



TC02577

Appeal number: TC/2012/03906

*INCOME TAX – adjustments to self-assessment – discovery assessment –
fairness of estimates by HMRC – penalties for inaccuracies - appeal
dismissed*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

**BHAGYA RAJ SUBBRAYAN t/a
SWISS COTTAGE DIET CLINIC**

Appellant

- and -

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

**TRIBUNAL: JUDGE NICHOLAS ALEKSANDER
A HUGHES**

Sitting in public at 45 Bedford Square, London on 29 November 2012

V Dhoshi, accountant, for the Appellant

W Kelly, an officer of HMRC, for the Respondents

DECISION

- 5 1. Dr Subbrayan appeals against the following income tax assessments and penalties:

Tax Year	Assessment Amount	Penalty Amount
2005/06	£3828.02	£1323.00
2006/07	£6320.32	£2158.00
2007/08	£5387.06	£1589.00
2008/09	£5040.00	£1229.21
Total	£20,575.4	£6299.21

- 10 2. At the hearing Dr Subbrayan was represented by Mr Dhoshi and HMRC was represented by Mr Kelly. The Tribunal had before it bundles of documents, and heard evidence from Mr Subbrayan (Dr Subbrayan's husband) and from Mrs Ann Jackson, an officer of HMRC who was responsible for the enquiry into Dr Subbrayan's affairs. Dr Subbrayan did not attend the hearing and did not give evidence to us.

Background facts

3. We find the background facts to be as follows:

- 15 4. Dr Subbrayan is a self-employed doctor, practising as a weight loss consultant under the trading name "Swiss Cottage Diet Clinic". She employs no staff, but her husband, Mr Subbrayan, who is a retired architect, helps her with administrative and reception duties (including helping with financial matters). She has been in business since September 1990.

- 20 5. On 22 September 2008, Mrs Jackson opened an enquiry into Dr Subbrayan's 2006/7 tax return under section 9A, Taxes Management Act 1970 ("TMA"). Enclosed with the letter opening the enquiry was a schedule of information requested from Dr Subbrayan. Dr Subbrayan submitted to HMRC some, but not all, of the information requested. In particular, Mr Subbrayan told Mrs Jackson on 5 December 2008 that cheque book stubs and paying-in books had not been kept. Further requests 25 for information were made and further information and documents were provided to Mrs Jackson as the enquiry progressed. Mrs Jackson had two meetings with Dr and Mr Subbrayan, one on 29 April 2009 and one on 8 September 2010.

- 30 6. Notes of the meetings held on 29 April 2009 and 8 September 2010 were prepared by Mrs Jackson and were included in the bundles. Copies of these notes were sent to Dr Subbrayan shortly after each meeting, inviting Dr and Mr Subbrayan to review them and notify Mrs Jackson if there were any material inaccuracies. In the case of the meeting of 29 April 2009, the notes of the meeting were countersigned and returned by Dr and Mr Subbrayan together with a letter setting out various amendments. As regards the meeting of 8 September 2010, neither Dr nor Mr

Subbrayan responded with details of any inaccuracies. We find that the notes (taking into account the comments made by Mr Subbrayan in respect of the 29 April 2009 meeting) are a materially accurate record of the points discussed at the meetings.

5 7. At the meeting on 29 April 2009, Dr Subbrayan discussed her pricing policy in detail. It also became clear that Dr Subbrayan did not keep any books of account. Her only financial records were her appointment book, cheque stubs and bank statements. Periodically, Mr Subbrayan totalled and recorded the amounts shown in the appointments book with separate columns for cash and cheques. He then banked cheques received from clients. The appointment books were destroyed.

