



Neutral Citation: [2024] UKFTT 00509 (TC)

Case Number: TC09197

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

By remote video hearing

Appeal reference: TC/2019/06672
TC/2019/06673

INCOME TAX and CORPORATION TAX – Discovery Assessments – deliberate behaviour of agent – whether validly made – yes – assessments confirmed - penalties for inaccuracy also confirmed – appeals dismissed

Heard on: 30,31 May 2023
Judgment date: 6 June 2024

Before

**TRIBUNAL JUDGE VIMAL TILAKAPALA
MEMBER SUSAN STOTT**

Between

JOANNE LUNN AND VANILLA MONSOON LTD

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY’S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Dr Robert Milton

For the Respondents: Simon Bracegirdle, litigator of HM Revenue and Customs’ Solicitor’s Office

DECISION

INTRODUCTION

1. The format of the hearing was via video link. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.
2. This case concerns two linked appeals.
3. The first relates to discovery assessments and penalties in respect of underpaid income tax, issued under s.29 and s. 95 of the Taxes Management Act 1970 (“TMA 1970”) for tax years 2005/06, 2006/07 and 2007/08 against Joanne Samantha Lunn (the “Income Tax Appeal”).
4. The second relates to discovery assessments and penalties in respect of underpaid corporation tax, issued under paras. 41 and 20 sched.18 Finance Act 1998 (“FA 1998”), and sched. 24 Finance Act 2007 (“FA 2007”) for accounting periods ending 31 March 2008, 2009, 2016 and 2017 against Vanilla Monsoon Limited. (“VML”), a company wholly owned by Ms Lunn (the “Corporation Tax Appeal”).
5. The appeals are linked as the major part of the Income Tax Appeal and all of the Corporation Tax Appeal relate to the Appellants’ contention that arrangements between them amounted to a trade carried on by Ms Lunn, that purported trade being reflected in their accounts and consequently their tax returns, so affecting the tax liabilities of each of them.

BACKGROUND

6. Ms Lunn’s and VML’s tax returns and accounts for the relevant years were prepared by Christopher Lunn & Company (“CLAC”) an accounting business run by Ms Lunn’s father, Christopher Lunn. Mr Lunn was personally involved with the relevant returns and accounts.
7. On 22 June 2010 as part of an ongoing criminal investigation into CLAC, HMRC officers searched CLAC’s business premises, seizing various records and documents under the terms of a search warrant. The records seized included files and papers relating to Ms Lunn and VML.
8. It is those records which prompted the enquiry that led to the assessments which are the subject of these appeals.
9. The appeals relate to what HMRC regard as (i) inflated expenses being claimed as tax deductible by Ms Lunn and (ii) a purported trading arrangement between Ms Lunn and VML giving rise respectively to payments claimed as tax deductible by VML and a claimed trading loss for Ms Lunn.

THE EVIDENCE

10. The evidence before us consisted of a main hearing bundle of 472 pages and a supplemental hearing bundle of 45 pages. We also heard witness evidence from Ms Lunn, Mr Lunn and HMRC Officer Darran Baker.

RELEVANT FACTS

11. We set out most of our findings of fact in this section. However we also make findings of fact later in the decision notice where relevant to the specific issues considered.
12. Ms Lunn was a client of CLAC for all of the years involved in these appeals. CLAC prepared her tax returns and her accounts.

13. CLAC was authorised corporation tax agent for VML from 27 March 2006 to 16 July 2007 and continued to act on its behalf after July 2007.

14. CLAC also acted as VML's accountant and prepared its accounts and tax returns. It was for example described as VML's accountant in VML's accounts for the period ending March 31 2009 and it submitted VML's VAT registration in 2007.

15. In July 2010 following their raid on CLAC's premises and seizure of documents, HMRC wrote to all clients of CLAC including Ms Lunn and VML, informing them that they might as a consequence have to check their tax returns.

16. HMRC then wrote several times to Ms Lunn and VML asking them to review their tax affairs and to disclose any irregularities found. Neither Ms Lunn nor VML made any disclosures.

17. On 18 Jan 2018, HMRC (Officer Elvin) wrote again to Ms Lunn explaining that as she had made no disclosures following HMRC's invitation for her to review her tax affairs, HMRC had carried out their own review of her and VML's tax returns and accounts. The letter stated that irregularities had been found, namely the likely inflation of expenses and the claims relating to her purported sole trade.

18. On 1 Feb 2018 Ms Lunn replied to Officer Elvin, stating:

“my company is a personal service company and has no rights or entitlement to any assets or intellectual property so all of that remains with me. The company has been used to trade my knowledge and expertise with the outside world. Throughout the period I have had no security of contract and have used the company as well accepted and recognised security.

Meanwhile I have charged my company for the use of such assets and for the provision of infrastructure. The income of the sole is naturally the cost of the company. I believe that anything different would have been false accounting.”

19. HMRC (Officer Elvin) replied on 21 Feb 18. He stated that “much more information” would be required for HMRC to consider Ms Lunn's position as to her sole trade and asked, *inter alia*, what her assets, intellectual property and infrastructure were and how they had been valued. He also asked to see the contract between Ms Lunn and VML detailing the arrangements that she said existed.

20. Ms Lunn replied on 1 March 2018 (n.b. this letter appears to be mistakenly dated 1 February 2018):

“In order to better explain, the sole trader is not a trade but is a method of recharging business expenses to my limited company. As you say I must as a director only claim those things I believe correct. I believe that I could claim the same amount as a direct charge through a director's loan account but that would be less transparent.

The assets that belong to me and not my company are my portfolio, my contact data, my website and my intellectual property. I provide these to the company together with the use of my home office and my computer and other equipment.”

21. HMRC replied on 5 April 2018 noting that Ms Lunn had confirmed that she had no separate sole trading entity and reiterating its view on the tax position of Ms Lunn and VML. This letter also explained the approach taken by HMRC in computing the adjusted tax for Ms Lunn and VML – which involved essentially disregarding the purported sole trade.

22. Ms Lunn replied on 25 April 18 saying, *inter alia*, that:

“you have stated that I have confirmed that there never was a separate sole trader. This is not actually a true representation of my comments. As I stated before the sole trader is not a trader but is a method of recharging business expenses to my limited company and so exists as such.”

23. Correspondence between HMRC and Ms Lunn continued without resolution or agreement until 10 January 2019 when HMRC wrote to Ms Lunn with their conclusions and on 17 May 2019 HMRC wrote to Ms Lunn outlining the action they intended to take.
24. On 17 May 2019 HMRC also issued corporation tax assessments to VML for the periods ending 31 March 2008, 2009, 2016 and 2017.
25. On 30 May 2019 HMRC issued income tax assessments against Ms Lunn for the tax years 2002/03, 2005/06, 2006/07 and 2007/08.
26. Ms Lunn appealed the income tax and corporation tax assessments on 11 June 2019 and on 13 June 2019 requested an HMRC review of all of them.
27. On 1 July 2019 HMRC issued a penalty determination for underpaid income tax for the tax years 2002/03, 2005/06, 2006/07 and 2007/08.
28. On 1 July HMRC issued a penalty determination for underpaid corporation tax for the accounting period ending 31 March 2009. Penalty determinations for the accounting periods ending on 31 March 2009, 2016 and 2017 were issued on 29 August 2019.
29. In a series of letters and emails to HMRC in July and August 2019 Ms Lunn confirmed her appeal against all of the assessments and penalties and also asked for an independent review of those decisions.
30. HMRC undertook an independent review of the assessment and penalty decisions which concluded on 13 Sept 2019. The conclusion was that (i) the income tax assessment and penalty for 02/03 should be cancelled, (ii) the income tax assessments and penalties for 05/06, 06/07 and 07/08 should be upheld, (iii) the corporation tax assessments for the periods ended 31 March 2008 and 2017 should be varied and (iv) the corporation tax assessments for the periods ended 31 March 2009 and 2016 should be upheld. It is those assessments together with the related penalty assessments which are now being appealed.

