TC02321

Appeal number: TC/2010/08947

INCOME TAX – computation of profits – admitted understatement of profits in one year – discovery assessments raised for other years to make good understated profits – whether assessments justified – yes – onus of proof on taxpayer in relation to amount assessed – failure to produce adequate evidence to displace assessments – appeal dismissed and assessments confirmed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MARK SMITH **Appellant**

- and -

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

TRIBUNAL: JUDGE MALCOLM GAMMIE CBE QC
SHEILA CHEESMAN

Sitting in public at Bedford Square, London WC1 on 24 February 2012

Paul Britt (Accountant) of Baker Britt Helm for the Appellant

B R Morgan (Presenting Officer) for the Respondents

DECISION

1. These were appeals by Mr Mark Smith against assessments to tax and amendments to self-assessments in respect of the years ended 5 April 2001 to 5 April 2007. Throughout that period Mr Smith traded as a builder. The assessments were raised and the amendments were made on 10 November 2009. The assessments for 2000/01 to 2002/03 were raised under section 36 of the Taxes Management Act 1970 ("TMA"); those for 2003/04 and 2006/07 were raised under section 29 TMA; and the amounts assessed for 2004/05 and 2005/06 were by way of amendment to Mr Smith's self-assessment through closure notices under section 28A TMA.

2. The details of the additional profits and tax for each year are as follows:

(1) 2000/01: additional profits of £43,189 giving rise to tax of £17,275.60

(2) 2001/02: additional profits of £65,205 giving rise to tax of £24,972.02

(3) 2002/03: additional profits of £73,889 giving rise to tax of £27,737.86

(4) 2003/04: additional profits of £70,023 giving rise to tax of £27,503.41

(5) 2004/05: additional profits of £70,000 giving rise to tax of 27,704.18

(6) 2005/06: additional profits of £65,240 giving rise to tax of £26,735.44

(7) 2006/07: additional profits of £45,541 giving rise to tax of £18,671.81

There was also a penalty determination in respect of 2004/05 in an amount of £8,311.

3. Mr Smith first appealed against the assessments for 2000/01 to 2003/04, 2005/06 and 2006/07 on 4 December 2009. A late appeal was made against the closure notice for 2004/05 and the penalty determination in respect of that year on 13 May 2010. The applications for late appeals were refused by HMRC on 30 June 2010. In the event Mr Smith did not dispute the closure notice for 2004/05 or the penalty notice. Mr Smith also did not pursue his appeal against the assessment for 2006/07.

4. HMRC's letter of 30 June 2010 refusing the late appeal had also requested further information and had asked for it to be supplied by 31 August 2010. In the absence of any response HMRC wrote on 19 October 2010 indicating that the matter had been reviewed (purportedly under section 49C TMA) and confirmed the amounts charged in respect of 2000/01 to 2003/04, 2005/06 and 2006/07.

5. The appeal was notified to the Tribunal and received by the Tribunal on 22 November 2010, out of time. The form was dated 16 October 2010 and by letter of 29 November 2010 Mr Smith's representative indicated that they had notified HMRC of Mr Smith's intention to appeal on 16 October 2010 when the forms were sent to the Birmingham Tribunal Centre. They considered that the forms must have been delayed in the post. HMRC did not object to Mr Smith's application to extend the time for notifying the Tribunal of his appeal. We accordingly allowed the application.

6. The form notifying his appeal indicated in respect of the years 2000/01 to 2003/04 that Mr Smith would contend that no additional profits fell to be charged and that the assessments for those years should be reduced to nil. No reference was made to the year 2005/06. HMRC sought clarification in respect of the year 2005/06 and in the absence of any response from Mr Smith or his representative the Tribunal directed that the appeal should be treated as relating only to the years 2000/01 to 2003/04 unless written confirmation to the contrary was received by the Tribunal by a specified date, in which the Appellant identified the basis upon which he disputed any other year.

