# TC07719

*CORPORATION TAX, VALUE ADDED TAX – penalties - inaccuracies in tax returns – cash sales largely not recorded – were inaccuracies deliberate on the second and third appellants' parts? – yes – were they attributable to the first appellant? – yes – did the penalty percentages reflect the quality of disclosure? – yes – was it right to reduce the penalties because of special circumstances affecting family of first appellant? – yes – did the Tribunal have the power to do so? – yes – appeal allowed in part*

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**Appeal number: TC/2018/01696**
**TC/2018/02943**
**TC/2018/02946**
**TC/2019/01331**
**TC/2019/01333**

**BETWEEN**

**HAMID ALI**
**TOP NOTCH TYRES LIMITED (in liquidation)**
**ADS TYRE LIMITED (in liquidation)**

**Appellants**

**-and-**

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

**TRIBUNAL: JUDGE ZACHARY CITRON**
**MR CHRISTOPHER JENKINS**

**Sitting in public at Taylor House London EC1 on 11 February 2020**

**Mr L Ahmed of CTM Tax Litigation Ltd for the Appellant**

**Mr P Marks, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents**

## DECISION

### INTRODUCTION

1. This appeal was about whether inaccuracies in the corporation tax and VAT returns of two London tyre-shop companies (the second and third appellants) under the control of the first appellant (Mr Ali) were deliberate; and, if so, whether the penalties charged reflected the quality of the companies' disclosure, and whether it was right to reduce the penalties because of special circumstances.

### THE APPEAL

2. HMRC raised penalties under Schedule 24 Finance Act ("FA") 2007 for deliberate inaccuracies

(1) on the third appellant ("ADS") in respect of

(a) corporation tax for five periods (ending 30 September 2012, 30 September 2013, 31 October 2013, 31 October 2014 and 31 October 2015), on 31 January 2018 – in the amount of £4,998.95. A personal liability notice ("PLN") was issued to Mr Ali on 8 February 2018, for 100% of the penalty;

(b) VAT in respect of 19 quarterly periods from 1 February 2013 to 31 October 2017, on 17 April 2018 – in the amount of £34,363.77. A PLN was issued to Mr Ali on 15 October 2018, for 100% of the penalty. At the hearing HMRC explained that the correct amount for this penalty was in fact £34,342.

(2) on the second appellant ("Top Notch") in respect of

(a) corporation tax for two periods (ending 27 October 2014 and 31 October 2015), on 31 January 2018 – in the amount of £8,753.28. A PLN was issued to Mr Ali on 8 February 2018, for 100% of the penalty;

(b) VAT in respect of 11 quarterly periods from 1 November 2013 to 31 July 2016 on 31 January 2018 - £28,917.49. A PLN was issued to Mr Ali on 16 February 2018 for 100% of the penalty. At the hearing HMRC said that the penalty had been incorrectly raised for the 7/16 quarterly period. The correct amount for this penalty was in fact £25,837.78.

3. Mr Ali appealed against the four PLN penalties on 2 March 2018.

4. On 2 May 2018 ADS and Top Notch (the "companies") appealed against the corporation tax penalties. The companies appealed against the VAT penalties on 13 November 2018.

5. The Tribunal joined the three appellants' appeals.

### EVIDENCE

6. We had hearing bundles containing, amongst other things:

(1) appeal papers and decision notices;

(2) papers relating to HMRC's enquiries into the companies' tax returns from March 2017, including HMRC's report of their visit to ADS's shop in March 2017 and photographs taken (of invoices issued to the companies by third parties; and of some invoices issued by one of the companies to the other; and of a cheque book of ADS);

(3) assessments and penalty notices;

(4) Companies House extracts;

(5) copies of invoices issued to the companies by two tyre suppliers;

(6) explanatory information for the creditors of Top Notch (July 2017);

(7) hospital letters in respect of Mr Ali's daughter from 2019 and 2020;

(8) a letter to HMRC dated 17 December 2015, signed by Mr Ali as director of ADS, in relation to VAT repayment for the 07/2015 quarterly period. Mr Ali said in the letter that he had called HMRC about his new address and informed them that he had not received his postal order for the VAT repayments. In the letter he confirmed his new address and asked HMRC to send the new cheque there. He said for that further correspondence HMRC could contact his accountant. There is a hand-written postscript in what appears to be Mr Ali's handwriting saying: "Note: I have also sent VAT 484 Form in order to change Bank account and address details"; and

