



TC06727

Appeal number: TC/2017/06820

INCOME TAX & NATIONAL INSURANCE CONTRIBUTIONS – return amended by closure notice to remove most of deduction for payments to sub-contractors and all amounts said to have been suffered by appellant under the CIS scheme agreed not to have been suffered – whether deductions for payments made allowable – whether turnover should be reduced on account of fictitious CIS amounts deducted which were nevertheless added to turnover by the appellant – appeal allowed.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

VALENTINO DUMITRAȘCU

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE RICHARD THOMAS
JOHN WOODMAN**

Sitting in public at Taylor House London EC1 on 14 September 2018

The appellant in person, assisted by Ms Mioara Sanda Matei

Mr Paul Hunter, Litigator, HM Revenue and Customs, for the Respondents

DECISION

1. This was an appeal by Mr Vasile Dumitraşcu against the conclusion stated and amendments made to his return by a closure notice under s 28A Taxes Management Act 1970 (“TMA”) for the tax year 2015-16.

Evidence

2. We had a bundle of documents prepared by HMRC who had no witnesses. The appellant gave evidence, as did two people who worked for him, Mr Dragos Popilei and Mr Marcel Docianu. The appellant and the other two witness were assisted, to a greater or lesser degree, by Ms Matei, an adviser to the appellant who translated questions asked for them and statements made by them to and from Romanian. We were satisfied that Ms Matei, although not appointed by the Tribunal, was properly interpreting what was said both into English and Romanian. All three witnesses were cross-examined by Mr Hunter and asked questions by the Tribunal.

3. We give our views of the witnesses and their evidence later.

Facts

4. We take this account of the undisputed facts from the bundle of papers.

5. On 25 June 2016 the appellant delivered his tax return for the tax year 2015-16. The only entries related to his trade of construction work. The return showed:

Turnover	£101,966
Payments headed “construction industry”	£41,430
Other expenses	£22,864
Net profit	£37,672
Total Construction Industry scheme deductions	£20,044
Tax & Class 4 NICs overpaid	£11,818.

6. On 28 July 2018 HMRC opened an enquiry under s 9A TMA into the return.

7. Under the heading “What we will be checking” HMRC commented that the total allowable expenses at £64,294 was high in relation to the turnover.

8. They also said that there was discrepancy between the CIS amount claimed of £20,044 and the amount on HMRC’s records which was nil, and that they would be checking this aspect of the return.

9. Pending resolution of the enquiry they were withholding the refund shown of £11,818.

10. The letter opening the enquiry then asked for a breakdown of the £41,430 costs in the “construction industry” box and asked the appellant to check the details of the claim for set off of £20,044.

11. On 3 October 2016 in the absence of a reply the appellant was given a Schedule 36 FA 2008 notice asking for the same information and records.
12. On 9 November 2016 a penalty of £300 was assessed for the failure to supply the information.
- 5 13. On 30 November 2016 a letter from HMRC gave their conclusion about what was wrong with the return.
14. On 6 December the appellant wrote to HMRC with business bank statements and invoices and information about payments to sub-contractors from his ledger book. He also said that all his work was for private clients and he was not registered for the CIS.
- 10 15. On 9 January 2017 HMRC said that in view of his statements the £20,044 was not available for credit and would be removed on closure of the enquiry.
- 15 16. As to the payments to sub-contractors in relation to a Mr Popa HMRC had invoices for £5,750 but could only see £4,000 going through the bank statements they could only find payments of £4,000. He was asked to explain the difference. As to Mr Dragos Pintelei and Mr Marcel Diaconu he was asked the method of payment to them and evidence of payment, as there was nothing on the bank statements in relation to them.
- 20 17. On 10 March 2017 HMRC issued another conclusion letter in the absence of any reply. The conclusion on expenses was that the amount was to be reduced from £41,430 to £4,000 as this was the only verified amount. Penalties for incorrect returns were mentioned.
- 25 18. On 11 April 2017 HMRC issued a closure notice under s 28A TMA. In this they repeated their conclusions in the earlier letters and said they had amended the 2016 (*sic*) Self Assessment tax return accordingly. The result was whereas the previous tax calculation showed an overpayment of £11,831.97, the revised calculation showed additional tax of £23,332.99. The difference of £35,164.96 was the additional tax due.
- 30 19. The letter enclosed a copy of the Self Assessment Statement (of account between the appellant and HMRC) dated 7 April 2017. This showed the balance owing was £34,938.63 which “must be paid now”.
- 35 20. The letter also explained briefly how HMRC were calculating penalties and that the amount of them would be £6,329.69 which was a rate of 18% on the additional tax. HMRC could not suspend the penalties. A notice of penalty assessment would be sent shortly.
21. On 10 May 2017 the appellant wrote to HMRC. He accepted the claim for CIS tax was mistake. But he wanted to appeal about the payments to sub-contractors disallowed and gave UTRs and NINOs for Mr Pintelei and Mr Diaconu, adding that he did pay them and the invoices they supplied are genuine.

