



TC05335

Appeal number: TC/2014/01416

INCOME TAX – alleged under-declaration of trading income – whether taxpayer discharged burden of proof – held partially – whether or not HMRC had discharged burden of proof that under-declaration was deliberate – held not

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

MRS GEMMA SCOTT

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE PHILIP GILLETT
TYM MARSH**

Sitting in public at Fox Court, London on 21 July 2016

Mr Keith Scott, Appellant's husband, for the Appellant

Miss Anne Rees, Officer of HM Revenue and Customs, for the Respondents

DECISION

1. This was an appeal against an HMRC closure notice in respect of the Appellant's taxable income for the year 2010-11 which was issued following an enquiry into her income tax affairs. After various internal reviews and amendments HMRC were seeking additional payments of income tax of £4,267.48 together with penalties of £2,289.95. The key issue in the appeal was whether or not unidentified bank deposits represented undisclosed trading income. In addition Mrs Scott had claimed a deduction for £2,000 as an Annual Investment Allowance, which she has acknowledged she was not entitled to.

2. Mrs Scott's income was entirely received in cash and at the outset of the enquiry HMRC had proceeded on the basis that none of the income declared by Mrs Scott had been banked but following the internal reviews they had revised this position to include all the declared income as having been deposited in the bank account, which lead to a significant reduction in the tax being demanded.

3. Also, at an earlier stage of the enquiry, HMRC had raised additional assessments in respect of the three month period from 13 January 2010 to 5 April 2010 and in respect of the following year, 2011-12. However, on review, HMRC decided that it did not have sufficient grounds to challenge the returns for these periods and the assessments were therefore cancelled.

4. Having considered the evidence we decided that we should allow the appeal in part and that the amount of taxable profits on which the tax assessment for 2010-11 should be based should be reduced from £21,927 to £19,487. We also decided that the penalty percentage in respect of the incorrect claim for an Annual Investment Allowance should be confirmed at 15% but that the under-declaration of income was not deliberate and that the penalty percentage in respect of the under-declaration of income should as a consequence be reduced from 59.5% to 25.5%.

Background

5. Mrs Scott described her trading activity as Events Organiser on her tax return but stated in a letter dated 2 February 2013 that she worked in the "adult industry". She advertised her services on the internet and worked irregular hours, averaging 30 hours per week. This activity was recorded as starting on 13 January 2010.

6. It is also relevant that Mr Scott's main source of income was stated to be playing poker, and that his tax affairs were investigated by HMRC at the same time as those of Mrs Scott. We understand that the profits from Mr Scott's activities were all received in the form of cash but are regarded as non-taxable.

7. It was noted from the correspondence files that there had been significant concerns by Mr and Mrs Scott as to the manner in which the HMRC investigation had been conducted. There had been a number of complaints made by Mr and Mrs Scott and at one stage the police had become involved. These matters do of course fall

outside the jurisdiction of the tribunal but clearly did not help the progress of the investigation.

8. Mrs Scott's Self-Assessment tax return for 2010-11 contained the following entries:

5	Turnover	£13,350
	Cost of Goods	£ 4,664
	Annual Investment Allowance	£ 2,000
	Net Taxable Profit	£ 6,686

Evidence

10 9. We heard evidence and representations from Mr and Mrs Scott and representations from Miss Reece. We also had the benefit of an extensive bundle of documents.

15 10. As stated above HMRC believe that deposits made into Mrs Scott's bank account represent undeclared income from her trade, which it was explained was a cash-only trade. However Mr Scott explained that he and his wife used Mrs Scott's bank account to pay their household bills. Mr Scott stated that he had made regular deposits into this account, to help in paying these bills, and that these deposits came from his activities as a professional poker player, the proceeds of which were also wholly in cash.

