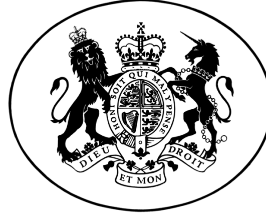

TC01265

Appeal number: TC/2010/00789

Income tax – failure to notify commencement of self-employment or return profits – amendments to self-assessments and discovery assessments – failure to return capital gains – whether adjustments required to HMRC figures – assessments and amendments to self-assessments confirmed subject to amendment – penalties for failure to notify liability to tax and for incorrect returns – penalties confirmed subject to amendment

FIRST-TIER TRIBUNAL

TAX

NARESH CHAUHAN — **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (Income Tax/Capital Gains Tax) — **Respondents**

TRIBUNAL: KEVIN POOLE (TRIBUNAL JUDGE)
MOHAMMED FAROOQ

Sitting in public in Birmingham on 7 and 8 June 2011

The Appellant appeared in person

Mr R Blundell, Senior Officer for the Respondents

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DECISION

Introduction

1. This case concerns allegations by HMRC that the Appellant failed to notify them of his commencement in self-employment, that he either failed to deliver a proper return at all or made under-declarations of his profits from self-employment (initially as a sole trader and subsequently in partnership) and that he failed to declare income from property and chargeable gains.

The facts

2. The Appellant, having previously been in employment and then unemployed, started business as a sole trader on 23 September 1996. He had bought an off-licence business called "Chester Wines" on the outskirts of Birmingham. He had decided to become self-employed because he felt he was discriminated against in his employment. He described himself as "naive" in buying and carrying on the Chester Wines business – he had no experience in the off-licence (or indeed any retail) trade and the shop was in a very disadvantaged area. He approached the whole undertaking carefully, however, obtaining advice and registering for VAT. He was aware of his obligation to notify his commencement in business to HMRC for income tax purposes, and he made all necessary preparations to do so.

3. He had only been open a few days however when he was subjected to a violent robbery late one evening at his shop. All his cash was stolen and he was threatened and then hit with a hand gun. He bled profusely from a head wound. He was warned not to tell the police, or the robber would return and "finish him off". After recovering from the initial shock, he decided to call the police and did so. He was told to stay at the shop and they would be around quickly. He waited for more than two hours but they did not appear. By this time, the bleeding had stopped and he decided not to go to hospital. Eventually he went home and stayed there, in shock. He left the shop unopened for two weeks before realising that he had to re-open it otherwise he would lose everything he had as the shop would be repossessed by the landlord and the bank would call in its loan. He did not take any steps at the time to find out why the police had not come, nor did he take any other steps such as contacting his MP or local councillor.

4. As a result of this extremely traumatic event, he decided not to notify HMRC of his business for income tax purposes. He felt let down by the authorities and felt he was justified in withholding his taxes if they failed to deliver the services for which those taxes paid. He had made further attempts to resuscitate his complaints more recently, but in view of the time lapse of nearly 15 years now since the event, they had not taken up his complaint. Whilst we cannot accept that he had any legal excuse for what he did, it is an important part of the background to the whole appeal and we accept that the whole incident affected him emotionally to the extent where it forms a significant part of the reason for his subsequent actions. A similar incident might have affected others differently.

5. He continued in business at Chester Wines for some five and a half years, until 28 February 2003. At that point, he left Birmingham and moved to Leicester, where he and his wife acquired a post office and stores called the Beaumont Off Licence, which they operated in partnership.

6. The Appellant was appointed as the sub-postmaster of the post office, and received payments from Post Office Limited for performing these duties. Whilst he was self-employed from the employment law point of view, the payments from Post Office Limited were paid to him through the PAYE system as if he was an employee. This was due to the particular nature of the position of sub-postmaster, which is an "office" for income tax purposes.

7. Again, the Appellant registered for VAT in relation to Beaumont Off Licence but did not notify HMRC that the partnership had commenced.

8. He and his wife operated in partnership at Beaumont Off Licence until 14 December 2005, when the partnership business ceased.

9. On 15 December 2005, the Appellant was issued with a tax return for the year 2003-04. We were not told what had prompted the issue of this return to him, and nothing turns on it. The Appellant ticked to indicate he had been in employment, filled in no figures but returned his P60 from Post Office Limited with the form when he signed it on 10 January 2006 and returned it to HMRC.

