TC04617

Appeal number: TC/2013/04003

INCOME TAX – penalties for careless inaccuracies - failure by taxpayer to include various items of income in tax return – whether careless – yes– whether decision of HMRC flawed - yes - whether appropriate to suspend penalties – yes – allow appeal in part – Schedule 24, Finance Act 2007

FIRST-TIER TRIBUNAL
TAX CHAMBER

BHARAT PATEL **Appellant**

- and -

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

TRIBUNAL: JUDGE ALEKSANDER
DEREK SPELLER FCA

Sitting in public in Sutton on 10 November 2014

The Appellant in person

Miss KM Evans, an officer of HM Revenue & Customs, for the Respondents

© CROWN COPYRIGHT 2015

DECISION

1. This appeal relates to enquiries carried out into the self-assessment tax return of Mr Patel for 2009/10 (and consequential assessments made in respect of prior periods). Simultaneously with the enquiry into Mr Patel's personal tax return, an enquiry was also carried out into the tax affairs of World Class Products Limited, a company owned by Mr Patel. The results of these enquiries were subject to a review, which was then appealed. Most of the issues in the appeal were settled following an alternative dispute resolution process. However three issues remained outstanding, which were the subject matter of the hearing before this Tribunal.

2. We gave our decision immediately following the hearing, and that decision was recorded in a summary decision notice. Mr Patel has requested a fully reasoned decision, which we now issue.

3. Mr Patel represented himself, and Miss Evans represented HMRC. We heard oral evidence from Mr Patel and from Mr Blackman and Mr Lister, the HMRC officers responsible for the enquiries. A bundle of documents was presented in evidence.

Background Facts

4. The background facts are not in dispute and we find them to be as follows.

5. Mr Patel is a self-employed locum pharmacist. His income is taxed as trading income. In addition, Mr Patel owns a company (World Class Products Limited) through which he had intended to import medicines. However this business (for various reasons) did not commence – but Mr Patel in future intends to undertake his locum pharmacist business through the company.

6. HMRC opened enquires into the income tax and VAT returns of Mr Patel and his company. Mr Lister was the HMRC officer responsible for the VAT aspects, and Mr Blackman was the HMRC officer responsible for the income tax aspects.

7. The first of the outstanding issues relates to an interest deduction claimed by Mr Patel in respect of a loan taken out by him personally from NatWest Bank. The loan was used to finance the acquisition of guaranteed equity bonds by Mr Patel. The purpose of the acquisition was to provide Mr Patel with income in his retirement. This arrangement was described as a "self investment personal plan" (sic) or "SIPP".

8. The second issue was whether Mr Patel was entitled to a deduction for the cost of acquiring these bonds as part of his "SIPP".

9. The final issue related to the penalties levied. Penalties were charged under Section 95(1)(a) Taxes Management Act 1970 of £2688 and under Schedule 24 Finance Act 2007 of £6813.35

10. We find that neither the interest on the NatWest loan, nor the cost of the bonds is an allowable deduction against Mr Patel's trading income. Section 34 Income Tax (Trading and Other Income) Act 2005 disallows expenditure in computing the profits of a business if it is not incurred wholly and exclusively for the purpose of that business. The burden of proof is on Mr Patel to show that the expenditure was so incurred (see s50(6) Taxes Management Act 1970).

11. On no basis can Mr Patel's arrangements be described as a self-invested personal pension. He is just saving for his retirement. We find that the bonds were not purchased for the purposes of any trade undertaken by Mr Patel, and that the NatWest loan was not taken out for the purposes of any trade. We also note that the arrangements do not amount to an approved personal pension scheme, for which a deduction is allowed under the relevant statutory provisions for pension contributions.

12. Mr Patel told us that banks were not prepared to lend to small companies, and that is why he had to take out the loan personally (and buy the bonds personally), but if the loan had been made to the company, the company would have been allowed a deduction for the interest expense.

13. The Tribunal stated to the parties during the course of the hearing that small incorporated businesses with bank lending regularly appeared before the Tribunal (although the loans were often subject to security or a director's guarantee), and Mr Patel's evidence that banks did not lend to small companies was not credible. The Tribunal also noted that whether or not the loan interest would have been deductible in the hands of the company would depend on various factors – but the tax rules for loan interest for companies were very different to those which applied to loan interest incurred by unincorporated traders such as Mr Patel.

14. Even if the bonds had been purchased by a company, the purchase price would not be deductible in computing the company's income for corporation tax purposes. The purchase would have been a capital expense. The purchase would not be under an approved pension scheme for which a statutory deduction was available. Indeed, if the arrangement could be described as a pension scheme, the arrangements would be "unapproved" to which a complex tax regime would apply – possibly to the great disadvantage overall to Mr Patel.

