[2016] UKFTT 0659 (TC)

# TC05385

**Appeal number: TC/2015/02286**

***Income tax –partnership return- whether closure notice under s 28B TMA was effective in absence of amendment to partners' individual returns under s28B(4) – whether amendment to partnership return to reflect alleged unrecorded sales should stand good***

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

**WONG YAU LAM and SAU YAU LAM T/A SUNLIGHT TAKEAWAY MEALS** — **Appellants**

**- and -**

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

**TRIBUNAL: JUDGE SARAH FALK**
**JULIAN SIMS, FCA, CTA**

**Sitting in public at the Royal Courts of Justice, The Strand, London WC2A 2LL on 8 July 2016**

**Michael Feng of Feng & Co, for the Appellants**

**Steve Goulding, Officer of HM Revenue and Customs, for the Respondents**

DECISION

1. This is an appeal against a closure notice issued on 18 February 2015 pursuant to s 28B Taxes Management Act 1070 ("TMA") in respect of a partnership return for the tax year 2006-07. The partnership has the trading name Sunlight Takeaway Meals and the partners are a husband and wife, Mr WY Lam and Mrs SY Lam. The closure notice increased the partnership profit figure from £40,673 to £108,654, an increase of £67,981, on the basis that sales had been omitted.

2. There are two issues for decision. First, the appellants maintain that the closure notice did not satisfy all the requirements of s 28B and on that basis was invalid (the "closure notice issue"). Secondly, the appellants argue that the amendment made by the closure notice was not justified because sales were accurately recorded or in the alternative that the amendment was excessive.

## Preliminary points

3. The appeal was listed for a one day hearing. During the hearing full submissions were made by both parties on the closure notice issue and all witness evidence was heard in full. There was insufficient time to hear the full oral submissions the appellants' representative had intended to make on the substantive issue of whether the amendment to the partnership return should stand good, or to hear submissions from HMRC on that issue, so we heard a summary of the key points from Mr Feng for the appellants, allowed Mr Goulding for HMRC a shorter period of a few minutes to respond with any points he wished to make orally, and required further submissions from both parties in writing following the hearing (including an opportunity for the appellants to reply to HMRC's submissions). We have taken account of those submissions, except those parts of the appellants' reply which disregarded the specific direction that it should be a reply to any point raised in the respondents' submissions and should be limited to addressing points not addressed in earlier submissions.

4. A second preliminary point to mention is that prior to the hearing HMRC had sought permission to include a document previously omitted from the document bundle. This document was a copy of a print out of the partnership return as amended to show the increase in profits. Mr Feng objected to its inclusion and we were required to decide whether to allow the objection. Since this point was linked to, and makes sense only in the context of, the closure notice issue it is most convenient to address those points together.

## Evidence

5. We heard oral evidence from Mr Lam, through a Tribunal appointed Cantonese interpreter. Mr Lam had also produced a short written statement in English, which included what we understood to be translations of the text into Cantonese. We were informed that this was prepared with the assistance of Mr Feng. It was apparent that Mr Lam had some knowledge of English but that he was not fluent.

6. HMRC had one witness, Mr John Corbett, who also gave oral evidence and produced a written statement. Mr Corbett is a Higher Officer of HMRC and conducted the enquiry.

7. We found Mr Corbett to be a straightforward witness who provided clear evidence. We accept his evidence so far as it relates to matters of fact. We did not find Mr Lam to be a straightforward witness. Whilst aspects of his evidence are accepted there are other parts that we cannot accept because we do not consider that Mr Lam was wholly truthful. This is addressed further below.

8. Documentary evidence included HMRC correspondence related to the enquiry, notes of meetings held during the enquiry, some documentation related to the business including a menu, sample meal tickets, gas supply bills, financial statements, VAT returns and accountants' working papers, and some health related information in respect of Mr Lam.

## Background

9. At the time in question Sunlight Takeaway Meals was a Chinese takeaway outlet. The business was established by Mr Lam's father and at the relevant time was carried on by Mr and Mrs Lam in partnership, having been taken over by them around 20 years earlier. Mr Lam's father now resides in Hong King. The accounts and tax return information we saw for the period in question indicate that profits were split 60:40 between Mr and Mrs Lam.

