is that the transactions relating to Dollond Street were not of the same kind as those which are characteristic of ordinary trading as Mr Williams intended to keep the properties on a longer term basis and in fact installed tenants in the properties which, as we have said, would not typically be the case where a person simply purchases a property in order to renovate it and then sell it at a profit.

136. Ms Hartstill also referred to the decision of Rowlatt J in *Pickford v Quirke* (1927) 13 TC 251 at [263] where the judge notes that:-

> "… one transaction of buying and selling a thing does not make a man a trader, but if it is repeated and becomes systematic, then he becomes a trader …"

137. However, there is no disagreement that Mr Williams was trading as far as his property development business is concerned. There is no reason why he could not at the same time carry on a separate property investment business.

138. We therefore accept that the purchase and sale of the two properties at Dollond Street were not trading transactions and that any profit is, in principle, subject to capital gains tax.

139. As HMRC note, the question as to what expenditure is deductible for capital gains tax purposes is different to the principles which apply to trading expenses. HMRC and Mr Williams will need to agree the amount of any taxable gain. Should they be unable to agree the calculation of gain, either party has liberty to apply to the Tribunal for a determination. However, given the relatively small amounts involved (the combined profits on these two properties calculated on a trading basis being approximately £2,000), we would very much hope that this would not be necessary.

PENALTIES

140. The final issue we have to deal with is the amount of the penalties which HMRC have charged. The penalties arise under section 7(8) TMA in respect of Mr Williams' failure to notify HMRC of his chargeability to tax for the tax years ended 5 April 2004 and 5 April 2005.

141. As we have found that Mr Williams did fail to notify HMRC of his chargeability, the penalties are in principle due. The maximum penalty which can be charged is equal to the amount of the tax which is found to be due.

142. Under section 100 TMA (as it stood at the time) HMRC have discretion as to the amount of the penalty. On an appeal, section 100B TMA gives the Tribunal the power to reduce the penalty if it considers it to be excessive. The penalty can be reduced to nil.

143. As we have said, Mr Williams' does not suggest that he has a reasonable excuse for the failure to notify chargeability given that his case is that he did notify chargeability. His objection to the penalty is that he considers it excessive as, in his view, he has co-operated with HMRC throughout their investigation.

144. HMRC's practice is to make reductions for disclosure, cooperation and seriousness. They have not allowed any reduction for disclosure but have allowed a 25% reduction for cooperation and a 20% reduction for seriousness. The total reduction is therefore 45% and so the penalty is 55% of the tax which is due.

145. At the hearing, Ms Hartstill accepted that it was arguable that a greater reduction for seriousness might be justified given that, during the course of the investigation, HMRC have accepted many of Mr Williams' points. Their initial estimates would have given rise to tax liabilities in excess of £100,000. Even on HMRC's current figures, the maximum tax liability is now £12,000. To reflect this, we propose to increase the reduction allowed for seriousness from 20% to 30%.

146. As far as the reductions for co-operation and disclosure are concerned, having reviewed the voluminous correspondence since 2014, we share HMRC's view that Mr Williams has been less than forthcoming throughout the investigation and has provided information to HMRC which clearly cannot be supported. This is well demonstrated by the fact that Mr Williams initially claimed that he had spent £35,000 renovating each of the properties and then, four years later produced detailed schedules which showed that, even on his case, the amount spent on average on each of the properties was less than half of this.

147. We also note that HMRC issued two information notices given Mr Williams' failure to provide information. Whilst those information notices may have been withdrawn, there is no doubt that there was significant delays by Mr Williams in providing information. Even allowing for the difficulty of recreating records after ten years, it is difficult to see how a gap of four years before providing any detailed information about the expenditure on the properties can be justified. It is clear that a large amount of the information came from Mr Williams' bank statements which he had clearly been able to obtain. There is no evidence as to when he obtained bank statements but it cannot conceivably have taken him four years to do so.

148. In addition, when that information was provided, it was unreliable (for the reason that we have explained above) with the expenses claimed (based on our findings above) being significantly overstated.

149. Having said this, we would accept that a small reduction of 5% for disclosure should be made as Mr Williams did, as he submits, make voluntary disclosure of certain matters such as an additional four properties which HMRC had not included in their original list.

150. The result is that the total reduction that we would allow is 60% (the reduction of 45% allowed by HMRC plus an additional 15%) so that the penalties should be set at 40% of the tax due.

CONCLUSION

151. Mr Williams did not notify HMRC of his chargeability to tax for the tax years ended 5 April 2004 and 5 April 2005.

152. The discovery assessments issued by HMRC for each of those tax years were validly issued as the loss of tax has been brought about carelessly by Mr Williams so that a 20 year time limit applies.

153. Mr Williams has been overcharged by the assessments. They should be reduced to reflect the review conclusions. They should be further reduced by deducting expenses totalling a further £20,500 allocated across all of the nine properties in proportion to the expenses which have already been allowed in respect of those properties.

154. The profits on the sale of 7 Dollond Street and 13 Dollond Street are subject to capital gains tax rather than income tax. The profits need to be recalculated using capital gains tax principles. If the calculations cannot be agreed, the parties have liberty to apply to the Tribunal for a determination of the amount of the gains.

155. The penalties charged are excessive and should be reduced to 40% of the tax which, taking into account our conclusions above, is now found to be due.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

156. 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.

ROBIN VOS
TRIBUNAL JUDGE

Release date: 16th MAY 2024