Ms Lunn

31. Ms Lunn carried on business as a self-employed marketing consultant in the 2005/06 tax year.
32. On 13 March 2006 Companies House were notified that she had become a director of VML. On the notification to Companies House Ms Lunn described her occupation as “jewellery designer”

Ms Lunn’s accounts and income tax return for 2005/06

33. Ms Lunn’s accounts for her sole trade for 2005/06 showed the following:

£15,600 turnover
£10,280 expenses
£67 disallowable expenses
£4,924 net taxable profit

34. Ms Lunn’s tax return for 2005/06 showed
£2,100 employment income (director’s fees from VML)

£4,924 self-employment profit

£12,960 dividend income

35. Ms Lunn's accounting records for 2005/06 showed in a list of gross expenses:

UK travel and subsistence costs incurred of £1,116

Research books & Journals costs incurred of £176.25

36. Mr Lunn made manuscript annotations to Ms Lunn's accounting papers increasing the figures for UK travel and subsistence costs and research books & journal costs by £1000 and £500 respectively.

Ms Lunn's 2006/07 accounts and income tax return for 2006/07

37. Ms Lunn's tax return included a self-employment page. This showed her carrying on a business as a self-employed marketing consultant and a trading loss of £4,150 was claimed. Her self-employment income details were recorded on a handwritten sheet produced by CLAC. This sheet listed the following:

Turnover £1,805

Expenses £5,281

"Capital Allowances" £674

38. Her tax return for 2006/07 also included an employment page for a job at UCCP Ltd. This showed:

Salary £32,787

Tax deducted £6,579

39. There was also an employment page for VML although this showed no income for the year.

Ms Lunn's accounts and tax return for 2007/08

40. Ms Lunn's tax return included a self-employment page showing a loss of £860

Details of the self-employment were produced by CLAC on a handwritten sheet showing:

Turnover £6,000

Expenses £6,219

"Cap Allowances" £641

41. Her tax return also included an employment page for her employment at UCCP Ltd. which showed:

Salary £19,584

Tax deducted £3,481

42. An employment page for VML was also included which again showed no income.

Ms Lunn's tax return for 2015/16

43. Ms Lunn's tax return for 2015/16 included a self-employment page which stated her trade as "Jewellery & Advertising". This showed the following:

Turnover £11,634

Expenses £7,635

Taxable profit £3,999

44. No other income was included on this return

Ms Lunn's tax return for 2016/17

45. Ms Lunn's tax return included a self-employment page which stated her trade as "Service Provider" and showed the following:

Turnover £11,717

Allowable expenses £5,860

Taxable profit £5,857

It also included:

Dividends £17,505

Salary from VML £5,143

VML

46. VML was incorporated on 22 February 2006 and Ms Lunn has been its sole shareholder and director since March 2006.

47. On registering with HMRC, VML's trade was described as "jewellery designer". VML commenced trading on 22 February 2006.

48. Full trading accounts were provided for VML for its periods ending 31 March 2007, 2008 and 2009. Accounts produced for the period ending 31 March 2010 indicated that VML was dormant throughout the period.

VML's accounts for the period ending 31 March 2007

49. These accounts showed the following:

Director's fees £2,100

Manuscript notes made by Mr Lunn show the following additions to expenses incurred

Travel expenses £400

Telephone £100

"PPS" £107

"RBJ" £292

Accountancy £800

VML's accounts for the period ending 31 March 2008

50. These accounts showed the following:

Turnover £21,348

Cost of sales £6,750

"Admin expenses" £7,304

51. A manuscript note made by Mr Lunn stated "D/C 6000 to S/T + 750" and listed several expenses. Some of these expenses have "say" written after them.

VML's accounts for the period ending 31 March 2009

52. These accounts showed the following:

Turnover £29,548
Cost of sales £18,836
"Admin expenses" £11,002

53. VML was then dormant for several years, submitting tax returns for periods ending 31 March 2011, 2012, 2013, 2014 and 2015 showing no turnover or profits.

VML's accounts for the period ending 31 March 2016

54. After a five year break VML submitted accounts for the period ending 31 March 2016. The accounts showed the following:

Turnover £33,006
Cost of raw materials and consumables £11,634
Staff costs £6,000
Other charges £5,795
Taxable profit £9,577

VML's accounts for the period ending 31 March 2017

55. VML's accounts for the period ending 31 March 2017 showed the following:

Turnover £54,075
Cost raw materials and consumables £19,711
Staff costs £5,143
Other charges £7,136
Taxable profit £22,085

ISSUES FOR THE TRIBUNAL TO DETERMINE

56. The Tribunal must determine the following issues:

- (1) Whether the discovery assessments for each year were validly raised; and
- (2) Whether the penalties have been charged correctly.

57. The burden of proof in respect of the validity of the discovery assessments is with HMRC.

58. If it is found that those assessments have been validly raised, the burden of proof to displace the quantum of those assessments (provided the quantum is fair and reasonably assessed in the circumstances) moves to the Appellants.

59. The standard of proof is the civil standard which is the balance of probabilities.

Consideration of the tax position of Ms Lunn and VML for the relevant years

60. Before turning to the validity of the assessments and penalties for the relevant years we first set out our findings in relation to Ms Lunn and VML's tax position for the tax years and accounting periods in question.

61. We then consider whether HMRC's discovery assessments for these years were validly issued following which we consider the correctness of the penalties imposed.

62. We start with Ms Lunn.

Ms Lunn's income tax assessment for 2005/06

63. For the tax year 2005/06, HMRC submit that the amounts claimed by Ms Lunn to have been incurred for travel and subsistence and research and books were inflated resulting in excessive relief being given, so leading to a loss of tax for the period.

64. There is no dispute as to the technical position. Section 34(1) of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005") provides for income tax purposes that

34(1) In calculating the profits of a trade, no deduction is allowed for –

- (a) expenses not incurred wholly and exclusively for the purposes of the trade, or
- (b) losses not connected with or arising out of the trade

65. The effect of these provisions is that for a deduction shown in trading accounts to be allowable for income tax purposes, expenditure must be incurred and if incurred it must be incurred wholly and exclusively for the purposes of the trade in question.

HMRC's submissions

66. HMRC say that the amounts claimed to have been incurred by Ms Lunn on UK travel and subsistence and on research, books and journals were artificially increased by Mr Lunn.

67. HMRC point to Ms Lunn's (typed) accounting papers which show the following expenses incurred under those headings:

"Travel & Sub UK - 1,116

Res, Books & JI's - 176.25"

68. They then point to Mr Lunn's manuscript amendments to those accounting papers against each of those headings which increased the amounts as follows:

"Travel & Sub UK - + 1000 (DCU)

Res, Books & JIs - + 500"

69. The amounts in respect of which tax deductions were the inflated sums.

70. HMRC say that there is no indication of the basis on which the increases made by Mr Lunn were made or on which they can be supported.

71. They point to Mr Lunn's criminal conviction showing that in December 2015 he was convicted of four counts of cheating the public revenue – one of those counts relating to him inflating or causing to be inflated expenditure in client accounts.

72. Mr Bracegirdle referred us also to three recent First Tier tax tribunal cases involving former clients of Mr Lunn of CLAC in which CLAC was found to have artificially increased expenditure for the purpose of reducing his clients' tax liabilities. Those cases are: *McFarlane v HMRC* [2018] UKFTT 282 TC, *Magnet v HMRC* [2022] UKFTT 288 TC and *Clive Kingdon, Terry Stead and Anne Kingdom v HMRC* [2022] UKFTT 407 TC (together the "CLAC Cases")

73. These case, he said, showed that Mr Lunn's approach to deliberately creating artificial losses in his clients' tax returns was not a one-off but something he had done systemically for several clients over a sustained period.

Ms Lunn's submission

74. Ms Lunn submitted that the sums were properly incurred and the manuscript amendments reflect amounts that were incurred but which she did not recall or list at the time the accounting papers were put together.