20 11. Mrs Scott explained that her basic record of earnings was prepared using records of her appointments which were on her mobile phone and that she transcribed the information from these appointments into her cash book. She acknowledged that she did not complete her cash book on a daily basis but she did not earn money every day and she said that she therefore filled in her cash book on an approximately weekly
25 basis. Copies of this cash book were provided in the tribunal's papers and they showed a fairly erratic pattern of earnings, in that there would be two or three days during which money was earned followed by a number of days on which there were no earnings. These earnings did not appear to reflect Mrs Scott working approximately 30 hours a week, as she had stated to HMRC, at the rates which were
30 shown on her website, a copy of which was also included in the papers. However Mrs Scott explained that the vast majority of her 30 hours worked consisted of marketing activity using a web-cam at her home, which was not income producing.

35 12. Mrs Scott also stated that her activities had always been "a bit of fun" rather than carried on as an active trade, and that she had not accepted all the potential customers who had approached her.

13. Mr Scott had been asked repeatedly by HMRC for documentary evidence of his poker winnings to support these deposits but he explained that this was not possible owing to the nature of the business. He had not kept any personal record of his

winnings and acknowledged that he was not a particularly organised person in this regard. Neither had he and his wife kept any record as to which bank deposits were from Mr Scott and which were from Mrs Scott. There was however one deposit, of £1,400, into the bank in Nuneaton which Mr Scott stated was from a particular poker game in Nuneaton, whereas all the other deposits were local to their home in Essex.

14. Mr Scott argued that this deposit in Nuneaton demonstrated that he had paid cash into Mrs Scott's account and that if he had paid in cash in Nuneaton then it was highly likely that he had made some of the more local deposits. In addition there were specified transfers from Mr Scott's bank account shown in the bank statements for Mrs Scott's account, although these only amounted to £2,100 in the year in question. It is difficult to tell if the deposit made in Nuneaton was part of a pattern of payments but we did note that the account was in overdraft immediately before the Nuneaton deposit was made, which may have encouraged Mrs Scott to ask Mr Scott to pay his winnings into the account in Nuneaton, without waiting until he returned home to do so.

15. Mr Scott also stated that the couple had married on 10 October 2010 and that therefore some of the deposits were likely to be wedding presents. A deposit of £2,000 on 13 July 2010 had already been identified as being from Mr JW Way, Mrs Scott's father, and possibly related to the wedding. This deposit had however already been excluded from HMRC's calculations.

16. In order to obtain further information about the deposits into Mrs Scott's bank account Mrs Scott stated that she had spoken to the bank manager who had suggested that, in the description of the deposit on the bank statement, where the name of the branch at which the deposit had been made was followed by a number then this was probably a cash deposit whereas if there were no such number then that would have been a cheque receipt. There were two such receipts in the bank account in the year, a receipt of £1,420 on 11 June 2010 and a receipt of £1,020 on 16 September 2010. After significant discussion between themselves Mr and Mrs Scott suggested that the receipt of £1,420 related to an insurance claim regarding one of their cars and that the receipt of £1,020 was a wedding gift, in particular they recalled that Mrs Scott's aunt had given them £1,010.10, to reflect the fact that they had married on 10 October 2010. Both these receipts had been included as unidentified receipts in HMRC's calculations.

17. It seemed strange that this information had not emerged earlier during the course of the HMRC investigation, but Mr Scott explained on a number of occasions during his representations that Mr and Mrs Scott had often not been clear exactly what HMRC were looking for as regards evidence to support these deposits, and this may have been partly due to the poor state of the relationship between HMRC and Mr and Mrs Scott at this time. In addition Mr Scott said that at the outset of their initial interview with HMRC, the officer leading the investigation, Mr Paul Laycock, had stated that if they did not know the answer to a question they should not guess but should say that they didn't know. It appears that Mr and Mrs Scott had taken this instruction very literally and had only given an answer when they had been totally sure it was correct.

