TC02090

Appeal number: TC/2010/07499

Income tax – failure to declare income from self employment – failure to report chargeability to tax – assessments raised by HMRC together with penalties – assessments and associated penalties upheld – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JOHN TRODDEN **Appellant**

-and-

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

TRIBUNAL: **JUDGE KEVIN POOLE**
RUTH WATTS-DAVIES MHCIMA FCIPD

Sitting in public at 45 Bedford Square, London on 27 April 2012

The Appellant appeared in person

Paul Reeve, Higher Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against discovery assessments for income tax, class 4 National Insurance contributions and associated penalties in respect of alleged under-declarations of profits from the Appellant's self-employment in the property construction and maintenance industry.

The assessments under appeal

2. The assessments under appeal are for additional income tax and class 4 NICs as follows:

Tax year	Date of original assessment	Amount of assessment under appeal	Associated penalty under appeal
1999-2000	9 Dec 2008	£13,781.60	£6,890
2000-2001	9 Dec 2008	£14,296.05	£7,148
2001-2002	11 Dec 2009	£14,443.95	£7,222
2002-2003	21 Oct 2009	£16,852.35	£8,426
2003-2004	7 Feb 2008	£18,769.93	£9,385
2004-2005	7 Feb 2008	£25,880.80	£12,940

The facts

3. The Appellant started in self-employment on 13 September 1999 in the property construction/maintenance sector. He reported the cessation of that business on 30 June 2000 in his self-assessment tax return for the year ended 5 April 2001.

4. The Appellant had a son, James, who left school in the summer of 2001 after reaching the age of 16 in September 2000. The Appellant's evidence was that he handed the business over to his son, who had shown a great aptitude and interest for it. He remained in control of the business, however, and only paid his son from the business what he thought was appropriate.

5. The son had delivered tax returns, starting with a return for the year ended 5 April 2003, in which he reported that he had commenced self-employment on 7 April 2001. No explanation was given as to the apparent nine month gap between the Appellant ceasing the business and his son commencing it. On 11 January 2005, HMRC sent a letter to James Trodden informing him that they intended to enquire into the whole of his return for the 2002-03 tax year. They requested certain

information, including the business records. After the bulk of the material was delivered by accountants on behalf of James Trodden, there followed a meeting at HMRC on 24 October 2005, at which various questions were put by HMRC arising out of their examination of the records and information supplied. At that meeting, the Appellant took the lead in replying to questions, saying that he controlled the business. It is clear from the level of detail which he provided in response to questions that it was he rather than his son who was in control of the business. In addition, the only customer of the business from whom we heard evidence considered she was dealing with the Appellant.

6. We find as a fact that the business was being carried on by the Appellant rather than his son at all material times. To the extent his son was involved in the business, we find it was as nominee for the Appellant.

7. At the meeting on 24 October 2005, HMRC asked a number of detailed questions that had arisen from an examination of the business records and information supplied to them. They followed this up with a letter dated 4 November 2005 and the enquiry process continued from there. At that stage, HMRC gave no indication that they considered the Appellant's son was not in fact running the business in his own right.

8. On 23 January 2006, HMRC issued a protective notice of enquiry to the Appellant's son in respect of his 2003-04 tax return, but they did not seek any information or records to continue with that enquiry.

9. As the enquiries into the 2002-03 return continued, HMRC focused on a number of addresses to which the business had had materials or equipment delivered (according to its purchase invoices) but for which there did not appear to be any sales invoices. Three such addresses in particular were followed up.

10. At the first address, Memsahib Restaurant, the Appellant's explanation was that the restaurant was owned by a good friend of his, who permitted the business to use its car park for storage while the yard of the business was being resurfaced and the restaurant was closed for conversion into a residential property. It was denied that the business had carried out the conversion work at the restaurant, and the site meetings between the Appellant and the local authority building inspector at the restaurant were explained as a favour for a friend. No corroborating evidence in support of this explanation was put before the Tribunal, in particular the Appellant's friend did not attend to give evidence.