10. On 3 December 2008 Mr Corbett opened an enquiry under s12AC TMA into the partnership return for 2006-07, which covered the trading period for the year to 30 September 2006. Although this had the effect of deeming each partner's individual return to be under enquiry (s 12AC(6)), following an initial meeting with the appellants and their then advisers Wilkins Kennedy LLP on 15 December 2008 Mr Corbett also opened separate enquiries into the personal returns under s 9A TMA and requested personal financial information. Information relating to accounts with UK banks was disclosed following formal notices under s 19A TMA. At a further meeting in December 2009 it emerged that there was also an account held by Mr and Mrs Lam at the Bank of East Asia London branch which had not been disclosed. Some information relating to this account was provided by the appellants pursuant to notices under Schedule 36 Finance Act 2008 ("Schedule 36") but the information was incomplete. Fuller information and statements for what turned out to be three accounts at this branch were subsequently provided by the bank following an informal approach by HMRC.

11. At a third meeting in November 2010 it emerged, according to Mr Cassidy's meeting notes and witness evidence, that there was a further undisclosed joint account at the Hong Kong branch of the same bank. No information was provided about this account and so notices requesting the pass book or statements were issued to Mr and Mrs Lam under Schedule 36. (HMRC was not able to use exchange of information arrangements with Hong Kong because the arrangements were not in force for the relevant period.) It was around this time that Mr Feng took over from Wilkins

Kennedy as adviser to the appellants. The original Schedule 36 notices were cancelled due to a technical error but fresh notices were issued in June 2011. An appeal against the notices was heard and dismissed by the First-tier Tribunal ("FTT") in October 2011. The full decision is reported at [2012] UKFTT 118 (TC). There was no suggestion during that appeal that a Hong Kong branch account did not exist and the decision records at [66] that Mr Lam explained that the passbook for the account was held by his father in Hong Kong.

12. The Schedule 36 notices which were the subject of the FTT decision were not complied with. Applications for closure notices in respect of the enquiries were dismissed following a separate FTT hearing in May 2013. At this hearing both Mr and Mrs Lam gave evidence denying that either of them held or had held an account with the Hong Kong branch of the Bank of East Asia. The applications were dismissed on the basis that, in the light of the earlier decision which found that the information required was in the appellants' possession or power and that there was credible evidence that the account existed, HMRC had shown that there were reasonable grounds not to close the enquiries. The decision following the May 2013 hearing also records a finding that Mr Lam did state at the meeting in "November 2011" (which we assume should have been a reference to November 2010) that he and his wife held a joint bank account in Hong Kong.

13. Mr and Mrs Lam have incurred both initial and daily penalties in respect of their failure to comply with the Schedule 36 notices. Appeals against the initial penalties were heard and dismissed by the FTT in October 2013. The existence of the account was again denied at this hearing, but the FTT found that Mr and Mrs Lam did have a joint bank account at the Hong King branch. Appeals against the daily penalties were heard and dismissed by the FTT following a fourth hearing in April 2014. The total penalties incurred have amounted to £22,920.

14. HMRC sought to close the enquiry into the 2006-07 return by a closure notice dated 18 February 2015. The notice was preceded by earlier correspondence, in particular a letter from Mr Corbett to Mr Feng dated 27 January 2015, from which it appears that as well as closing the enquiry for 2006-07 HMRC also intended to adjust the returned figures for other years between 2000-01 and 2007-08 inclusive. It was clear that for most years this would be under the discovery assessment rules, which in the case of partnership returns are set out at s 30B TMA and permit HMRC to amend a partnership return in certain circumstances to correct a deficiency in profits discovered by an officer of HMRC.

15. There was a lack of clarity at the hearing about whether the discovery procedure was the only avenue potentially available for 2007-08 or whether there was an open enquiry for that year. Mr Corbett could not recall the position at the hearing (we should make clear that we reject Mr Feng's subsequent written submission that this meant that Mr Corbett misled the Tribunal). However, it is reasonably clear from the correspondence and the dates that any adjustment would be by way of the discovery procedure. Mr Goulding relied on submissions in a letter dated 23 March 2010 in which Mr Corbett referred to "extending my enquiries into earlier years and the 2008 year using the discovery provisions". However, neither this nor any other

correspondence we saw indicated that a discovery assessment or amendment to the partnership return had actually been made under s 29 or s 30B TMA, either for 2007-08 or any other year. In any event this appeal is concerned with the single tax year 2006-07 and not with discovery assessments or amendments to other years.