22. On 7 June 2017 HMRC replied treating the letter as an appeal against the amendments to the return and the penalty. They had postponed the tax and stood over the penalty (which must therefore have been issued). They repeated as HMRC's view of the matter what had been said before, but added that:

- 5 (1) The invoices did not seem genuine.
 (2) There were no good records of the cash payments.
 (3) The appellant was not registered for the CIS as a contractor.
 (4) The new information in the appeal letter was insufficient to verify the payments to Pintelei and Diaconu.

10 23. As to the penalty the letter offered the possibility of suspension but that was conditional on the view of the matter being accepted.

24. The letter concluded by saying that if the appellant disagreed he could provide further information, ask for a review or notify the Tribunal.

15 25. It seems the appellant asked for a review as on 8 November 2017 he was told that a member of the Appeals and Reviews section had been allocated it.

26. On 20 November 2017 the appellant wrote to the review officer with his Ledger books for income and expenses with receipts and bank statements and said the two labourers were ready to come and testify to HMRC that they received cash from the appellant for their services.

20 27. There is nothing in the papers showing the conclusion of the review but we assume it was to uphold the HMRC view of the matter, as on 28 August 2017 the appellant notified his appeal to the Tribunal saying the date of the decision he was appealing was 13 June 2017. On it he said that the latest time for sending the Notice of Appeal was 13 July 2017 and that he was asking for permission to notify late, as the letter took 10 days to reach him and he waited for his documents to be returned by
25 HMRC.

28. HMRC say they do not object to the late appeal and we therefore give permission for it to be notified late.

30 29. The appellant included in the Notice of Appeal further explanations, including that he was mistaken about the CIS but as a good faith gesture he had grossed up his turnover by the amount, so his actual turnover was £81,922.87. Her maintained that the payments to the two labourers were genuine and that they had said they would pay their own tax.

The parties' submissions

35 30. HMRC's submissions were as set out in the "view of the matter" letter and the review conclusion. There was insufficient evidence to verify the cash payments to Mr Pintelei and Mr Diaconu, and only £4,000 of the payments to Mr Popa. The CIS payments was accepted by the appellant as not correct. They asked the Tribunal to uphold the amendments to the return.

31. The statement of case did not specifically ask for anything in relation to the penalty.

32. HMRC also asked the Tribunal to find that the appellant had failed to comply with his statutory obligations in relation to the filing his CIS returns for his sub-contractors.

33. The appellant put forward all the points he had made in correspondence, particularly in his letter to the Tribunal of 28 July which stood as his grounds of appeal.

Law

34. On expenses s 25 ITTOIA provides that profits of a trade must be computed in accordance with GAAP, but this subject to any statutory disallowances.

35. Section 34 ITTOIA prohibits a deduction for any expense not incurred wholly and exclusively for the purposes of the trade.

36. As to turnover s 62(1)(b) FA 2004 says that where a deduction is made from a payment made by a contractor, the recipient is treated as receiving the gross sum.

37. Under s 62(2) FA 2004 the recipient may treat the amount deducted as income tax or Class 4 National Insurance Contributions (“NICs”), and subject to set off against any such liabilities, the amount may be repaid.