10. On 23 June 2006, HMRC wrote to the Appellant to inform him that they were intending to enquire into his 2003-04 return, and asking for certain information and documents to be supplied.

11. On 3 October 2006, the Appellant submitted a revised personal tax return and a partnership return for 2003-04 to HMRC. Attached to the partnership return were some accounts prepared by the Appellant's accountants Rabheru & Co. The accounts incorporated both the Post Office payments and the off-licence sales, dividing the overall net profit equally between the Appellant and his wife.

12. By letters dated 16 March 2007, HMRC informed the Appellant and his wife that they were enquiring into the partnership return for the year 2003-04, and that the Appellant's personal tax return for that year might be affected as a result. They asked for delivery of various supporting records and information. These letters were clearly issued within the statutory time limit for opening enquiries into returns laid down by section 9A TMA.

13. There followed a lengthy enquiry into the tax affairs of the Appellant, during the course of which he disclosed his previous involvement in Chester Wines. There also came to light some rental properties where rental income and a chargeable gain had not been declared.

14. By letter dated 23 January 2008, HMRC opened an enquiry into the Appellant's tax return for the year 2005-06. The date of filing of the return was not

clear to us, but the enquiry was in any event opened within the statutory time limit (which expired no earlier than 31 January 2008).

15. HMRC took the view that the normal time limits for assessments did not apply in relation to the earlier years of the Appellant's affairs because of the application of section 36 Taxes Management Act 1970 ("TMA"). They considered the loss of tax for the earlier years to be attributable to the Appellant's fraudulent or negligent conduct and accordingly they considered that the extended deadline of 20 years set out in section 36 TMA should apply. Given the reason cited by the Appellant for not making returns of his tax liabilities for those years, we agree with HMRC that the longer time limit is engaged.

16. In due course, therefore, after raising initial assessments and closure notices, HMRC (following their review) issued amended closure notices and revised assessments in respect of all relevant years from 1996-97 up to 2005-06 inclusive, seeking to bring into charge the under-declared profits and gains. They had issued original assessments and closure notices dated 2, 5 and 12 March 2009 and the revised versions were issued on 27 January 2010. We find that all the relevant notices and assessments were issued within the relevant time limits. This fact was not disputed by the Appellant.

17. HMRC also issued penalty determinations (subsequently revised following their review) under section 7(8) TMA (failure to notify liability to tax) in respect of each of the years 1996-97 to 2002-03 inclusive and under section 95(1)(a) TMA (negligent delivery of incorrect returns) in respect of the years 2003-04 and 2005-06. In each case, they applied a penalty loading of 45% of the under-declared/undeclared tax liability, though the way the loading was calculated was slightly different for the "failure to notify" years than for the "under-declaration" years.

18. The Appellant appealed against the penalties, the assessments and the amendments to his self-assessments and to the partnership return.

The law

19. Under section 36 TMA, the burden lies on HMRC to show that the loss of tax which they have assessed in relation to the years up to 2002-03 is attributable to the fraudulent or negligent conduct of the Appellant or someone acting on his behalf. As we find they have discharged that burden, the burden of proof then shifts to the Appellant, subject to one preliminary point.

20. HMRC must satisfy the tribunal that the assessments and amendments they have raised are fair (based on reasonable inferences from known facts). We are satisfied that they are. Accordingly, under section 50(6) TMA, the burden then lies on the Appellant to show that he is overcharged by the assessments and the amendments to his self-assessments and to the partnership return. Unless and until he does so, the assessments, self-assessments and return (as so amended) must stand.

21. In relation to penalties, once HMRC have determined the amount they consider appropriate under section 100 TMA, the taxpayer has a right of appeal under

section 100B TMA, pursuant to which the Tribunal has a wide discretion to confirm, increase or reduce the penalties.

Undeclared profits of Chester Wines

22. In the absence of any primary records of takings, HMRC had estimated the Appellant's profits for this business on the basis of the available VAT returns made by the Appellant. They had subtracted the total declared inputs (net of VAT) from total declared outputs (net of VAT), giving net profit figures of £11,954 for 2000-01, £13,168 for 2001-02 and £10,882 for 2002-03 (a trading period of approximately 11 months). They had then estimated the profit figures for previous years (for which no VAT return information was available) by taking the 2000-01 figure and carrying it back, adjusting for inflation by reference to the Retail Prices Index.