7. Within the time allowed by the Tribunal Mr Smith's representative confirmed in writing that the appeals were withdrawn in respect of 2004/05 and 2006/07 but would include 2005/06. The confirmation did not identify the basis upon which 2005/06 was disputed and therefore did not comply with the Tribunal's direction. In a later letter, however, Mr Smith's representative indicated that they had demonstrated that "the receipts for the period 01/02 to 05/06 were not materially different from those declared". The Tribunal also sought reasons as to why the appeal for 2005/06 had been notified late (having been omitted from the original notification, which was itself late). It was explained by Mr Smith's representative that 2005/06 had been omitted from the original notification as a result of an oversight. Notwithstanding this omission and the failure to comply fully with the Tribunal's direction within the time allowed, we heard Mr Smith's appeal in respect of 2005/06.

8. HMRC produced a Statement of Case as required by Rule 25 of the Tribunal Rules. This was subsequently amended to include 2005/06. We also received in evidence a file of papers and a file of authorities, both of which were prepared by HMRC, and a witness statement for Paul Clarke, an investigator based in the Civil Investigation of Fraud Office in Somerset House, who gave evidence before us.

9. In response to the Tribunal's standard directions Mr Smith's representative indicated that no witnesses would be called on his behalf and that there were no documents on which Mr Smith wished to rely that had not already been provided to HMRC. HMRC pointed out that Mr Smith had failed to supply a list of documents upon which he intended to rely as directed by the Tribunal. It appears from the correspondence that in a conversation between Mr Smith's representative and HMRC Mr Smith's representative had indicated that they did not consider that HMRC had taken account of the figures provided with the appeal letter of 4 December 2009 and that they had done further work on the figures but were not prepared to provide them other than for negotiation at a meeting.

10. In consequence of this HMRC applied for a direction that the figures could not be relied upon at the hearing unless they had previously been disclosed to HMRC in accordance with the Tribunal's original directions. Having regard to the indication previously given on Mr Smith's behalf that there were no other documents on which he intended to rely, the Tribunal declined to make such a direction but reminded Mr Smith's representative that if it was intended to produce any documents in support of his appeal, the documents would have to be disclosed in sufficient time for them to be properly addressed at the hearing.

11. In the event on 22 February 2012 (two days before the hearing), Mr Smith's representative faxed to the Tribunal a two page capital and income statement. Together with the appeal letter of 4 December 2009, which incorporated a summary of Mr Smith's turnover based on his VAT returns, this comprised the only material produced on Mr Smith's behalf. We were provided with no business records or bank statements beyond one statement that was shown to us at the hearing.

12. HMRC's bundle of documents comprised the correspondence and meeting and telephone notes, reflecting the course of HMRC's enquiries that had initially been opened for 2004/2005. In relation to this year (for which no appeal was pursued) an adjustment to profits of £70,000 was eventually made. The inspector had then extended his enquiries to other years but relatively little further information appears to have been forthcoming on Mr Smith's behalf and there was no substantively documented response to HMRC's letters. We pointed out to Mr Britt at the hearing that our decision could only be based upon the evidence before us and invited him to produce any material on his client's behalf. Nothing further was forthcoming.

13. Presenting the case for HMRC Mr Morgan accepted that the onus was on HMRC in the first instance to establish the validity of the discovery assessments but that thereafter it was for the taxpayer to demonstrate that the assessments were excessive. In the present case, HMRC's enquiries into 2004/05 had led to a substantial understatement of profits being identified. In the absence of any evidence to suggest that the business had changed substantially over the period of years concerned and having regard to the information obtained during the course of the enquiry, HMRC had concluded that Mr Smith had been negligent in the conduct of his tax affairs and that further assessments were therefore justified.

14. Mr Paul Clarke gave evidence on HMRC's behalf and was cross-examined by Mr Britt. Mr Clarke opened an enquiry into Mr Smith's self-assessment return for 2004/05 on 12 January 2007. The return in respect of Mr Smith's building trade showed turnover for the year ended 31 March 2005 of £194,049 and a net taxable profit of £29,908. In summary, Mr Clarke's evidence was to the following effect—

(1) On opening the enquiry he was provided with some business records, including those retained on a commercial software package, Sage. He was advised that other records used in the preparation of the business accounts (including some for earlier and later years) were being held by the Croydon VAT office following a VAT inspection visit in October 2005.