18. As stated above HMRC had also carried out an enquiry into Mr Scott's tax affairs, which had delayed the tribunal hearing regarding Mrs Scott's tax affairs. This enquiry had been concluded with no further tax payable and this was confirmed by a copy of an email which we were shown from Paul Suter of HMRC dated 12 May 5 2015. This email confirmed that HMRC accepted that Mr Scott had made a significant amount of money from his poker playing activities, which explained his ability to fund household expenditure. Unfortunately Mr Suter had not ascertained precisely how much money Mr Scott had made from his poker playing activities, which might have made a useful contribution to determining how much if any of the 10 deposits to Mrs Scott's bank account had come from Mr Scott. Presumably he had concluded that this was not necessary once he had established that the moneys came from playing poker, which we understand would not be taxable as income, even when carried on with a view to profit on a professional basis.

19. For HMRC Miss Reece said that HMRC expected to see proper records being 15 kept of any trading activity and that there should be evidence to support possible responses to enquiries, which clearly had not been available in this case. The only available records were Mrs Scott's cash book, but HMRC regarded this as unreliable and wholly inadequate because Mrs Scott could not state that it had been completed on a regular basis. In addition the original records, which were the record of 20 appointments held on the mobile phone, were not available because the phone had been replaced.

20. In this regard we noted that Mrs Scott had explained that the mobile phone only 25 contained records of the appointments and not records of the cash actually received. When recording takings in her cash book therefore she had taken the times of the appointments and simply converted them into cash at her normal rates of charge. There were no records of any reconciliation between the amount of cash she had received and the amounts included in her cash book and no record of when the cash 30 takings were banked or any reconciliations between their cash records and the bank statements. Mr Scott said that he thought what they had done was adequate and that no such reconciliations had been carried out.

21. Miss Reece said that the fundamental problem in HMRC's view was that Mrs Scott's account had been used to bank both trading and non-trading receipts but that it was not clear which was which. In addition both personal and business expenditure had been made from the same account, again without clear segregation, although it 35 was possible to ascertain which was which in many cases by looking at the payee.

22. Miss Reece argued that it was not likely that all Mrs Scott's cash receipts had been banked, but this was the assumption that had been made in calculating HMRC's latest figures. She pointed out that there were very few cash withdrawals, implying that a significant proportion of their everyday expenditure would have been made out 40 of the cash earnings, but we noted that the bank statements showed many small payments made by debit cards, and Mr and Mrs Scott confirmed that they did not use cash much and tended to make most payments by card.

23. In summary Miss Reece said that HMRC accepted that the Nuneaton banking deposit had been from poker winnings but believed that the other cash deposits had been from Mrs Scott's trade.

Legal Framework

5 24. The key statutory provisions in this appeal as regards the assessment to tax are set out in s 50(6) Taxes Management Act 1970, as set out below:

(6) If, on an appeal notified to the tribunal, the tribunal decides—

(a) that the appellant is overcharged by a self-assessment;

10 (b) that any amounts contained in a partnership statement are excessive;
or

(c) that the appellant is overcharged by an assessment other than a self-assessment,

the assessment or amounts shall be reduced accordingly, but otherwise the assessment or statement shall stand good.

15 25. As regards the penalties the relevant statutory provisions are set out in para 4 Sch 24 Finance Act 2007 as below:

4 (1) This paragraph sets out the penalty payable under paragraph 1.

(2) If the inaccuracy is in category 1, the penalty is—

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

20 (b) for deliberate but not concealed action, 70% of the potential lost revenue, and

(c) for deliberate and concealed action, 100% of the potential lost revenue.

(3) ...

25 (4) ...

(5) Paragraph 4A explains the 3 categories of inaccuracy.

4A (1) An inaccuracy is in category 1 if—

(a) it involves a domestic matter, or ...

30 26. The legislation regarding appeals against penalties is set out in s 100B(1) and (2) TMA 1970 as below:

5 (1) An appeal may be brought against the determination of a penalty under section 100 above and, subject to the following provisions of this section, the provisions of this Act relating to appeals shall have effect in relation to an appeal against an assessment to tax except that references to the tribunal shall be taken to be references to the First-tier Tribunal.