38. Penalties may be imposed where there is an error in a return and the error is careless or deliberate. The penalty is a percentage of the “potential lost revenue” the meaning of which is given by paragraphs 5 and 6 Schedule 24 FA 2007:

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

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

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

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

(3) In sub-paragraph (1) “tax” includes national insurance contributions.

6 ...

(2) In calculating potential lost revenue where P is liable to a penalty under paragraph 1 in respect of one or more understatements in one or more documents relating to a tax period, account shall be taken of any overstatement in any document given by P which relates to the same tax period.

(3) In sub-paragraph (2)—

- (a) “understatement” means an inaccuracy that satisfies Condition 1 of paragraph 1, and
- (b) “overstatement” means an inaccuracy that does not satisfy that condition.”

5 **Discussion**

39. We divide this into three parts.

Turnover

40. The appellant did not disagree with HMRC’s amendments to the return to remove the tax credit for the CIS amounts he had claimed, as he agreed it was mistake to think
10 that the homeowners for whom he worked would have deducted tax from the payments they made.

41. However he had informed the Tribunal in his grounds of appeal that his real turnover, the amounts he had actually received for work done for the clients was lower, by the amount of the CIS amount, than the turnover in the return.

15 42. HMRC had not made any amendments on that account but we hold that it must follow that the actual turnover, not that inflated by the CIS amount, must be used in the calculations of the profit.

Payments to sub-contractors

43. This is where the real dispute lies.

20 44. The appellant gave evidence that he had started on his own as a main contractor in 2015, having previously worked as a sub-contractor.

45. He paid other people working for him by bank transfer but had paid Mr Pintelei and Mr Docianu in cash because they did not have bank accounts. The cash came from the payments made by the clients and was not drawn from the bank account. They had
25 given him invoices which he had supplied to HMRC.

46. They had worked for him as labourers throughout 2015-16 and still did. They told him that they were set up for income tax and he had supplied their NINOs and UTRs to HMRC.

30 47. He agreed with Mr Hunter that he was familiar with the CIS up to a point. He did not realise that he should pay Mr Pintelei and Mr Docianu subject to deduction of CIS amounts even if they agreed to pay their own tax.

48. Asked why there was no evidence of payments to the two he said he was told this as the way to do it and tried his best to keep records: it was only possible to pay them cash.

35 49. Each of Mr Pintelei and Mr Docianu gave evidence that they had received cash from the appellant for supplying their services as labourers to him and had given him invoices showing monthly amounts. The appellant had shown them what to put on the

invoices, but Mr Pintelei had written the invoices in his own handwriting, and Mr Docianu's daughter had done his. They did not have bank accounts in the period.

50. Mr Pintelei was asked what he did with the cash. Did he bank it? He said no.

51. Questioned by Mr Hunter they denied that the invoices were not genuine or had all been prepared after the event. Mr Pintelei was insistent that he was registered for tax and has a tax bill although he had not necessarily paid everything he owed. Mr Docianu was less clear about his tax position.

52. We are satisfied from their evidence that Mr Pintelei and Mr Docianu have notified their liability to tax on these amounts. HMRC have had the opportunity to check from the UTRs and NINOs given by the appellant but have not said anything that contradicts the evidence.

53. When payments are made in cash there is always a difficulty in verification. HMRC are rightly suspicious of claims of unvouched cash payments. But we bear in mind what the great American judge Learned Hand said on this subject in *George M Cohan v Commissioner of Internal Revenue* 39 F.2d 540 (2d Cir. 1930):

“In the production of his plays Cohan was obliged to be free-handed in entertaining actors, employees, and, as he naively adds, dramatic critics. He had also to travel much, at times with his attorney. These expenses amounted to substantial sums, but he kept no account and probably could not have done so. At the trial before the Board he estimated that he had spent eleven thousand dollars in this fashion during the first six months of 1921, twenty-two thousand dollars, between July first, 1921, and June thirtieth, 1922, and as much for his following fiscal year, fifty-five thousand dollars in all. The Board refused to allow him any part of this, on the ground that it was impossible to tell how much he had in fact spent, in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent. True, we do not know how many trips Cohan made, nor how large his entertainments were; yet there was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any, even though it were the traveling expenses of a single trip. It is not fatal that the result will inevitably be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence.”