15. We find that the purchase of the bonds was not a contribution to an approved pension scheme for which a statutory relief applies. We also find that the expenditure on the bonds is not of a revenue nature, and even if it was, it would not have been incurred wholly and exclusively for the purposes of Mr Patel's trade. Accordingly Mr Patel is not entitled to a deduction for the purchase of the bonds.

16. As regards the loan interest: the loans were taken out to finance the purchase of the bonds. Given our findings above that the expenditure on the bonds was capital in nature, and that they were not acquired wholly and exclusively for the purposes of Mr Patel's trade, it follows that the interest incurred on the loans is not deductible, as the interest was not incurred wholly and exclusively for the purposes of a trade.

Penalties

17. Until 1 April 2008, penalties for errors in tax returns were governed by s95 Taxes Management Act 1970. This provided for HMRC to levy penalties (of up to 100% of the tax at stake) in circumstances where a person negligently submits an incorrect tax return. For tax periods commencing on or after 1 April 2008, penalties for errors in tax returns are governed by Schedule 24, Finance Act 2007.

18. The paragraphs of Schedule 24 that are relevant to this appeal are set out below:

> 1(1) A penalty is payable by a person (P) where—
>
> (a) P gives HMRC a document of a kind listed in the Table below, and
>
> (b) Conditions 1 and 2 are satisfied.
>
> (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to—
>
> (a) an understatement of P's liability to tax,
>
> (b) a false or inflated statement of a loss by P, or
>
> (c) a false or inflated claim to repayment of tax.
>
> (3) Condition 2 is that the inaccuracy was careless or deliberate (within the meaning of paragraph 3).
>
> […]

Tax	Document
[…]	
Income tax or capital gains tax	Return under section 8 of TMA 1970 (personal return).
[…]	

> […]
>
> 3(1) Inaccuracy in a document given by P to HMRC is—
>
> (a) "careless" if the inaccuracy is due to failure by P to take reasonable care,

[…]

4(1) The penalty payable under paragraph 1 is—

(a) for careless action, 30% of the potential lost revenue,

[…]

5(1) "The potential lost revenue" in respect of an inaccuracy in a document or a failure to notify an under-assessment is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment.

[…]

9(1) A person discloses an inaccuracy or a failure to disclose an under-assessment by—

(a) telling HMRC about it,

(b) giving HMRC reasonable help in quantifying the inaccuracy or under-assessment, and

(c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy or under-assessment is fully corrected.

(2) Disclosure—

(a) is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy or under-assessment, and

(b) otherwise, is "prompted".

(3) In relation to disclosure "quality" includes timing, nature and extent.

10(1) Where a person who would otherwise be liable to a 30% penalty has made an unprompted disclosure, HMRC shall reduce the 30% to a percentage (which may be 0%) which reflects the quality of the disclosure.

(2) Where a person who would otherwise be liable to a 30% penalty has made a prompted disclosure, HMRC shall reduce the 30% to a percentage, not below 15%, which reflects the quality of the disclosure.

[…]

11(1) If they think it right because of special circumstances, HMRC may reduce a penalty under paragraph 1 or 2.

(2) In sub-paragraph (1) "special circumstances" does not include—

(a) ability to pay, or

(b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

[…]

5

13(1) Where P becomes liable for a penalty under paragraph 1 or 2 HMRC shall—

(a) assess the penalty,

(b) notify P, and

10 (c) state in the notice a tax period in respect of which the penalty is assessed.

[…]

(3) An assessment of a penalty under paragraph 1 must be made within the period of 12 months beginning with—

15 (a) the end of the appeal period for the decision correcting the inaccuracy, or

(b) if there is no assessment within paragraph (a), the date on which the inaccuracy is corrected.

[…]

20

14(1) HMRC may suspend all or part of a penalty for a careless inaccuracy under paragraph 1 by notice in writing to P.

(2) A notice must specify—

(a) what part of the penalty is to be suspended,

25 (b) a period of suspension not exceeding two years, and

(c) conditions of suspension to be complied with by P.

(3) HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy.

30 (4) A condition of suspension may specify—

(a) action to be taken, and

(b) a period within which it must be taken.

15(1) P may appeal against a decision of HMRC that a penalty is payable

35 by P.

(2) P may appeal against a decision of HMRC as to the amount of a penalty payable by P.

(3) P may appeal against a decision of HMRC not to suspend a penalty payable by P.

5 (4) P may appeal against a decision of HMRC setting conditions of suspension of a penalty payable by P.

16(1) An appeal under this Part of this Schedule shall be treated in the same way as an appeal against an assessment to the tax concerned (including by the application of any provision about bringing the appeal by notice to HMRC, about HMRC review of the decision or about determination of the appeal by the First-tier Tribunal or Upper Tribunal).

10

(2) Sub-paragraph (1) does not apply in respect of a matter expressly provided for by this Act.

15

17(1) On an appeal under paragraph 15(1) the tribunal may affirm or cancel HMRC's decision.