(9) copies of text messages between Mr Ali and someone whom Mr Ali said was one of the companies' accountants, from 6-13 November 2017: in the first message, Mr Ali says: "I was away on holiday as soon as I am back I called you but you didn't answer my calls or text. I need those documents today because it's the deadline day today." "For the last five or six months the HMRC asking for those documents and you are not sending it. I spoke with HMRC and told them that you have send it by post but they haven't received it and I ask you many times to email them but you emailed them just the receipt of the post." "They need the documents now." HMRC objected to these being admitted in evidence as they had not been on the appellants' list of documents. We found them of limited relevance – see [66] below.

7. We heard oral evidence (and had witness statements) from Officer Ben Preston and Officer James Parker of HMRC, who gave evidence as to their enquiries from 2017, and from Mr Ali, who gave evidence as to the companies' business, record-keeping and relationship with their accountants, as well as aspects of his personal circumstances. Mr Ali provided two witness statements: one dated 14 August 2019 and another dated 17 December 2019.

**FINDINGS OF FACT**

8. Our findings of fact, based on the above evidence, follow. To the extent our findings have had to choose between conflicting evidence, we have explained this in what follows or in our later "discussion" section.

*The tyre shops*

9. Each of the companies operated a small tyre shop in London. Both companies were founded by Mr Ali – ADS in September 2011, Top Notch two years later in 2013. Mr Ali was a small businessman who had come to the UK in 1999 as refugee from Afghanistan.

10. Mr Ali was the controlling mind of the companies at all relevant times. He was a director of ADS from 27 September 2011 to 1 April 2014; from then on, his wife was the sole director (although Mr Ali wrote to HMRC twice in December 2015 describing himself as director of ADS). He was sole director of Top Notch from 28 October 2013 to 1 November 2016; his wife was sole director from then onwards.

11. The shops were in Hendon (ADS) and Wandsworth (Top Notch) and sold new and used tyres. Each shop had a small staff. Some customers paid by card; others paid in cash. Cash received from sales was generally used to fund purchases from suppliers (rather than depositing it in the bank, which took up staff time and had a small cost).

12. Bookkeeping and record keeping at the shops was poor. In particular, there was no reliable, consistent system for recording cash sales. If sales were made by card, then a record was automatically kept on the card machine; but if sales were made by cash, those sales were not recorded in any reliable, consistent fashion: no sales book or cash book was kept, and no

copies were kept of any receipts given to customers for sales. Sometimes brief, hand written notes were made on suppliers' invoices indicating if the supplier had been paid by cash and if so how much – however, these were inconsistent and difficult to follow, and did not amount to a reliable or consistent method of recording cash sales. As a result, cash sales at the shops went largely unrecorded. This was the case from the time the shops were opened. In making this finding, we have considered statements by Mr Ali in oral evidence to the effect that sales were noted in a "small notebook" – however, this was contradicted by evidence in his second witness statement, on which we place more weight, and no corroborating evidence of the existence of such notebooks was produced – hence our finding that no reliable, consistent system existed for recording cash sales.

13. Each of the companies retained a local firm of accountants to draw up its accounts and prepare its tax returns. Whatever books and records were made in the shops, as well as bank statements, were passed to each of these accountants for this purpose.

14. The following is a summary of Mr Ali's evidence as to his interactions with and expectations of the companies' accountants. We shall make our findings of fact on these matters in our discussion below.

> Mr Ali's evidence was that the accountants knew (i) that the companies did not raise invoices for cash sales and (ii) that hand-written notes were made on invoices from suppliers about whether cash was used to make the purchase. He said the accountants therefore should have added the amounts notated on the suppliers' invoices, to cash at bank, in working out how much cash had been received from sales. He said he had explained this to them; but even if he hadn't, they should have been able to work it out for themselves. Mr Ali stated that had he not been under so much personal pressure, he may have identified the under-declaration of sales; but at the time he had no idea that the sales were being under-declared.