(2) Mr Clarke obtained the records held at Croydon VAT office but it transpired that not everything was held by them. He accordingly issued a production notice under section 19A TMA and eventually most of what he required was produced. Nevertheless, certain statements for a Halifax account and certain credit card statements were missing.

(3) At a meeting with Mr Smith's representative, Mr Clarke expressed a number of concerns about discrepancies in the business records. In particular, identified sales were understated and deposits in Mr Smith's business account

were far greater than the sales declared or even the revised sales based on those that were apparently omitted.

(4) Mr Smith's representative agreed to review the records to address Mr Clarke's concerns and subsequently agreed that Mr Smith's profits for the period had been understated.

(5) The basis for adjusting the profits for year 2004/05 was agreed at a meeting in October 2008. At the same time Mr Clarke asked Mr Smith's representative to provide an explanation with Mr Smith's assistance as to why bank deposits were greater than sales declared for the year of enquiry. Mr Clarke asked that the bank deposits in the preceding and next year should also be reviewed. Mr Clarke provided Mr Smith's representative with his computation of the additions to profits for the year 2004/05. He also provided a summary of deposits into the business account and of purchases, together with appropriate analyses.

(6) In the absence of a satisfactory response, Mr Clarke wrote in May 2009 with his proposals for bringing matters to a conclusion for 2004/05. He computed that the total additions should be £96,000 (subsequently adjusted to £70,000 – see below).

(7) Mr Clarke considered that it was unlikely that sales would have risen from £219,037 in 2003/04 to £350,132 in 2004/05 before falling to £309,015 in 2005/06. He had also discovered that sales had been understated in earlier and later years. When the VAT officers had visited the business premises in 2005 they had seen purchase invoices similar to those that had given rise to the understated sales in the enquiry year for periods prior to and after that period.

(8) Mr Clarke had noticed from reviewing the sales and profit declared in earlier and later years that the profit had declined sharply in 2000/01 even though turnover had been similar. He also observed that both turnover and profits had increased sharply in 2007/08. He therefore decided to limit the extent of his amendments to the years 2000/01 to 2006/07 as his observations suggested that the irregularities existed primarily in those years.

(9) He calculated that increasing the profit in 2004/05 by £70,000 rather than £96,000 and then applying the retail price index to the revised profit resulted in a gradual increase in profits over a seven year period from 1999/00 to 2007/08, which might be expected in a gradually improving business scenario.

(10) In May 2009 adjustments on that basis were put to Mr Smith's representative with the qualification that if bank statements could be provided for earlier and later years which proved that bankings in those years did not exceed sales declared, Mr Clarke would be prepared to accept that 2004/05 was a one-off year in which irregularities had occurred. No response was forthcoming.

(11) In September 2009 Mr Clarke indicated that he intended to close his enquiries and raise assessments on the basis previously communicated. Due to his transfer to another position in HMRC the assessments proposed by Mr Clarke were in fact raised by Mr Clarke's successor.

(12) Mr Clarke also undertook an analysis of the undeclared turnover with bankings in the business account for 2001/02 to 2005/06 using figures obtained from the VAT system "Vision". His analysis showed that in every year deposits in the bank account exceeded the VAT outputs and output tax.

15. Mr Clarke's evidence was reflected in the correspondence that we had seen and was not significantly challenged by Mr Britt. We accept it and given the admitted substantial under-declaration of profits in 2004/05 (and the unappealed adjustment in 2006/07) we concluded that that the discovery assessments were fully justified and the basis upon which they had been raised was an appropriate one.

16. The basis of Mr Britt's contentions for Mr Smith was that 2004/05 was a 'one-off' under-declaration of profits and that the evidence did not support any adjustment for other years (notwithstanding the unappealed adjustment in 2006/07). In part the explanation lay in the fact that Mr Smith had also traded as a plumber in 2004/05 but that there was no plumbing income for other years. It was also the case that bank deposits for other years were not materially different to the income declared for VAT and income tax purposes. In support of his contentions Mr Britt went through the income and capital statement but that statement was unsupported by any evidence by Mr Smith or otherwise.