23. It was noted that the Appellant had operated as a sole trader without employees, and he could not propose any better basis for estimating his profits over the relevant period. The only significant income or expense which would not have appeared in the relevant boxes on the Appellant's VAT returns were business rates. Whilst it was an enquiry to the Birmingham City Council that had established for HMRC that the Appellant was occupying the Chester Wines premises, the information from the Council did not include the amount of the rates paid. The Appellant said the rates had been approximately £2,000 per year and in the absence of any other evidence, we accept this estimate. Accordingly we confirm the method of calculation of the Chester Wines profits, subject to an extra deduction of £2,000 per year in respect of business rates (pro rata for part years of trading – i.e. £1,000 for 1996-97 and £1,833 for 2002-03).

Profits of Beaumont Off Licence

Calculation of partnership profits

24. The Appellant's accountants had constructed the 2003-04 accounts by reference to the Appellant's VAT returns and various estimates of other expenditure. Broadly, HMRC have accepted that general approach but made some adjustments.

25. First, HMRC have proposed various specific changes to the accounts as submitted. We consider that those changes are based on reasonable assumptions and provide a fair estimate of the true profits for the year 2003-04. Apart from some changes with no overall effect (transferring expenses between the Off Licence and Post Office parts of the business, and replacing depreciation with capital allowances), they added £520 for "own consumption" (which the Appellant accepted), they added £2,168 for unexplained credits to the Appellant's bank account from "NCH" and they added £1,164 to the profits in respect of overclaimed costs of plastic bags. The Appellant was unable to demonstrate to our satisfaction that any of these additions were incorrect. We therefore agree that the revised 2003-04 profit figure for the partnership as a whole should be increased from £10,566 to £17,278.

26. Second, they have made an estimate for the first one month's trading (March 2003), which falls into the year 2002-03, based on an apportionment of VAT returns

which we consider results in an unrealistically high profit figure. We consider that the appropriate figure for the March 2003 trading profit of the partnership should be £1,440, being one twelfth of the total revised figure of £17,278 for the following year.

27. Third, they have estimated the profits of the partnership for 2004-05 (based on the previous year's figure increased by reference to the Retail Prices Index) at £17,826. We agree this revised profit figure for the partnership as a whole for the year 2004-05.

28. Finally, they have estimated the profits for 2005-06 (during which the partnership ceased to trade on 14 December 2005) on the basis of ¾ of the adjusted profit for the previous year, increased again by reference to the Retail Prices Index. This came out with a figure for the partnership of £13,711. We agree this revised profit figure for the partnership as a whole for the year 2005-06.

Allocation of partnership profits

29. We do not agree with the way HMRC have allocated the partnership profits between the Appellant and his wife. They have started from the basis set out in the partnership return that the profits were to be shared equally between the Appellant and his wife. However it is quite clear that this allocation of profits was intended to apply to the global profits of both the off-licence trade and the post office counter – the accounts submitted with the original 2003-04 return clearly showed this, and the Appellant confirmed in his evidence that this was the case.

30. HMRC have made various adjustments between the partnership trade and the post office earnings – especially wages and rent. The effect of these is to allocate a net "employment earnings" amount of £5,663 to the Appellant for 2003-04 and, in addition, a half share of the off-licence profits of £17,278. The end result is that they allocate a total to the Appellant of £14,302 (combined employment earnings of £5,663 and self-employment earnings of £8,639) out of the total combined off-licence and post office earnings of £22,941 (£17,278 plus £5,663). We consider this a misallocation. In order to achieve the overall profit share clearly intended by the Appellant and his wife, he should have £5,807.50 of self-employed earnings of the partnership allocated to him. When added to his £5,663 of employment earnings from the post office counter, this will give him a total earnings figure of £11,470.50 for 2003-04 (50% of the overall combined earnings of the off-licence and post office).

31. Similar issues arise in relation to 2004-05 and 2005-06, which therefore require similar adjustments. According to the figures produced by HMRC (which we accept), the Appellant has employment earnings in 2004-05 of £10,693. The total partnership profits for that year were £17,826. The combined earnings of both parts of the business were therefore £28,519, of which the Appellant's overall share was £14,259.50. He should therefore have allocated to him a share of partnership profits for 2004-05 amounting to £3,566.50 (which, when added to his employment earnings of £10,693, equates to 50% of the overall earnings of both parts of the business).