*Mr Ali's personal circumstances*

15. Shortly after the ADS shop was opened in 2011 Mr Ali's father, in Afghanistan, became ill and died a few months later. Mr Ali went to Afghanistan intermittently in this period to be with his father and left the business under the care of the shop staff. He again went to Afghanistan in May 2013 to marry and then returned to the UK shortly afterwards with his wife.

16. In around October 2014 serious medical problems were discovered with the unborn child that Mr Ali's wife was then carrying. Their daughter was born prematurely, in April 2015, and had serious medical conditions. Mr Ali's daughter had to stay in hospital for six months after her birth. Mr Ali and his wife spent much of their time at the hospital; he understandably reduced the time and energy he devoted to running his business. Even after his daughter came home, there was a period of months in which there were frequent emergency visits to the hospital. Mr Ali's daughter continued to need four injections daily and had unpredictable visits to the hospital.

17. Mr Ali and his wife had a second child, a son, born in 2017, who was diagnosed with autism in 2019.

*HMRC's enquiries and liquidation of the companies*

18. On 30 March 2017 HMRC officers Parker and Preston made an unannounced visit to the ADS shop. Mr Ali attended and answered questions. They discussed the audit trail for business records, the business operation and money handling procedures.

19. On 10 April 2017 HMRC sent a letter to ADS opening a corporation tax enquiry into its corporation tax returns for the year ending October 2015 with a schedule of requested records. The requested items were:

(1) full breakdown of turnover figure in the accounts;

(2) prime sales records e.g. sales book or receipts;

(3) credit card receipts;

(4) purchase invoices;

(5) details of cash receipts;

(6) bank statements;

(7) credit card statements;

(8) breakdown of stock figure in the accounts;

(9) breakdowns of creditor figures in the accounts; and

(10) list of employees

20. On 23 May 2017 HMRC issued a notice under Schedule 36 FA 2008 to ADS to produce documents and records – the items requested were substantially the same as those in the letter of 10 April 2017. The items were required by 30 June 2017.

21. On 4 July 2017 ADS went into liquidation.

22. HMRC received a breakdown of the accounts from ADS's accountant on 13 July 2017.

23. On 18 August 2017 ADS's accountant sent HMRC some purchase invoices and bank statements.

24. On 22 August 2017 HMRC issued a penalty notice under Schedule 36 FA 2008 to ADS, with a schedule of items not provided

25. On 13 September 2017 HMRC told ADS of their intention to issue a "third party notice" under Schedule 36 FA 2008 to Bond International ("Bond") and Group Tyre Wholesale Ltd ("Group Tyre"), both tyre suppliers, requesting information on supplies made by them to ADS.

26. On 13 September 2017 HMRC opened an enquiry into Top Notch's corporation tax return for the period ended 31 October 2015; and informed it of their intention to issue the "third party notices" to the parties above concerning their supplies to Top Notch.

27. Top Notch went into liquidation on 28 September 2017.

28. HMRC issued "third party notices" to Bond and Group Tyre on 16 October 2017, asking for information and documents relating to a breakdown of sales made to the companies from the first sale to the present day – date, description and amount of each sale together with the method of payment. Detailed information was received back from these companies in October and November 2017.

29. HMRC used the information from Bond and Group Tyre, alongside information in the accounts and information from card sales, to perform a financial analysis for ADS for the year ended 31 October 2015. In summary the analysis was as follows:

(1) Turnover per the accounts was £100,493;

(2) from information from Group Tyre and Bond, and certain other suppliers, HMRC worked out that there had been £89,016 in cash receipts: they increased this by 10%, to £97,918, to allow for cases where the payment type was uncertain;

(3) card sales were £62,066;

(4) they noted that the ratio of card sales to cash receipts was £97,918/62,066 = 1.58:1;

(5) the above means actual sales were £97,918 (cash) + £62,066 (card) = £159,984;

(6) that figure included VAT charged on sales – before VAT, sales were £133,320;

(7) if one compares that figure to the figure in (1) above, the difference is £32,827 – this is the "undeclared" turnover;

(8) at a profit margin of 9% on sales (pre-VAT) of £133,320, this gives undeclared profit of £11,998. Corporation tax of 20% on this was £2,399

30. The above workings indicated to HMRC that the companies' cash purchases had been funded by cash from sales. The workings showed that when the calculated amount of cash sales was added to the data from the card machine, there was a considerable uplift in turnover (and profit) compared to declared gross sales. The ratio found between cash and card sales (£1.58: £1) was used for other periods, resulting in an uplift for all periods for both corporation tax and VAT. A similar approach was taken for Top Notch but, since there was less information, a slightly lower cash: card ratio was used (£1.50: £1).