Witness evidence

75. We turn to the witness evidence in respect of these entries.

Mr Baker's evidence

76. We heard the following from Darran Baker, the HMRC investigating officer responsible for the case:

- (1) He accepted that the sums initially outlined in Ms Lunn's accounting papers had been incurred.
- (2) He did not believe that the additional amounts set out in Mr Lunn's manuscript entries had been incurred. He believed that they had been added simply to reduce Ms Lunn's taxable profit.
- (3) He pointed out that the amounts claimed were entirely unsupported. No evidence contemporaneous or otherwise had been provided for them nor could he find any invoices relating to them (or any part of them) despite having looked through the papers available to him which included files of receipts.
- (4) He accepted that he could not categorically state that the full amounts were not incurred but said that he would have expected some papers to show what the amounts claimed were actually for.
- (5) He denied that his view was a consequence of bias against Mr Lunn or CLAC and made it clear that he reached his decision having reviewed the information and evidence as identified by Officer Elvin (the previous HMRC officer responsible for the case).

Ms Lunn's evidence

77. We heard the following from Ms Lunn:

- (1) She explained how she would generally keep receipts showing her expenses and prior to her accounts being drawn up would speak to Mr Lunn who would question her and help her find out if there were more expenses that she should be taking into account. She emphasised that her discussion with her father was a key part of her accounting and tax process as she did not necessarily know what would or would not be claimable.
- (2) She said that having had the initial discussion referred to above, an accounting paper would be put together by her and Mr Lunn.
- (3) She acknowledged that the manuscript annotations to the accounting paper were made by Mr Lunn and thought that they were likely to represent items of expenditure that she would have missed.
- (4) She could not recall specifically what all the additional items claimed for were but was confident that when all of her expenses were looked at they represented accurately the sums that should be added.

(5) She said that she could not be expected to remember all of the information relating to her expenditure in detail as so much time had passed.

Mr Lunn's evidence

78. We heard the following from Mr Lunn:

- (1) He acknowledged that the manuscript annotations to the accounting paper were his.
- (2) He said that the figures represented estimates based on expenditure that Ms Lunn had incurred but which were not recalled or listed at the time the accounting paper was produced. In short, the additions represented “under-estimated” but “properly incurred” expenditure, and there was no “fabrication”.

Discussion

79. It is for us to determine on the evidence available, whether the additional amounts added by Mr Lunn to Ms Lunn's expenditure were amounts actually incurred by Ms Lunn or artificial amounts added simply to reduce Ms Lunn's taxable profit.

80. Having considered the evidence we find, on the balance of probabilities, that those sums did not represent expenses incurred by Ms Lunn but were instead arbitrary amounts added by Mr Lunn in order to reduce taxable profit.

81. In making our determination we noted, in particular, the following:

- (1) That HMRC Officer Baker was a credible witness able to explain clearly the steps he had taken in order to reach his determinations.
- (2) That Mr Lunn's manuscript amendments were made after his initial discussion with Ms Lunn as to her expenditure and after the date on which Ms Lunn acknowledged that they had together produced the accounting paper.
- (3) That neither Mr Lunn nor Ms Lunn could provide any specific information in relation to the increases that Mr Lunn made to the amounts in question.
- (4) That Ms Lunn could not recall having discussed the increases with Mr Lunn
- (5) That no receipts or other contemporaneous evidence are available to support the increased amounts.

82. We have taken into account also the tribunal findings in each of the CLAC Cases that Mr Lunn had artificially increased his clients' expenditure in order to reduce their tax liabilities.

83. In particular we note in *McFarlane* the Tribunal's finding that CLAC had in one year included claims for expenses including mobile telephone, home telephone, printing, postage and stationery travel which bore no relation to a schedule of expenses given to CLAC by his client, Mr McFarlane. The Tribunal's conclusion in that case was that there was no doubt that CLAC had acted deliberately to inflate the expenses – so resulting in a loss of tax.

84. We accept of course that the current case must be considered on its own merits and that what happened in the CLAC Cases is not necessarily what has happened in this case. However, the similarity in the approach taken to expenses is remarkable and we find it a relevant factor in helping us determine what has happened in this case.

85. We have noted also Mr Lunn's criminal conviction for cheating the public revenue. We have not sought to investigate any aspect of that case – notwithstanding Mr Lunn's numerous

references to it. It is simply not appropriate in this case to do so. What we have noted is that Mr Lunn has been convicted of an offence of dishonesty in relation to tax which involved inflating expenditure. As with the Tribunal's findings in the CLAC Cases we find this a relevant factor in making our determination in this case.

86. In relation to the 2005/06 tax year we find accordingly that there was a loss of tax as Ms Lunn should not have been entitled to deduct from her income the full amount of expenditure claimed in computing her tax liability for the year.

Ms Lunn's income tax assessments for 2006/07 and 2007/08

87. In each of these years Ms Lunn claimed to be carrying on a trade and sought to offset losses arising from that trade against her other income.

88. HMRC say that she was not carrying on a trade during these years.

89. They have also noted the following which Ms Lunn has not disputed;

That Ms Lunn ceased to be a marketing consultant before 6 April 06

That for these periods she was employed by UCCP

That for these periods she was also a director of VML (which carried on its own trade)

90. Ms Lunn's self-employment details for 2006/07 and 2007/08 were contained on a hand-written sheet produced by CLAC. Unlike for previous years there did not seem to be a set of accounts, printed schedules or any formal records for those years.

2006/07

91. The following details were shown in her 2006/07 tax return in respect of her, which together resulted in a loss of £4,150:

Turnover of 1,805

Expenses of 5,281

Capital allowances of 674

92. This return also showed gross employment income of £32,787 with tax deducted of £6,579 from her employment with UCCP.

2007/08

93. The following details were shown in her 2007/08 return in respect of her self-employment details, which together resulted in a loss of £860:

Turnover of 6,000

Expenses of 6,219

Capital allowances of 641

HMRC's submissions

94. HMRC say that no trade was being carried on by Ms Lunn. They say that her purported activities, even if they did take place (and this is of course disputed), were not sufficient to amount to a trade. In HMRC's view there was a single trade which was the trade carried on by VML, and any arrangement between VML and Ms Lunn was simply an artificial mechanism for the transfer of amounts between the two of them designed to reduce the overall taxes payable.

Ms Lunn's submissions

95. Ms Lunn says that she was carrying on a trade for these periods and further, that, the approach she has taken in her arrangement with VML is both logical and not uncommon.

The activities in question

96. Ms Lunn described her activities in several different ways in her correspondence with HMRC. These included the following:

- (1) 1 Feb 2018 - Ms Lunn told HMRC that her income related to charges made to her company for the use of “assets and for the provision of infrastructure”
- (2) 1 March 2018 - Ms Lunn explained to HMRC that her sole trade was “not a trade but is a method of recharging business expenses to my limited company and so exists as such”
- (3) 7 August 2018 - Ms Lunn said that “the income from the sole trade from the inception of the limited company is as I explained before simply my charge to my company for expenses incurred on its behalf together with a charge for legitimate use of assets”
- (4) On 15 November 2018 - Ms Lunn advised HMRC that “What I have said is that the self-employment was not the same as the trade of the limited company. The sole trade as I have explained was used to charge to my company facilities and use of assets. This is a trade but not the same trade. Included in this is a claim for the use of my office.”

Discussion

97. The issue for us to determine is whether Ms Lunn’s activities amount to a trade for tax purposes.

98. Again, there is no dispute as to the technical position.

99. If Ms Lunn was not carrying on a trade in the relevant periods (or was carrying on a trade but not on a commercial basis and with a view to the realisation of profits) she would not have been entitled to set her losses against her other income for the year. This was the effect of sections 380 and 384 of the Income and Corporation Taxes Act 1988 (“ICTA 1988”) for the tax year 2006/07 and sections 64 and 66 of the Income Tax Act 2007 (“ITA 2007”) for the tax year 2007/08.