10 8. Few prime accounting records had been retained by Dr Subbrayan. In particular Dr Subbrayan's appointment book, which recorded the fees charged to patients, had been destroyed, and cheque stubs and paying-in books were not kept. Mr Subbrayan told us that there had been a burglary at the premises in January 2008, and that the thieves had left the clinic in a complete mess. In particular they broke the window
15 (which was beyond repair) and broke into a cupboard where all the medicines and records were stored, and the content of the cupboard was tipped onto the floor. He had to arrange for a new window frame to be installed, and had to pay for professional cleaners to clean up the mess. Mr Subbrayan told the cleaners to throw away the old appointment books, as they were not in a state that was worth keeping.

20 9. We find Mr Subbrayan's explanation implausible. We do not believe it for the following reasons. Neither Dr nor Mr Subbrayan had ever mentioned a burglary to HMRC during the course of their investigations as the reason why Dr Subbrayan could not produce her appointment books and other prime records. If this explanation had been true, we would have expected Dr and Mr Subbrayan to have mentioned it to
25 HMRC at an early stage as the reason why they could not produce the appointment books and other records. Secondly, Mr Subbrayan produced no other evidence to corroborate his story. He did not produce any report made to the police. There were no records of payments made to either the carpenter who replaced the window or to the professional cleaners (Mr Subbrayan told us that they were both paid in cash).
30 Thirdly, it seems to us unlikely that thieves would have been interested in the appointment books and cheque stubs to the extent that they would have damaged them to the extent suggested. Finally, this explanation is inconsistent with the explanation given in the notes of meetings, which is that Mr Subbrayan destroyed the appointment books once he had transcribed the takings onto his A4 sheets.

35 10. Dr Subbrayan did not keep her business income and expenditure separate from Dr and Mr Subbrayan's personal finances. They had a number of bank and credit card accounts, and business income and expenses were paid into and out of whichever account was most convenient.

40 11. On the basis of the information supplied, Mrs Jackson undertook two exercises. These exercises were reviewed with Dr and Mr Subbrayan at the meeting on 8 September 2010. First she undertook a cash availability exercise, where cash income and cash withdrawals from accounts were compared with cash outlays. This exercise indicated that more cash had been spent than was available. Mrs Jackson cross-

checked her cash account exercise by undertaking a business economics model, based on Dr Subbrayan's pricing policy, mark-up of medicines together with known clients. This too indicated that more cash had been spent than was available.

5 12. Following the meeting on 8 September 2010, further information was supplied by Dr Subbrayan to HMRC, and Mrs Jackson's exercises were fine-tuned based on the further information supplied. On 29 June 2011 Mrs Jackson wrote to Dr Subbrayan with her final view on the matter. These were that:

- (a) Dr Subbrayan had failed to keep a proper record of her income
- 10 (b) She had understated her income by at least £17,772.43 during the year 2006/07
- (c) She had overstated her expenses by £3614.21 during the same period
- (d) She had submitted an incorrect return for 2007
- 15 (e) As Dr Subbrayan had explained that the only change in her business was that she had seen more patients in prior years, which is not reflected in those prior year accounts, the same errors had occurred in prior years.

13. Accordingly Mrs Jackson that Dr Subbrayan's taxable income for 2006/07 should be increased to reflect her findings, and that the retail prices index would be applied to the revised profit for 2006/07 to arrive at revised profits for the other years. In respect of the year 2005/06, carried forward losses of £7,900 from prior years were allowed. A closure notice for 2006/07 and assessments for 2005/06, 2007/08 and 2008/09 were issued on 29 June 2011.

14. Penalty determinations were raised on 25 August 2011. For the periods 2005/06 to 2007/08, the penalties charged are governed by the s95(1)(a) Taxes Management Act 1970. These provide for penalties of up to 100% of the tax charged. Under HMRC's published practice the penalty was abated to reflect the following:

- (a) Disclosure – Mrs Jackson stated that only the over-claimed expenses had been disclosed. She therefore allowed a 5% abatement out of a maximum available abatement under HMRC practice of 20%
- 30 (b) Co-operation – As Dr Subbrayan had attended meetings and provided some information (although piecemeal), and shown generally a willingness to co-operate Mrs Jackson allowed an abatement of 35% (max 40%)
- 35 (c) Seriousness – as the returned profits were very low and the adjustments were very large, Mrs Jackson allowed a 30% abatement (max 40%)

15. The overall abatement given by was 65%, leaving a penalty charge of 35%, and a penalty determination notice was issued in this amount on 25 August 2011.

