



TC06304

Appeal number: TC/2016/03518

*INCOME TAX – underdeclaration of profits – additional assessment -
whether taxpayer had demonstrated that additional assessment was
excessive – held yes – appeal allowed in part*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

DEREK MONTAGUE

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE PHILIP GILLETT
JULIAN SIMS**

Sitting in public at Havant on 6 December 2017

The Appellant appeared in person

Simon Bates, Officer of HMRC, for the Respondents

DECISION

1. This was an appeal against a closure notice in respect of the year 2011-12 issued on 1 December 2015 assessing additional income tax and National Insurance totalling £16,724.08. This appeal was subject to an internal review and a review letter, varying the original assessment and reducing the amount of income tax and National Insurance payable to £4,944.96, was issued on 12 May 2016.

Facts

2. Mr Montague gave oral evidence and we found him to be a fundamentally truthful witness but he was genuinely unable to remember many of the details of what had happened. Mr Montague said he was unable to read or write until a recent period in prison when he had learnt to do so to some extent. He had also, by his own admission, had serious problems with alcohol and gambling during the years in question. Given his problems with reading and writing, and with, at the time, alcohol and gambling, he had found it very difficult to keep proper records and his memory of events during that period was very poor.

3. In November 2014 Mr Montague was sentenced to three and a half years in prison on four counts of fraud and two Consumer Protection Act offences. Inter alia he was convicted of charging a pensioner £41,000 for work valued at only £15,500 and of taking another customer to a cash point to obtain payment. It was this alleged receipt of £41,000 which triggered the initial HMRC investigation into his tax affairs, since it was clearly in excess of the figures shown in his tax return for the period. Mr Montague explained to us that the figures disclosed in the court case were not accurate and included amounts which he had received on behalf of other workers who had provided services to the same customer. This seems to have been accepted by HMRC.

4. The initial HMRC investigation had extended to cover the years 2009-10, 2010-11 as well as 2011-12, but this had been reduced to cover only 2011-12 during the course of the investigation.

5. Mr Montague was trading as a home improvements building contractor. His tax return for the year 2011-12 was submitted on his behalf by Mr Stevens of South Coast Accountants and had been prepared from invoices and receipts which Mr Montague had provided to him. It was however clear from the HMRC investigation into Mr Montague's tax affairs that this return was inaccurate.

6. Mr Stevens had eventually ceased acting for Mr Montague because Mr Montague was unable to pay him.

7. The original return had shown turnover of £18,455 and allowable expenses of £12,211, leaving a net profit of £6,244. However, when HMRC examined the bank statements which Mr Montague had provided they discovered deposits into his

account totalling £36,660. The bank statements also showed business expenses paid out of £5,319.

5 8. Mr Stevens had returned all Mr Montague's documents to him once the return had been prepared but, because he could not read or write, Mr Montague did not consider them of any value to him and had destroyed them.

10 9. HMRC had previously assessed Mr Montague to additional income tax in respect of 2009-10, 2010-11 and 2012-13 on the basis that if there had been an underdeclaration of profits in respect of 2011-12 then, on the principle of continuity, there would have been underdeclarations in respect of those years as well. They had also assessed Mr Montague to penalties in respect of those underdeclarations. Having completed their investigations however they dropped the assessments in respect of the other years and removed the penalties.

15 10. The final HMRC decision, contained in the review conclusion letter of 12 May 2016, was that Mr Montague should be assessed on the basis of a turnover of £36,660, in line with the deposits into his bank account, and expenses of £12,211, as claimed in his tax return. This produced a figure for taxable profits for the year of £24,449 and income tax and NI of £4,944.96.

20 11. Mr Montague disputed the figure for expenses and had put together an estimate of his business expenses for the year with the assistance of someone he had met in prison. This estimate totalled £31,600. The largest items were Fuel - £6,000, Advertising - £2,000, Tools and Equipment - £2,000, Scaffolding - £2,500 and Materials £14,000. There were however no underlying documents which might support these estimates and no other written evidence which Mr Montague could provide to the tribunal.

25 12. As stated above, the estimated expenses included an estimate for fuel of £6,000, based, Mr Montague said, on an estimate of £20 to £25 per day. Simple mathematics would therefore suggest that he had estimated £25 per day for 240 days or £20 per day for 300 days. It seemed unlikely to us that Mr Montague had worked consistently for 240 days in the year, let alone for 300 days, and there were no invoices or other
30 documentation to support expenditure at this level. We therefore treated Mr Montague's estimates with a degree of caution.

13. Equally however, the figure for fuel expenses shown in his bank statements, and which HMRC had allowed, of £156, was clearly totally inadequate.