31. HMRC raised corporation tax discovery assessments on 21 December 2017

(1) on ADS for accounting periods ending 30 September 2012, 30 September 2013, 31 October 2013 and 31 October 2014; the additional tax, including a revenue assessment for the accounting period ending 31 October 2015, was £8,401.60

(2) on Top Notch for accounting periods ending 27 October 2014 and 31 October 2015; the additional tax was £14,711.40.

32. A summary of the corporation tax adjustments follows:

| **Company** | **Period ending** | **Turnover per returns** | **Profit per returns** | **Adjusted turnover** | **Adjusted profit** | **Tax due per returns** | **Adjusted tax due** |
|---|---|---|---|---|---|---|---|
| ADS | 30/9/2012 | £37,565 | 0 | £84,458 | £7,601 | 0 | £1,520 |
| | 30/9/2013 | £96,001 | 0 | £120,160 | £10,890 | 0 | £2,178 |
| | 31/10/2013 | £8,000 | 0 | £10,924 | £907 | 0 | £181 |
| | 31/10/2014 | £101,614 | 0 | £117,914 | £10,612 | 0 | £2,122 |
| | 31/10/2015 | £100,493 | 0 | £133,320 | £11,988 | 0 | £2,399 |
| Top Notch | | | | | | | |
| | 27/10/2014 | £157,331 | 0 | £321,804 | £32,180 | 0 | £6,436 |
| | 31/10/2015 | £223,408 | 0 | £413,779 | £41,377 | 0 | £8,275 |

33. HMRC raised VAT assessments on 13 February 2018

(1) on ADS for the time frame 1 February 2013 to 30 April 2017 in the amount of £57,718

(2) on Top Notch for the time frame 13 November 2013 to 31 July 2016 in the amount of £43,425

34. The penalties summarised at [2] above were charged on the basis that the errors concerned were deliberate, but not concealed, on the part of the companies. When considering mitigation, HMRC treated the disclosure by the companies as prompted. HMRC reduced the penalties by the following percentages of the potential maximum reduction (35% - from 70% to 35%):

(1) 0% (of 30%) for telling HMRC about the inaccuracy

(2) 10% (of 40%) for helping HMRC to quantify the potential lost tax (as no help provided during enquiry)

(3) 20% (of 30%) for giving HMRC information and documents (as not all requested documents were provided)

35. Accordingly HMRC reduced the penalties by 30% of the maximum reduction (35%), giving a resulting penalty percentage of 59.5% of potential lost revenue ("PLR").

36. HMRC gave no reduction in the penalties by reason of special circumstances.

**LEGISLATION AND CASE LAW**

*Schedule 24 FA 2007*

37. Under paragraph 1, a penalty is payable by a person (P) where

(1) P gives HMRC a document including a company tax return and a VAT return;

(2) the document contains an inaccuracy which amounts to, or leads to –

(a) an understatement of a liability to tax

(b) a false or inflated statement of a loss, or

(c) a false or inflated claim to repayment of tax; and

(3) the inaccuracy was careless or deliberate on P's part.

38. Under paragraph 3, inaccuracy in a document given by P to HMRC is "deliberate but not concealed" if the inaccuracy is deliberate on P's part but P does not make arrangements to conceal it.

39. The normal rule is that PLR is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy (paragraph 5)

40. For an inaccuracy involving a domestic matter, the penalty for deliberate but not concealed action is 70% of PLR (paragraph 4). However, where P discloses an inaccuracy, HMRC must reduce this to a percentage that reflects the quality of his disclosure (but not below a minimum of 35% in the case of prompted disclosure) (paragraph 10). "Quality" includes timing, nature and extent. A person discloses an inaccuracy by

(1) telling HMRC about it;

(2) giving HMRC reasonable help in quantifying the inaccuracy; and

(3) allowing HMRC access to records for the purpose of ensuring the inaccuracy is fully corrected.

