



TC04285

Appeal number: TC/2012/05828

Income tax – incorrect returns – HMRC amendments to self-assessment return in respect of profits of self-employment and capital gains – whether HMRC had incorrectly disallowed expenditure – on the facts, no – whether assessment correctly calculated – yes – whether penalties correctly assessed – yes – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

DANIEL POOLE

Appellant

- and -

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

**TRIBUNAL: JUDGE MICHAEL S CONNELL
MR MICHAEL SHARP FCA**

Sitting in public at 45 Bedford Square London on 4 November 2014

Mr Martin Arthur for the Appellant

**Mr Maurice Chapman, Officer of HM Revenue and Customs, for the
Respondents**

DECISION

The Appeal

- 5 1. This is an appeal by Daniel Poole (“the Appellant”) against HMRC’s closure notice and amendments to his self-assessment return for the tax year ended 5 April 2004 (“tax year 2004”) in respect of the profits of his self-employment and capital gains on a property sale. The amendment was issued on 17 June 2011.
2. The Appellant also appeals against the penalty determination imposed for the submission of an incorrect return for the tax year 2004.
- 10 3. The points at issue are:
- (1) whether, the Appellant understated his profits from his self-employment for tax year 2004;
 - (2) whether the Appellant understated his capital gain on the disposal of Flat 6, 127 West End Lane for tax year 2004;
 - 15 (3) whether the Appellant’s calculations for expenditure claimed to have been incurred should be accepted;
 - (4) whether HMRC are correct to impose penalties on the Appellant for making an incorrect income tax return for tax year 2004 and, if so, in what amount.

20 Background

4. By profession the Appellant is an artist and engineer. He is also a property dealer and developer. In the tax year 2004 the Appellant had the following sources of income:
- Self-employment - fashion consultant trading as D P Consultancy.
 - 25 • Partnership - fashion designer/consultancy trading as D P Products.
 - Director of Haran Poole Associates Ltd.
 - Director of Format Design Ltd - fashion design and building development.
 - Capital Gains – on the purchase and sale of Flat 6 127 West End Lane London (“West End Lane”).
- 30 5. On his 2004 self-assessment return the Appellant declared a net profit of £15,435. He declared income as a fashion consultant showing a turnover of £32,000, cost of sales £6,000, other expenses £10,565 (employee costs £4,000, general admin £1,000, motor £4,725 (adjusted for 10% private use) and legal and professional fees £840).
- 35 6. He also declared a capital gain of £6,000, which after applying his annual exemption resulted in a nil gain on the disposal of West End Lane.

7. On 9 December 2005, HMRC opened an enquiry under s 9A Taxes Management Act 1970 into the Appellant's 2004 return and requested the business records for D P Consultancy and also the Appellant's calculations in respect of the capital gain on West End Lane.
- 5 8. Numerous meetings took place between the Appellant and HMRC from 2005 up until August 2011, in order to identify bank deposits for 2003-04 and various expenses claimed both with regard to D P Consultancy and the refurbishment and sale of West End Lane.
- 10 9. Following the provision of information and records, HMRC established that the Appellant's bank account deposits exceeded his declared turnover of £32,000 and that expenses claimed were incorrect. The Appellant agreed that income for D P Consultancy had indeed been understated. He said that with regard to his other potential sources of income no remuneration had been received from Format Design Ltd and Haran Poole as they had not traded since being set up.
- 15 10. The Appellant said he used Format Design Ltd to deal with his property portfolio. The company was dissolved on 1 July 2003 without the Appellant's knowledge, as due to a misunderstanding no accounts were submitted after the year ended 30 September 2000. The Appellant says he only discovered this when the company's bank account was frozen. He employed a solicitor to undo the striking off but was
20 advised that this was not possible without incurring considerable expense.
11. HMRC advised the Appellant that because the company did not file any accounts after 2000, no tax had been paid on letting income or property sales (from other properties) and irrespective of the fact that income and expenditure had been claimed through the company's bank account, as the properties were in the Appellant's name
25 he was liable to pay the tax due on the income.
12. Miscellaneous bank deposits of £120,863.41 were treated by HMRC as follows:
- £23,000 drawings from DP Products (partnership)
 - £15,000 loan from Halifax (loan agreement)
 - £62,863.41 income from self-employment (D P Consultancy)
- 30 £20,000 loan from the Appellant's parents (although no evidence of the loan had been provided).
13. Most of the copy invoices provided to HMRC were addressed to Format Design Ltd and were paid from the Format Design bank account. Some were paid by the Appellant personally.
- 35 14. HMRC wrote to the Appellant on 3 March 2010 identifying further information and documents required in connection with the enquiry.