54. Thus the absence of “items and details” in George M Cohan's return was not fatal to an allowance of some amount, based on the probability that some expenses had been incurred. Here though we do have evidence. We have, as HMRC had, the invoices. We have had the benefit, as HMRC did not have up to now (although the appellant had

offered to produce the two recipients for interview) of the oral evidence, including evidence about the invoices. And standing back it seems unlikely that the appellant could have earned the amount of turnover he did without the kind of help that they gave to the appellant.

5 55. We find that the witnesses were telling the truth about what happened and that the appellant paid them in cash and they provided their services throughout 2015-16 and that they were paid cash by the appellant at a rate of about £250 per week as shown on the invoices.

10 56. Accordingly the payments made to them are allowable as expenses of the appellant's trade.

15 57. As to the payments to Mr Popa, the evidence supplied by the appellant was that was that 15 invoices of £500 each (totalling £7,500) were rendered in the period 27 April 2015 to 21 December 2015. This rate is consistent with the evidence of Mr Docianu and the invoices submitted by him and Mr Pintelei. £4000 of that was agreed by HMRC to be properly evidenced. A quick look at the bank statements show where a statement covers the date of invoice from Mr Popa there is a transfer to him on that date or shortly after. Where HMRC have not accepted a payment there is no bank statement in the file. From what we have seen we think it is more likely than not that in the periods for which there is no statement, payments were made in accordance with the invoices. We therefore allow all the payments said to have been made to Mr Popa on the basis of his invoices, which HMRC had no qualms about as to their genuineness.

Decision on the amendments to the return

58. Our jurisdiction in a case like this is given by s 50 TMA:

25 (6) If, on an appeal notified to the tribunal, the tribunal decides—
(a) that, ... the appellant is overcharged by a self-assessment;
the assessment or amounts shall be reduced accordingly, but otherwise
the assessment or statement shall stand good.

30 (7) If, on an appeal notified to the tribunal, the tribunal decides
(a) that the appellant is undercharged to tax by a self-assessment ...
the assessment or amounts shall be increased accordingly.

59. In *d'Arcy v HMRC* [2006] UK SpC 549 the Special Commissioner, Dr John Avery Jones, said that under self-assessment, s 50(6) TMA should be treated as saying (updated to refer to the Tribunal)"

35 "If, on an appeal against a conclusion or amendment to a self-assessment stated in a closure notice notified to the tribunal, the tribunal decides —
(a) that, ... the appellant is overcharged by an amended self-assessment so far as concerns matters appealed against; ...
the assessment ... shall be reduced accordingly, but otherwise the assessment ... shall stand good."

60. In our view the appellant is overcharged by the amendment because the profit for the year should reflect the original deduction of £41,430 for payments to subcontractors not the amended one of £4,000 and should also take account of a reduction in turnover of £20,044 so making the profit £17,628.

5 61. On that basis:

(1) the trading profit for income tax purposes, the appellant's only income, after deducting personal allowances is £7,028 on which the income tax at 20% is £1,405.60.

10 (2) the Class 4 NICs profit is then also to be calculated by reference to a profit of £17,628, so that after deducting the lower threshold of £8,060, the Class 4 NICs profit is chargeable at 9% of the excess, ie £861.12.

(3) the Class 2 NICs amount remains the same at £145.60.

15 62. We add here that even if we had upheld the HMRC figures, the officer conducting the investigation was wrong to say that the appellant had, as a result of the amendment made by the closure notice, to pay £36,164.96 if that is what they meant in the notice by "the additional tax due". The additional tax payable as a result of the amendment was £23,332.99 (the difference between the tax and NICs shown on the amended return of £23,332.99 and the tax payable as shown on the original self-assessment which was nil. The fact that the Statement of Account issued at the same time showed a very
20 similar figure of £34,938.63 actually owing was because of the inclusion of the first instalment for 2016-17 which was 50% of the additional tax of £23,332.99 together with some small miscellaneous amounts.