(2) On an appeal against the determination of a penalty under section 100 above section 50(6) to (8) of this Act shall not apply but—

10 (a) in the case of a penalty which is required to be of a particular amount, the First-tier Tribunal may—

(i) if it appears that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears ...² to be correct, confirm the determination, or

15 (iii) if the amount determined appears to be incorrect, increase or reduce it to the correct amount,

(a) in the case of any other penalty, the First-tier Tribunal may—

(i) if it appears that no penalty has been incurred, set the determination aside,

20 (ii) if the amount determined appears to be appropriate, confirm the determination,

(iii) if the amount determined appears to be excessive, reduce it to such other amount (including nil) as it considers appropriate, or

25 (iv) if the amount determined appears to be insufficient, increase it to such amount not exceeding the permitted maximum as it considers appropriate.

27. S 50(6) makes it clear that as regards the assessment to tax the burden of proof to disprove the assessment rests with the taxpayer. This was stated clearly by Park J in *Hurley v Taylor* (ChD) [1998] STC 202 71 where he said: “It is well settled by authority that this places the onus of discharging the assessment on the taxpayer. If the commissioners, having heard his case, are uncertain where the truth lies, they must dismiss the appeal and uphold the assessment.”

28. The position is however different as regards the penalties because s 100B specifically disapplies s 50(6). As regards the penalties therefore the burden of proof falls on HMRC to demonstrate that the taxpayer was guilty of default. In both cases however, the standard of proof required is the normal civil standard of “on the balance of probabilities”.

Discussion - Income

29. Dealing first with the assessment to income tax, the main contention on behalf of HMRC was that Mrs Scott's bank account contained unidentified deposits which, in the absence of evidence to the contrary, they considered were additional receipts of Mrs Scott's trade which had not been disclosed in her tax return. In response, Mr Scott, on behalf of his wife, stated that many of these deposits were in fact funded by his poker winnings and they were not therefore undeclared income but were his contributions towards household bills funded from his (non-taxable) poker winnings.

30. Unfortunately Mr Scott was unable to provide any documentary evidence to support this proposition. We fully accept that the nature of poker winnings means that it is not possible to obtain written evidence as to the amount of any winnings, either from the venues where the games took place or from the other participants in the games. However we consider that it is not unreasonable to expect him to have kept some written note of his winnings and the amounts banked. This is simple domestic budgeting. However, no such record was kept and this left him and his wife exposed when they were required to respond to HMRC's enquiries.

31. As stated above we are required to base our decision on the principle expressed by Park J in *Hurley v Taylor* that "If the commissioners, having heard his case, are uncertain where the truth lies, they must dismiss the appeal and uphold the assessment." We are quite prepared to accept that Mr Scott did pay monies into his wife's bank account to fund household bills, and the HMRC numbers assume that Mr Scott paid in £3,500 over the course of the year, being the £1,400 banked in Nuneaton and £2,100 in four other identified payments. However, as regards the other deposits, in the absence of records of any sort to support Mr Scott's contentions we are uncertain where the truth lies. We are therefore obliged by these principles to dismiss the appeal.

32. However, we were taken to two bank deposits in the bank statements which were stated by Mr and Mrs Scott to be cheque payments. The only support we had for the fact that these were cheque payments was a reported conversation between Mrs Scott and a bank manager, but there was no doubt that these two deposits were recorded differently in the bank statement from the cash deposits. Since all monies earned by Mr and Mrs Scott were agreed to be totally in cash, any cheque payments were therefore unlikely to represent undeclared income.

33. The two deposits in question were the £1,420 deposited on 11 June 2010 and one of £1,020 deposited on 16 September 2010. After some discussion Mr and Mrs Scott told the tribunal that the first of these two deposits related to an insurance claim. They had made some, unclear, reference to a receipt involving a car at an early meeting with HMRC, but when HMRC asked for details none could be provided. Nevertheless, the details of this comparatively complex transaction which were related by Mr and Mrs Scott persuaded us that on the balance of probabilities, this deposit did not represent undeclared income. If we accept that this deposit was a cheque deposit then the description of the second of these deposits on the bank statement, being in identical format to the first deposit, probably indicated that this

too was a cheque deposit. Mr and Mrs Scott were not as clear as to what this might have been but suggested that it was, at least in substantial part, a wedding present. On the balance of probabilities we decided that we should accept this explanation.

