Neutral Citation: [2022] UKFTT 369 (TC)

Case Number: TC08619

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing

Appeal reference: TC/2020/03928
TC/2020/03929
TC/2020/03930
TC/2020/03931
TC/2020/03933

INFORMATION NOTICE AND APPLICATION FOR A CLOSURE NOTICE-whether information "reasonably required" in relation to year subject to enquiry-whether information for previous years relevant to enquiry year-whether there was "reason to suspect" underpayment of tax for previous years-whether information for previous years reasonably required-whether closure notice should be granted

Heard on: 25 May 2022
Judgment date: 10 October 2022

Before

TRIBUNAL JUDGE MARILYN MCKEEVER
MR SIMON BIRD

Between

BARRY DAVIES (1)
RUPINDER MAHIL (2)
DAVIES MAHIL PARTNERSHIP (3)

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Michael Clarke, Counsel

For the Respondents: Mr Paul Marks, litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. This is an appeal against taxpayer notices issued to each of Mr Davies and Ms Mahil under paragraph 1 of Schedule 36 to the Finance Act 2008 (Sched 36). The Appellants also apply for a closure notice in relation to the enquiries opened into their tax returns for the year 2017-18 (the enquiry year). It is acknowledged that if we dismiss the appeal against the information notices, we should refuse the application for the closure notices, but it is argued that if we allow the appeal against the information notices we should order the closure notices.

2. HMRC have sought information in relation to all tax years from 6 April 2014 "to date" that is to the date of the information notices which were issued on 6 February 2020, although in fact, information was only sought up to the 2017-18 tax year.

> 3. HMRC have enquired into the Appellants' tax returns only in respect of the 2017-18 tax year. The main issue in this case is the extent to which HMRC is entitled to call for information which relates to the years not under enquiry, i.e. 2014-15 to 2016-17 inclusive (the earlier years). This in turn requires a consideration of what information HMRC "reasonably requires" in relation to the enquiry year and whether HMRC had "reason to suspect" an underpayment of tax in the earlier years and the extent to which HMRC can now require the Appellants to produce that information.

4. With the consent of the parties, the form of the hearing was V (video). All parties attended remotely. The remote platform was the Tribunal's Video Hearing System. A face to face hearing was not held because of the ongoing effects of the Covid-19 pandemic and it was considered in the interests of justice to hold the hearing remotely. The documents to which we were referred are a Hearing Bundle of 588 pages, an Authorities Bundle of 284 pages, a second witness statement and exhibits of Mr Roberts, the HMRC officer who had been dealing with the enquiry and had issued the information notices (his first witness statement was contained in the Hearing Bundle), an additional authority drawn to the parties' attention by the Tribunal, the Skeleton Arguments of the Appellants and the Respondents and an extract from a book written by Mr Davies, admitted in the course of the hearing. It was not possible to complete the hearing in the time allotted and it was agreed, and the Tribunal gave Directions accordingly, that the parties' closing submissions should be made in writing. We also had before us the Respondents' written closing submissions, submitted on 1 June 2022, the Appellants' written closing submissions submitted on 20 June 2022 and the Respondents' written reply dated 27 June 2022. At the hearing, we heard oral witness evidence from Mr Davies, Ms Mahil and Officer Roberts.

5. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

6. References to paragraphs are references to paragraphs of Sched 36 unless otherwise stated.

THE LAW

7. Paragraph 1 of Sched 36 empowers HMRC to issue a taxpayer notice. It provides:

> "1(1) An officer of Revenue and Customs may by notice in writing require a person ("the taxpayer")–
>
> (a) to provide information, or
>
> (b) to produce a document,

if the information or document is *reasonably required by the officer for the purpose of checking the taxpayer's tax position ….*

1(2) In this Schedule, "taxpayer notice" means a notice under this paragraph." [emphasis added]

8. Paragraph 21 places restrictions on the information which can be demanded in a taxpayer notice where the taxpayer has submitted a tax return. Paragraph 21 provides, so far as material:

> "21(1) Where a person has made a tax return in respect of a chargeable period under section 8, 8A or 12AA of TMA 1970 (returns for purpose of income tax and capital gains tax), a taxpayer notice may not be given for the purpose of checking that person's income tax position or capital gains tax position in relation to the chargeable period.
>
> 21(2) …
>
> 21(3) Sub-paragraphs (1) and (2) do not apply where, or to the extent that, any of conditions A to D are met.
>
> 21(4) Condition A is that a notice of enquiry has been given in respect of–
>
> (a) the return, or
>
> (b) a claim or election (or an amendment of a claim or election) made by the person in relation to the chargeable period in respect of the tax (or one of the taxes) to which the return relates ("relevant tax"),
>
> and the enquiry has not been completed so far as relating to the matters to which the taxpayer notice relates.
>
> 21(5) In sub-paragraph (4), "notice of enquiry" means a notice under–
>
> (a) section 9A or 12AC of, or paragraph 5 of Schedule 1A to, TMA 1970, or
>
> (b) paragraph 24 of Schedule 18 to FA 1998.
>
> 21(6) Condition B is that, as regards the person, an officer of Revenue and Customs has *reason to suspect that–*
>
> *(a) an amount that ought to have been assessed to relevant tax for the chargeable period may not have been assessed,*
>
> (b) an assessment to relevant tax for the chargeable period may be or have become insufficient, or
>
> (c) *relief from relevant tax given for the chargeable period may be or have become excessive*." [emphasis added]

THE FACTS, HMRC'S CONCERNS AND THE EVIDENCE

9. Mr Davies and Ms Mahil are husband and wife and they operate a property investment business in partnership.

10. On 3 May 2019 HMRC opened an in time enquiry into Mr Davies' tax return for 2017-18. The enquiry was into "the whole of the tax return". A schedule was attached to the letter requesting information and documents running to 21 items, many of them with further sub-divisions. An equivalent letter was issued to Ms Mahil on the same date. The two enquiries cover the same matters and for brevity, we will refer below just to the documents relating to Mr Davies.

11. For completeness, we mention that a separate enquiry was opened into the partnership tax return on 2 May 2019, but that is not the subject of this appeal.

12. Following extensive correspondence and meetings between the Respondents and the Appellants' then representative, formal information notices were issued on 6 February 2020. The Schedule set out four items of information and documents which were required. Information has been provided in relation to item 4 and the present appeal relates to items 1 to 3 only. The information and documents required are set out below.

> **Information and documents**
>
> "Please provide all Information and documents as noted below:-
>
> 1. A breakdown since 6 April 2014 to date of all refinancing done on the property portfolio or personal property owned for all properties owned as an individual or jointly with others. Please include:-
>
>   a. Date of the refinancing
>
>   b. Which property was refinanced
>
>   c. Completion statement for the refinancing
>
>   d. How the monies received from the refinancing were utilised
>
> 2. Supply all bank statements for accounts wherever held in the world for the period from 6 April 2016 to 5 April 2017 that are:-
>
>   a. In your name
>
>   b. Held jointly
>
>   c. That you have use of
>
> 3. Provide details of any other sources of monies that were used to personally finance yourself or to finance the property portfolios and the requisite costs of building improvements since the 6 April 2014 to date, that were not from refinancing properties."

13. Mr Roberts' main concerns were as to the means of the Appellants. In his view, the household income disclosed in the tax returns was insufficient to support their apparent lifestyle and expenditure.

14. In his first witness statement dated 10 May 2021, Mr Roberts sets out what he states to be the "income as per the tax returns for Rupinder Mahil and Barry Davies" for the tax years ended 2013 to 2018 inclusive. The figures stated are as follows.

15.

Tax year ending 5 April…	Mahil income as per returns	Davies income as per returns
2013	£44,172	Loss £13,832
2014	£32,499	£35,657
2015	Loss £29,365	Loss £20,542
2016	Loss £52,389	Loss £20,735
2017	£55,965	£33,281
2018	£57,965	£19,002

16. Mr Roberts states that the figure for 2017 would be reduced by overpayment relief claims and the figures for 2018 include amounts for Residential Finance Costs.