11. At the second address, Stoatley Rise, the explanation was that the business had originally been instructed to carry out some major groundworks, including levelling and building a large retaining wall. After the work had been substantially completed, the customer raised a spurious complaint but they decided to cut their losses and resign from the job without payment.

12. At the third, Neadfield Hanger, the explanation was that the address was a car park that was simply used as a delivery address for the hire of equipment in order to

avoid excessive delivery charges that would be incurred if the equipment were delivered by the hire company to the works address. The business supposedly used its own vehicles to transport the equipment to the works site from this delivery address. At the hearing the Appellant produced some photographs showing a small digger, a four wheel drive vehicle and a trailer parked just inside the entrance to what appeared to be a large private drive with name plates on the gate pillars apparently identifying a number of properties to which the drive gave access, including Neadfield Hanger.

13. HMRC followed up the explanation given in relation to the Stoatley Rise work and were able to speak to Mrs Knapp, the customer, who confirmed that the job had been completed to her satisfaction and she had paid the Appellant cash for it, as he had specified. By reference to bank statements, she was able to establish that she had withdrawn cash from her bank account totalling £17,900 in March and April 2002 to make these payments. HMRC explained their findings in a letter to the Appellant's son dated 26 March 2007, in response to which the Appellant telephoned to agree to the meeting which had been proposed by HMRC in that letter.

14. At the meeting, which took place on 17 April 2007, HMRC explained they considered that there was undeclared business income for the Stoatley Rise job and the other work which they believed had been paid for but not declared in relation to the sites reflected in the other purchase invoices. They said they were contemplating adding £37,218 to the taxable profits for the enquiry year 2002-03 for this. When the calculations were performed, this would result in an increased tax liability over the three tax years 2001-02 to 2003-04 of some £45,000, to include interest and penalties. They offered to settle the enquiry on this basis.

15. Mrs Knapp (the customer on the Stoatley Rise job) gave evidence before us as to the cash payments referred to. The Appellant sought to persuade us that she was not giving a true picture of events. We found her to be an entirely credible witness and accept her version of events. She confirmed that she had withdrawn the money from her account in order to pay the Appellant in cash, as he had requested. He had said that cash was needed so he could pay his workers in cash. Of the £17,900 she had withdrawn, she was confident that all except for perhaps £250 was paid over to the Appellant.

16. Following the April 2007 meeting, the Appellant and his son appointed new advisers to help in the enquiry. HMRC's attempt to obtain agreement to the proposed increases was rejected and a further meeting took place on 15 August 2007 between HMRC and the new advisers.

17. At that meeting, HMRC explained their concerns to the advisers in more detail, confirmed that their previous informal offer of settlement was withdrawn and explained that unless it was accepted that the accounts of the business were wrong, they would press ahead and raise assessments. They also said they had grave doubts as to whether it really was the Appellant's son who was carrying on the business, rather than the Appellant himself.

18. There followed further inconclusive correspondence (including a very detailed letter dated 20 September 2007 from the Appellant's advisers, which repeated the assertion that no cash had been received, as alleged, from Mrs Knapp in respect of the Stoatley Rise job).

19. HMRC were not satisfied with the explanations offered and on 7 February 2008 they issued assessments to the Appellant as follows:

(1) For the year 2003-04 for £24,310.38 income tax and class 4 NICs in respect of undeclared profits of £73,378 from self-employment;

(2) For the year 2004-05 for £28,276.32 income tax and class 4 NICs in respect of undeclared profits of £75,709 from self-employment, £9,516 of employment income and £1,060 of interest received;

(3) For the year 2005-06 for £33,874.47 income tax and class 4 NICs in respect of undeclared profits of £77,645 from self-employment, £22,198 of employment income, £24,000 of profit from UK land and property, £1,692 of interest received and £5,360 of UK dividend income.