15. On 20 April 2010 HMRC issued a Notice under Paragraph 1 Schedule 36 FA 2008 as the Appellant had not forwarded the information/documents requested. The outstanding documentation was to be delivered by 28 May 2010.
- 5 16. On 24 May 2010 a meeting was held between HMRC and the Appellant at which some of the outstanding documentation and other information required to complete HMRC's enquiry was provided.
- 10 17. By 24 August 2010 HMRC had heard nothing further from the Appellant and therefore informed him that they proposed to take formal steps to obtain the outstanding information. A final penalty warning letter was also issued on 24 August 2010 with a list of documents/information required by 10 September 2010.
18. No further progress was made, and on 21 December 2010, HMRC wrote to the Appellant summarising the overall position, saying that due to the lack of records to support the Appellant's claims, it was HMRC's intention to close the enquiry.
- 15 19. On 9 May 2011 the Appellant was provided with details of the assessment by HMRC of his tax liability 2003-04.
- 20 20. A closure notice was issued on 17 June 2011, pursuant to s 28A TMA, with HMRC's amendment of the Appellant's self-assessment and the penalty determination.
21. On 10 July 2011 the Appellant appealed against the assessment and penalties.
- 20 22. At the meeting on 25 August 2011 the Appellant provided copy bank paying in slips for two accounts which had not previously been disclosed, showing that deposits of £10,930 had not been included in sales of D P Consultancy.
- 25 23. On 24 January 2012, following another exchange of correspondence, HMRC further amended the Appellant's self-assessment return for 2003-04 in respect of his income from self-employment and capital gains, notifying a penalty determination under s 95(1) (a) TMA 1970, for negligently delivering an incorrect return.
24. Following a request for a review, HMRC confirmed and summarised their findings as follows:

Self-Employment

- 30 (1) Based on unidentified bank deposits, information and explanations provided by the Appellant, HMRC concluded that the Appellant's gross business income for 2003- 04 was £62,863.
- 35 (2) No primary evidence of expenditure for the tax year 2004 had been provided by the Appellant. HMRC said that strictly, no costs should be allowed but it was accepted that the Appellant must have incurred some expenditure in earning the income of £62,863. In the absence of any records, HMRC therefore agreed a number of concessions.

(3) Following various adjustments, HMRC determined that the Appellant's declared net profits should be increased by £11,636 as a result of which additional tax and class 4 national insurance contributions arose in the total sum of £3,260.

5 Capital Gains

(1) The Appellant had provided no records to support the declared Capital Gain of £6,000 on the sale of the property at West End Lane. He said that a capital gains tax liability had not been computed as, based on expenditure, his accountant had concluded that no tax was payable. However, he was not able to provide any evidence in support of this.

(2) The difference between the sale and purchase price after allowing for incidental sales costs (solicitors' fees etc.) for West End Lane was £103,254. However the Appellant claimed that the flat was altered to such an extent that it amounted to a reconstruction of the property, and taking into account £100,000 renovation costs, he had made a loss on the sale. However, no documentation was provided to support this.

(3) HMRC explained that for capital gains purposes, allowable expenditure is limited to capital improvements and the incidental costs of acquisition and disposal. The renovation costs therefore had to be split between revenue expenditure in the form of repairs and capital expenditure.

(4) HMRC explained that although the costs of the work to the property had been met by both the Appellant and by Format Design Ltd, the gain arising on the property was the Appellant's personal capital gain and the (unverified) costs met by the company were not allowable for tax purposes. HMRC said they would by concession allow costs met by the Appellant, even though it could not be shown that those costs qualified as capital expenditure.