17. Mr Marks stated, in his skeleton argument, that the net income position for the household in the four year period 6 April 2013 to 5 April 2017 was £26,700. It is unclear where this figure came from and on the basis of the figures at [15] the net income would be £33,954.

18. To add to the confusion, In Mr Roberts' "view of the matter" letters to the Appellants of 27 July 2020, he included a table which purported to set out the joint taxable income for the years ended 5 April 2012 to 2018 inclusive. The figures were as follows:

(1) 2012: £23,778

(2) 2013: £48,972

(3) 2014: £49,524

(4) 2015: £12,520

(5) 2016: £26,820

(6) 2017: £10,300

(7) 2018: £159,633

19. It is unclear where any of these figures come from and they bear no resemblance to the alleged income set out in Mr Roberts' witness statement.

20. Unfortunately, the Hearing Bundle contained the tax returns only for 2017-18, the enquiry year. The screen prints and computations for Mr Davies showed gross income from employments, partnership profits and his property rental business as £107,789 and net income after reliefs of £45,408.Income tax after allowances and reliefs was ££2381.60, leaving Mr Davies with £43,026.40. Ms Mahil's gross income was £109,252 and her net income, after reliefs and allowances was £84,252. Income tax and NICs due were £12,704.50 leaving Ms Mahil with 71,547.50. Ms Mahil made a pension contribution of £25,000 in the year. It is unclear how Mr Roberts has dealt with the finance costs in his figures for the enquiry year.

21. We are unable to reconcile the various figures and we are unable to make any findings as to what the household income actually was for the years in question. We consider the Appellants' statements about income below.

22. Much of the discussion at the hearing was about whether Mr Roberts had a "reason to suspect an underassessment of tax" for all the year in question. In the case of the enquiry year, Mr Marks relied on both Condition A and Condition B. As regards Condition A, he argued that information for the earlier years was required to ascertain the tax position in the enquiry year and in any event, HMRC could rely on having a reason to suspect to require information for the earlier years. In relation to years not under enquiry, HMRC relied on having a reason to suspect, that is, Condition B, as a justification for issuing the information notices in relation to the earlier years.

23. Mr Roberts' reasons to suspect underassessments were set out at paragraph 95 of his first witness statement dated 10 May 2021.

(1) Tax returns for previous periods showed minimal household net income. As noted above, we have been unable to make any findings about this.

(2) The partnership business was transferred to a company in 2018 and the value of the portfolio was £8.8m. The Appellants claimed this substantial portfolio was financed by a mixture of their own funds, loans from other people at attractive rates of interest, refinancing properties once they had been refurbished/increased in value, and bridging loans and mortgages from financial institutions. The majority of the portfolio was built up before the year of enquiry by continually refinancing properties. The financing of the

numerous properties has not been fully evidenced, with the evidence being verbal except in relation to the financing for the personal property.

(3) Mr Davis and Ms Mahil purchased their home, Bracken Hill House, on 31 March 2016 for £1.7m. It was financed via a bridging loan which was replaced with a mortgage of £1.25m and finance from other properties owned. Mr Roberts contended that the interest payable for the last two months of 2017-18 was over £16,000 and on a 12 month basis, a household income of nearly £97,000 would be needed just to pay the mortgage. The 2018-19 tax returns (not in the Hearing Bundle) suggest a household income of approximately £132,000.

(4) The purchase of Bracken Hill House was financed by refinancing properties in the business portfolio. This was also the case for refurbishment work carried out at the property. Mr Roberts considered that he needed to understand how the refinancing had been done for all years in order to see how the deduction for interest paid by the business should be restricted in relation to finance used for personal purposes.

(5) Refurbishment work was carried out at Bracken Hill House in the enquiry year which cost £395,000.The tax returns did not show enough income to fund these works.

(6) In addition, Mr Roberts assumed that a similar amount of money must have been spent in 2016-17 on refurbishment as he would not expect someone to wait for a year before commencing the works.

(7) Bank account statements produced by the Appellants show a balance of £195,000 at the start of the 2017-18 tax year but there is no evidence to show how that balance had been built up based on the income declared in the tax returns.

(8) Mr Davies had made claims in his book, "Retire on One Property Deal", that he had made net profits of £50,000 and £91,000 on two properties owned by the Appellants and in articles from 2015 stated that their five biggest properties were earning profits of £145,000. In the same book he had claimed to have had four holidays, totalling six weeks abroad. HMRC stated that this related to the period between September 2014 and February 2015 when the taxable household income was said to be £12,500.

24. Essentially, HMRC's view was that the Appellants' declared income was insufficient to meet their living expenses and to purchase and refurbish Bracken Hill House. There was therefore "reason to suspect" there was undeclared income.

25. The Appellants, via their agents provided a good deal of information and documents to HMRC and there was a meeting on 22 July 2019 when information was provided by way of a memory stick and a box of paper records. At that meeting, it was stated that the Appellants had about 160 tenants across 26 properties.

26. The Appellants made lengthy witness statements, with exhibits, which they said should allay Mr Roberts' suspicions. Mr Davies' witness statement dealt mainly with the business model and the build-up of the portfolio and Ms Mahil's statement dealt mainly with how the business started and issues about means. Both were cross examined on their statements.

27. Mr Davies began developing property in 2007. He and Ms Mahil met at a property investment seminar in 2011 and later that year bought a property together as a joint venture. They then entered into lease option agreements on four further properties, which enabled them to start building a property portfolio with little capital or risk. Under a lease option, the property owner receives a lease fee and grants the option holder a right to buy the property at a fixed price within a specified period of time. The option holder can profit by renting out the property for more that the lease fee. Mr Davies would then seek to add value by refurbishing the

properties and the value would also increase through market growth. Mr Davies wrote a book on the subject "Escape the Rat Race with Property Lease Options".

28. By 2016, the properties had increased in value by between 30% and 100%. The Appellants exercised their options to buy the properties at the original fixed price using a deposit. They then refinanced based on the higher values within a few months which released their deposit funds which were reinvested in new ventures. By 2016, the properties had generated over £500,000 of equity which was used to grow the business.

29. Ms Mahil said she worked in paid employment between 1991 and 2013, when she began to manage properties full time. She claimed to have earned a salary of approx. £80,000 and to have had a company car in "some" of those years. Mr Marks stated that HMRC's records showed that the highest amount of income earned was £78,374 in 2004-5 (£74,405 after expenses) with the next highest year being £63,666 and that she only had a company car for two years. HMRC's records show her gross income between 1999/2000 and 2004/5 varied between £35,887 and £74,409. Income for 2005/6 was very low and no returns were submitted from 2006/7 to 2010/11.

30. Ms Mahil also stated that she lived with her parents during that period so her living expenses were low and she saved much of her earnings, often £2,500 a month. She used up her ISA allowance in full. Her parents encouraged her savings by making matching gifts to her. In 1998 she bought her first property for £88,000 with a 50% deposit. She made further purchases by saving for a deposit and then investing the money. She states that by 2013 she had about £822,000 of equity and £280,000 of savings, some of which had been invested into new purchases with Mr Davies.

31. HMRC comments that she did not declare significant savings income in the period. However, we note that some of the savings went into ISAs where the income is not taxable. And savings were invested in properties, which would have produced rental income. Mr Roberts raised the issue that Ms Mahil had not declared any rental income in the years 1998-2012. Mr Clarke explained that she had previously been advised that she did not need to declare the rent as she was making losses as she had been wrongly advised that she could take capital expenses into account. A subsequent agent made a voluntary disclosure of the profits and losses for the period and submitted additional returns up to 2011-12. He also indicated that Ms Mahil did not submit returns for some years as she was travelling abroad.