32. In relation to 2005-06, his employment earnings are accepted as £8,313 and the overall off-licence profit is accepted as £13,711. The combined total is £22,024. He should therefore have £2,699 of partnership profit allocated to him for the year 2005-06, in order to bring his overall earnings from the combined business up to the agreed 50% level of £11,012.

Income from property

33. There were three relevant properties over the years in question.

8 Banstead Close, Wolverhampton

34. HMRC have assessed the Appellant on 12 months' rent at £250 per month, less £50 per month agents' fees and £800 per year maintenance costs. Their assessments cover the period from 6 April 2001 to 12 March 2004, so the figures for the respective years are £1600 each for 2001-02 and 2002-03 and £1467 for 2003-04. The Appellant accepted these figures at the hearing and we confirm them.

33 Canal Street, Wigston

35. HMRC had amended the Appellant's self-assessment for 2005-06 to include income from property of £1,500 (being his half share of total rent on the property, which was jointly owned with his wife). No allowance can be made for the Appellant's personal time spent in collecting the rent. We do however accept the Appellant's evidence that in fact only a total of £1,000 rent was received on Canal Street during 2005-06, his share being £500. The amendment to his self-assessment should be adjusted accordingly.

128 South Road, Erdington

36. HMRC had assessed the Appellant to tax on income from property totalling £2,750 received during 2001-02 in respect of this property. Their information was gained from Birmingham City Council, who confirmed they had paid housing benefit in that amount in respect of the rent of this property. HMRC were however unable to confirm that this rent was paid to the Appellant as landlord rather than to the tenants. The Appellant claimed he had never received any of this rent, the tenants having absconded after a few months without paying anything. We accept his evidence on this point and therefore find that the assessment for 2001-02 should be reduced by the tax on this amount.

Capital gains tax

37. When the Appellant sold Banstead Close in 2003-04, he realised a gain. HMRC estimated the chargeable gain at £11,505 after the annual exemption, based on the evidence available as to the purchase and sale prices and the legal costs incurred on the sale. The Appellant did not disagree with the calculation as it stood, but pointed out that no relief had been given for the £500 agent's fee he paid on the sale, or the legal expenses he incurred on the purchase. The Appellant was not able to recall the precise level of legal fees he paid on the purchase, but we are satisfied that

such fees were incurred and we assess them at £595, being the same amount as the fees he incurred on the sale. This reduces the chargeable gain to £10,410 (after annual exemption).

Changes to HMRC adjustments

5 38. It follows from the above that we consider the assessments and the amendments to the Appellant's self-assessments need to be varied, as follows.

1996-97

39. Income from self-employment (Chester Wines) should be reduced from £5,396 to £4,396. By our calculation, this reduces the tax payable from £326.20 to 10 £126.20.

1997-98

40. Income from self-employment (Chester Wines) should be reduced from £11,228 to £9,228. By our calculation, this reduces the tax and national insurance payable from £1,782.17 to £1,202.17.

15 *1998-99*

41. Income from self-employment (Chester Wines) should be reduced from £11,408 to £9,408. By our calculation, this reduces the tax and national insurance payable from £1,775.87 to £1,195.87.

1999-2000

20 42. Income from self-employment (Chester Wines) should be reduced from £11,746 to £9,746. By our calculation, this reduces the tax and national insurance payable from £1,762.49 to £1,182.49.

2000-01

43. Income from self-employment (Chester Wines) should be reduced from 25 £11,954 to £9,954. By our calculation, this reduces the tax and national insurance payable from £2,012.61 to £1,432.61.

2001-02

44. Income from self-employment (Chester Wines) should be reduced from £13,168 to £11,168. Income from property should be reduced from £4,350 to £1,600. 30 By our calculation, this reduces the tax and national insurance payable from £3,234.97 to £2,049.97.

2002-03

45. Income from self-employment (Chester Wines) should be reduced from £10,882 to £9,049. Income from property should remain at £1,600. Income from

self-employment (Beaumont Off-Licence) should be reduced from £1,787 to £720. By our calculation, this reduces the tax and national insurance payable from £2,457.26 to £1,616.26.

2003-04

5 46. Income from self-employment (Beaumont Off-Licence) should be reduced from £8,639 to £5,807.50 (see [30]). Income from property should remain at £1,467. Employment income should remain at £5,663. Chargeable gains should be reduced from £11,505 to £10,410. By our calculations, after taking account of the tax deducted at source (of £4,642.44), this reduces the tax and national insurance from 10 £199.16 payable to a repayment of £869.40.