5 34. The removal of these two items therefore reduces the alleged taxable profits from £21,927 to £19,487, a difference of £10,801 from the figures originally submitted. We note that in arriving at this figure HMRC have assumed that all of Mrs Scott's cash earnings were deposited in the bank account. This assumption is one which we think is reasonable given the uncertainties in this case.

Discussion - Penalties

10 35. There are two elements to the penalties charged, that relating to the claiming of an Annual Investment Allowance and that relating to the underdeclaration of income.

15 36. Looking first at that relating to the claiming of an Annual Investment Allowance, Mrs Scott, having been challenged, acknowledged at an early stage of the enquiries that this was a mistake and HMRC have therefore treated this as a careless and prompted penalty. The range of possible penalties for a careless error is 15% to 30%. HMRC have positioned this penalty at the bottom end of the range and we consider this to be reasonable.

20 37. HMRC have however treated the issue of under-declaration of income as deliberate. Based on the significant difference between the income returned and that which has now been assessed they argue that Mrs Scott must have known that there was missing income and that therefore the under-declaration was deliberate. As stated above, the burden of proof on this issue lies with HMRC to demonstrate that there was a deliberate under-declaration of income.

25 38. Again we find ourselves faced with uncertainty. Our overall impression was that Mr and Mrs Scott had a somewhat disorganised approach to their personal finances, as witnessed by the complete lack of underlying records as regards cash receipts and banking. We therefore consider it quite possible that any under-declaration was caused by carelessness rather than by deliberate default. Using the same logic for the uncertainty surrounding this issue as we did for the uncertainty surrounding the tax assessments we therefore find that HMRC have failed to discharge the burden of proof on them to demonstrate that there was a deliberate under-declaration of income by Mrs Scott. We therefore consider that HMRC should have calculated any penalty by reference to the careless default regime rather than the deliberate default regime.

35 39. If the under-declaration is regarded as careless rather than deliberate the penalty must be calculated by reference to a different level of potential penalties. The under-declaration was prompted in that HMRC raised the issue. The range of possible penalties therefore is from 15% to 30%, as for the Annual Investment Allowance issue. In this case however the taxpayer's response to the issue was different. In their original penalty calculation HMRC proposed that they should allow no reduction in the penalty for "Telling" on the basis that Mrs Scott still did not accept that there was

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any under-declaration. They then proposed a deduction of 10% for “Helping” on the basis that Mrs Scott had provided bank statements on request and had attended meetings with HMRC, and then proposed a reduction of 20% in respect of “Giving Access” to records. We see no reason to interfere with these proposed reductions.
5 The total reductions proposed are therefore 30%.

40. The range of possible penalties for careless prompted under-declaration is, as stated above, 15% to 30%. The maximum reduction therefore is 15%. Using a reduction percentage of 30% therefore gives an actual reduction of 4.5% (15% of 30%), leaving a net penalty percentage of 25.5%, which we consider reasonable.

10 **Decision**

41. On the question of the assessment to tax for the year 2010-11 we decided that the amount of taxable profits on which the tax assessment should be based should be reduced from £21,927 to £19,487. We do not have access to the detailed tax calculations so we will leave these to be determined between the parties.

15 42. On the question of the penalty in respect of the incorrect claim for an Annual Investment Allowance we decided that this penalty, at the rate of 15%, should be confirmed.

43. On the question of the penalty in respect of the under-declaration of income we decided that this penalty should be reduced from 59.5% to 25.5% of the potential lost revenue, this figure to be determined by reference to the revised figure for tax assessed following the reduction in profits to £19,487 as set out above.
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44. 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.
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**PHILIP GILLETT
TRIBUNAL JUDGE**

RELEASE DATE: 19 AUGUST 2016

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