32. There is some evidence that Ms Mahil's father made gifts to her. The Hearing Bundle contained correspondence and bank statements indicating that he gave her £30,000 in the enquiry year.

33. Whilst we cannot make a finding as to the exact amount of capital introduced into the business by Ms Mahil, we accept that she had built up substantial savings and these represented capital introduced.

34. After the Appellants joined forces, the business model was to buy properties, refurbish them , rent them out as Houses in Multiple Occupation and then refinance them. This enabled them to extract additional value to invest in further properties.

35. There were two sides to the business; the rental portfolio and the purchase/development business. The rental profits were invested in new acquisitions which generated further rental profits. The reinvested rental profits represented further capital introduced.

36. Mr Davies stated that they used a number of sources of funding including various types of borrowing, gifts from parents, savings, credit cards, loans from private investors, joint ventures, refinancing existing properties, rental income, income from other businesses and income from employment.

37. One of HMRC's concerns was as to the claims made in the promotional material of large profits made from single deals. Mr Davies stood by these claims, explaining, in some detail that they related to a single property and that they had indeed made a rental profit of £91,000. However, this had been reinvested, along with other financing, into the purchase and renovation of six further properties. The substantial revenue costs incurred on these properties and the original property could be set against the rental profit, so the £91,000 did not appear as profit in the Appellants' tax returns.

38. During this period of rapid expansion, overall profits were relatively low. HMRC also challenged whether the income disclosed in the tax returns could support their lifestyle. Again, they considered that there was insufficient income declared so that there must be undeclared income.

39. The claims in Mr Davies book about multiple overseas holidays were raised in this context. The Appellants' both indicated that during this period they lived very frugally. Their mortgage was £900 a month. Mr Davies said their "personal costs" were £500 a month. Ms Mahil said their "bills" were approximately £300 a month and they had one, old car between them. The joint total monthly expenditure rarely exceeded £2,000 a month. Everything else was reinvested.

40. Mr Davies' gave evidence that the holidays took place but they were not lavish. They travelled on budget airlines and stayed in airbnbs or hostels. Holidays were not included in the figures for monthly expenditure.

41. Even on the figures put forward by the Appellants, their required income would exceed Mr Roberts' figure of joint household income of £26,700 over the period. Mr Davies stated that those amounts did not represent the actual cash they had available. Their taxable income was reduced by capital allowances and generous wear and tear allowances (which exceeded their actual expenditure) and that over the period, the money available to them was £140,000. Mr Roberts did not accept that there was more money available as losses had to be financed and expenditure had to be incurred in order to obtain the allowances although he agreed that the expenditure could have been in an earlier year.

42. As noted, HMRC have not provided adequate evidence as to what the actual income was in the years in question and on the basis of the figures we have seen and the evidence presented we find it more likely than not that the household income over the four years in question exceeded £26,700.

43. A major concern of Mr Roberts was how the Appellants had funded the purchase of Bracken Hill House and its refurbishment. This was explained in some detail by Ms Mahil. The purchase price of the property was £1.7m and with Stamp Duty Land Tax and other expenses, the total purchase costs were shown on their solicitors' completion statement as £1,822,417.80. The exhibits to Ms Mahil's witness statement showed that this was funded as follows:

(1) A bridging loan. The interest was deducted from the initial advance.

(2) A loan from a private investor

(3) Over £700,000 from remortgaging two properties comprised in their portfolio.

(4) The bridging loan was replaced by a development loan from Lloyds Bank and a further £76,439 was raised from a further advance on an existing property.

44. The borrowings were subsequently replaced by a mortgage with Handelsbanken.

45. Mr Roberts accepts that the funding of the purchase of Bracken Hill House has been fully explained, so that he no longer suspected there were hidden profits, although this raised concerns about the diversion of capital from the business to personal use, which ought to have meant that the interest deductions claimed for the business were restricted.

46. Croner Taxwise, the Appellants' current agent, wrote to Mr Roberts on 15 October 2019 providing documentation to confirm that mortgage repayments only really commenced in February 2018 after the advance from Handelsbanken and so the Appellants did not need to find the £96,000 which Mr Roberts estimated they needed in 2016/17. Mr Roberts accepted that the money was not needed in that year.

47. The refurbishment costs of £359,741 incurred in 2017/18 were funded in part (£150,000) from the Lloyds Bank loan and the balance by remortgaging existing properties. Mr Roberts accepted there was no means issue in relation to the refurbishment expenditure in 2017/18 although it again raised the issue of interest restrictions which ought to have been made in the business accounts.

48. Mr Roberts remained concerned about alleged refurbishment costs in the first year Bracken Hill House was owned. He relied on the presumption of continuity and considered it a fair inference that a person would not buy an expensive property, hold it for a year, then spend a large sum on it in the second year. He concludes that he has a reason to suspect that there was expenditure in the first year and there is no evidence how it was paid for. He has no evidence to show that work began in the first year. He contends that he cannot determine that until he is given the documents.

49. A further concern was the opening bank balance of £194,000 at the beginning of the enquiry year as the tax returns did not show sufficient income to produce such a sum.

50. Ms Mahil's explanation was that the funds, held across three accounts did not represent income. Nearly £35,000 was rent received from tenants into the business account. £57,500 was a drawdown on the Lloyds facility. She exhibited a bank statement showing the credit on 5 April 2016 although it did not state the payer. The remaining funds came from the remortgage of one of their existing properties which were paid into the account on 30 March 2016. Ms Mahil said these payments had been evidenced by documents sent to HMRC, although we were only referred to the bank statements.

51. While Mr Roberts accepted that the information was credible, he said that it had not been evidenced and he wanted the underlying documents. In particular, he wanted the bank statements referred to in item 2 of the information notice.

52. There was also an issue about an alleged discrepancy of £100,000 in banking records relating to rents received. Mr Roberts was provided with information more than two years ago and despite repeated requests from the Appellants he has not provided any details. At the hearing Mr Roberts said he no longer relied on that as a reason to suspect.

53. In a letter from Mr Roberts to Croner Taxwise of 11 November 2019 Mr Roberts confirmed that "the main crux of my issues are relating to means. This has included the costs relating to the purchase of Bracken Hill House, the claims made by Barry Davies in his promotional literature, how they have afforded to build up their property portfolio and how they have afforded to live based on income build up based on returns submitted to HMRC." He stated that he needed information relating to earlier years as this was relevant to the build up to the tax position in the year of enquiry. He then asked for various items of information including a breakdown of the refinancing since 2014 and an explanation and documentary evidence for various receipts into a number of bank accounts.

54. The agents provided information about refinancing for 2017/18 but did not consider HMRC were entitled to the information for earlier years. Information was provided about receipts which were gifts to Ms Mahil from her father.

55. Mr Roberts was not satisfied that the information provided dealt with item 3 of the information notice for the enquiry year as, although the agent had provided information about receipts and resources for the year he had not confirmed that they were the only sources.

56. Mr Roberts made a second witness statement on 11 May 2022, only two weeks before the hearing, in response to the Appellants' witness statements (filed in May 2021) and subsequent correspondence with the agent. Mr Roberts states that he continues to believe there is underpaid tax, although he acknowledges he has not made a formal assessment or laid out a position. He contends he has not had the information that would allow him to assess. The only identified underpayment of tax relates to overclaimed interest on the portion of the business refinancing which was used for personal purposes i.e. the purchase and refurbishment of Bracken Hill House.

57. As noted above, the information notices were issued because of Mr Roberts' concerns about the means of the Appellants. Having accepted the evidence as to how they could afford to buy and refurbish Bracken Hill House, his concerns have transferred to the lack of interest restrictions on the business borrowing and he contends that he needs information and documents from the previous periods to see how the figure has built up over time and how much restriction is needed.