## The closure notice issue

16. Mr Feng submitted that the closure notice dated 18 February 2015 was not effective. The key basis for his argument was that HMRC had not made any amendments to the partners' individual returns as required by s 28B(4) TMA. In the absence of a valid closure notice Mr Feng argued that the enquiry was not completed as contemplated by s 31(1) TMA and that the Tribunal had no jurisdiction under s 50(6) TMA.

*The legislation*

17. Section 28B TMA provides as follows:

> "(1) An enquiry under section 12AC(1) of this Act is completed when an officer of the Board by notice (a "closure notice") informs the taxpayer that he has completed his enquiries and states his conclusions.
>
> In this section "the taxpayer" means the person to whom notice of enquiry was given or his successor.
>
> (2) A closure notice must either--
>
> (a) state that in the officer's opinion no amendment of the return is required, or
>
> (b) make the amendments of the return required to give effect to his conclusions.
>
> (3) A closure notice takes effect when it is issued.
>
> (4) Where a partnership return is amended under subsection (2) above, the officer shall by notice to each of the partners amend--
>
> (a) the partner's return under section 8 or 8A of this Act, or
>
> (b) the partner's company tax return,
>
> so as to give effect to the amendments of the partnership return.
>
> (5) The taxpayer may apply to the tribunal for a direction requiring an officer of the Board to issue a closure notice within a specified period.
>
> (6) Any such application is to be subject to the relevant provisions of Part 5 of this Act (see, in particular, section 48(2)(b)).
>
> (7) The tribunal shall give the direction applied for unless satisfied that there are reasonable grounds for not issuing a closure notice within a specified period."

18. Section 31(1) TMA provides:

"(1) An appeal may be brought against--

(a) any amendment of a self-assessment under section 9C of this Act (amendment by Revenue during enquiry to prevent loss of tax),

(b) any conclusion stated or amendment made by a closure notice under section 28A or 28B of this Act (amendment by Revenue on completion of enquiry into return),

(c) any amendment of a partnership return under section 30B(1) of this Act (amendment by Revenue where loss of tax discovered), or

(d) any assessment to tax which is not a self-assessment."

19. Section 50(6), (7) and (9) TMA provide as follows:

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

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

(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.

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

(a) that the appellant is undercharged to tax by a self-assessment

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

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

the assessment or amounts shall be increased accordingly.

…

(9) Where any amounts contained in a partnership statement are reduced under subsection (6) above or increased under subsection (7) above, an officer of the Board shall by notice to each of the relevant partners amend--

(a) the partner's return under section 8 or 8A of this Act, or

(b) the partner's company tax return,

so as to give effect to the reductions or increases of those amounts."

*Mr Feng's submissions*

20. Mr Feng pointed to the use of the word "shall" in s 28B(4), which he said put an obligation on HMRC to make the amendments. In the absence of those amendments the closure notice was not complete: all that had happened was that the partnership profit number had been adjusted, but nothing had been done to translate that into increased tax charges on the partners which the partners could challenge. That could

only occur by amendments to the individual returns. It was clear that an appeal was only possible where there had been a "completion" of the enquiry, see s 31(1)(b) TMA. The failure to comply with s 28B(4) meant that the Tribunal did not have jurisdiction under s 50(6)(b) TMA.

21. Mr Feng also argued that the print out of the amended partnership return that HMRC was seeking to adduce in evidence (see [4] above) was critical. That document appeared to have a date of 17 February 2015, one day before the date of the letter purporting to be the closure notice, yet the appellants had been unaware of the document's existence until June 2016. Either the document did not exist at the date of the closure notice, in which case the closure notice was invalid without it, or it did exist on 17 February 2015 in which case it amounted to an amendment to the partnership return made prior to the date of the closure notice, contrary (in Mr Feng's submission) to s 28B(1) and (2).

22. Mr Feng did not go on to describe the consequence of his arguments being correct. As far as we can see that consequence could only be that the present appeal would fall away but the enquiry would still be running, and could therefore be closed by a further (valid) closure notice which fulfilled all the requirements of s 28B.

*Section 28B(4)*

23. We do not accept Mr Feng's arguments in relation to s 28B(4) and we have concluded that a valid closure notice was issued on 18 February 2015. We therefore have jurisdiction. Our reasons are set out below, followed by a discussion of the case law that we have considered in arriving at our conclusions.