40 16. We have noted that the figures for abatement given in Mrs Jackson's letter of 25 August 2011 actually add up to 70%. The difference is explained in the internal

5 correspondence between Mrs Jackson and her senior officer at HMRC who reviewed and approved the penalty determinations. Under the seriousness heading, Mrs Jackson was only authorised to give an abatement of 25% - and there was a typographical error made when this was transcribed into the letter sent to Dr Subbrayan. However the error was not raised before us on behalf of Dr Subbrayan, and it makes no difference in practice, as the formal penalty determinations (which are governing in this case) show the actual amounts of penalties that were calculated on the basis of the 35% penalty percentage.

10 17. As regards 2008/09, the penalty is governed by schedule 24, Finance Act 2007. Mrs Jackson allowed the maximum abatements possible under the new regime in order to bring the penalties in line with those charged in the earlier years, and so a penalty of 35% was charged.

15 18. Following a request by Dr Subbrayan's accountant, Mrs Jackson's decision was reviewed. Small adjustments to the adjusted profits for 2006/07 were made by the reviewing officer to reflect the fact that two items that had been treated as having been paid in cash had in fact been paid into the bank. As the other years were based on the profits for 2007/07 adjusted by RPI, a corresponding adjustment was made to the other years. The reviewing officer did not adjust the 35% penalty percentage. But the cash amount of the penalties were adjusted to reflect the reduction in the amount of profits. The adjusted amounts are set out in paragraph 1 of this Decision. 20 It is these adjusted amounts against which Dr Subbrayan now appeals.

Taxable Income

25 19. The bulk of Mr Subbrayan's objections to Mrs Jackson's calculations related to the manner in which her business economics model had been constructed. However it was apparent from the correspondence with Dr Subbrayan in the bundles and from Mrs Jackson's evidence at the hearing that her assessments had been based on her cash availability exercise, and the business economics model was merely used as a cross-check. Mr Subbrayan's comments on, for example, amounts charged for each visit by a patient or the discounts given to students or nurses, were therefore 30 irrelevant.

35 20. Mr Subbrayan also complained to us that there was an element of double counting in Mrs Jackson's calculations, as the bank statements would include, for example, his pension. In addition, he regularly transferred funds from one account to another to keep within overdraft limits and avoid penal charges. However, on analysing Mrs Jackson's spreadsheets, it was clear that she had stripped out pension payments and various other payments. She had also removed transfers between accounts. So that the only amounts left were cash and cheque deposits that could only have come from the business. We reviewed Mrs Jackson's spreadsheets and are satisfied that she took care to avoid double counting. As regards the transfers 40 between accounts, many of the items in the bank statements that Mr Subbrayan said represented transfers between accounts did not reconcile, and Mr Subbrayan could not give us any satisfactory explanation for the differences in dates and amounts.

21. There are however two items where we would allow an adjustment. The first is for a payment of £69.61 made on 25 July 2006 to Higher Nature. We are satisfied that this was a business expense. We also consider that the payment of £2240 for Dr Subbrayan's subscription to the Healthcare Commission for 2006/07 should also be allowed as a deduction. Although the amount only cleared the bank account on 22 March 2007 (after the accounting date), we are satisfied that the amount relates to the 2006/07 period. We also note that the corresponding subscription for 2005/06 had not been included at the beginning of the year, so that there would be no element of double counting. These adjustments would reduce Dr Subbrayan's taxable profits by £2309.61.