58. The further correspondence referred to relates first, to Ms Mahil's failure to declare rental income in years up to 2006, which we have dealt with above. We accept the explanation given for this and note that the tax was paid and we do not consider that this is any indication that Ms Mahil is in the habit of underdeclaring her income. We also note that HMRC enquired into Ms Mahil's 2015/16 tax return and made no adjustments, although that, of itself, does not prevent HMRC revisiting that year.

59. On 2 February, the agent acknowledged that an interest adjustment was required to reflect the business borrowing which had been used for personal purposes, but indicated that it was not straightforward as they needed to consider the withdrawal of capital introduced by the Appellants.

60. Mr Davies produces a schedule of mortgages and capital costs of the properties. Mr Roberts stated that the difference between the mortgage debt and the total of purchase prices and capital costs was £691,706. Comparing this with the funds used from the property refinancing for the purchase and refurbishment of Bracken Hill House of £1,121,827, Mr Roberts concluded that the Appellants would have had to invest over £430,000 into the property portfolio and their home and the implication was that this represented undeclared income. Mr Clarke points out that this assumes there was no equity in the properties when they were introduced into the partnership and he pointed out that increased borrowing on refinancing would be against the increased market value at the time. He contends that it is not reasonable to assume that the £430,000 is attributable to anything other than the increase in value.

61. On 5 April, the agent submitted an overpayment relief claim as the Appellants did not claim deductions for the cost of raising finance which they thought was a capital expense. He thought that once the adjustments had been quantified and netted off it was possible there would be a net adjustment in HMRC's favour. He did not, however, consider that this should affect the appeal. There is a further issue to be resolved concerning a claim for the deduction of the costs of using part of Bracken Hill House as a home office. One room is dedicated to business use and two employees work there. Both Appellants claimed 10% of the running costs of the

house as attributable to the business. It seems that they intended to claim 10% in total. The issue was "parked" at the time, but we do not consider it material to the current appeal.

62. On 6 May 2022 the agent produced a spreadsheet to show extraction of capital since 31 March 2016 (when Bracken Hill House was purchased). We will return to this below, but note that Mr Roberts is not satisfied by this and still considers that he needs the information requested in the information notice to establish the true position.

63. The written closing submissions of the parties set out what "reasons to suspect" have now been allayed and what reasons Mr Roberts continues to rely on to justify the information sought in the information notices. Also what has been provided and what remains outstanding.

64. In oral evidence, Mr Roberts largely accepted that his concerns as to means had been dealt with. He accepts the evidence as to how the Appellants were able to afford to buy Bracken Hill House i.e. through the use of refinancing of the property portfolio. He accepts that repayments on the mortgage did not commence until February 2018 so that he Appellants did not need £96,000 to fund the mortgage in 2017-18. He accepts the evidence as to the funds used for the refurbishment of the house in the enquiry year. He accepts how the opening balance on the bank accounts of £194,000 was made up but contends that this shows that interest on the business loans should be restricted and he therefore still needs to see the bank statements for 2016-17. Whilst he accepted that Mr Davies explanations regarding the claims made in his promotional material were credible-that the claimed profits were put back into the business and offset by further expenses, he continues to require the underlying documents.

65. Mr Roberts continued to maintain that there must have been refurbishment expenditure in 2016-17 and therefore he requires the information about how that was afforded.

66. Mr Marks accepts that the information in item 1 of the information notice has been provided for the enquiry year, except for item d.. The agent provided some information about funds received by way of gift from Ms Mahil's father but Mr Roberts contends that his failure to say those items were the only additional funds used for personal purposes means that item 3 has not been satisfied for the enquiry year.

67. The information at item 2 has not been provided and the information in items 1 and 3 have not been provided for the earlier years.

68. HMRC accept that the information requested in item 4 has been provided.

SUBMISSIONS

69. Mr Marks submits that Condition A is satisfied for items 1 and 3. The focus has, however, shifted from means and undeclared income to the fact that funds have been taken from the business refinancing activities for personal use, so that interest restrictions must be applied. Mr Marks contends that Condition A entitles the respondents to obtain information relating to the earlier years on the basis that the use of business financing for personal purposes in the earlier years would affect the amount of the interest restriction required in the enquiry year which would result in further tax being due for the enquiry year.

70. Mr Marks also submits that Condition B is satisfied as Mr Roberts had an objective reason to suspect that there were errors in the returns for the earlier years as the Appellants could not have met their living expenses on the income which he had calculated-£26,000 over the period.

71. In relation to item 2, only Condition B is relevant. Mr Marks accepts that HMRC must show that there was a reason to suspect an underassessment of tax for 2016-17 at the time of the information notice and that the reason continued to the hearing date or the information would not be reasonably required.

72. The original reason for requesting the bank statements was a concern as to means: how had the balance built up given Mr Robert's view of the Appellants' income. The Respondents' current position is that it appears that business money was used for personal expenditure so the interest payments claimed were not correctly restricted and so Condition B is satisfied.

73. As there remain issues to be resolved, the enquiry should remain open.

74. Mr Clarke submits that Condition A cannot routinely give rise to an entitlement to information about earlier years on the basis that the treatment of items in earlier years is relevant to the year of enquiry. This would render Condition B largely otiose.

75. Mr Roberts had initially, and until quite late in the day been focused on means. That is, he was concerned about how the Appellants had afforded to build up their portfolio, buy Bracken Hill House, where the profits claimed by Mr Davies in his promotional material had gone to and how they had afforded to live on their apparent income. This was set out in his letter of 11 November 2019, just three months before the issue of the information notices. The question of the interest deduction was not explicitly raised until Mr Roberts' first witness statement of May 2021.

76. Mr Clarke submits that the shift in focus from means to the interest deduction is significant. It does not compensate for the absence of a reason to suspect in relation to means. Whilst it is accepted that an adjustment is needed for the interst overdeducted, Mr Clarke submits that in the context of the portfolio as a whole the issue is a minor one and that the accountant's approach to quantifying the adjustment is reasonable and shows that a relatively modest amount of additional tax is due.

77. Further, he contends that the information and documents requested in the information notices are not reasonably required to resolve this issue and that the provision of the information and documents would be a vast and onerous undertaking.

78. In relation to Condition B, Mr Clarke submits that, at least initially, Mr Roberts might have had a "reason to be interested" in how the Appellants built up their portfolio, but this did not constitute a reason to suspect. The explanations that have been provided by the Appellants have now removed any reason to suspect, but Mr Roberts is not prepared to accept an explanation not supported by documentary evidence. Mr Clarke contends that approach is flawed and unreasonable and notes that in evidence, Mr Roberts accepted that he had been provided with credible explanations, but still wanted the documentary evidence.

79. The matters that remain to be resolved are:

(1) The adjustment to the interest deductions

(2) The overpayment relief claim in relation to unclaimed finance costs

(3) The error in relation to the costs claimed in respect of the home office.

80. These items do not require the enquiry to remain open and a closure notice should be issued.

81. The parties agree that if the Tribunal directs HMRC to issue a closure notice, 90 days is a sufficient amount of time to enable these issues to be resolved.

BURDEN OF PROOF

82. The burden of showing that the documents and information are "reasonably required" rests with HMRC as does the burden of showing that the officer has "reason to suspect' an underassessment of tax.

DISCUSSION

83. The gateway to the issue of an information notice is paragraph 1(1) of Schedule 36. In all cases, the officer of HMRC must show that the information or document requested is reasonably required by the officer for the purpose of checking the taxpayer's tax position.

84. Where a tax return has been submitted, one of four further conditions must be satisfied under paragraph 21. The conditions relevant to this case are Condition A and Condition B.

85. Condition A is that a notice of enquiry has been given in respect of the return. That is the case in relation to the tax year 2017-18.

86. Condition B is that, as regards the person, an officer of HMRC has reason to suspect that an amount that ought to have been charged to tax may not have been assessed or that relief from tax, given for the chargeable period has become excessive. HMRC rely on Condition B in relation to the enquiry year and the earlier years.