20. It is worth mentioning at this stage that the 2005-06 assessment was later withdrawn by HMRC and the other two were substantially reduced. It is fair to say that, on the basis of the evidence before the Tribunal, the three assessments as originally issued would appear to have been excessive (though not on the basis of the information available to HMRC at the time).

21. These three assessments were appealed, but the Appellant's advisers also made a formal complaint about their issue. This process took up more time, but in June 2008 the Appellant appointed new specialist investigation advisers, who met with HMRC in August 2008. HMRC drew various outstanding issues to the attention of the new advisers, including the outcome of their preliminary review of the Appellant's known assets and a comparison of those assets with his declared income. It was ultimately agreed that the new advisers would prepare a disclosure report to HMRC on the Appellant's instructions. A timetable for delivery of this report of six months was agreed, running to late March 2009.

22. Having considered the up to date position in their researches and the preliminary discussions they had had with the new advisers, HMRC became concerned about what they perceived to be the unpaid tax at risk for 1999-2000 and 2000-2001 and therefore on 9 December 2008 they issued the following further assessments to the Appellant:

(1) for 1999-2000 for £34,419.20 unpaid income tax and class 4 NICs in respect of undeclared profits of £100,000 from self-employment;

(2) for 2000- 2001 for £34,592.05 unpaid income tax and class 4 NICs, also in respect of undeclared profits of £100,000 from self-employment.

23. A small payment on account was received from the Appellant and work apparently continued on the disclosure report. Things do not appear to have gone smoothly and it was delayed beyond the agreed deadline. In October 2009 HMRC lost patience and asked the Appellant to supply them with copies of all bank account and credit card statements in which he had an interest for the period from 7 April 2001 to 30 April 2005. They also raised, on 21 October 2009, a further assessment in respect of the tax year 2002-03 for £34,347.95 in respect of unpaid income tax and class 4 NICs on undeclared profits of £100,000 from self-employment.

24. The issue of this latest assessment did not go down well with the Appellant. He telephoned HMRC and told them he was not prepared to provide the bank statements etc that they had requested. However, he did then agree to attend a meeting at HMRC in mid-November 2009, at which he did in fact supply various documents, including bank and credit card statements. He also appears to have dismissed his specialist investigation advisers at about the same time.

25. Following the meeting, HMRC reviewed the documents provided, in particular the bank statements. They considered in particular the 2001-02 tax year and noted that there appeared to be substantial deposits into the Appellant's bank account despite him having no declared source of income for that year. They therefore decided to complete the picture by raising an assessment for that year (which was done on 11 December 2009) for £14,443.95 in respect of unpaid income tax and class 4 NICs on undeclared profits of £50,000.

26. The Appellant had originally maintained (and he continued to do so before the Tribunal) that £17,000 of the deposits to his personal bank account in 2001-02 were contributions to the capital of the business made by his partner (whom he subsequently married). Copies of her bank statements were produced which included payments made out of it (to an unnamed payee) as follows:

Date of statement entry	**Amount paid out**
9 April 2001	£8,000
20 April 2001	£5,000
3 May 2001	£2,000
15 May 2001	£1,000
15 May 2001	£1,000

27. No evidence from the Appellant's wife was forthcoming before or at the hearing to corroborate the Appellant's explanation. There are a number of obvious inconsistencies in the explanation, not least the fact that the Appellant's bank account shows credit amounts of £8,000 and £5,000 being received shortly before those amounts are shown as debited to his partner's account, and there are no corresponding

entries in his personal bank account for the other three alleged payments. In addition, the account of his partner from which the payments are supposed to have been made appears to have been a specially opened account, described as "Clockhouse Account" (for no identified reason) and on the two statement sheets before us (numbered 2 and 3), there were totals of £110,000 paid out and £17,000 received for which no explanation was given. We are therefore sceptical about the Appellant's allegations in relation to these supposed payments and in the absence of any corroboration we do not accept this explanation given by the Appellant.