24. First, we should make it clear that we agree with Mr Feng that s 28B(4) does impose an obligation on HMRC to amend each partner's return. This clearly follows from the use of the word "shall", rather than (for example) "may". We also do not understand HMRC to have made any submission to the contrary. However, that does not itself demonstrate that, without such amendments, there is no valid closure notice. For that argument to succeed it would be necessary to show not only that compliance with s 28B(4) is mandatory but also that a failure to comply with it means that the closure notice itself is not valid.

25. The provisions which in our view govern the issue and effectiveness of a closure notice are subsections (1) to (3) of s 28B. Section 28B(1) sets out how an enquiry is completed. It describes a "closure notice" as a notice from an officer of HMRC that "informs the taxpayer that he has completed his enquiries and states his conclusions". It is apparent that a document that does not do these things will not be a closure notice, since it will not meet the definition. Section 28B(2) contains an additional mandatory requirement for the content of a closure notice: it must either state that no amendment of the return is required or it must "make the amendments of the return required to give effect to his conclusions". Section 28B(3) then goes on to say that a "closure notice takes effect when it is issued".

26. In our view it is clear that a closure notice that meets the requirements of both sub-sections (1) and (2) is a "closure notice" that takes effect when it is issued in accordance with subsection (3). Section 28B(3) is clear and unqualified, and the only provisions that govern what a closure notice is and what its contents should be are those in subsections (1) and (2). There is nothing in s 28B that provides any indication that the effectiveness of a closure notice is subject to compliance with s 28B(4). On the contrary, in our view there is a very strong indication that there must be a valid closure notice in order for amendments to individual returns to be made under subsection (4). Section 28B(4) can only apply on its terms when a partnership return "is amended" under subsection (2). This can only occur via the issue of the closure notice, since it is the closure notice itself that makes the amendments of the return under that subsection. Subsection (3) is very clear that a closure notice takes effect when it is issued, and in our view that must mean that the amendments to the partnership return made under s 28B(2)(b) take effect at that time (that is, at the time of issue). It is only at the point that those amendments become effective that there is any basis for amendments to be made to the individual returns to reflect the amendments to the partnership return. Otherwise subsection (4) cannot apply because, up until that point, it would not be correct to say that the partnership return "is amended".

27. Logically, therefore, the closure notice takes effect first and amendments to individual returns must either follow it or, at the least, cannot precede it. But a key point is that subsection (4) cannot operate on its terms without a valid closure notice, since it requires that the partnership return "is amended under subsection (2)". It cannot therefore itself be part of the process which creates a valid closure notice. If subsection (4) had been intended to be part of the process for issuing a valid closure notice then we think the draftsman would have approached the point differently. There would be something in subsection (3) to indicate that it was subject to compliance with subsection (4), and subsection (4) would not be drafted on the basis that a valid closure notice exists. The order of the subsections might also have been different because subsection (3) would logically follow on from compliance with subsection (4).

28. We therefore do not agree with Mr Feng's argument that an effective appeal is not possible unless the tax effect on the individual partners has been made clear by amending their returns. Section 50(6)(b) and (7)(b) make it clear that, in the context of an enquiry into a partnership return, the Tribunal's jurisdiction is to decide whether "any" amount contained in the "partnership statement" is excessive or insufficient. The term "partnership statement" is explained in s 12AB TMA as a statement of certain specified amounts that are required to be included in a partnership return. The amounts specified include at subsection (1)(a)(i) "the amount of income…which…has accrued to… the partnership". It also includes at subsection (1)(b) the amount of each partner's share, but it is clear to us from the use of the word "any" in s 50(6)(b) that an appeal can be made against an amendment which increases the overall profit and does not go on to allocate that amount between the partners. Appeals are not limited to circumstances where the amendment covers both the amount of the overall profit and the question of how that profit is divided between the partners, and they are

certainly not limited to cases where the precise tax effect of any amendment on the position of the individual partners has also been worked out.

*Content of closure notice and effect of the amended return*

29. It is convenient at this point to deal with Mr Feng's submissions about the document HMRC wished to adduce in evidence which comprised a print out of the partnership return showing the amendments made. In our view the existence or contents of this document are not material to the question of whether there was a valid closure notice in this case. Under s 28B(2) it is the notice that makes the amendments of the return, not anything else that HMRC might do by way of entries on its internal systems. If the notice meets the requirements of subsections (1) and (2) then nothing more is required in order for it to be valid.