87. Where there is an open enquiry HMRC do not have to show a reason to suspect an underassessment of tax. They can, and do, open enquiries at random. They do need to show that the information and documents they require are reasonably required for the purpose of checking the taxpayer's tax position.

88. The meaning of "reasonably required" was considered in the FTT case of *Marathu Delivery Service Limited v HMRC* [2019] UKFTT 553 (TC), where the Tribunal said at [40]:

> "40. No analysis was put to us as to the meaning of "reasonably required" within paragraph 1 of Schedule 36. However, in our view "reasonably required" must impose a limitation on HMRC's issue of notices to the extent that each item of information requested must be required for the purposes of an enquiry into the taxpayer's tax affairs and that it is objectively reasonable for HMRC to do so. If HMRC had the information already it would not be required nor would it be reasonable for HMRC to ask for it again. Similarly HMRC must be pursuing a legitimate purpose in issuing the notice, so HMRC cannot undertake a fishing exercise where HMRC have no reason to believe tax has been understated."

89. The expression "reason to suspect" was considered in *Michael Hegarty and Flora Hegarty v HMRC* [2018] UKFTT 774 (TC), where the Tribunal said at [95]

> "95. It is, as Judge Thomas in *Newton* suggested, not a high bar for HMRC to surmount. On reflection Judge Thomas thinks that the bar here may be somewhat higher than that in s 29(1) TMA where a discovery is concerned. But if a statutory provision requires a particular person to show their reasons for suspicion, the Tribunal must be in a position to decide whether the officer did in fact genuinely hold that suspicion, and whether the suspicion was objectively justified by reference to the facts put forward. It may be that in a very straightforward matter the facts do speak for themselves, but if an officer is relying on evidence they have that enabled them to form their suspicion, it seems to us to be an irreducible necessity to expose it to the scrutiny of the tribunal and to enable the officer giving their reasons for suspicion to be cross-examined by the appellant and to answer any questions the tribunal might have."

90. So a suspicion must be objectively justified and the officer must explain what facts and evidence they are relying on which have given rise to their suspicion.

91. It was suggested in *Hegarty*, that the level of suspicion required is higher than that in "discovery" cases under section 29 Taxes Management Act 1970. We prefer the view of Judge Aleksander in *Hackmey v HMRC* [2022] UKFTT 160 (TC), where he said at [37]

> "37. I disagree with Judge Thomas that the bar for reasonable suspicion is set at about the same height as that for making a discovery. In the case of a discovery, the officer must believe there to be – rather than merely suspecting - an insufficiency of tax. "Belief" sets a higher bar than mere "suspicion" (see *Jerome Anderson v HMRC* [2018] UKUT 0159 (TCC) at [28] – not cited to us). So, I find that the bar in Paragraph 21(6) is set somewhat lower than the bar for a "discovery". But on any basis, that bar is low."

92. We also consider that the bar for suspicion is a low bar and is lower than that required for discovery. It it were at the same level or higher, the officer could make a discovery assessment, rather than seeking information.

93. Mr Clarke suggested that there was a threshold for "suspicion" as set out in the case of *Kevin Betts v HMRC* [2013] UKFTT 430 (TC). The issue in that case was whether Mr Betts was resident in the UK for tax purposes in a particular year. There were a number of factors which suggested to HMRC that Mr Betts was in fact UK resident. They were seeking bank statements to provide evidence as to where Mr Betts had been paying bills, spending money etc which would indicate where he had been spending his time. The Tribunal said at [95]

> "95. We accept that some if not all of the nine factors on which HMRC relied may have given HMRC cause to be **interested** in whether the appellant's case as to residence was true. After all, there was a lot of tax at stake. But the notice under appeal was not, as Mr Gordon pointed out, given in the course of an enquiry. HMRC had lost that opportunity. They could not therefore rely on the more generous terms of condition A as compared with those of condition B. Being interested does not suffice to meet condition B in our judgment."

94. Mr Clarke does not seek to introduce a further category of "interest" which is something less than "suspicion" but relies on the case to say that in order for a suspicion to be objectively justified there has to be some threshold which renders it reasonable for HMRC to request the information and documents they seek in a particular case.

95. Mr Clarke also relied on *Betts* for the proposition that HMRC must have the suspicion first, before they can ask for the documents which may allay or confirm their suspicion. What they cannot do is to seek the documents first in order to see whether they have a reason for their suspicion.

96. The Tribunal put it like this at [90]

> "90. But it is clear, in our judgment, that in order for condition B to be met, there has to be reason to suspect that an amount that ought to have been assessed to relevant tax for the chargeable period may not have been assessed as regards the appellant. That is the plain and ordinary meaning of paragraph 21(6)(a), and we see no reason to go behind that. Seeking information or documents in order to try to meet condition B is simply the wrong way round in our judgment."

97. That must be correct. In *Betts* itself, HMRC sought the bank statements in order to get the "full picture" of Mr Betts life in the year in question so they could decide whether they had a reason to suspect that he was resident. At [20]:

> "20. We asked Mr Birkett whether he was really saying, as indicated in paragraph 29 of HMRC's statement of case …, that he needed the information in order to satisfy condition B. Mr Birkett replied "yes"".

98. In those circumstances, the Tribunal found that Condition B was not satisfied.

99. The next question is when the "reason to suspect" must exist and for which earlier tax years information may be sought under Condition B.

100. In *Hackmey*, the Tribunal said at [35]

> "35. It is not disputed that the role of the Tribunal in this appeal is not supervisory, rather this is a full appellate hearing (see *Sarah Duncan* [2018] UKFTT 296 (TC) at [51]) and the Tribunal has to come to its own conclusion that:
>
> (1) an HMRC officer has a reasonable basis for suspecting a tax insufficiency, and
>
> (2) the information and documents sought are reasonably required in order to check Mr Hackmey's tax position (see *Hargreaves* at [55]).
>
> In reaching its decision, the Tribunal must take account of all matters that have come to light since the Information Notice was issued – so I need to determine not whether there was a reasonable basis for HMRC to be suspicious of Mr Hackmey's level and source of income in 2018 when the Information Notice was issued, but whether there is a reasonable basis for suspicion today (in light of all the evidence before me – including material subsequent to the date of issue of the Information Notice), and if so, whether the information and documents sought remain reasonably required."

101. Mr Marks submitted that this was incorrect, but it appears he may have misunderstood what the Tribunal was saying. He submitted that we must look to see whether there was a reason to suspect at the date the information notice was issued. He goes on to concede that we may also need to look at the position at the date of the hearing as well as, if the officer no longer had a reason to suspect, the information/documents would no longer be reasonably required to check that reason to suspect.

102. It seems to us that that is exactly what *Hackmey* says. Mr Roberts clearly must have had a reason to suspect at the time the information notices were issued, or he would fall into the error highlighted in Betts. However, in our view that suspicion must still exist at the time of the hearing. If it had been allayed beforehand or if information/documents had been provided which meant that it was no longer objectively reasonable to harbour that suspicion, the information and documents requested would not be reasonably required to check the taxpayer's tax position.

103. Under section 34A TMA, HMRC can make an assessment within four years of the end of the tax year to which the assessment relates. Under section 36 TMA the time limit is extended to six years, where the taxpayer has been careless and twenty years where the taxpayer's behaviour is deliberate. In order to raise an assessment outside the normal four year time limit, HMRC must satisfy the conditions to make a "discovery assessment" set out in section 29 TMA.