(2) On an appeal under paragraph 15(2) the tribunal may—

(a) affirm HMRC's decision, or

20 (b) substitute for HMRC's decision another decision that HMRC had power to make.

(3) If the tribunal substitutes its decision for HMRC's, the tribunal may rely on paragraph 11—

(a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or

25

(b) to a different extent, but only if the tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed.

(4) On an appeal under paragraph 15(3)—

(a) the tribunal may order HMRC to suspend the penalty only if it thinks that HMRC's decision not to suspend was flawed, and

30

(b) if the tribunal orders HMRC to suspend the penalty—

(i) P may appeal against a provision of the notice of suspension, and

(ii) the tribunal may order HMRC to amend the notice.

35 (5) On an appeal under paragraph 15(4) the tribunal—

(a) may affirm the conditions of suspension, or

(b) may vary the conditions of suspension, but only if the tribunal thinks that HMRC's decision in respect of the conditions was flawed.

> (5A) In this paragraph "tribunal" means the First-tier Tribunal or Upper Tribunal (as appropriate by virtue of paragraph 16(1)).
>
> (6) In sub-paragraphs (3)(b), (4)(a) and (5)(b) "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.
>
> (7) Paragraph 14 (see in particular paragraph 14(3)) is subject to the possibility of an order under this paragraph.

19. We find that Mr Patel's conduct in claiming a deduction for these matters in his tax return was careless for the reasons set out in HMRC's review letter.

20. Penalties are therefore chargeable.

21. Under the ADR process, HMRC agreed to suspend the company's penalties on conditions, but not the penalties levied against Mr Patel personally. This is because Mr Patel would in future conduct his locum pharmacist business through the company. The company would therefore continue to file tax returns – and the conditions imposed under the penalty suspension regime could and would be directed at Mr Patel's company's continued good tax compliance. Paragraph 14(3) of Schedule 24 allows HMRC to suspend penalties "only if compliance with a condition of suspension would help [the taxpayer] to avoid becoming liable to further penalties […] for careless inaccuracy". As Mr Patel would cease to trade personally, he would no longer submit personal tax returns, and therefore, submit HMRC, it would not be possible to impose conditions that would address his continuing personal tax compliance, and so HMRC had no power to suspend penalties against Mr Patel personally.

22. However, Mr Patel will derive income from his company in the form of salary (or deemed salary as a result of the application of "IR35") or dividends. Mr Patel can be required to file a self-assessment tax return in respect of this income. It is therefore possible for HMRC to impose conditions on Mr Patel personally which address his continued tax compliance. We therefore find that HMRC's decision that it could not suspend penalties to be "flawed" for the purposes of Schedule 24, as an HMRC officer acting reasonably (in a "judicial review" sense) would have appreciated that it was possible to impose conditions that would address Mr Patel's continuing compliance with his personal income tax and CGT obligations.

23. The penalties were charged by HMRC at 15%. We note that this rate gives Mr Patel the maximum mitigation available under Schedule 24. There is no suggestion that 15% is inappropriate for the penalties charged under the Taxes Management Act 1970. We find that there are no special circumstances which would justify a reduction in the penalties. We therefore uphold the penalties levied by HMRC.

24. We have decided that one of the reasons for the errors in the tax returns made by Mr Patel and his company stem from his careless and negligent misunderstanding of the way in which businesses undertaken by individuals and companies are taxed. If Mr Patel

had the benefit of competent advice, we consider that he may never have got himself and his company into this position.

25. We therefore have concluded that it would be appropriate to suspend the penalties levied against Mr Patel under Schedule 24 for 24 months from 14 July 2015 (the date of release of the summary decision) on the following conditions:

(1) That Mr Patel engages a professional accountant or tax advisor (and procures that World Wide Trading Limited engages such an accountant or advisor) to advise them on their tax affairs and to prepare their tax returns. The accountant or advisor must be a chartered member of: (a) the Institute of Chartered Accountants in England and Wales (or the corresponding Institutes in Scotland or Ireland), (b) the Association of Chartered Certified Accountants or (c) the Chartered Institute of Taxation.

(2) That Mr Patel and the company file accurate tax returns by the relevant due dates and pay their tax on time.

26. The conditions refer not only to Mr Patel but also to his company, this is because Mr Patel's future income will derive from the company, and therefore it is important that the company's taxable income is properly recorded as it has "knock-on" consequences for Mr Patel's own personal income (for example, in considering the possible application of "IR35" and similar legislation to the company's income). This will therefore help Mr Patel avoid becoming liable to further penalties for careless inaccuracy.

27. 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.

NICHOLAS ALEKSANDER
TRIBUNAL JUDGE

RELEASE DATE: 7 SEPTEMBER 2015

Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 18 November 2015

Authorities quoted in skeletons but not referred to in this decision:
Hurley v Taylor (71 TC 268)
Jonas v Bamford (51 TC 1)