30. We therefore need to consider the content of the letter dated 18 February 2015 which HMRC rely on as the closure notice. This was a letter from Mr Corbett (whose status as an officer of the Board was not challenged before us) and was addressed to Mr Lam. Since Mr Lam was also the person to whom the original notice of enquiry was given he is the "taxpayer" for these purposes, within s 28B(1). The heading of the letter refers to s 28B(1) and (2) TMA. The key parts of the letter read:

> "I have now completed my check of the Partnership Tax Return for Sunlight Takeaway Meals for year ended 5 April 2007…
>
> **My conclusion**
>
> The return is incorrect as sales have been omitted.
>
> I have amended your partnership profit figure to reflect this. The figure for your partnership profit is as follows:
>
> - The original Partnership profit figure was £40,673.00
> - The Partnership profit figure is now £108,654.00"

31. In our view this is a notice that satisfies the requirements of s 28B(1) and (2). It informs the "taxpayer" (as defined) that Mr Corbett has completed his enquiries and it goes on to state his conclusions. It also makes the amendments required to give effect to those conclusions by increasing the profit figure. We might, strictly, take issue with the reference to "have amended" since it is clear that it is the closure notice itself that makes the amendments, rather than the amendments somehow preceding the closure notice. However, we do not think that this affects its validity and in our view the amendment made to the partnership return is clear: namely that the profit figure is increased to the amount stated.

32. The document HMRC wished to include in evidence - and which Mr Goulding explained at the hearing that they had wished to do only for completeness - neither forms part of the closure notice nor is a necessary ingredient in the issue of the notice. It is an internal document without legal effect. We should however briefly record our findings of fact in relation to it in case it becomes relevant to any appeal. These are as follows. We accept Mr Corbett's evidence that the date shown on the document, 17 February 2015, is accurate. We also accept his explanation that the document would

have been generated once he had given internal instructions for the return to be amended on HMRC's systems, which he would have done by email on the day he produced the closure notice. The explanation for the closure notice being dated one day later is that officers' computers are set up to switch to the following day's date after a particular time in the working day. This is designed to fit in with postal collection and is intended to provide some recognition of the fact that letters written after that time will not be posted until the following day.

*Relevant case law*

33. We have found nothing in the relevant case law that is inconsistent with our conclusions on the closure notice issue. The leading authority is the Supreme Court decision in *Tower MCashback LLP v HMRC* [2011] STC 1143 ("*MCashback*") and the most recent authority that considers closure notices in some detail is the Court of Appeal decision in *Fidex Ltd v HMRC* [2016] EWCA Civ 385 ("*Fidex*"). The appellants placed particular reliance on the Court of Appeal decision in *R (on the application of De Silva and another)* [2016] STC 1333 ("*De Silva*"). We also considered *Bristol & West plc v HMRC* [2016] EWCA Civ 397.

34. Starting with *De Silva*, Mr Feng relied on a description of s 28B(4) in paragraph 7 of the Appendix to the decision. However this simply refers to the fact that s 28B(4) TMA requires HMRC to amend the individual returns to give effect to the amendments made to the partnership return. We agree that there is such an obligation. Mr Feng did not refer us to the substantive decision, which indicates that in that case closure notices were issued in respect of the relevant partnerships in around July 2013 but that it was only subsequently, once those closure notices had been the subject of appeals which were compromised under s 54 TMA, that HMRC wrote to the individual partners amending their returns (see paragraphs [16] to [20]). Gloster LJ comments that this later notification was required under s 50(9) TMA. That provision is in similar terms to s 28B(4) and applies when an appeal is determined. There is no suggestion in the judgment that there was any earlier notification under s 28B(4) or that such a notification was essential for the closure notices to be valid. The reference to the closure notices at [16] refers to s 20B(1)-(3) TMA, which we think must have been intended to refer to s 28B(1)-(3). We think that the description is consistent with the approach we have taken: namely that it is s 28B(1) to (3) (alone) that govern the contents and validity of a closure notice.

35. Similarly, in *MCashback* the closure notice in question simply adjusted the position at the level of the partnership, by disallowing the losses claimed: see [13] in the Supreme Court decision. There is no suggestion that HMRC also needed to comply with s 28B(4) TMA before a valid appeal could be made. Lord Hope specifically referred to the requirements of s 28B(1) and (2), and the right of appeal under s 31 TMA, at [82] and [83] in terms which we think is consistent with the approach we have taken.