104. Mr Marks submitted that the four year time limit must apply as at the date of the information notice. The notice was issued on 5 February 2020 so, at that time, the years which could be assessed without resorting to a "discovery" were 2015-16 onwards. Mr Marks accepted that *Hackmey* indicates that for tax years earlier than 2015-16, HMRC must show that when the notice was issued they could reasonably have issued an assessment to recover the tax. That is to say, HMRC must have had an objectively reasonable suspicion that the taxpayer had been, at least, careless, so that a discovery assessment could be made for the year in question if the documents requested as a result of the reasonable suspicion turned that suspicion into a discovery that "as regards … (the taxpayer) and a year of assessment… an amount of income tax or capital gains tax ought to have been assessed but has not been assessed…". This would apply to 2014-15.

105. In his oral evidence, Mr Roberts stated that he could request information for the 2014-15 tax year on the basis that he had a reasonable suspicion which, if shown to be true would allow him to make a discovery assessment on the basis of carelessness at the least. The carelessness in question was that the Appellants knew they were using funds raised by refinancing their business properties for personal use and a reasonable business person would know that they could not claim deductions for the element of interest costs relating to the personal use. The failure to apply interest restrictions demonstrated at least careless behaviour on the part of the Appellants and this meant that, at the time the information notices were issued, there was a reasonable possibility that he could raise an assessment for the 2014-15 tax year and could therefore ask for documents and information for that year.

106. We note that, at the time the notices were issued, Mr Roberts was focussed on the question of means and that he did not know, and had not said he suspected, that business finance was being diverted to personal use. The earliest point at which this was mentioned was in his first witness statement when the issue was raised in response to the evidence produced my Ms Mahil as to how the purchase of Bracken Hill House and its refurbishment was funded. There is no evidence to show that there was any extraction of funds for personal purposes in 2014-15.

107. In relation to items 1 and 3 in the notices, HMRC rely principally on Condition A, but in addition on Condition B.

108. In relation to item 2, which relates to the tax year 2016-17, Mr Marks stated that no submissions on carelessness were made, or he considered, were required. That year was within the normal four year time limit at the date of the notices.

109. *Hackmey* has further comments to make on time limits. At [42]-[44], the Tribunal said:

> "42. In his submissions, Mr Turnbull noted that paragraph 1 provided that a notice could be issued if the information and documents were required for the purposes of "checking the taxpayer's tax position", and that "tax position" was defined by paragraph 64 to include the taxpayer's "past, present and future" tax liabilities. In consequence, he submitted that HMRC were not barred from requiring information and documents relating to periods which might be out of time for assessment. He referred me to the Tribunal's decision in *Cowan* [2013] UKFTT 604 (TC), where the periods for which HMRC required information were time-barred for assessment in support of his submission. However, one of the issues in *Cowan* was the residence status of the taxpayer, and HMRC contended (and the Tribunal agreed) that the information sought was relevant to the residence status of the taxpayer for the periods for which HMRC were not time barred. This is because, for example, the number of days spent in the UK by an individual in year one could be relevant to their UK residence status in year two. I agree with Mr Howard that *Cowan* does not provide blanket authority for HMRC to seek information and documents relating to periods that are time-barred for assessment.
>
> 43. However, I find that HMRC are not barred from requiring information and documents for 2013/14 providing they have a reasonable basis for suspecting that they could make a discovery assessment for that period, and that the information and documents are otherwise reasonably required. In *Perring* (at [26] to [27]), Judge Gething said that the purpose of the Schedule 36 information powers is to enable HMRC to raise assessments to collect tax. It must then follow that it cannot be reasonable for HMRC to require documents and information that relate to a period for which HMRC are out of time to raise assessments. She went on to say at [29]:

> "29. In our view, in the absence of a discovery, which requires evidence of an assessment being an under assessment, or compelling mismatches of income and expenditure, it would be unreasonable for an Officer to issue an information notice for a tax year in respect of which no enquiry has been made and therefore no assessment may be made. A desire for background information is not sufficient to justify the issue of an information notice. An information notice cannot therefore be issued in respect of:
>
> (1) 2012/13 as that is more than 6 years prior to the issue of the notice, and in the absence of dishonest conduct, no assessment can be made.
>
> (2) 2013/14 as there was no evidence to amount to a discovery to justify an assessment under section 29 TMA."
>
> 44. In my view, what Judge Gething says at [29] is expressed too narrowly – I disagree that the officer must have already made a "discovery" before the issue of an information notice can be justified. In his skeleton argument, Mr Howard submits that
>
> In relation to period 2013/14 HMRC must also have objective evidence of a reasonable suspicion of a careless or dishonest under-assessment to tax; and the material must be reasonably required to establish this.
>
> I broadly agree with Mr Howard's submission – but I would express it slightly differently. I find that, in the circumstances of this case, as regards 2013/14, HMRC must have reasonable grounds (based on evidence) to suspect an insufficiency of tax for 2013/14 due to carelessness, and that the information and documents sought by the Information Notice are reasonably required to determine whether this is in fact the case."

110. The principles we take from the cases are as follows.

(1) The officer must have an objectively reasonable reason to suspect an underassessment of tax at the time the information notice is issued.

(2) In order to request information for tax years more than four years earlier, but not more than six years earlier, there must be reasonable grounds, based on evidence to suspect an insufficiency of tax for those years due to carelessness.

(3) In all cases the information/documents must be reasonably required for the purposes of checking the taxpayer's tax return.

(4) The Tribunal is entitled to take account of evidence and materials since the date the information notice was issued to determine whether there remains a reasonable suspicion at the date of the hearing and whether the information and documents remain reasonably required.

111. We now apply these principles to the present case.

112. At the time when the information notice was issued in February 2020, all the years for which information was sought were within the assessment time limits. HMRC would have to be able to make a discovery assessment to issue an assessment for 2014-15 as that was more than four years before the issues of the notice. At that time there was an open enquiry for 2017-18 and it is clear from the correspondence that the focus of that enquiry was means and the possibility that the Appellants had received undeclared income.

113. The basis of that enquiry was that the Appellants had built up a large property portfolio in a relatively short period, they had purchased an expensive home and refurbished it and paid the mortgage on it. Mr Davies had published material indicating that he had realised large

profits on various property deals, but the alleged profits did not appear in his tax returns and he also boasted about a number of apparently lavish holidays. When compared with the Appellants' income declared in their tax returns, there was a significant discrepancy.

114. On 22 July 2019 a meeting was held between Mr Roberts, the Appellants and the Appellants' agents, Elite Financial Accounting and Croner Taxwise. At this meeting the Appellants explained their business model and that they had lived frugally with a small mortgage, one old car between them and minimal personal expenditure. They also explained that Bracken Hill House had been purchased using finance, including money realised by the refinancing of a business property.

115. The Appellants' agents provided working papers and underlying documents for the enquiry year but maintained that discovery was required before documents from the earlier years had to be produced. Mr Roberts wrote to the Croner Taxwise on 25 July 2019, following up from the meeting and subsequent correspondence. He stated that the information provided had added to his concerns about means. In particular, he wanted to understand how the refurbishment works at Bracken Hill House had been afforded and how they had paid the £96,000 interest he thought had been paid in the 2017-18 tax year, given the apparent net income. The reiterated request for the bank statements related to "my main concerns [about the] means of the individuals concerned". Mr Roberts also noted that payments from the personal bank accounts had been made for the business which made the accounts records of the business. Although he was aware that the funding had, at least in part, come from refinancing business properties he did not raise the issue of interest restrictions.

116. There was further meeting between Mr Roberts and the agents in October 2019 when further detail was provided about the financing of Bracken Hill House. Croner Taxwise followed up with supporting documentation and spreadsheets with an analysis of the two main private accounts and the credit card statements. Mr Robert replied in November 2019, reiterating that the "main crux of my issues are relating to means" and stating that he needed the information from the earlier years to understand the build up to the position in the enquiry year.

117. Further information and documents were provided for the enquiry year but not the earlier years which ultimately led to the issue of the information notices.

118. At no time was the issue of interest restriction raised. As noted, this was first explicitly mentioned in Mr Roberts' witness statement.