(5) The incidental costs of disposal of the property would also be allowed. However because the Appellant had not provided any evidence of the incidental costs of acquiring the property, nor of who paid those costs, HMRC made no allowance for those costs.

(6) HMRC's conclusion was that the Appellant had made a capital gain for 2004 on the disposal of West End Lane of £68,478.

25. The Appellant notified his appeal to the Tribunal Service on 21 May 2012. His statement of case was submitted on 22 January 2014 - in which the main points made were:

- The purchase and sale of West End Lane should be treated as part of his trade or business and assessed as income tax not capital gains tax. This would then provide greater clarity and direction. Without this, all individual items would have to be examined and identified (as either capital or revenue expenditure) which would make the enquiry extremely confusing and complicated. The Appellant claimed that the enquiry had been closed before this aspect had been properly examined.

- Although most of the renovation costs had been paid by Format Designs Ltd, these had been mainly funded by the Appellant through his director's loan account which at the relevant time was in credit by £105,854.83. Therefore the expenditure should be allowed.
- 5
- He had incurred stamp duty of £9,000 and legal costs together with capital costs on the acquisition of the property but could not produce any information relating to those costs because the solicitors who had dealt with the transaction had closed down in June 2006.
26. HMRC responded on 5 February 2014, saying:
- 10
- The evidence held indicated the purchase and sale of West End Lane should not be considered as a trade.
- 15
- The main issue was that expenditure on West End Lane was incurred by Format Design Ltd and not the Appellant. The position remained the same whether or not the profit from the sale of West End Lane is assessed to capital gains tax or income tax.
- 20
- Income paid into the Format Design Ltd bank account after October 2000 had not been identified or declared and therefore not taxed. If the company had submitted accounts, the expenditure could have been allowed against income of the company.
- 25
- A detailed analysis by HMRC of bank deposits and payments from the Format Design Ltd account showed that money paid in by the Appellant was less than money paid out on his behalf. The analysis showed that the director's loan account was not in credit as claimed, but in debit by £120,505. The conclusion was therefore that monies introduced into the company by the Appellant were not sufficient to fund the refurbishment costs on West End Lane. Therefore, irrespective of the fact that the costs had been incurred by the company and not the Appellant, expenditure could not be claimed by the director because it could not have been incurred by the Appellant from his own capital.
- 30
- The stamp duty of £9,000 and legal costs of £1,200 would be allowed.
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- The assessments raised were necessarily estimates, based on information provided to HMRC. Estimates were necessary as the Appellant had not maintained sufficient records to enable HMRC to calculate and determine the assessments with complete accuracy. HMRC had however compromised on the expenditure available, giving the benefit of doubt to the Appellant where possible.

27. On 6 February 2014, after various adjustments, HMRC issued a revised tax calculation for 2004. After various adjustments the revised final additional tax liability was as follows: -

	Income Tax & Class 4 NIC	£ 3,260
	Capital Gains Tax	£23,312
	Interest	£11,692
	Penalty (25%)	<u>£ 6,643</u>
5	Total	<u>£44,907</u>

Legislation

28. Under s 29(1) Taxes Management Act 1970, if an officer of the board or the board discovers as regards any person and a year of assessment, 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, or that any assessment to tax is or has become insufficient, or that any relief which has been given is or has become excessive, the officer, or as the case may be the board, may subject to subsections (2) and (3) 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.

29. The relevant legislation with regard to penalties for the submission of an incorrect return for income tax or capital gains tax is contained in s 95 TMA 1970, which states:

“95

- (1) Where a person fraudulently or negligently –
- (a) delivers any incorrect return of a kind mentioned in [section 8 or 8A of this Act (or either of those sections) as extended by section 12 of this Act ...], or
 - (b) makes any incorrect return, statement or declaration in connection with any claim for any allowance, deduction or relief in respect of income tax or capital gains tax, or
 - (c) submits to an Inspector or the Board or any Commissioners any incorrect accounts in connection with the ascertainment of his liability to income tax or capital gains tax,
- 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, statement, declaration or accounts as made or submitted by him had been correct.