Disclosure is "prompted" unless made at a time when the person making it had no reason to believe that HMRC had discovered or were about to discover the inaccuracy. (paragraph 9)

41. If they think it is right because of special circumstances, HMRC may reduce a penalty (paragraph 11).

42. A person may appeal against a decision of HMRC (i) that a penalty is payable by the person; or (ii) as to the amount of a penalty payable by the person (paragraph 15).

43. On an appeal, the Tribunal may affirm or cancel HMRC's decision or substitute for HMRC's decision another decision that HMRC had power to make. The Tribunal may rely on paragraph 11 to a different extent than HMRC, but only if the Tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed (in the light of principles applicable in proceedings for judicial review (paragraph 17).

44. Where a penalty is payable by a company for deliberate inaccuracy which was attributable to an officer of the company, the officer is liable to pay such portion of the penalty which may be 100%) as HMRC may specify by written notice to the officer. Officer means a director (including a shadow director within the meaning of s251 Companies Act 2006) or a manager (paragraph 19).

*Deliberate inaccuracy*

45. In *Auxilium Project Management Ltd v HMRC* [2016] UKFTT 249 (TC) at [63], the Tribunal stated its view that "a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test. The question is not whether a reasonable taxpayer might have made the same error or even whether this taxpayer failed to take all reasonable steps to ensure that the return was accurate. It is a question of the knowledge and intention of the particular taxpayer at the time."

*The Tribunal's decision in* Udlaw

46. We summarise below the Tribunal's decision in *Udlaw Ltd v HMRC* [2020] UKFTT 0052 (TC), as the appellants cited it in their submissions:

(1) The taxpayer company had submitted inaccurate VAT returns for periods between 1 January 2014 and 30 June 2017; and HMRC had charged penalties on the basis that the inaccuracies were careless i.e. due to failure by the taxpayer to take reasonable care. The Tribunal decided both that the taxpayer had taken reasonable care, and that HMRC's decision that there were no special circumstances in the case was flawed.

(2) The taxpayer was a family-run company letting mobile homes at a holiday park. The director who gave evidence had not been involved in the day to day running of the business – that had been done by her father (whom we shall refer to as the "father") – but was a reasonably experienced bookkeeper, and she submitted the taxpayer's VAT returns once they had been prepared by the father's bookkeeper and signed off by the father.

(3) The taxpayer had engaged accountants. One element of their responsibility was to reconcile the money received from the lettings - as shown by the sales invoices and reflected in the VAT returns - with the annual accounts and the money credited to the taxpayer's bank account. During the period in question, due to a merger of firms, the accountants stopped performing this reconciliation exercise. This led to an under-declaration of VAT, as they failed to notice that the VAT returns showed figures after a 20% "retention" of revenues from customers.

(4) In considering whether the taxpayer had taken reasonable care, the Tribunal noted that the particular circumstances of the taxpayer had to be taken into account – and, in this case, the father, who was running the business, was ill with cancer for most of the period in question; his eyesight was failing; his wife died; and his surviving son had a stroke. The Tribunal held that, in such circumstances, it was acceptable for the taxpayer to have relied on its accountants to carry out the reconciliation exercise described above

(so ensuring the financial position reported to HMRC was correct). The Tribunal held that the taxpayer did take reasonable care.

(5) The Tribunal further found that HMRC's decisions regarding special circumstances were flawed because they did not take into account the father's death during the period, did not give reasons, or mis-stated the law. The Tribunal held that HMRC's decisions were flawed, and stated that it would have reduced the penalty to nil on the basis that there were special circumstances.

*Proof*

47. The burden of proof in this case was on HMRC to show the penalties were correctly charged. The standard of proof was the normal civil standard: on the balance of probabilities.

**THE PARTIES' ARGUMENTS**

48. The parties' arguments revolved around the question of whether the inaccuracies in the companies' tax returns were deliberate.