100. S 989 ITA 2007 defines trade as:

“any venture in the nature of trade”

101. Its predecessor, s 832 ICTA 1988 defined trade as

“every trade, manufacture, adventure or concern in the nature of trade”.

102. It is also well established law that whether a trade exists is a question of fact to be determined by the tribunal taking into account all the information available.

103. Mr Bracegirdle referred us to the decision of the Court of Appeal in *Eclipse Film Partners No 35 LLP v HMRC* [2015] EWCA 95, citing the following comment of the Chancellor of the High Court:

“it is necessary to stand back and look at the whole picture and, having particular, regard to what the taxpayer actually did, ask whether it constituted a trade” [111]

104. He took us also to the Chancellor’s summary of the meaning of trade:

“As an ordinary word in the English language “trade” has or has had a variety of meanings or shades of meaning. Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation, depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles” [112]

105. Mr Bracegirdle also cited the comment of Lord Reid in *Ransom v Higgs* [1974] 3 All ER 949:

“The Income Tax Acts have never defined trade or trading farther than to provide that trade includes every trade, manufactured, adventure or concern in the nature of trade. As an ordinary word in the English language “trade” has or has had a variety of meanings or shades of meaning. Leaving aside obsolete or rare usage it is sometimes used to denote operations of commercial character but which the trader provides to customers for reward some kind of goods or services.”

106. Finally he referred to *Marson v Morton* [1986] 1 WLR 1343 and Sir Nicholas Browne-Wilkinson V-C’s conclusion after he had identified the nine indications of trading or “badges of trade”:

“I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive. I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question – and for this purpose it is no bad thing to go back to the words of the statute –was this an adventure in the nature of trade?”

107. Mr Bracegirdle went on to say that on the basis of the case law the correct approach is to look holistically at what Ms Lunn actually did and to then determine whether it amounted to a trade.

108. We agree with this approach.

Ms Lunn’s activities

109. We first look at what Ms Lunn’s activities were for the relevant tax years. From the evidence provided, her main activities for the relevant periods consisted of the following:

- (1) being an employee of UCCP Ltd.,
- (2) being a director of VML, and
- (3) charging particular amounts to VML (some amounts of which were expenses incurred by the Appellant)

110. It is the third of these which she seeks to characterise as a trade.

111. From Ms Lunn's witness evidence and her responses to the various HMRC enquiries, we found her argument to be that her "trade" was essentially a composite, which included; (a) recharging to VML expenses incurred by her for the purpose of VML's business, (b) charging VML for the use of her home as business premises and (c) charging VML for the use of her "intellectual property".

112. This was outlined in her witness statement as follows:

"[I] accept that recharge of expenses on its own is not a trade but when combined with legitimate charges for assets properly held away from the company but which the company has to use, most definitely is. Here I cite the cases of all celebrities who are able to charge vast sums simply for image rights which are totally personal and cannot be sold or assigned to personal service companies. The best that can be done is to license them and that is particular what I have, effectively, done."

113. She went on to explain how she regarded herself as justified in claiming and charging her company "for the legitimate and essential use of my IP, data base and the like" and her strongly held belief that "HMRC are claiming that these were "manipulations" when in fact they were genuine charges for perfectly sound reasons...".

114. When asked by HMRC to explain what her IP consisted of, Ms Lunn's answers were not detailed. There were references to: "protected assets without the use of which my company could not trade", her "portfolio" and her "contact data". In her oral testimony there were also references to her website, and "her little black book".

115. It is also the case that despite requests from HMRC Ms Lunn has not, at any time, provided a comprehensive list of her intellectual property assets.

116. Given the lack of specificity as to the IP assets, Ms Lunn has also been unable to provide any breakdown of the amounts said to have been incurred by VML in respect of those intellectual property assets.

117. In terms of the expenses purported to have been charged for the non IP assets (including for use of her home) again only very limited details were provided, with Ms Lunn explaining that they included amounts for; "software", "CRM systems" and "mail-chimp".

118. It also became clear to us during the course of the hearing that no formal or written agreements were entered into between Ms Lunn and VML to formalise or record any arrangements in this regard. Ms Lunn explained, in her oral testimony, that she and Mr Lunn calculated the fees for the various items but admitted that she had "no idea" as to how the calculations were actually done.

119. Having considered the written and oral evidence before us and adopting what we consider to be a realistic view of the facts, we find that Ms Lunn's arrangements with VML did not amount to a trade for 2006/07 or 2007/08.

120. Our reasons for this determination include the following:

(1) We fail to see how the recharging of expenses could amount to a trade. Assuming for this purpose that the expenses were actually incurred, the arrangement would simply be a reimbursement mechanism. There would be no element of "trading" on any ordinary interpretation of that term. "Packaging" that recharging with Ms Lunn's purported licensing of IP assets does not change our conclusion.

(2) Leaving aside the question of whether an individual can carry on a trade of licensing personal IP to their wholly owned service company, if as Ms Lunn contends, her trade is what she terms the "effective licensing" of her IP, we would expect at the

very least for that IP to be clearly identified and for the commercial terms of such an arrangement to be clear. Not only was Ms Lunn unable to explain adequately what her IP consisted of, she was also unable to point to any formal arrangement setting out the terms on which VML was able to use that IP or the basis on which it would pay for it.

(3) Ms Lunn's key argument was that it was very common for people in the creative industry to have such an arrangement. She referred also to her stepmother's arrangements which she said were similar and had been accepted by HMRC. Whether or not that might be the case (we have no evidence that it is) does not impact Ms Lunn's position. This is because we are confined to looking at the evidence before us and the affairs of other taxpayers are largely irrelevant. Mr Lunn was also unable to provide a satisfactory explanation of the arrangements – offering only a generalised explanation of the legitimacy of such an arrangement and how it was recognised widely by HMRC as appropriate.

121. We note that HMRC also raised the question of how, if Ms Lunn was carrying on a trade that consisted of licensing her personal IP and recovering her expenditure, she was able to generate losses for the periods in question. Having determined that she was not trading, we do not need to consider that question as the question of loss relief falls away.

122. In relation to the 2006/07 and 2007/08 tax years we find accordingly, on the balance of probabilities, that the arrangements between Ms Lunn and VML did not amount to a trade for Ms Lunn and that the losses claimed to have been incurred in those years were not therefore offsettable against her other income. There was, therefore, a loss of tax for those years.

123. We turn next to VML's position.

VML

VML's accounting periods ending 31 March 2008 and 31 March 2009

124. HMRC say that for each of these periods VML's sought to deduct under the heading "cost of goods sold" purported payments to Ms Lunn which were in essence artificial sums intended to reduce its taxable profit.

125. HMRC's position here reflects its view of Ms Lunn's purported trade for those periods.

126. In essence HMRC say that the amounts that CLAC sought to treat as payments by VML to Ms Lunn for the use of her assets were artificial amounts which were not properly incurred by VML or charged by Ms Lunn and which were instead simply a mechanism for allocating sums between VML and Ms Lunn.

127. VML and Ms Lunn contend that this is not the case and that the amounts were genuinely charged by Ms Lunn and incurred by VML.

128. Again the technical position is not in dispute.

129. For the accounting periods in question s. 74(1) ICTA 1988 provided:

“... in computing the amount of the profits to be charged to corporation tax
... no sum shall be deducted in respect of –

(a) any disbursements or expenses not being money wholly and exclusively
laid out or expended for the purposes of the trade ...”

130. For a deduction in a company's accounts to be an allowable deduction for tax purposes for those periods, it must have been incurred and if incurred it must have been incurred wholly and exclusively for the purposes of the company's trade.

131. We look at each of the years in question.

Period ending 31 March 2008

132. VML's accounts for the year ended 31 March 2008 show, under the heading "cost of sales" an amount of £6750 described as "Direct Costs".

133. From examination of Ms Lunn's sole trade accounts for the year ended 31 March 2008 and from various manuscript annotations to Ms Lunn's sole trade accounting papers (and a schedule of outgoings) for that period, HMRC say that £750 of the Direct Costs relate to expenditure on a course attended by Ms Lunn. The £6,000 is shown in the manuscript annotations simply as "+6000 to S/T" and "I ex Ltd 6000".