(3) The relevant years of assessment for the purposes of this section are, in relation to anything delivered, made or submitted in any year of assessment, that, the next following, and any preceding year of assessment; ...”

5 30. Section 100 TMA 1970 allows an authorised Officer of the Board in making a penalty determination to set it at such an amount as in his opinion is correct or appropriate.

The Appellant’s case

10 31. In his Notice of Appeal, the Appellant says that although he has enjoyed some commercial success as an artist and engineer, having won an award for his export achievements and his brand having been internationally renowned, he has never been any good at business administration. He finds maths very difficult. Until 1999 his tax affairs were handled by his company’s full-time accountant and monitored by a firm of chartered accountants. He had his own design studios and shops in Covent Garden,
15 Paris and Amsterdam.

20 32. Unfortunately the Appellant’s company eventually went into liquidation and he had to start afresh from home. He engaged a part-time accountant to keep records and advise him financially. He says that he was commissioned to work as a costume designer for TV, and also carried out some property development work. He then became a partner in a fashion company. His major income came via the partnership, which was administered by an accountant separate from his other interests.

25 33. In 2000, the Appellant was introduced to an accountant, Mr Bean of Tax Assist Direct, part of a national franchise, who advised that any future properties should be administered via a limited company. Mr Bean set up Format Design Limited. The Appellant says he was advised that even if a property was bought in his personal name he could still purchase and pay for development costs via the company. He says the majority of the finance came via his residential property jointly owned with his wife.

30 34. The Appellant bought a number of properties in 2001 and 2002, and in 2003 West End Lane, each of which were purchased in his personal name but capital costs and finance costs were funded via the bank account of Format Design Limited.

35 35. The property at West End Lane was purchased at auction and had suffered from fire damage. The property had to be comprehensively rebuilt. The Appellant says that he wanted to learn the trade to better understand the design process in order to save on costs. He bought the materials himself and hired individual contractors. He paid for the work from the Format Design account and used a Premier Gold card which, although in his private name, was also paid for from the Format Bank account. After Format was struck off he paid via his private bank account. He attended the site from eight in the morning to six in the evening most days. For most of 2002 and 2003 this
40 was the Appellant’s principal trade or business. He says that the time and dates on the hundreds of receipts evidence this.

36. The Appellant says he presented all of the receipts and invoices to Mr Bean to file his tax return for 2003. The bookkeeper having examined the information provided by the Appellant concluded that the Appellant had made a substantial loss of over £30,000. Because the Appellant also had an annual Capital Gains Tax allowance, although it was not clear whether some items of expenditure were capital or revenue, there would be a tolerance of approximately £36,000 in the event of any error.

37. The company's registered office was at Mr Bean's address. After the company was struck off Mr Bean did not pass on letters to the Appellant about the striking off, or explain how serious that could be. The Appellant hired a firm of solicitors to re-establish the company paying £1,500 in fees but was informed that the cost of re-establishing the company would not be viable. He says he was not advised that the cost of not re-establishing the company would involve a huge tax liability.

38. The Appellant acknowledged that, apart from giving him incorrect advice, the bookkeeper had made a number of mistakes. He had for example incorrectly included finance costs as part of the capital expenditure.

39. The Appellant did not understand why HMRC, having examined the receipts and accounts, concluded that £66,000 had been paid by Format Design but nonetheless disallowed those expenses. Despite allowing expenses paid by Format Design for another property bought in the Appellant's name, in respect of West End Lane, none of the money spent by Format Design was allowed. HMRC said that because the property was in his name and was not renovated as part of his normal trade or business, the profit had to be treated as a capital gain and that none of the renovation costs or finance charges could be allowed.

40. The Appellant argues that it is forensically evident from the amount of time he spent on the project that he was undertaking the activity as a trade or business. The Appellant had spent most of the previous two years working as a property developer on another property, acting as designer and consultant for clients, attending numerous auctions and viewing property for sale at auction. This activity he says is clearly evidenced as his normal trade or business. The development work and the Appellant's contribution in terms of fashion and interior design were intertwined.