17. Mr Morgan reminded us of what the statute requires in these cases. Section 50(6) provides that—

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

18. What section 50(6) requires is well known and longstanding and has been explained in cases both ancient and modern. In *Haythornthwaite & Sons Ltd v Kelly* (1927) 11 TC 657, Lord Hanworth put it in the following terms (at page 667)—

> "Now it is to be remembered that under the law as it stands the duty of the Commissioners who hear the appeal is this: Parties are entitled to produce any lawful evidence, and if on appeal it appears to the majority of the Commissioners by examination of the Appellant on oath or affirmation, or by other lawful evidence, that the Appellant is over-charged by any assessment, the Commissioners shall abate or reduce the assessment accordingly; but otherwise every such assessment or surcharge shall stand good. Hence it is quite plain that the Commissioners are to hold the assessment standing good unless the subject - the Appellant - establishes before the Commissioners, by evidence satisfactory to them, that the assessment ought to be reduced or set aside."

19. More recently in *Dr I Syed v HMRC* [2011] UKFTT 315, Judge Hellier put the matter in these terms—

> "Thus in relation to questions about the amount of an assessment the rule is that once HMRC have made an assessment, the amount of that assessment stands unless the taxpayer can provide evidence to the Tribunal which convinces the Tribunal that, on balance, the assessment should be different. Section 50 TMA reinforces that requirement. The evidence may be oral or documentary; it can be first or second hand; it need not be enough to show that it is certain that the amount should be different, but it must be enough to weigh the scales in favour of the taxpayer. The more precise, the more corroborated, the more believable the evidence, the better it will serve the taxpayer's purpose.

20. Mr Britt on behalf of Mr Smith requires that we should conclude, on the basis of no real evidence at all beyond his unsupported capital and income statement and a turnover summary based on VAT returns, that the assessments for all years under appeal in this case should be reduced to nil notwithstanding the admitted under-declaration of £70,000 (initially calculated as £96,000) in 2004/05. Even in relation to that year Mr Britt on behalf of Mr Smith has produced no evidence on which we can rely to explain why the under-declaration occurred and for what reason, therefore, that year represented a one-off aberration. Even if we accept that in that year Mr Smith's trade included plumbing activities that were absent from all other years, it provides no explanation as to why we should accept that Mr Smith was so lax in recording his profits when conducting plumbing activities in that year and yet so diligent in all other years when he was only carrying on trade as a builder.

21. We therefore dismiss Mr Smith's appeals and confirm the assessments in the amount in which they were raised.

22. The final words on this matter can be taken from Lord Hanworth's judgement in *Haythornthwaite & Sons Ltd v Kelly* where he concluded at page 670:

> "The Commissioners have to find the facts. If this assessment is to be set aside it must be because they are satisfied upon sufficient evidence that the assessment ought not to be made. There was clearly on the 5th August a clear indication of matters which required further explanation, further elucidation and further proof by reference to books. Whether the precept was good or bad, the witnesses who were called would obviously be asked in cross-examination: "Have you got your books? Have you got your pass book? Do you say this? Where did you get the money from?" and the like, and I do not think that the Commissioners intended to stand upon the legitimacy of the precept, but they intended to show that there was not produced to them evidence or corroborative evidence of the assertions of the Company, with the consequent result that their duty was to hold that the assessment stood good. I cannot say that they have gone on a wrong principle. The whole matter of fact was for them. They do not say that they would not deal with the case unless and until they had the pass books. On the other hand, one cannot shut one's eyes to the fact that, from the point of view of the Company, before the Commissioners a somewhat grave situation was created when it was found that no director and no shareholder went into the box to explain that the books were said to be not available, if not

existing, and there were matters which clearly required elucidation and explanation on the part of the Company."

23. 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.

MALCOLM GAMMIE CBE QC
TRIBUNAL JUDGE

RELEASE DATE: 18 October 2012