134. HMRC say that the £6,000 did not represent allowable direct costs of VML and was simply a shifting of amounts between VML and Ms Lunn's sole trade, noting that it is equal to the entire turnover of the purported sole trade for the same period. They contend that it was simply an artificial mechanism employed to decrease the taxable profit in VML.

135. HMRC further contend that either the amounts were not actually paid, representing "paper allocations" between VML and Ms Lunn or if incurred they were not incurred for the purposes of VML's business. In either case they say that the amounts are not allowable expenses in computing VML's taxable profit.

Ms Lunn's evidence

136. Ms Lunn could not fully explain the basis on which the £6000 of expenditure had been allocated to VML. As we have outlined in our discussion above on whether Ms Lunn was carrying on a trade, she described the payment as being made for use of her personal IP. She could not, however, provide any information in respect of the method of allocation or an analysis of what the payments were for. She said that she did not make those decisions – they were made by Mr Lunn.

137. Ms Lunn was also asked about the £750 and it became apparent on questioning that this related to a training course on astrology which Ms Lunn and her team attended in connection with her employment with UCCP. This was because it was the only cost of £750 that could be identified and also because the manuscript annotations referred to a "course". Ms Lunn could not explain why the cost was being claimed as a cost of sales for VML. When asked whether she had raised this with her father she said that she could not remember.

Mr Lunn's evidence

138. Mr Lunn said that the £6,000 represented charges for "the use Ms Lunn's assets".

139. He went on to say that Ms Lunn's sole trade was a "cipher or charging" vehicle as "recommended by HMRC". He added that this arrangement was one which had been regularly condoned and approved of by HMRC

140. He said that as he saw it Ms Lunn had two options. The first was to sell her assets to VML, the second was to retain them and the ability to use them and to carry on as a sole trader – this involved charging VML for their use. She had taken the second option.

141. He explained that the payments were for her "skill, assets and experience". He was however unable to definitively list what the assets were.

142. He also acknowledged that there was no formula in place for determining the usage charge nor was there any licence agreement.

143. Mr Lunn could not explain a rational basis on which the amounts were computed. When questioned he said that the amounts were varied and depended, in each year, on “where we wanted profit”. He went on to say that in making that determination he looked at the overall position including the expenses incurred by Ms Lunn and their recharging and also taking into account utilisation of Ms Lunn’s personal allowance.

144. Mr Lunn also stressed that the apportioned amounts were based on the “use of the assets” which was distinct from the “value” of the relevant assets. The asset value was therefore irrelevant.

145. When asked about the claim for £750 for the course he said that the claim may not have been for the course. He could not however say what it was for.

Our determination

146. We find that £6,000 of the “cost of sales” was, on the balance of probabilities, an arbitrary apportionment of amounts between VML and Ms Lunn’s sole trade. In effect it was as HMRC put it, a “paper exercise of moving sums between the accounts”

147. We could not identify a supportable basis on which the payment was made and find that it was either not incurred or if incurred it was clearly not incurred wholly and exclusively for the purposes of VML’s trade.

148. Ms Lunn could not explain the basis for the allocation and Mr Lunn’s explanation confirmed that there was no commercial basis for the allocation.

149. As we have explained in our discussion in relation to Ms Lunn’s purported sole trade, we find that the arrangements between VML and Ms Lunn’s sole trade did not reflect any commercial reality.

150. We have again taken into account in our assessment the CLAC Cases which show that CLAC has in other situations previously apportioned expenditure between entities on an entirely artificial basis.

151. Notably, in *Kingdon* Mr Lunn sought to allocate artificially the revenues of what was found to be a single business between two businesses (a partnership and a company). The Tribunal concluding that:

“.. in our view Lunn undertook no analysis of the underlying commercial activities of the respective trading entities and simply apportioned the income and expenses between them as Lynn thought fit, there was no verification undertaken as regards the reality of the position. “ [50]

152. Although the facts of this case are distinct from those in *Kingdon*, we believe that *Kingdon* is helpful as it is an example of Mr Lunn being found to have demonstrated a complete disregard for the commercial reality of a situation and his willingness to present knowingly to HMRC an artificial allocation of expenditure between two entities.

153. We noted Mr Lunn’s numerous comments as to the validity of partnerships/sole traders and companies being run “alongside each other”. This was a key point for him. He also stated that his wife operated a similar system to Ms Lunn and HMRC had not made any adjustments to her position, a point reinforced by Ms Lunn.

154. We are not however determining whether as a general principle an individual can charge their personal service company for the use of assets and recovery of expenses. We are looking here at whether particular expenditure has in fact been incurred by VML.

155. On the £750 – we find that this was likely to be the same sum claimed for the astrology course by Ms Lunn in her self-employment accounts – and further that it related to her employment with UCCL Ltd.. Ms Lunn and Mr Lunn both said that it was not necessarily the same amount – but it is a specific figure 750 and the expense was labelled specifically as “course” – on the balance of probabilities it is therefore likely to be the same expense.

156. We find accordingly that there was a loss of tax for the two accounting periods.

VML’s accounting period ending 31 March 2009

157. The position for the period ending 31 March 2009 is very similar to the previous period and HMRC’s submission is the same.

158. The amount described in the accounts as the cost of goods sold is £18,836 of which £12,786 represented the turnover of Ms Lunn’s purported sole trade for the same period.

159. Here HMRC point to the following:

(1) A manuscript note on Ms Lunn’s self-employment accounts for 2008/09 stating “T ex o/s Ltd” which HMRC submit means that the turnover (T) of the sole trade was derived from the expenses of VML (Ltd).

(2) The trial balance of VML does not include the £12,786

160. Ms Lunn had no further information for this period.

161. Mr Lunn noted that VML did not actually produce a trial balance – as “double entry book keeping” was never used by it. He saw HMRC’s reference to a trial balance as an example of its lack of integrity.

162. As with the costs of direct sales for the period ended 31 March 2008 we find that the direct costs of £12,876 were, on the balance of probabilities, either not incurred at all or if incurred were not incurred wholly and exclusively for the purposes of VML’s trade.

163. This is for the same reasons given in relation to the earlier period. In short they were arbitrary allocations of amounts between VML and Ms Lunn.

164. Accordingly, we find that there was a loss of tax for the period as the expenditure was not allowable.

VML’s accounting periods ending 31 March 2016 and 31 March 2017

165. After being dormant for several years and submitting tax returns showing no turnover or profit for the periods ending 31 March 2011 - 2015, VML produced trading accounts for the period ending 31 March 2016 and 17.

Accounting period ending 31 March 2016

166. VML’s accounts for this period showed, under the heading, “cost of raw materials and consumables” an amount of £11,634. This is the same amount shown in Ms Lunn’s self-employment page of her income tax return for 2015/16 as her turnover.

VML’s Accounting period ending 31 March 2017

167. VML's accounts for this period showed under the heading "cost of materials" an amount of £19,711.

168. Ms Lunn's self-employment page of her income tax return for 2016/2017 showed turnover of £11,717.

169. It is not disputed that the entire £11,634 "cost of raw materials and consumables" shown in the 2016 accounts and £11,717 of the "cost of materials" shown in the 2017 accounts were treated by Ms Lunn as the turnover of her sole trade in her tax returns for the corresponding tax years.

170. HMRC submit that, as for the accounting periods ending 31 March 2008 and 2009 the sums were not actually incurred by VML or if incurred they were not incurred wholly and exclusively for the purposes of VML's trade and in either case represented paper transactions with no commercial reality undertaken for the purpose of reducing taxable profit.

171. HMRC have not been able to provide the documentary supporting evidence that they were able to provide in respect of the previous years. This is because the papers obtained from the raid on CLAC's premises cover only periods up to 31 March 2009.