41. The Appellant says that he 'provided photographic and documentary evidence of the expenditure' and that HMRC 'do not dispute that I made a loss on the project. It is purely a question of not allowing the expenditure that had been paid for from Format Design's account. It is in particular that part of HMRC's decision that he appeals against'.

42. The Appellant asserts that the enquiry has been protracted, extremely time consuming and burdensome, but that he has cooperated fully throughout. During the last five years he has had to spend a lot of time caring for his parents who suffer from Parkinson's disease. Two years ago his mother died as the result of a Parkinson's related accident. He has a young family and continues to be self-employed so time is precious. Because of the enquiry and the crash in the property market some years ago,

his bankers withdrew support and he lost his family home. He has been unable to afford a financial adviser and has therefore had to deal with the enquiry himself.

5 43. The Appellant produced a letter from his consultant psychiatrist, which said that the Appellant was undergoing a diagnostic assessment to confirm whether he suffers from Adult Attention Deficit Hyperactivity Disorder. The results of an initial assessment in July 2014 strongly supported that diagnosis.

10 44. The Consultant said that the condition is associated with significant impairment of attention, concentration and the organisation and completion of tasks. It is also associated with high levels of anxiety and depression. The Appellant was currently disabled by anxiety, which is exacerbating his cognitive difficulties. In the Consultant's opinion some of the Appellant's financial difficulties may be related to chronic symptoms associated with the condition.

15 45. At the hearing the Appellant produced evidence of costs associated with the sale, which he said had not been taken into account in the calculation of the taxable gain. The costs included £4,500 consideration paid to the freeholder for an agreement lengthening the term of the Appellant's lease, subject to an uplift in ground rent, and associated legal fees. He was not certain however whether the costs had been paid by the company or himself, as no documentary evidence had been retained.

HMRC's submissions

20 46. Where an amendment is made to a return following an enquiry, the burden of proof is on the Appellant to show that the amendment is wrong and the amount by which it is wrong.

25 47. HMRC say that with regard to the revised assessment of the Appellant's 2004 self-assessment income, the facts of the case speak for themselves. With regard to the unidentified bank deposits, in the absence of any satisfactory explanation those had to be treated as being additional trading profits [*Woodrow (Executor of Charles D Woodrow) v Whalley (HM Inspector of Taxes)* 42 TC 24]. The Appellant had in fact agreed that his income had been understated.

30 48. With regard to the capital gain, HMRC had to estimate the gain made by the Appellant on the sale of West End Lane because the Appellant had not kept proper records and provided sufficient evidence of expenditure or the source of that expenditure. The Appellant produced two spreadsheets which he said were constructed from an analysis of Format Design's bank accounts and from which he says HMRC could readily have ascertained that the company owed the Appellant 35 £105,854.38. HMRC however arrived at the opposite conclusion; that the Appellant's loan account had a debit balance. Expenditure incurred by the company was not allowable, particularly given that the Appellant's capital account was overdrawn

40 49. As regards penalties, it is for HMRC to show an incorrect return was submitted negligently in 2003-04, and to show that the inaccuracy in the return was a result of careless behaviour. If this is established the onus of proof reverts to the Appellant to show the quantum of the penalty is wrong. The statutory onus of proof is on the

Appellant (s 50(6) Taxes Management Act 1970). HMRC assert that the Appellant had not discharged that onus.

50. In the case of *Julie Ashton* [2013] UKFTT 140(TC), Judge Staker commenting on the definition of 'careless', stated at Para 35:

5 "The Tribunal considers that a prudent and reasonable taxpayer must at the very least be expected to take prudent and reasonable steps to ascertain what his or her tax obligations are."

and at Para 37 he agrees with what was said in *Verma* at {13}

10 "An omission may be innocent, in the sense of not having been deliberate, but such an innocent omission may still be the result of a failure to take reasonable care."