119. At the time when the information notices were issued, the Appellants had provided much information for the enquiry year and information about the financing of Bracken Hill house. The agents did not consider they had to provide information about the earlier years and had not done so.

120. Assuming that the information and documents are reasonably required (which we will return to), HMRC were clearly able to request information for the enquiry year under Condition A.

121. In relation to the earlier years, there remained sufficient unanswered questions at the date the information notices were issued to make it objectively reasonable to remain concerned about how the Appellants afforded to live, pay for their house and its refurbishment and build up their portfolio. Also, the public claims about profits and holidays by Mr Davies were unexplained. In other words, there continued to be a "means issue" and it was reasonable to suspect that income had been under-assessed, satisfying Condition B. While we do not know what the Appellants' income was in the relevant years, they had incurred major expenditure on the house and made significant investments which would have required income far greater than

they appeared to have received. This discrepancy could provide a reason to suspect carelessness, enabling Condition B to apply to 2014/15.

122. Mr Clarke submitted that credible explanations addressing Mr Roberts' concerns on these matters had been provided to HMRC and that in insisting on obtaining documentary evidence Mr Roberts had fallen into the error highlighted in *Betts*, in that he was seeking evidence in order to provide him with a reason to suspect. We disagree. Mr Roberts already had his reason to suspect an underassessment and, although the Appellants' explanations might have been credible, he was entitled to seek the evidence to substantiate those explanations. In *Betts*, HMRC had not made up their minds as to whether Mr Betts was UK resident or not. They were seeking the information in order to establish that fact and it could have gone either way. In other words, they were seeking the information to find out if they had a reason to suspect (they might not have had). That is clearly "the wrong way round". In this case, Mr Roberts had an objectively reasonable reason to suspect and was therefore entitled to ask for the information. This is not the case in relation to the alleged refurbishment expenditure in the first year of ownership of Bracken Hill House. Mr Roberts has no reason or evidence to suspect that expenditure was incurred in the first year and in seeking documents relating to such alleged expenditure, he is indeed seeking documents to provide himself with a reason to suspect.

123. Although the focus at the hearing had shifted to the interest restrictions required as a result of the acknowledged diversion of business funding for private use, the Respondents continued to assert that the net income declared by the Appellants was insufficient to support them. In oral evidence, Mr Davies asserted that the net income position did not show the whole story and that, in fact, they had more money available over the four year period from 2013/14 to 2016/17—£140,000 as a result of wear and tear allowances and capital allowances. This had not been put to HMRC before. Ms Mahil, when challenged about this, took the view that they did not need to mention it as HMRC had all the figures in the tax returns. Mr Marks argued that the wear and tear allowances would not produce the alleged amount of cash which Mr Davies said was available. He suggested that even if the rents before costs were £200,000 and the full 10% i.e. £20,000 was available as income in each year, that would increase the alleged income position from £26,700 to £106,700, not £140,000.

124. As noted, the only returns which were in the Hearing Bundle were those for 2017-18. The partnership return showed net partnership profits of around £450,000 (before deduction of finance costs) and the net profit available to each partner was almost £90,000, In Ms Mahil's individual return she returned a further £57,000 of rental income which after brought forward losses and expenses provided a net £8,000. There were finance costs (for which relief was given) and Ms Mahil also had the money to make a £25,000 pension contribution. Her total income was over £109,000 and taxable income was over £84,000 on which approximately £13,000 was payable. After deducting finance costs, that left her with over £37,000. Mr Davies total income was £107,789 and taxable income was £45,408. After deducting income tax and finance costs of £47,765, he would be left with £57,652.

125. These figures do not tally with the various figures for income produced by HMRC. They are for a year outside the four year period HMRC was looking at, but it does suggest there was quite a lot of money around.

126. The Respondents challenged the Appellants' witness evidence that they lived frugally and subsisted on a very modest amount of income. There were some queries about whether the monthly living expenses (over and above the mortgage of £900) were £500 a month (Mr Davies) or £300 (Ms Mahil). This was explained on the basis that Ms Mahil's figure was for bills only. Mr Davies' £500 included other expenditure such as food. Neither figure included holidays which Mr Davies said might have been another £2,000 each. It was unclear whether

this was each year or over the four year period. Ms Mahil said in her witness statement that their joint outgoings rarely exceeded £2,000 a month. If we assume that the monthly expenditure was, on average, £1,600, this would require an income of £76,800 over the four year period, which could well have been covered by additional cash available as a result of reliefs and allowances. HMRC did not produce any evidence to show that their lifestyle was more extravagant than claimed.

127. The problem we have is that we do not know what the income available in those years actually was. HMRC have not provided the evidence. The burden lies on HMRC to prove, on the balance of probabilities that they had, and have, a reason to suspect an underassessment of tax as a result of undeclared income, owing to the discrepancy between income declared on the tax returns and lifestyle. In relation to the day to day living expenditure they have not done so.

128. In relation to the bigger means issues of the house purchase and refurbishment, we consider that the explanations and evidence produced about how these were financed allay the Respondents' concerns about means. Although Mr Roberts continued to assert that there must have been refurbishment costs in the first year of ownership, there is no evidence at all that that was the case.

129. However, in dealing with the means issue, the Appellants have provided evidence that they have been using business funds for their personal purposes, which potentially means that they have overclaimed interest deductions in the business. In turn, this may mean that the profits of the partnership are more than the profit declared, and that "relief from relevant tax may be or have become excessive". It is not disputed that if some of the business loans have been used partially for personal purposes, the interest deduction on the loan must be restricted to the business element. Interest on the part of the loan used for personal matters is not allowable.

130. We say "potentially" because the question is not whether the Appellants have withdrawn capital from the business, but whether they have overdrawn their capital accounts. That is, have they taken out of the business more capital than they have introduced, either initially or by way of reinvestment of the profits from the partnership and rental businesses?

131. Mr Roberts asserts that the capital account must be overdrawn by at least £700,000 as that was the amount used for the purchase and refurbishment. This assumes that the Appellants introduced no capital into the business and this is unlikely to be correct. As well as the initial capital contributions, the Appellants reinvested the profits of their businesses which also counts as capital introduced.

132. The Appellants have shown that they supported their lifestyle by withdrawing capital from the business. In essence, the remaining issue between the parties is whether they have overdrawn capital and, if so, to what extent the interest deductions in the business accounts should be restricted, and whether that results in additional tax being due.

CONDITION A

133. There is an open enquiry in relation to the 2017-18 tax year, so the question is whether the information requested is reasonably required for the purpose of checking the Appellants' tax position. Paragraph 64(1) provides so far as relevant that:

> "Tax position" in relation to a person…[includes] the person's position as regards-
>
> (a) Past, present and future liability to pay any tax….
>
> (c) claims…that have been or may be made or given in connection with the person's liability to pay any tax."

134. The only year for which HMRC can now raise an assessment within the normal time limits is 2017/18. An assessment could be made for 2016/17 if the Appellants were shown to be careless, but Mr Marks, in his closing submissions expressly stated that no submissions on carelessness were being made. The Appellants' tax position includes their position in relation to past liabilities and claims which have been made. It is therefore permissible to seek information about previous tax years where the liabilities or claims in earlier years have a direct impact on the year under enquiry in that are relevant to the tax position in the year of enquiry. We emphasise that HMRC are not routinely permitted to investigate earlier years when carrying out an enquiry into a particular year and in particular, they cannot use a Sched 36 notice to seek background information. That would amount to an impermissible "fishing expedition".

135. In the present case, the status of the Appellants' capital accounts in previous years is directly relevant to the Appellants' tax position in the enquiry year. If the capital accounts were overdrawn in the earlier years the interest deduction should have been restricted and this may feed through to the interest which can be allowed in the enquiry year.

136. We conclude that, in principle, HMRC are entitled to seek information from earlier years where that information is directly required to check the taxpayer's liability in the enquiry year. Those earlier years must be years for which HMRC could have raised an assessment (including a discovery assessment) at the time the information notice was issued.