172. They rely here on the similarity between the facts for 2016 and 2017 and the facts of the pre-dormancy years – in particular the fact that the costs claimed by VML in those years was equal to the turnover of Ms Lunn's purported sole trade - and say that a presumption of continuity should apply.

The legislation

173. The applicable legislation is materially the same as for the earlier accounting periods, although section 74 ICTA 1988 was replaced with section 54(1) of the Corporation Tax Act 2009 ("CTA 2009") which provides:

“in calculating the profits of a trade, no deduction is allowed for –

(a) Expenses not incurred wholly and exclusively for the purposes of the trade, or

(b) Losses not connected with or arising out of the trade.”

Discussion

174. The arrangements appear to be the same as those adopted by VML and Ms Lunn for the periods ending 31 March 2008 and 2009.

175. It is also clear to us that the allocation of income to the "sole trade" by VML and Ms Lunn was based on a very firmly held belief of appropriateness by Mr Lunn, and neither Ms Lunn nor Mr Lunn indicated that this principle had changed in any way for 2016 or 2017.

176. Additionally Ms Lunn did not refute in her correspondence with HMRC its contention that the same methodology had been adopted after the period of hiatus, and she continued to maintain that the turnover of her sole trade consisted of the reimbursement of expenses, charges for use of assets or both.

Determination

177. We consider therefore that on the balance of probabilities the expenditure was, as for the previous years, an artificial transfer of income between VML and Ms Lunn.

178. On this basis we find that these amounts were not expenditure incurred by VML but were artificial amounts designed to reduce profit as per the earlier periods and that they were

either not incurred by VML or if incurred were not incurred wholly and exclusively for the purposes of VML's trade.

179. We find accordingly that there was a loss of tax for these periods as VML was not entitled to deduct for corporation tax purposes the amounts shown in its accounts for these charges.

THE DISCOVERY ASSESSMENTS

180. Having considered Ms Lunn's and VML's tax position for each of the relevant years we turn now to consider the validity of the discovery assessments.

181. The relevant legislation for individuals and corporates is in all material respects as regards these appeals the same, although it is contained in different statutes.

182. For individuals the relevant provisions are in TMA 1970 and for companies they are in schedule 18, FA 1998.

183. In this judgment we set out in full, for convenience and to avoid duplication, the provisions for individuals and we refer to the corresponding statutory references for companies.

184. We deal first with Ms Lunn's assessments and VML's assessments for its accounting periods ending 31 March 2008 and 2009 as these were made more than four years after the end of the years of assessment to which they relate.

185. S. 29(1) TMA 1970 (para. 41, sched.18 FA 1998) provides, so far as relevant, that

“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 ... [has] 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.”

186. S. 29(2) TMA 1970 (para. 45, sched. 18 FA 1998) provides that a taxpayer may not be assessed where the loss is attributable to an error or mistake made in accordance with generally prevailing practice at the time it was made.

187. S. 29(3) TMA 1970 (para. 42, sched. 18 FA 1998) provides that an assessment may not be made unless one of two conditions set out at ss. 29(4) and 29(5) is fulfilled.

188. S. 29(4) TMA 1970 (para. 43, sched. 18 FA 1998) is fulfilled where:

“... the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf”

Ms Lunn

Was there a discovery?

189. For there to be a discovery, two tests must be met by an HMRC officer. The first is subjective and the second objective. The tests were helpfully set out by the Upper Tribunal in *Anderson v HMRC* [2018] 4 All ER 338.

190. The subjective test is that:

“The officer must believe that the information available to him points in the direction of there being an insufficiency of tax”

That formulation in our judgment acknowledges both that the discovery must be something more than suspicion of an insufficiency of tax and that it need not go so far as a conclusion that an insufficiency of tax is more probable than not.” [28]

191. The objective test is satisfied if:

“.. the officer’s belief is one that a reasonable officer could form.” [30]

192. The Upper Tribunal added:

“It is not for a tribunal hearing an appeal in relation to a discovery assessment to form its own belief on the information available to the officer and then to conclude, if it forms a different belief, that the officer’s belief was not reasonable.” [30]

Discussion

193. As we have outlined earlier, Officer Baker explained that he became aware of the likely loss of tax when he reviewed the records identified by his predecessor Officer Elvin from the materials obtained in June 2010 following HMRC’s seizure of documents from CLAC.

194. He explained how in forming his view he had taken into account the manuscript amendments made to Ms Lunn’s accounting records by Mr Lunn, the lack of any supporting evidence in respect of the amounts claimed and the lack of any evidence as to Ms Lunn’s purported trade. He also said that he agreed with the conclusions reached by Officer Elvin.

195. Ms Lunn contends that HMRC were only able to make such a determination as they had approached the case with a less than open minded view. She claims that HMRC’s view was prejudiced because of Mr Lunn and CLAC’s involvement.

196. We do not agree with Ms Lunn. It is of course the case that HMRC’s suspicion arose as a result of its investigations into CLAC. This is clear from the letters sent to Ms Lunn and to other CLAC clients. It would also be difficult to conclude that the context in which the papers were obtained, and Mr Lunn and CLAC’s history were not factors in the determination reached. However, it does not follow that it was a prejudiced view which led to Officer Baker’s determination. Officer Baker was able to point to specific facts which underpinned his conclusions on Ms Lunn’s position for each of the relevant years and those facts appear to us to be reasonable.

197. We find accordingly that Officer Baker’s view was reasonable and objective.

198. We have concluded that there was a loss of tax in 2005/06 as Ms Lunn’s expenses were, on the balance of probabilities, overstated. We have also concluded that there were losses of tax in the 2006/07 and 2007/08 tax years as Ms Lunn was not carrying on a trade and so could not have generated trading losses for offset against her general income.

199. Having made those findings, it is then necessary to consider whether the loss of tax was brought about carelessly or deliberately by Ms Lunn or someone acting on her behalf.

Carelessly or deliberately

200. HMRC say that the losses were deliberately brought about by CLAC as a person acting on behalf of Ms Lunn.

Was CLAC acting on behalf of Ms Lunn?

201. HMRC cited the Upper Tribunal decision in *John Hicks v HMRC* [2020] UKUT 0012 (TCC) in which the UT agreed at [122] that the test for whether a person acts on another's behalf for the purpose of s 29 TMA 1970 is the test set out in *Bessie Taube Trust v Revenue & Customs* [2010] UKFTT 473 TC which is as follows;

“In our view, the expression “person acting on ... behalf” is not apt to describe a mere adviser who only provides advice to the taxpayer or to someone who is acting on the taxpayer's behalf. In our judgment the expression connotes a person who takes steps that the taxpayer himself could take or would otherwise be responsible for taking. Such steps will commonly include steps involving third parties but will not necessarily do so. Examples would in our view include completing a return, filing a return, entering into correspondence with HMRC, providing documents and information to HMRC and seeking external advice as to the legal and tax position of the taxpayer, The person must represent, and not merely provide advice to, the taxpayer” [93]

202. It is clear to us that CLAC as authorised tax agent of Ms Lunn was a person acting on behalf of Ms Lunn whilst that engagement lasted.

203. It is then necessary to consider whether CLAC's behaviour was deliberate.

204. S. 118(7) TMA 1970 provides that:

“In this Act references to a loss of tax or a situation brought about deliberately by a person includes a loss of tax or a situation that arises out of deliberate inaccuracy in a document given to Her Majesty's Revenue and Customs by or on behalf of that person.”

205. The meaning of the phrase “deliberate inaccuracy” was considered by the Supreme Court in *Tooth* which summarised its conclusion as follows;

“It may be convenient to encapsulate this conclusion by stating that, for there to be a deliberate inaccuracy in a document within the meaning of section 118(7) there will have to be demonstrated an intention to mislead the Revenue on the part of the taxpayer as to the truth of the relevant statement, or perhaps Recklessness as to whether it would do so” [47].

206. For the 2005/06 tax year we have found that, on the balance of probabilities, Mr Lunn chose to inflate the amounts initially specified in Ms Lunn's accounting papers. Those amounts were intended to be and were actually taken into account as deductible expenditure in Ms Lunn's tax return which was prepared by CLAC. We find that this behaviour was clearly deliberate.