25 63. We also think that the original self-assessment was wrong, not because of any error on the part of the appellant, but because of what appears to be a programming fault in the tax calculation. We think that what the tax calculation should have shown so as to follow the law was that the appellant was due to pay £145.60 (Class 2 NICs) and that income tax overpaid was £11,964.52.

30 64. The overpayment arises because the tax calculation program must take account of the provision of s 62 FA 2004 (treatment of deductions under the CIS scheme suffered by a person). What s 62(2) provides for is:

(2) If the sub-contractor is not a company a sum deducted under section 61 and paid to the Board is to be treated as being income tax paid in respect of the sub-contractor's relevant profits.

35 If the sum is more than sufficient to discharge his liability to income tax in respect of those profits, so much of the excess as is required to discharge any liability of his for Class 4 contributions is to be treated as being Class 4 contributions paid in respect of those profits."

40 65. This is what s 62(2) said in 2014-15. It is also what it continued to say in 2015-16. The difference between those two years is that in 2014-15 Class 2 NICs were payable independently of the self-assessment system. From 2015-16 s 11(5) Social Security Contributions and Benefits Act 1992 ("SSCBA"), inserted into that Act by paragraph 3 Schedule 1 National Insurance Contributions Act 2015, provided that"

“Class 2 contributions under subsection (2) are to be payable in the same manner that Class 4 contributions in respect of relevant profits are, or would be, payable (but see section 11A for the application of certain provisions in relation to such Class 2 contributions).”

5 66. And by s 11A (inserted into SSCBA at the same time the self-assessment machinery in TMA and elsewhere was made applicable to Class 2 NICs. But there is nothing in s 11A or in Schedule 1 NICA 2015 that amends s 62 FA 2004 or treats it as amended.

10 67. It follow from that, unless we have missed something, that CIS amounts cannot be set against Class 2 NICs payable, which is the effect of the tax calculation (the self-assessment) in the tax return.

Penalty

15 68. We are not sure where we are here. The HMRC letter of 11 April 2017, the closure notice, says that the penalties cannot be suspended. The HMRC letter of 7 June 2017, the response to the appeal and view of the matter, says there is a possibility of suspension, but only if HMRC’s view of the matter is accepted.

20 69. A letter of 13 June 2017, calling itself a closure notice, says that the penalty of £6,329.69 is suspended. It gives no indication of how long for or what the conditions for suspension are. We do not have the review conclusion letter but the statement of case says that terms of suspension were sent to the appellant. But we do not know if he has agreed them.

25 70. We accept that the penalty assessment is under appeal. We shall confine ourselves to saying that we agree that the overstatement of the credit for the CIS amount was careless and we have no quarrel with HMRC’s penalty rate of 18%. The potential lost revenue (“PLR”) here is the additional tax (including a reduction in any repayment due) arising as a result of removing that credit, ie the amount of the credit £20,044. But that must be balanced in accordance with paragraph 6(2) Schedule 24 FA 2007 by the tax overpaid as a result of the overstatement of turnover. That is £20,044 at 40% or £8017.60 leaving a net PLR of £12,026.40. 18% of that is £2,164.75. Should the penalty cease to be suspended that is, in our view, the correct figure in relation to income tax. But it is not a matter on which we have to make ay decision.

Decision

35 71. In accordance with s 50(6) TMA the appellant is overcharged by the amendment to his return and the correct amounts are income tax £1,405.60, Class 4 NICs £861.12 and Class 2 NICs £145.60.

40 72. Although HMRC asked us to find that the appellant had failed to comply with his statutory obligations in relation to the CIS, we decline to do so. For one thing HMRC did not take us to the law or show how it related to the facts of the case. But the main reason is that we can only make findings of fact or law if there is a decision on a matter in dispute which can be and has been appealed against.

73. 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
5 after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

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**RICHARD THOMAS
TRIBUNAL JUDGE**

RELEASE DATE: 25 September 2018

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