15 51. Taking the ordinary every day meaning of the word negligent - lack of proper care and attention or carelessness, HMRC suggest the comments by Judge Staker in the *Ashton* case, at paras 35 and 37 support their view that by failing to take steps to correctly prepare his 2003-04 tax return, the Appellant was negligent.

52. A reasonable person would amongst other things:

- make a complete and correct return of their income
 - keep such records as are necessary to enable them to make an accurate return
 - be in a position to supply to HMRC accurate information during the course of an enquiry
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53. The Appellant has accepted that he submitted incorrect returns. HMRC contend that, based on the evidence and explanations provided during the course of the enquiry, the conclusions reached by the HMRC and assessments are fair.

25 54. The maximum statutory penalty under s 95 TMA 1970 is 100% of the additional duties arising from the omissions and understatements. The maximum penalty was therefore £26,571.68 (Capital Gains Tax £23,312, income tax £2,661.26 and Class 4 NIC £598.42).

30 55. The penalties were mitigated by taking into account total abatements of 75%, being 15% for disclosure, 30%, for cooperation and 30% in respect of seriousness. A 25% penalty was therefore applied which meant that a penalty of £6,643 was imposed.

35 56. Section 100 TMA 1970 allows an authorised Officer of the Board in making a penalty determination to set it at such an amount as in his opinion is correct or appropriate. HMRC submit that a penalty of 25% is reasonable and the Appellant has not discharged the onus upon him to demonstrate that the penalty is excessive or has been calculated incorrectly

Conclusion

57. The issues for determination by the Tribunal are:

- (1) whether the Appellant understated his profits from his self-employment for 2003-04.
- 5 (2) whether the Appellant's calculations for expenditure claimed to have been incurred on the renovation of Flat 6, 127 West End Lane should be accepted, and if not whether the Appellant understated his capital gain on the disposal of the property.
- 10 (3) whether HMRC are correct to impose penalties on the Appellant for making an incorrect income tax return for 2004 and, if so, in what amount.

58. As HMRC argue, the facts of the case speak for themselves and the Appellant agreed that his profits were understated. The unidentified bank deposits in the absence of any satisfactory explanation have to be treated as being additional trading profits.

15 59. With regard to the capital gain, HMRC had to estimate the gain made by the Appellant on the sale of West End Lane, because the Appellant had not kept proper records or provided sufficient evidence of expenditure. Expenditure incurred by the company was not allowable, given that the Appellant's capital account was overdrawn. No evidence was provided to support the Appellant's contention that capital monies raised on the security of other properties owned by the Appellant had
20 been injected into the company as claimed. Although the Appellant produced extracts from a spreadsheet of monies paid into and out of Format Design's bank account, which he said showed that his director's loan was in credit, the information was not particularly clear or supported by copy accounts, primary or other evidence. An independent accountant's forensic analysis may have offered some credence to his
25 arguments. On the information provided HMRC's analysis of bank deposits and payments from the Format Design Ltd account showed that money paid in by the Appellant was less than money paid out on his behalf. The director's loan account was in debit by £120,505. In the absence of any evidence to show that HMRC's conclusions are incorrect, we accept their conclusion.

30 60. The onus is on the Appellant to show that he has been overcharged by the amendments to his self-assessment. In our view he has not discharged that burden, either with regard to his under-stated income or the capital gain arising on the sale of West End Lane. The amendment to his self-assessment for 2003-04 is accordingly confirmed.

35 61. The Appellant made mistakes on his returns. A taxpayer taking reasonable care with regard to their tax affairs would ensure they had all the relevant information they needed when completing their return. We accept that the Appellant's problems arose from carelessness and a failure to take reasonable care in maintaining records and completing his accounts. This resulted in the Appellant being negligent when he
40 submitted the inaccurate return for 2003-04. We do not accept that the mistakes were due to the Appellant's medical condition.

62. We concur with HMRC that the penalties imposed have been correctly calculated. They are therefore confirmed.

63. We dismiss the appeal.

5 64. 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
10 “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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**MICHAEL S CONNELL
TRIBUNAL JUDGE**

RELEASE DATE: 16 February 2015

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