35 14. The only figure in Mr Montague's estimate for which we had any specific evidence was for the advertising expenditure paid to Yell. Mr Montague had estimated this expenditure at £2,000 for the year and said that this had been paid by direct debit. This compared with a figure of £1,531.11 paid to Yell in the year according to his bank statements. Importantly, however, although it is possible that this figure was included in the figures for Mr Montague's expenses shown in his tax
40 return, the only individual figures in his return which were large enough to incorporate this expense were under the headings "Cost of Goods for resale or Goods

used” and “Car, Van and Travel expenses”, neither of which would be an appropriate description for advertising expenses. This would imply that either Mr Stevens misallocated this expense or, more likely in our view, that he was simply not provided with an invoice for it and either was not given the bank statements or did not check Mr Montague’s bank statements for other payments. We decided that this figure was not therefore included in the expenses claimed in Mr Montague’s original tax return.

15. In his evidence Mr Montague acknowledged that he had on occasions been paid in cash and that not all of that cash would have been paid into his bank account. Some would have been used to pay for materials and fuel, some for casual labour to assist him, such as clearing waste, and some for personal expenditure such as drink and gambling. None of this cash income or cash expenditure had been taken into account by HMRC.

Discussion

16. The burden of proof in such cases lies initially with HMRC to demonstrate that their additional assessment is made to the best of their ability on the basis of the best information available to them. Once they have demonstrated this to the tribunal then the burden of proof moves to the taxpayer to disprove HMRC’s figures, in accordance with common law and, by implication, s50 Taxes Management Act 1970. The standard of proof required in such circumstances is the ordinary civil standard of proof of the balance of probabilities.

17. There is no doubt that HMRC have been quite generous to Mr Montague in some respects in that they have not assessed any additional income to take into account the cash receipts which Mr Montague acknowledged he had received but had not paid into his bank account. In addition they dropped the assessments into other years and the penalties which they had originally raised.

18. We do not find this unreasonable in that it was clear to us from his evidence that Mr Montague was totally incapable of managing his business and tax affairs without the assistance of an accountant. Unfortunately, in this case, the accountant appeared, based on the evidence before us, to have filed an inaccurate return.

19. However, without seeing the original documents provided to Mr Stevens by Mr Montague, we are unable to say if Mr Stevens knowingly filed an incorrect return or if Mr Montague had simply provided him with an incomplete set of invoices and receipts. It was however clear that Mr Stevens had not checked his figure for turnover against Mr Montague’s bank statements, but, as regards the other figures, we can say no more.

20. We are therefore left in a difficult position in that HMRC have not assessed Mr Montague’s full income, but have also restricted his allowable expenditure to the amount initially claimed in his tax return, which we have found to be incomplete, at least in respect of the payments to Yell.

21. The net result of HMRC's figures is to assess Mr Montague on the basis that he achieved a net profit of 67% of his turnover, which we find very unlikely. For his part, Mr Montague said that he aimed to achieve a net profit of 20%, but we also find this to be unlikely.

5 22. In our opinion the most likely scenario, on the balance of probabilities, is that Mr Montague's turnover was approximately £40,000, if we include amounts which he acknowledged that he received in cash, and that he probably made a net profit of approximately 40%, ie a profit of £16,000.

10 23. It is not open to us to increase the figure used by HMRC for Mr Montague's turnover because, given that it is the amount shown in his bank statements, we must accept that HMRC have discharged the burden of proof on them to demonstrate that Mr Montague's tax return understated his turnover and that his turnover was at least £36,660.

15 24. However, in our view, Mr Montague has succeeded in demonstrating that the figure of £12,211 understates his allowable expenditure, but we do not agree that this figure should be increased to the £31,600 which he has claimed. It is clear that his figures are only estimates and are unsupported by any documentary evidence. In addition, the few estimates that we can examine in any detail, those for Yell and the fuel costs, appear to be on the high side.

20 25. The estimated expenses may also of course include expenses paid for in cash which had not been banked in the first place, and which was not therefore included in the figure for turnover of £36,660. It would be wrong to deduct expenses paid out of cash income which had not been banked from a turnover figure which only includes cash which has been banked.

25 26. Having considered the representations made by Mr Montague however, we decided that he had demonstrated that the figure for his expenses should be increased from the figure of £12,211, and we decided that it should be increased to £20,000, leaving a net profit of £16,660. We therefore decided, in accordance with s50(6) Taxes Management Act 1970, that the original assessment overcharged Mr Montague
30 and that the assessment should be reduced to reflect profits of £16,600.

Decision

35 27. For the reasons set out above therefore we decided that Mr Montague's appeal against the additional assessment of £4,944.96 should be ALLOWED IN PART and that the figure for assessable profits for the year 2011-12 should be reduced from £24,449 to £16,660. We will leave HMRC to calculate the impact this has on the income tax and National Insurance assessed.

40 28. 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.

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**PHILIP GILLETT
TRIBUNAL JUDGE**

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RELEASE DATE: 19 JANUARY 2018