28. Following a formal appeal against the December 2009 assessment, HMRC issued a detailed letter dated 17 March 2010 setting out their view of the matter. In that letter, they indicated that they proposed to reduce the 2005-06 assessment to nil (on the basis that the business was taken over by a limited company for nearly all of that period and there were very few unexplained personal bankings during the period from 6 April 2005 to the time the company took over the business, so any undeclared personal income was likely to be minimal). They confirmed the most recent (2001-02) assessment and reduced most of the other assessments after recalculating them based on undeclared profits of £50,000 per year (adjusted for inflation from 2001-02). In view of the large unidentified deposits totalling £62,318.80 in 2004-05, however, they only reduced their view of the undeclared profits for that year from £100,000 to £70,000.

29. This resulted in the figures set out at [2] above.

The basis of HMRC's estimated assessments

30. Miss Waterhouse, in her witness statement, gave evidence as to her thinking behind the initial raising of the assessments and her subsequent proposal to reduce them.

31. As to the 2002-03 assessment, she said this was originally calculated on the basis of the undeclared cash receipts for the Stoatley Rise job. She took the entire £17,900 as profit (as the Appellant had not made any allegation of costs to be set against that income which had not already been claimed in the accounts put forward by his son); on the basis that the job lasted approximately two months, she considered it reasonable to expect four times this profit to be earned in the course of a whole year. This gave a figure of £71,600, which she rounded down to £70,000 for the purposes of the assessment issued in February 2008.

32. She simply applied an inflation increase to this figure for the purposes of calculating the 2003-04 and 2004-05 assessments also issued in February 2008.

33. Before issuing the other assessments, she obtained further information. As a result of property searches she discovered that the Appellant had purchased some £615,000 of property in his own name in 2006 as well as further property jointly with others. She was also concerned, as a result of comments made to her by the specialist investigation advisers appointed by the Appellant, that the earlier assessments may have been underestimated. She therefore incorporated an estimated figure of

£100,000 per year in the assessments for 1999-2000 and 2000-01 issued in December 2008.

34. Similar thinking was behind her estimate of £100,000 of undeclared profits incorporated in the 2002-03 assessment issued in October 2009.

35. By December 2009, further information had been provided which led Miss Waterhouse to believe that an under-declaration figure for the final outstanding year (2001-02) of only £50,000 was appropriate. Some confirmation had been received to the effect that the property purchases were largely funded by mortgage borrowing rather than undeclared business profits, though there were still significant cash deposits in the Appellant's personal bank account for that year for which she did not consider a reasonable explanation had been provided.

36. In March 2010, when she was preparing her "View of the matter" letter, she re-considered the assessments for all the years. The most recent (2001-02) assessment remained appropriate in her view after her review of the information supplied. She considered however that the other assessments all required to be reduced, so as to be more in line with the 2001-02 figures. As a result, she made the reductions mentioned at [28].

37. The resulting adjusted figures were all confirmed by HMRC on their statutory review of the matter in August 2010.

Penalties

38. In addition, HMRC considered the question of penalties. They imposed penalties at a rate of 50% of what they considered to be the unpaid tax in respect of each of the relevant years. For 2001-02 and 2002-03 (the years for which the Appellant had made no return of his income) they imposed the penalties under section 7 Taxes Management Act 1970 ("TMA") and for the other years they imposed them under section 95 TMA. They gave abatements of 10% (out of a possible 20%) for disclosure, on the basis that the Appellant had initially provided some records, 20% (out of a possible 40%) for cooperation (on the basis that the Appellant had attended meetings as well as providing further records, albeit at a late stage) and 20% (out of a possible 40%) for size and gravity (on the basis that the under-declaration did appear to be deliberate and over a number of years, though not very large).