22. We are satisfied that Mrs Jackson made a discovery for the purposes of section 29 Taxes Management Act 1970 and that Dr Subbrayan had been negligent in making her tax returns for the tax years in question. As there had been no significant change in the nature of Dr Subbrayan's business for the years in question, the principle of continuity applies (see *Jones v Bamford* (1973) 51 TC 1) and it is proper for HMRC to raise assessments on the basis of the profits determined for 2006/07 adjusted for RPI.

23. The onus of proof is on Dr Subbrayan to show that HMRC's assessments are wrong. Save for the adjustment of £2309.61 mentioned above, we find she had not discharged this burden..

Penalties

24. Section 12B Taxes Management Act 1970 requires businesses to keep records (and supporting documents) of all amounts received and expended in the course of the business. The records in the case of this business would have included Dr Subbrayan's appointment book, as this was the prime record in which the income of her business was recorded. We find that Dr Subbrayan failed to comply with section 12B, as she did not keep the business records required.

25. In the case of a penalty under section 95(1)(a) Taxes Management Act 1970 (which is also applicable national insurance contributions by virtue of s16, Social Security Contributions and Benefits Act 1992) the burden of proof is on HMRC to show that the incorrect returns were made "fraudulently or negligently". From the evidence before us, we are satisfied that Dr Subbrayan negligently delivered incorrect tax returns for each of the years 2005/06, 2006/07 and 2007/08, and that HMRC satisfied the burden of proof.

26. The question is therefore whether the abatement of 65% made by HMRC is appropriate. In our view this abatement is fair and reasonable, and we do not propose to adjust it further.

27. For the year 2008/09, penalties for both income tax and NICs are levied under Schedule 24, Finance Act 2007. This provides for a penalty rates for delivering inaccurate returns at

(a) up to 30% of the potential lost revenue if the inaccuracy is careless

(b) up to 70% of the potential lost revenue if the inaccuracy is deliberate

5 (c) up to 100% of the potential lost revenue if the inaccuracy is deliberate and the person attempts to conceal it

28. HMRC have discretion to reduce these penalties depending upon whether the taxpayer disclosed the inaccuracy, whether the disclosure was prompted or unprompted, and for the “quality” of that disclosure.

10 29. In this case HMRC levied penalties on the basis that the inaccuracy in the 2008/09 return was deliberate, but that Dr Subbrayan gave prompted disclosure of the inaccuracy. The reduction given in this case was the maximum allowed, reducing the penalty to 35%.

15 30. We are satisfied that HMRC have discharged the burden of proof that the inaccuracy in Dr Subbrayan’s tax return was deliberate. From the evidence before us we are satisfied that she must have known that the amount of taxable income shown on the return was less than her actual income for that period. We are satisfied that she disclosed the inaccuracies following the opening of the enquiry, and that she therefore gave prompted disclosure. We consider that giving the maximum abatement in these
20 circumstances is generous, but we are not inclined in this case to interfere with HMRC’s decision to levy penalties at 35%.

Conclusions

31. For the reasons we have given above, we adjust the amount of taxable profits for 2006/7 by £2309.61. There will need to be consequential adjustments to the RPI
25 calculations for the other years under appeal.

32. We confirm that penalties should be levied at 35% (after taking account of the adjustments referred to above).

33. We leave it to the parties to agree the revised amounts of tax and penalties. If for any reason they are unable to reach agreement on the amounts, we give leave to
30 the parties to apply to the Tribunal (acting by a single judge) to determine the amounts payable.

34. 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
35 against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

**NICHOLAS ALEKSANDER
TRIBUNAL JUDGE**

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RELEASE DATE: 1 March 2013

Cases mentioned in argument but not referred to in this decision:

10 *T Haythornthwaite and Sons Ltd v Kelly* (1927) 11 TC 657

Nicholson v Morris (1976) 51 TC 95

Parmar v Woods (2002) 74 TC 562

Blyth v Birmingham Waterworks Co (1856) 11 Ex 781

Coy v Kime (1986) 59 TC 447

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