CONDITION B

137. We found that Mr Roberts had a "reason to suspect" an underassessment of tax at the time he issued the information notice on the basis that there were serious and justified concerns about how the Appellants were able to support their lifestyle with their apparent means.

138. We also found that, by the date of the hearing, the evidence provided showed, on the balance of probabilities, that the Appellants were able to support themselves and buy and refurbish an expensive property. That reason to suspect therefore falls away.

139. However, the evidence provided to show how the Appellants were able to support their lifestyle also gave rise to an objectively reasonable reason to suspect that tax relief given for the relevant years was excessive. It remains a suspicion, not, as Mr Marks submits, a certainty as there is only a problem if the Appellants' capital accounts were overdrawn and we do not know if that was the case.

140. Although Mr Roberts did not raise the issue of interest deductions until he made his first witness statement, Mr Marks submits that he had this in mind at the time he issued the information notice as "why else would he have asked the question?" [in item 1]

141. Again, assessments could have been raised for the years for which the information is sought at the time the information notice was issued.

142. We conclude that Condition B remains satisfied to date, albeit on a different basis than that originally contemplated. If the current basis was contemplated, it was not articulated at the time.

REASONABLY REQUIRED

143. Even though we have found that Condition A and/or Condition B are satisfied, we must still consider the overriding question of whether the information and documents actually requested in the information notice is reasonably required for the purpose of checking the Appellants' tax position.

144. HMRC have requested a great deal of detailed information including all the records of every refinancing transaction in relation to the property portfolio or Bracken Hill House since

6 April 2014, statements for all bank accounts for 2016-17and all sources of money used to finance the property portfolio or themselves and the costs of the building improvements which were not from refinancing properties from 6 April 2014.

145. The bank statements were requested to establish how the opening balance of £195,000 for 2017-18 arose. We now know this, and the issue has again become one of establishing the extent to which business funds have been diverted for personal use.

146. We accept Mr Davies statement in his witness statement that to provide all that information and the records and documents from 6 April 2014 up to the issue of the information notices, would take weeks of work by himself and Ms Mahil. They are very onerous requirements.

147. Further, compliance with the notice would not necessarily provide HMRC with the information they actually require, that is, the extent to which, if at all, the capital account has become overdrawn such that an interest restriction is needed in the enquiry year.

148. Mr Clarke took us to some extracts from HMRC's Business Income Manual. The Manuals are not, of course, law, but they represent HMRC's view of the law and provide guidance to their staff about the approach they should adopt in relation to tax matters.

149. BIM45700 states

> "**BIM45705 - Specific deductions - interest: Overdrawn capital account**
>
> This chapter applies for Income Tax purposes to the computation of trade profits and property income. References in the text to a 'business 'should therefore be taken to include both trades and property businesses. The chapter does not apply for Corporation Tax purposes, where there are separate rules in the loan relationships legislation (see CFM11000).
>
> S34 Income Tax (Trading and Other Income) Act 2005
>
> **The only certain way of ascertaining how much of an overdraft or loan has funded private expenditure is to look at each individual entry. This is usually impracticable and it is necessary to use a reasonable basis as an approximation.**
>
> An overdrawn capital account shown in the balance sheet is no more than an indication that a loan or overdraft is being used to fund private drawings. You must be able to demonstrate that it is private drawings, which have caused the account to become overdrawn, and that the overdrawn capital account has been funded by bank borrowings. You must look carefully at all of the components of the balance sheet to judge how the proprietor's drawings have been funded." [emphasis added]

150. And again at BIM45705

> **"BIM45705 - Specific deductions - interest: Overdrawn capital account**
>
> This chapter applies for Income Tax purposes to the computation of trade profits and property income. References in the text to a 'business 'should therefore be taken to include both trades and property businesses. The chapter does not apply for Corporation Tax purposes, where there are separate rules in the loan relationships legislation (see CFM11000).
>
> S34 Income Tax (Trading and Other Income) Act 2005
>
> **The only certain way of ascertaining how much of an overdraft or loan has funded private expenditure is to look at each individual entry. This is usually impracticable and it is necessary to use a reasonable basis as an approximation.**

> An overdrawn capital account shown in the balance sheet is no more than an indication that a loan or overdraft is being used to fund private drawings. You must be able to demonstrate that it is private drawings, which have caused the account to become overdrawn, and that the overdrawn capital account has been funded by bank borrowings. You must look carefully at all of the components of the balance sheet to judge how the proprietor's drawings have been funded." [emphasis added]

151. BIM45730 states:

> **"BIM45730 - Specific deductions - interest: Overdrawn capital account - example**
>
> This chapter applies for Income Tax purposes to the computation of trade profits and property income. References in the text to a 'business 'should therefore be taken to include both trades and property businesses. The chapter does not apply for Corporation Tax purposes, where there are separate rules in the loan relationships legislation (see CFM30000).
>
> S34 Income Tax (Trading and Other Income) Act 2005
>
> …
>
> **It must be emphasised that any method used to work out the amount of interest that is not allowed as a deduction is an approximation, because it is impracticable to look at every entry in the borrowing account. There is no one correct method. The explanation below uses some simple rules of thumb, but each case is different and must be looked at carefully.**
>
> **Is the capital account overdrawn?**
>
> **Are the borrowings financing net assets of the business?**
>
> **In years there is a trading profit the maximum amount by which an interest restriction is made is the amount by which drawings exceed profits, plus any restriction brought forward.**
>
> **In years there is a trading loss the maximum amount by which an interest restriction is made is the amount of drawings, plus any restriction brought forward**." [emphasis added]

152. The point here is that HMRC's own guidance to its staff indicates that it is impractical to look at every entry in the borrowing account. It refers to bank borrowings, but it would apply equally to other types of borrowing, e.g. from private investors.

153. Officers are directed to use "a reasonable basis as an approximation" to ascertain what loan interest is not allowable.

154. Croner Taxwise, in its letter of 6 May 2022 provided an analysis of the capital account for the years 2015/16 to 2018/19 based on adding the opening and closing balances and dividing the result by two to find the average capital position for the year. They have then calculated the percentage of capital overdrawn and the amount of interest which must be added back to the profits. This methodology results in additional tax due of £13,508.

155. This is not the only way to approach the matter.

156. Taking all of the above into account, we conclude that the information and documents requested in the information notice are not reasonably required to check the Appellants' tax position for the 2017/18 tax year.

157. Accordingly, we allow the appeals against the information notices.

APPLICATION FOR A CLOSURE NOTICE

158. Under section 28A(4) TMA a taxpayer may apply to the Tribunal for a direction requiring an officer of the Board to issue a closure notice within a specified period.

159. By section 28A(6), the Tribunal must give the direction unless satisfied that there are reasonable grounds for keeping the enquiry open.

160. The onus is on HMRC to show that the enquiry should remain open.

161. It is common ground that if we find that the documents in the information notice are not reasonably required, a period of 90 days is sufficient to complete the enquiry.

162. The matters which remain outstanding are:

(1) Quantifying the interest restriction to be applied to the loan interest and the additional tax due as a result.

(2) Quantifying the amount of the overpayment claim in relation to the unclaimed finance costs.

(3) Resolving any remaining issue about the percentage of costs claimed as a deduction for the use of the home office.

163. We therefore conclude that we should direct HMRC to issue the closure notice.

DECISION

164. For the reasons set out above, we have decided that the information and documents requested in the information notices are not reasonably required to check the Appellants' 2017/18 tax position and accordingly we allow the appeal against the information notice.

165. In consequence of the above decision we direct HMRC to issue a final closure notice in relation to the enquiry into the 2017/18 tax year within 90 days of the date of issue of this decision.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

166. 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.

MARILYN MCKEEVER
TRIBUNAL JUDGE

Release date: 10th OCTOBER 2022