The law

39. We consider first the main provision under which the assessments have been issued. Section 29 TMA, at all material times, provided so far as relevant as follows:

> "**29 Assessment where loss of tax discovered**
>
> (1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment –

> (a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed,
>
> .....
>
> the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.
>
> ....
>
> (3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above –
>
> (a) in respect of the year of assessment mentioned in that subsection; and
>
> (b) in the same capacity as that in which he made and delivered the return,
>
> unless one of the two conditions mentioned below is fulfilled.
>
> (4) The first condition is that the situation mentioned in subsection (1) was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf."

40. Thus HMRC are required to show that the Appellant has acted "carelessly or deliberately" in under-declaring his taxable profits for any tax year in respect of which he has made a return before they may raise an assessment for tax on the difference. In contrast, where the Appellant has not actually made a return, there is no such requirement.

41. As to the amount of any assessment that HMRC may raise under section 29 TMA, it is clear that they are required to make an estimate based on reasonable inferences. As was said by Walton J in *Johnson v Scott (HM Inspector of Taxes)* [1978] 52 TC 383 at 393:

> "Indeed, it is quite impossible to see how the Crown, in cases of this kind, could do anything else but attempt to draw inferences. The true facts are known, presumably, if known at all, to one person only – the Appellant himself. If once it is clear that he has not put before the tax authorities the full amount of his income, as on the quite clear inferences of fact to be made in the present case he has not, what can then be done? Of course all estimates are unsatisfactory; of course they will always be open to challenge in points of detail; and of course they may well be under-estimates rather than over-estimates as well. But what the Crown has to do in such a situation is, on the known facts, to make reasonable inferences. When, in para 7(b) of the Case Stated, the Commissioners state that (with certain exceptions) the Inspector's

figures were 'fair', that is, in my judgment, precisely and exactly what they ought to be – fair. The fact that the onus is on the taxpayer to displace the assessment is not intended to give the Crown carte blanche to make wild or extravagant claims. Where an inference, of whatever nature, falls to be made, one invariably speaks of a 'fair' inference, Where, as is the case in this matter, figures have to be inferred, what has to be made is a 'fair' inference as to what such figures may have been. The figures themselves must be fair."

42. Once an assessment which complies with this requirement has been raised, it is clear that the burden lies on the Appellant to show that it is wrong. Section 50(6) TMA provides as follows:

> "(6) If, on an appeal notified to the tribunal, the tribunal decides –
>
> ....
>
> (c) that the appellant is overcharged by an assessment other than a self-assessment,
>
> the assessment .... shall be reduced accordingly, but otherwise the assessment .... shall stand good."

43. We then consider the question of time limits within which any assessment must be raised. Sections 34 and 36 TMA, as they applied at all material times, provided as follows:

> "**34 Ordinary time limit of six years**
>
> (1) Subject to the following provisions of this Act, and to any other provisions of the Taxes Act allowing a longer period in any particular class of case, an assessment to income tax or capital gains tax may be made at any time not later than five years after the 31st January next following the year of assessment to which it relates
>
> **36 Fraudulent or negligent conduct**
>
> (1) An assessment on any person (in this section referred to as "the person in default") for the purpose of making good to the Crown a loss of income tax or capital gains tax attributable to his fraudulent or negligent conduct or the fraudulent or negligent conduct of a person acting on his behalf may be made at any time not later than 20 years after the 31st January next following the year of assessment to which it relates"

44. So far as penalties are concerned, sections 7 and 95 TMA provided, at the material times and so far as relevant, as follows:

> "**7 Notice of liability to income tax and capital gains tax**
>
> (1) Every person who –

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

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

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

....

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

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

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

....

95 Incorrect return or accounts for income tax or capital gains tax

(1) Where a person fraudulently or negligently –

(a) delivers any incorrect return of a kind mentioned in section 8... of this Act...

...

he shall be liable to a penalty not exceeding the amount of the difference specified in subsection (2) below.

(2) The difference is that between –

(a) the amount of income tax and capital gains tax payable for the relevant years of assessment by the said person (including any amount of income tax deducted at source and not repayable); and

(b) the amount which would have been the amount so payable if the return.... as made or submitted by him had been correct."