49. HMRC submitted that they were: the companies, under Mr Ali's control, knew that the information they gave to their accountants, for use in preparing the tax returns, under-stated cash sales; and there was no realistic way of the accountants deducing correct figures for sales, from the information they had (and the companies knew this too). This meant that the inaccuracies in the tax returns were deliberate on the part of the companies.

50. The appellants' argument was based on the evidence of Mr Ali summarised at [14] above: essentially, that the companies expected their accountants to make adjustments to the information provided so as to accurately reflect sales. The appellants acknowledged that perhaps the companies, through Mr Ali, should have identified the fact that the accountants were not making such "adjustments" – but due to Mr Ali's personal circumstances as described at [15] to [17] above (particularly, the need to take care of his daughter), his focus and energies were elsewhere at the relevant times. The inaccuracies were not deliberate on the companies' part because, acting through Mr Ali, the companies were not aware of them at the time the returns were submitted.

51. The appellants drew parallels with *Udlaw*, since, like the father there, Mr Ali had such distressing personal issues that it made him incapable of properly managing his business, although he did his best. As in *Udlaw*, the accountants here should have identified inconsistencies in the financial information provided to them by the taxpayers.

52. The appellants stated that the companies believed that the records provided to their accountants were sufficient for tax purposes – because some of their earlier VAT repayment claims had been reviewed by HMRC. HMRC objected to this as a "new point", not raised before the hearing.

53. The appellants made arguments with respect to the penalty percentages. They submitted that the companies' efforts to provide information to HMRC in a timely manner following HMRC's visit to ADS in March 2017 were hampered by their accountants, who were deliberately unhelpful, due to their own failure to make "adjustments" as described above to the sales figures for the tax returns. The appellants argued that this was evidenced by the November 2017 text message exchanges. The appellants argued that the accountants' lack of cooperation with HMRC was outside the companies' control and so should not be taken as reflecting the quality of the companies' disclosure. They argued that the maximum reduction for disclosure should be given. They argued that the companies (through Mr Ali) co-operated with HMRC from the time of the March 2017 visit – and provided all the documents and information that they held.

**DISCUSSION**

54. It was common ground that the companies' VAT and corporation tax returns in the relevant periods contained inaccuracies in the form of under-declaration of the companies' sales, and that those inaccuracies led to understatements of liability to tax, false or inflated statements of losses, or false or inflated claims to repayment of tax. The issues for decision here are therefore:

(1) Were the tax return inaccuracies deliberate on the companies' part? If so:

(2) Were they attributable to Mr Ali?

(3) Did the penalty percentage (59.5%) reflect the quality of the companies' disclosure of the tax return inaccuracies?

(4) Is it right to reduce the penalties because of special circumstances?

*Were the tax return inaccuracies deliberate on the companies' part?*

55. This question turns on what the companies knew and intended at the time the tax returns in question were submitted. As Mr Ali was the controlling mind of the companies, this comes down to what Mr Ali knew and intended at those times.

56. We find that Mr Ali knew the facts as we have found them at [12] above i.e. he knew that cash sales at the shops went largely unrecorded, and that this was the position from the time the shops opened. Although he was not regularly "behind the till" at the shops, he was sufficiently involved with the everyday running of the shops to be well aware of the facts as we have found them at [12]. Indeed, it is implicit in his evidence, as summarised at [14] above, that he knew that "adjustments" to the companies' sales records would need to be made, if cash sales were to be accurately reflected in tax returns.

57. Turning to Mr Ali's evidence as summarised at [14] above – this indicates that Mr Ali had an expectation or belief that the companies' accountants would "adjust" the sales information in the records kept by the companies, in order to arrive at an accurate figure for sales. In reality this did not happen – the accountants made no such adjustments. The question for us is - what light does this cast on the credibility of Mr Ali's evidence that he subjectively believed they would? We approach this in two steps:

(1) How reasonable was it to expect or believe that the companies' accountants would make such adjustments?

(2) How likely was it that Mr Ali genuinely held this expectation or belief?