2004-05

47. Income from self-employment (Beaumont Off-Licence) should be reduced from £8,913 to £3,566 (see [31]). Employment income should remain unchanged at £10,693. By our calculations, after taking account of the tax deducted at source (of 15 £4,891.26), this increases the required tax repayment from £1,530.80 to £3,040.58.

2005-06

48. Income from self-employment (Beaumont Off-Licence) should be reduced from £6,855 to £2,699 (see [32]). Employment income should remain unchanged at £8,313. Income from property should be reduced from £1,500 to £500. By our 20 calculations, after taking account of the tax deducted at source (of £3,732), this increases the required tax repayment from £1,235.94 to £2,527.06.

For ease of reference, we set out a summary of these figures in the following table:

Year	Liability contended for by HMRC	Liability as determined by Tribunal
1996-97	£326.20	£126.20
1997-98	£1,782.17	£1,202.17
1998-99	£1,775.87	£1,195.87
1999-2000	£1,762.49	£1,182.49
2000-01	£2,012.61	£1,432.61
2001-02	£3,234.97	£2,049.97
2002-03	£2,457.26	£1,616.26
2003-04	£4,841.60 (less £4,642.44 deducted at source = £199.16	£3,773.04 (less £4,642.44 deducted at source = £869.40

	liability)	repayment)
2004-05	£3,360.46 (less £4,891.26 deducted at source = £1,530.80 repayment)	£1,850.68 (less £4,891.26 deducted at source = £3,040.58 repayment)
2005-06	£2,496.06 (less £3,732 deducted at source = £1,235.94 repayment).	£1,204.94 (less £3,732 deducted at source = £2,527.06 repayment)

Penalties

General points

49. HMRC had applied penalties under section 7 TMA (in relation to the Appellant's failure to notify his liability to tax to HMRC for the years 1996-97 to 2002-03 inclusive) and under section 95 TMA (in relation to his under-declaration in the years 2003-04 and 2005-06).

50. In principle we agree that penalties are appropriate. We note however that the penalties were assessed in relation to a much higher level of believed default than has actually transpired.

51. In relation to the section 7 penalties, they had applied an abatement of 20% for disclosure (which we consider generous, but not sufficiently so to interfere with it), a 20% abatement for co-operation (in relation to which we would make a similar comment) but only a 15% abatement for seriousness. We consider that to be too low a level of discount given the amounts involved, and we propose to increase it to 30%. This results in an overall penalty loading of 30% (i.e. a total abatement of 70%) for the section 7 penalties.

52. In relation to the section 95 penalties, HMRC had arrived at a similar level of abatement, but by a slightly different means. They have allocated an abatement of just 5% for disclosure, a 20% abatement for co-operation and a 30% abatement for seriousness. We consider a more appropriate abatement would be 20% for disclosure, 20% for co-operation and 35% for seriousness. This results also in an overall 25% loading (i.e. a 75% abatement) for the section 95 penalties.

Calculation of penalties

53. It follows that our penalty calculations are as follows:

Section 7	**Calculation**	**Penalty**
1996-97	£126.20 @ 30%	£37.86

1997-98	£1,202.17 @ 30%	£360.65
1998-99	£1,195.87 @ 30%	£358.76
1999-2000	£1,182.49 @ 30%	£354.74
2000-01	£1,432.61 @ 30%	£429.78
2001-02	£2,049.97 @ 30%	£614.99
2002-03	£1,616.26 @ 30%	£484.87
Section 95		
2003-04	£1,250.50 (repayment claimed) less £869.40 (repayment due) = £381.10 @ 25%	£95.27
2004-05	Repayment due of £3,040.58	£Nil
2005-06	Repayment due has increased from £1,326.74 to £2,527.06	£ Nil
Total:		£2,736.92

54. We therefore allow the appeal to the extent necessary to substitute the above figures for the figures contended for by HMRC in relation to both tax/NIC and penalties.

55. The Appellant should be aware that the tax and national insurance due in respect of the earlier years will also carry interest, which will be separately calculated by HMRC on the statutory basis.

56. 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.

KEVIN POOLE
5 **TRIBUNAL JUDGE**
RELEASE DATE: 24 June 2011