207. For 2006/07 and 2007/08 we have found, again on the balance of probabilities, that Ms Lunn was not carrying on a trade. We also found that the purported trade was a mechanism devised and implemented by Mr Lunn to transfer amounts between VML and Ms Lunn in order to reduce taxes payable without regard to the reality of the arrangements between them.

208. Mr Lunn has maintained consistently that this represented a legitimate allocation of amounts between two trading entities and was an entirely valid business structure adopted by many other taxpayers.

209. The Appellants' joint skeleton argument also states that there was a “clear and logical reason and explanation why the acts that the respondent complains of were carried out”. On this basis they contend that there was no “careless or deliberate behaviour” intended to cause a loss of tax for the purpose of the discovery provisions. There was instead, they say, a genuine belief as to the appropriateness of the accounting treatment and the tax returns. A

genuine belief as to correctness would, even if subsequently found to be incorrectly held, would not amount to careless or deliberate behaviour.

210. As we have already mentioned we are not assessing whether or not it is possible for two entities to ever apportion amounts between themselves, with one making payments for the use of assets belonging to another. We are instead looking at the specific arrangements between Ms Lunn and VML and determining on the evidence available what was actually in place.

211. Here we found that there was no trade being carried on by Ms Lunn for the periods in question and neither Ms Lunn nor VML were able to provide any support for the payments purportedly made by VML for use of Ms Lunn's assets. This is not therefore a case of considering the legitimacy of a commercial arrangement, it is instead a case of what we consider to be an artificial and unsupported allocation of sums between two entities. We find this to clearly be deliberate behaviour on the part of CLAC.

212. We note also that this was not a mistake which for the purpose of s. 29(2) TMA 1970 could be regarded as being in accordance with generally prevailing practice at the relevant time.

213. The normal time limit for assessing a company is four years from the end of the accounting period to which the assessment relates (s. 34(1) TMA 1970).

214. That time limit is extended to twenty years in circumstances where the loss of tax has been brought about deliberately by a person (or a person acting on their behalf) (s. 36(1A) and (1B) TMA 1970).

215. As we have found, CLAC was a person acting on behalf of Ms Lunn and the loss of tax was brought about deliberately. The twenty year period therefore applies and the discovery assessments were made within that period.

Determination

216. We find therefore that the discovery income tax assessments for tax years 2005/06, 2006/07 and 2007/08 were validly issued.

VML

VML's accounting periods ending March 31 2008 and March 2009

217. Our findings in relation to VML correspond generally to our findings in relation to Ms Lunn.

218. Specifically, we find that there was a discovery, for the purpose of para. 41, sched. 18 FA 98, by Officer Baker of income that should have been assessed to tax but which had not been.

219. We also find that CLAC was a person acting on VML's behalf within the meaning of para. 43, sched. 18 FA 98 and that CLAC/Mr Lunn's behaviour was, for the purpose of that paragraph, "deliberate" and therefore the requirements of para. 42, sched. 18 are fulfilled.

220. As noted above, the normal time limit for assessing a company is four years from the end of the accounting period to which the assessment relates (para. 46, sched.18, FA 98).

221. That time limit is extended to twenty years in circumstances where the loss of tax has been brought about deliberately by a person or a person acting on their behalf (para. 46(2A) (b) and (2B), sched. 18 FA 98).

222. As we have found, CLAC was a person acting on behalf of VML and the loss of tax was brought about deliberately. The twenty year period therefore applies and the discovery assessments were made within that period.

223. We find accordingly that the discovery assessments for the periods ending 31 March 2008 and 2009 were validly issued.

224. For completeness we note para. 45, sched. 18 FA 1998 which prevents a taxpayer from being assessed where the loss is attributable to an error or mistake made in accordance with generally prevailing practice at the time it was made. As we concluded in relation to Ms Lunn we also find that VML's purported losses for the relevant years did not arise from an error or mistake made in accordance with then prevailing accounting practice.

VML's assessments for the periods ending 31 March 2016 and 31 March 2017

225. For these accounting periods HMRC do not rely on CLAC/Mr Lunn's deliberate behaviour in order to support the discovery assessment. They rely instead on para. 44, sched. 18 FA 98 which provides as follows:

“(1) a discovery assessment for an accounting period for which the company has delivered a company tax return, or a discovery determination may be made if at the time when [an Officer of Revenue and Customs]

(a) ceased to be entitled to give a notice of enquiry into the return, or

...

(b) [he] could not reasonably be expected, on the basis of the information made available to them before that time, to be aware of the situation mentioned in paragraph 41(1) or (2).

(2) For this purpose information is regarded as made available to [an officer of Revenue and Customs] if –

(a) It is contained in a relevant return by the company or in documents accompanying any such return, or

(b) It is contained in a relevant claim made by the company or in any accounts, statements or documents accompanying any such claim, or

(c) It is contained in any documents, accounts or information produced or provided by the company to [an officer of Revenue and Customs] for the purposes of an enquiry into any such return or claim, or

(d) It is information the existence of which, and the relevance of which as regards the situation mentioned in paragraph 41(1) or (2)

(i) could reasonably be expected to be inferred by [an officer of the Revenue and Customs] from information falling within paragraphs (a) to (c) above, or

(ii) are notified in writing to [an officer of Revenue and Customs] by the company or a person acting on its behalf.”

226. HMRC contend that for these periods there was nothing in the tax returns or information provided by VML or Ms Lunn to indicate or draw attention to there being any loss of tax and so they could not have been reasonably expected to be aware of the loss of the tax.

227. Mr Bracegirdle cited the decision of Auld LJ in *Veltema v Langham* [2004] All ER 436 to help show the nature of information which could make an HMRC officer “reasonably aware” of an insufficiency of tax. In that case Auld LJ concluded:

“it seems clear to me that the key to the scheme is that the Inspector is to be shut out from making a discovery assessment under the section only when the taxpayer or his representatives in making an honest and accurate return or in responding to a section 9A enquiry have clearly alerted him to the insufficiency of the assessment, not where the Inspector may have some other information, not normally part of his checks, that may put the sufficiency of the assessment in question.”

228. HMRC have submitted that the loss of tax for these periods became apparent only after the seized CLAC papers relating to VML and Miss Lunn were reviewed and their content compared with their earlier tax returns. This was when Officer Elvin had been able to review the papers which was some time after the seizure. We heard from Officer Baker that he had reviewed Officer Elvin’s findings and agreed with them and how following correspondence with VML and Miss Lunn he issued the assessments in May 2019.

229. We also heard from him how prior to the review of the CLAC papers HMRC did not have sufficient information to be aware of VML’s underpayments of tax and on this basis were justified in making the assessments.

230. We agree with HMRC, taking into account the decision in *Veltema*, that insufficient information was available until review of the CLAC papers for HMRC to be aware of the loss of tax.

231. As the normal time limit for assessing a company under a discovery assessment is four years from the end of the accounting period to which it relates and the assessments were both issued in May 2019 they are within that limit.

Determination

232. Accordingly we find that the discovery corporation tax assessments for 31 March 2016 and 2017 were validly issued.

The Penalties

233. We turn next to consider the penalties imposed

The penalty assessments for Ms Lunn for 2005/6, 2006/7 and 2007/8

234. There is no dispute as to the technical provisions.

235. For individuals, s. 95 TMA 1970 provided that where a person fraudulently or negligently delivered an incorrect return for that person to be liable to a penalty not exceeding the additional tax payable.

236. For companies, the equivalent provision was contained in para. 20, sched. 18 FA 1998

237. S. 100 TMA 1970 provided for both individuals and companies for the penalty to be set at an amount which in the opinion of an authorised officer of the board is correct or appropriate.