58. Based on our findings at [12] as to the state of the companies' records, as well as the information and analysis which HMRC, in 2017, had to gather and perform in order to come up with accurate figures, we find that it would have been very difficult, to the point of impossibility, for the companies' accountants to "adjust" the companies' sales records so as to come up with accurate numbers for sales. The companies' records simply did not include information about cash sales in any systematic or comprehensible way. We do not accept that the hand-written notes on some of the purchase invoices gave the accountants the means to do this: we find that these notes were inconsistent, sporadic and difficult to follow. It is for this reason that HMRC, when making enquiries in 2017, needed to obtain considerable further information from third party suppliers, as well as making assumptions about, for example, profit margins, in order to deduce accurate figures for sales. The companies' accountants were not in a position to do this. We thus find that an expectation or belief that the accountants would adjust the sales figures in the manner described in the summary of Mr Ali's evidence at [14], was either not genuinely held, or very naïve.

59. The circumstances here were, in our view, quite different from those in *Udlaw*, where the "reconciliation" exercise expected of the taxpayer's accountants (i) had been successfully performed for a number of years, before the accounting firm merger caused it to stop; and, more fundamentally, (ii) was capable of being performed - because the taxpayer's accounts contained, based on the taxpayer's records, accurate figures for lettings. Here, what was (purportedly) expected of the accountants was not a "reconciliation" exercise, but an exercise to discover figures for cash sales in the absence of any reliable record of them being kept by the companies.

60. Turning to the likelihood of Mr Ali genuinely holding the expectation or belief as to the companies' accountants making adjustments as described at [14] above: in our estimation, Mr Ali was not a naïve man when it came to business matters - we therefore find, on the balance of probabilities, that he did not genuinely hold such expectation or belief.

61. It follows that Mr Ali knew that the tax returns were prepared and submitted using figures from information provided by the companies that under-recorded cash sales. It was also his intention that HMRC rely on the figures in the tax returns: this is well illustrated by the letter to HMRC he signed in December 2015 requesting a repayment of VAT. The inaccuracies in question were therefore deliberate on the part of the companies of which Mr Ali was the controlling mind.

62. The argument made on behalf of the appellants at the hearing - that Mr Ali thought it was acceptable to submit tax returns with inaccurate figures for sales, because HMRC had not raised the issue on a previous enquiry into the companies' VAT affairs when similar information had been used in the tax returns - is not relevant to the considerations and conclusions as set out above, for the simple reason that it does not touch on the decisive matters of whether Mr Ali, as the companies' controlling mind, knew that the tax returns contained inaccuracies and intended that HMRC rely on them.

*Were the inaccuracies attributable to Mr Ali?*

63. We find that the inaccuracies were attributable to Mr Ali, as he was the controlling mind of the companies. He was also a director, shadow director or manager of the companies at the relevant times. The PLNs were therefore valid.

*Did the penalty percentage (59.5%) reflect the quality of the companies' disclosure of the tax return inaccuracies?*

64. HMRC reduced the penalties from 70% down to 59.5% - but not all the way down to 35%, which would be the maximum reduction. The question is whether this reduction reflects the quality of the companies' disclosure of the tax return inaccuracies. In terms of what the companies did to disclose the inaccuracies (noting from [40] above the three types of action that count as "disclosure"), the facts here are that

> (1) ADS allowed HMRC access to records, arguably for the purpose of ensuring the tax return inaccuracies were fully corrected, during HMRC's visit to its shop in March 2017. The quality of this disclosure was moderate to good in terms of its timing, nature and extent.
>
> (2) ADS provided further information in mid-July and mid-August 2017 – this too was allowing HMRC access to records to ensure the tax return inaccuracies were fully corrected. HMRC had initially requested this information in mid-April 2017 and then issued a Schedule 36 FA 2008 notice for it be produced by the end of June 2017. The quality of the disclosure was moderate to poor in terms of its timing, nature and extent.

(3) Neither of the companies disclosed the tax return inaccuracies by telling HMRC about them, or by helping HMRC with quantifying them – HMRC performed the quantification exercise themselves, relying heavily on information provided by Bond and Group Tyre.

65. In the light of the above, we find that HMRC's reduction of the penalty percentage by 30% of the maximum amount did reflect the quality of the companies' disclosure of the tax return inaccuracies, which we would classify, overall, as moderate to poor.

66. We considered the appellants' arguments for further reduction on the grounds (based in part on the November 2017 text exchanges) that the companies would have given HMRC better (and quicker) access to records had it not been for the uncooperative stance of ADS's accountant, but concluded they were not relevant to the analysis: what matters is the quality of the companies' disclosure (and not what the quality might have been in different circumstances).