36. *Fidex* did not relate to a partnership return so the point would not have arisen in the same way. However the provisions considered in that case, paragraphs 32(1) and 34(1) and (2) Schedule 18 Finance Act 1998, are in similar terms to s 28B(1) to (3)

TMA. *Fidex* is a good illustration of the point that it is the closure notice itself, not a separate process under which an amended return is produced on HMRC's systems, that effects the amendments to the return. This is clear from Kitchin LJ's judgment at [63] where he refers to paragraph 3 of the closure notice in that case as having stated "the amendment to the return that is required". As can be seen from [47], paragraph 3 of the closure notice set out the amount of the loss claimed in the return, the amount of the reduction made and the amount of the revised loss.

37. *Bristol & West*, which similarly considered the Finance Act 1998 closure notice provisions, also contains nothing that casts doubt on our conclusions, confirming at [24] that the essential requirements for a valid closure notice are that HMRC must state that they have completed their enquiry and state their conclusions.

38. We should mention that Mr Feng also relied on paragraphs [109] to [120] of the FTT decision in *Rotberg v HMRC* [2014] UKFTT 657 (TC), which consider s 50(6) TMA. Essentially the issue there was whether the question of a charge being "excessive" within s 50(6) was capable of encompassing public law arguments, and it was held that it was confined to the lawfulness of the charge under the legislation, rather than encompassing any question of the public law principle of legitimate expectation. Mr Feng appeared to rely on it to support his argument that the Tribunal had no jurisdiction because s 28B had not been properly complied with and therefore there was no legally amended partnership statement for the Tribunal to reduce. We agree that a valid closure notice is required, but we have held that there was one and therefore that the Tribunal has jurisdiction.

*What was the conclusion?*

39. We should also say that there was some dispute between the parties prior to the hearing about exactly what the conclusion was in the closure notice. This is of course important because, as *MCashback* and *Fidex* makes clear, any appeal can only be made in respect of those conclusions and they define the scope and subject matter of the appeal. We should therefore state our views on that point.

40. *Fidex* and *MCashback* make clear that it is necessary to distinguish between the reasoning behind a conclusion communicated by a closure notice and the actual conclusion.

41. Although the closure notice might have been better expressed, our view is that the conclusion was that the return was incorrect in that it omitted profits in the amount indicated, being the difference between the returned profit and the higher amount stated in the letter. The reference to "as sales were omitted" supplies the reason for that conclusion but was not itself the conclusion. We do not think that this is affected by subsequent email correspondence in which, when pressed by Mr Feng, Mr Corbett indicated that his conclusion was that sales were omitted. That is not our interpretation of the closure notice, read in the light of *Fidex* and *MCashback*. In any event, we have found it difficult to see why the point should be regarded as material since HMRC's reasoning has in fact remain unchanged.

## Partnership profits

42. We now turn to the substantive issue in dispute in this appeal, namely whether HMRC's amendment to the partnership profits for 2006-07 should stand good or, as Mr Feng submitted, that we should allow the appeal on the basis that the original return accurately reflected the trading results of the business.

## Findings of fact

*The business*

43. Sunlight Takeaway Meals was run as a pure takeaway outlet in a relatively small town. There were no facilities for customers to eat on site and no home deliveries were provided. The premises were used only for the business and did not have residential accommodation. Most business was done in cash, although cards and cheques were also accepted from customers. No menu was available from the relevant trading period (2005-06) but we did see a copy of a menu from 2010. Mr Lam gave evidence, which we accept, about the prices of six items during the first week of March 2006, being £1.70 for plain rice, £3.10 for special fried rice, £3.20 for sweet and sour chicken or shrimp chow mein, £4.10 for chilli beef and £4.20 for king prawns. The prices shown on the 2010 menu were slightly higher, for example £1.90 for plain rice. In other respects we understand and accept the 2010 menu to be indicative of the business as conducted in 2005-06, both as to the range of dishes and opening hours shown.

44. The 2010 menu shows around 100 dishes, with prices ranging from £1 for prawn crackers to £32 for a dinner for five. It also shows that the business was usually open every day except Monday, but that it also opened on bank holidays. Usual opening hours were lengthy: five and a half or six hours every evening and, other than on Sundays, two hours at lunchtime: a total of 44 hours in a typical week on our calculations. We accept Mr Lam's evidence that it was busiest between 6 and 8.30 pm and that the usual customers were local residents.