45. As to the process for imposing a penalty and appealing against the amount of it, sections 100 and 100B TMA provided, so far as relevant, at the relevant times as follows:

"**100 Determination of penalties by officer of the Board**

(1) ....an officer of the Board authorised by the Board for the purposes of this section may make a determination imposing a penalty under any provision of the Taxes Acts and setting it at such amount as, in his opinion, is correct or appropriate.

....

100B Appeals against penalty determinations

(1) An appeal may be brought against the determination of a penalty under section 100 above and, subject to sections 93 and 93A of this Act and the following provisions of this section, the provisions of this Act relating to appeals shall have effect in relation to an appeal against such a determination as they have effect in relation to an appeal against an assessment to tax except that references to the tribunal shall be taken to be references to the First-tier Tribunal.

(2) Subject to sections 93(8) and 93A(7) of this Act on an appeal against the determination of a penalty under section 100 above section 50(6) to (8) of this Act shall not apply but –

(a) in the case of a penalty which is required to be of a particular amount.....

....

(b) in the case of any other penalty, the First-tier Tribunal may –

(i) if it appears that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears to be appropriate, confirm the determination,

(iii) if the amount determined appears to be excessive, reduce it to such other amount (including nil) as it considers appropriate, or

(iv) if the amount determined appears to be insufficient, increase it to such amount not exceeding the permitted maximum as it considers appropriate."

Applying the law to the facts

46. First, we address the question of whether HMRC were entitled to raise assessments at all under section 29 TMA.

47. The Appellant has made returns in respect of the years 1999-2000, 2000-01, 2003-04 and 2004-05. We have found (see above) that the Appellant deliberately

concealed his taxable receipts of not less than £17,650 from the Stoatley Rise job in 2001-02 and 2002-03. We are satisfied on a balance of probabilities that this deliberate concealment was not a one-off occurrence and we infer that a similar pattern continued throughout all the years under appeal.

48. We find therefore that the Appellant did carelessly or deliberately under-declare his taxable profits for each relevant year and therefore HMRC were entitled to raise assessments in respect of the undeclared profits for those years which they subsequently discovered, subject to the following points.

49. For the years up to 2002-03, the assessments were raised outside the normal time limits prevailing at the time under section 34 TMA. We are satisfied, however, on a balance of probabilities that there was a loss of tax for each of the years 1999-2000 to 2002-03 and that loss of tax was attributable to the Appellant's fraudulent or negligent conduct. The extended time limit in section 36 TMA is therefore engaged in relation to the assessments for those years, which are therefore in time.

50. We see no basis to strike down HMRC's assessments as "wild" or "extravagant", either when they were originally made (in the light of the information then available) or when HMRC indicated later their preparedness to reduce them (in the light of more complete information). On the contrary, we consider the assessments to have been fair.

51. It follows that the burden lies on the Appellant to demonstrate that the assessments, as proposed to be reduced by HMRC, are excessive.

52. The Appellant has failed to discharge this burden. He has continued to maintain, right up to the hearing, that he did not receive the cash payments which Mrs Knapp says she paid him (and which we find to have been paid); he has failed to produce full records for the business or a comprehensive explanation for the unexplained amounts paid into his personal bank account.

53. It follows that we must dismiss his appeal against the reduced assessments as confirmed in HMRC's formal review letter dated 18 August 2010 and as summarised at [2] above.

54. So far as the penalties are concerned, we consider that penalties are indeed properly due under sections 7 and 95 TMA and have been properly imposed under section 100 TMA. We see no reason to interfere with the loadings applied by HMRC. It follows that the penalties appear appropriate to us and should therefore be confirmed.

Decision

55. We find the assessments for all the years in question, as set out at [2] above, to have been properly raised and within the appropriate time limits.

56. We find the penalties also to have been properly imposed and we consider the amounts to be appropriate.

57. The appeal is therefore dismissed.

58. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 18 June 2012