*Is it right to reduce the penalties because of special circumstances?*

67. We have power to reduce the penalties by reason of special circumstances only if we find that HMRC's decision not to do so was flawed. We shall nevertheless approach the analysis here first by asking if, had we the power, we would think it right to reduce the penalties because of special circumstances; and then, if we would, considering whether we have the power or not.

68. The circumstances described at [15]-[17] above – in particular those at [16], regarding Mr Ali's daughter – are potentially special circumstances. The question here is whether those circumstances had any kind of causal relationship to the liability of the companies for penalties. The appellants argued that if Mr Ali's attention had not been removed from the tyre shops by the circumstances described at [15]-[17] above, he would have ensured that accurate figures were used for sales in the tax returns. In our view, this argument is defeated by the simple fact that the inaccuracies in question were present in tax returns that were filed prior to the unfortunate onset of his daughter's medical conditions from the autumn of 2014 – we have in mind ADS's VAT returns for the 4/13, 7/13, 10/3, 1/14, 4/14 and 7/14 quarterly periods, and its corporation tax returns for the periods ending 30 September 2012 and 30 September 2013; and Top Notch's VAT returns for the 1/14, 4/14 and 7/14 quarterly periods. Although the events described in [15] occurred earlier, they were more temporary absences and cannot explain the systemic under-recording of cash sales.

69. The appellants argued, in addition, that the circumstances described at [16] and [17] above, prevented the companies from disclosing the tax return inaccuracies to the extent they would otherwise have done. Referring once again to the actions that comprise such disclosure as set out at [40] above,

(1) We are not persuaded that the unfortunate circumstances surrounding Mr Ali's children had any causal link with the fact that the companies never told HMRC about the tax return inaccuracies. This is because the companies never did so prior to the onset of those circumstances in the autumn of 2015.

(2) On the other hand, once HMRC commenced their enquiries in March 2017, we can see a causal link between Mr Ali's circumstances regarding his children, and (i) the failure of the companies to give HMRC help in quantifying the inaccuracies; and (ii) the companies' slow response to HMRC's request for access to records. We accept that, had Mr Ali been able to devote more of his time and energy to the companies' affairs, he would have ensured better quality disclosure of the tax return inaccuracies.

70. Based on the above, it would have been right, in our view, to reduce the penalty percentage by 70% (rather than 30%) of the difference between 70% and 35%. This gives a penalty percentage of 45.5%. We arrive at 70% adopting HMRC's approach as described at [34] above, but giving full reductions for helping and giving information. HMRC's approach is not ordained in law, but it is in our view a sensible approach to allocating quality of disclosure to the three types of disclosure action.

71. Finally, we consider whether we have the power to make a different decision as to special circumstances than that made by HMRC. We consider that we do, because when making their decision, HMRC did not take into account relevant matters, being the circumstances described at [16] and [17] above (as they had not been given this information by the companies at that stage); and so their decision was flawed.

**CONCLUSION**

72. The appeal is allowed in part: we substitute the following Schedule 24 FA 2007 penalties for deliberate inaccuracies in place of those set out at [2] above (the difference being that we have used a penalty percentage of 45.5% instead of 59.5%):

(1) ADS (with 100% PLN on Mr Ali)

(a) corporation tax for five periods (ending 30 September 2012, 30 September 2013, 31 October 2013, 31 October 2014 and 31 October 2015) – in the amount of £3,822.72.

(b) VAT in respect of 19 quarterly periods from 1 February 2013 to 31 October 2017 – in the amount of £26,261.52.

(2) Top Notch (with 100% PLN on Mr Ali)

(a) corporation tax for two periods (ending 27 October 2014 and 31 October 2015) – in the amount of £6,693.68.

(b) VAT in respect of ten quarterly periods from 1 November 2013 to 30 April 2016 – in the amount of £19,758.30.

**RIGHT TO APPLY FOR PERMISSION TO APPEAL**

73. 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.

**ZACHARY CITRON**

**TRIBUNAL JUDGE**

**RELEASE DATE: 21 MAY 2020**