238. HMRC submit that Ms Lunn’s tax returns for 2005/06, 2006/07 and 2007/08 were negligently delivered.

239. Here it is Ms Lunn’s behaviour rather than that of CLAC/Mr Lunn which is relevant.

240. The term “negligent” is not defined for the purpose of the penalty provisions but has been considered by the courts a number of times. Mr Bracegirdle referred us to the Upper Tribunal’s decision in *Colin Moore v HMRC* [2011] UKUT 239 (TCC). Here Judge Bishopp

when considering the term in the context of a discovery assessment agreed with the proposition that a two stage approach was necessary. He described the stages as follows:

“First, one must consider whether a person whose conduct is under scrutiny had a duty of care and, if so, the nature of that duty ... Once a duty of care has been identified, it is necessary to go on to decide whether the person has satisfied the duty.” [13]

241. He saw the first as a question of law and the second as a question of fact. He went on to say that:

“There can, I think be no doubt that any taxpayer completing a self assessment return has a duty to take care when doing so: the obligation upon him is plainly to submit an accurate return.” [15]

242. HMRC submit that although CLAC/Mr Lunn was Ms Lunn’s agent, she still had responsibility for checking and signing her tax returns. They point out that the two key inaccuracies – the inflation of expenses and the charging of amounts to VML by Ms Lunn on the basis of Ms Lunn’s purported trade - were so obviously incorrect that no tax expertise was needed in order to be aware of that incorrectness. HMRC submit that in effect Ms Lunn “collaborated in a fiction” and took no steps to ensure the accuracy of her tax returns.

243. Ms Lunn contends that she was not negligent, arguing that there was nothing wrong with her tax affairs. Much of her argument relates to her belief in the accuracy of her returns, Mr Lunn’s methodology and her view that HMRC were treating her unfairly on the basis of CLAC/Mr Lunn’s involvement in the returns.

244. Having considered the evidence and the submissions, we find that Ms Lunn was negligent. In relation to the inflated expenses we agree with HMRC that Ms Lunn could reasonably be expected to have known what her actual expenses were. We also agree with HMRC that no tax expertise would have been necessary to know that the preparation of her return on the basis of her charging VML for the use of her personal IP was not based on commercial reality.

The quantum of the penalties

245. S. 100(1) TMA 1970 provides for penalties to be set at an amount which in the opinion of an authorised officer of the board is correct or appropriate.

246. HMRC have explained how they allowed as deductible expenses the amounts originally stated in Ms Lunn’s papers as expenses for travel and subsistence and book and journals for the 2005/06 tax year, disallowing only the additions to those amounts corresponding to Mr Lunn’s manuscript notes. They also explained how for the 2006/07 and 2007/08 tax years they treated Ms Lunn and VML as carrying on a single trade, allowing VML the total expenditure shown in both sets of accounts but disregarding the arrangements between Ms Lunn and VML. This was intended to ensure that the single business was not denied relief for expenditure actually incurred and was consistent with the position that a single trade existed.

247. On the basis of these approaches the assessments and penalties for the relevant years were as follows

Tax year	Additional Assessment	Penalty
2005/06	450	157

2006/07	913	319
2007/08	190.32	66

248. Officer Baker explained in his witness statement how he had reduced the quantum of the penalties to take into account Ms Lunn’s co-operation and the fact that the amounts at stake were relatively small. The result of the abatements was a 65% reduction in the size of the penalty.

Determination

249. We consider the penalties to be reasonable and uphold the amounts assessed for each of the years.

VML

250. For accounting periods ending 31 March 2008 the rules for companies were equivalent to those for individuals (para. 20, sched. 18 FA 1998).

251. As with Ms Lunn, it is necessary to consider VML’s behaviour rather than that of CLAC/Mr Lunn in relation to its tax return for that period to see whether it was negligent.

252. Adopting the two stage approach set out in *Colin Moore*, VML had an obligation to take care that its tax return was accurate. We have found that the return was not accurate as it did not reflect the commercial reality of the arrangements between VML and Ms Lunn. As we have found in relation to the sole trade, the inaccuracy of the return and the fact that it did not reflect the commercial position is something that Ms Lunn as director of VML should have been aware of. No tax knowledge would have been necessary for such a determination.

253. We therefore find VML to have been negligent.

254. As outlined above, the approach taken by HMRC was to disregard the arrangements between Ms Lunn and VML and to treat VML as if a single trade was carried on.

255. The result of this approach for VML for this period was a tax assessment of £406.20 and a penalty of £142.

256. In determining the penalty amount, Officer Baker reduced the quantum of the penalties to take into account Ms Lunn’s limited co-operation and the fact that the amounts at stake were relatively small. As with the penalties for Ms Lunn the result of the abatements was a 65% reduction in the size of the penalty.

257. We consider the penalty reasonable and uphold the amount assessed.

The penalties for VML for accounting periods ending 31 March 2009, 2016 and 2017

258. For these periods para. 1, sched. 24 FA 2007 provides that a penalty is payable where, so far as relevant, a person gives HMRC a company tax return which contains an inaccuracy that amounts to or leads to an understatement of a liability to tax or a false or inflated statement of a loss and that inaccuracy was “careless”.

259. HMRC contends that for the relevant periods VML was “careless” for this purpose.

260. Para. 3, sched. 24 FA 2007 provides that an inaccuracy is careless for this purpose if it is “due to failure by P to take reasonable care”.

261. Mr Bracegirdle cited Judge Berner’s summary in *David Collis v HMRC* [2011] UKFTT 588 (TC) of the standard of behaviour against which carelessness is to be judged for this purpose:

“We consider that the standard by which this falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question”.

262. HMRC submits, consistently with its submission in respect of Ms Lunn’s returns and VML’s return for the accounting period ending 31 March 2008, that the inaccuracy in VML’s returns for these periods was attributable to Ms Lunn’s carelessness in her capacity as its director.

263. As with VML’s 2008 tax return, HMRC pointed out that VML’s tax returns and accounts did not reflect commercial reality and that this should have been apparent to Ms Lunn or any reasonable taxpayer in her position. They say that continuing to submit returns which showed that VML was trading with herself was neither reasonable nor prudent.

264. We agree with HMRC and find that VML was careless for the purpose of the penalty provisions.

265. As we have outlined above, HMRC recomputed VML’s tax position for the relevant years on the basis that a single trade was being carried on, effectively disregarding the arrangements between it and Ms Lunn.

266. On the basis of that approach the assessments and penalties for the relevant years were as follows:

Accounting period	Additional Assessment	Penalty
31 March 2009	1,878.03	478.89
31 March 2016	799.80	203.94
31 March 2017	1,171.40	297.02

267. Para. 4, sched. 24 FA 2007 provides that for careless inaccuracy the penalty is 30% of the potential lost revenue.

268. Paras. 9 and 10, sched. 24 FA 2007 provide for a reduction in penalties where a person discloses the inaccuracy, the percentage reduction depending on whether the disclosure is standard, prompted or unprompted.

269. Para.11, sched. 24 FA 2007 allows HMRC to reduce the penalty chargeable if there are “special circumstances”.

270. Officer Baker outlined in his witness evidence how he had reduced the penalty by a small amount to reflect Ms Lunn’s limited disclosure and that he saw no special circumstances justifying any further reduction in the penalties.

determination

271. We consider the penalties reasonable in the circumstances and uphold the amounts as assessed by HMRC.

CONCLUSION

272. For the reasons given we find that the discovery assessments against Ms Lunn for the tax years 2005/06, 2006/07 and 2007/08, and the assessments against VML for accounting periods ending 31 March 2008, 2009, 2016 and 2017 were validly issued.

273. We are also satisfied that the quantum of those assessments is reasonable and the appellants have not satisfied us that, on the balance of probabilities, those assessments are incorrect.

274. We find that the penalties levied on Ms Lunn for tax years 2005/06, 2006/07 and 2007/08 and the penalties levied on VML for accounting periods ending 31 March 2008, 2009, 2016 and 2017 are valid and set at an appropriate level.

275. The appeals are therefore dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

276. 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.

**VIMAL TILAKAPALA
TRIBUNAL JUDGE**

Release date: 06th JUNE 2024