45. The appellants produced copies of orders from the first week of March 2006. It was unclear to us whether these were the complete set of orders from that period. The business used pre-numbered meal tickets, with orders handwritten on the tickets. The example orders we saw were in most cases fairly modest, generally ranging from around £8 to £16 but with some either higher or lower.

46. Mr Lam's evidence focused on his menu prices. We did not get a clear picture of how many customers typically visited the premises or the size of the premises. However, in response to a question from the Tribunal we ascertained that four people worked in the business: Mr and Mrs Lam plus one full time and one part time employee. Mr Lam also gave evidence about health problems that he suffered from, to the effect that he has been an alcoholic for many years, suffered from liver damage and had also had a cataract problem. The health records we reviewed did indicate some health issues, but we do not consider these to be material to the period under appeal. The GP records indicate no appointments during the financial year to September 2006. Entries before that indicate an improving liver function and reduced

alcohol consumption. There was a referral for cataract treatment in one eye in April 2007, apparently following a first GP appointment on the subject in March 2007, so around six months after the end of the relevant trading period.

47. Mr Lam produced evidence of gas bills for periods between August 2005 and October 2006. Including VAT these total around £4,500 for a 15 month period. These were intended to demonstrate that the business could not have generated the level of turnover claimed by HMRC. However, in the absence of evidence either about what the gas was used for (whether for cooking, and if so whether all cooking was by gas, and/or whether for heating, and if for heating the size of the premises heated), or about the rate of usage that might be expected for any particular level of turnover, we have not been able to derive much assistance, and have therefore drawn no conclusions, from them.

*Bookkeeping*

48. The business had no till. Cash takings were placed in a box or tin. Takings, or at least recorded takings, were derived by Mr Lam and/or Mrs Lam going through the meal order tickets at the end of each day and transferring figures to a handwritten diary, which we did not see. All totals were rounded to the nearest £5. The explanation given to Mr Corbett was that this was regarded in Mr Lam's culture as a "lucky number". Correspondence from Wilkins Kennedy early in the enquiry suggested that the explanation was that Mr Lam only counted the majority of the cash and not the cash float he left in the tin, and used the cash counted as the basis for the takings figure. However, this is not consistent with the other evidence and we find that recorded takings were derived from the meal tickets, subject to the above rounding.

49. There was some dispute about whether it was the diary, or another document to which numbers had been transferred, that was provided to the appellants' then accountants, Fiddaman & Co, every three months to enable VAT and PAYE returns (and in due course annual accounts and tax returns) to be produced. A note of the first meeting during the enquiry indicates that the appellants prepared a cash book but that was denied by Mr Lam at the hearing and his witness statement referred to the cash book being written up by Fiddaman & Co. Mr Corbett's evidence, which we accept, was that figures were transferred from the diary to some handwritten exercise books and it was these that were provided to the accountants. This is consistent with Mr Corbett's notes of the meeting in December 2009, which was attended both by an interpreter and by Mr Jefferson, a partner at Wilkins Kennedy, as well as by Mr and Mrs Lam. Those notes record that Mr Lam wrote up the records every week, or sometimes two weekly. Details of takings were taken from the diaries and details of bankings were taken from paying in slips. The notes also record that Mr Lam explained that neither the business nor the method of record keeping had changed between taking over the business from his father and the commencement of the enquiry.

50. We were also provided with some handwritten workings, clearly produced by Fiddaman & Co, which show a detailed day by day summary of expenditure and

drawings (but not takings), which the appellants described as a cash book. In any event it is clear that Mr Lam provided details of takings, either in the form of the diaries themselves or the exercise books compiled using figures derived from them, together with purchase invoices and a list of other expenses incurred, to Fiddaman & Co each quarter, and they used the raw data to prepare accounts, VAT and income tax returns and to operate PAYE. There is no suggestion that Fiddaman & Co did not do an accurate job based on the information supplied to them.

51. Although Fiddaman & Co prepared the partnership accounts for the year to 30 September 2006 Mr Fiddaman then retired and the 2006-07 tax return was filed by the successor practice, Wilkins Kennedy. The accounts show a profit of £39,286 and drawings of £36,244. The returned taxable profit after adjustments primarily for depreciation and capital allowances was £40,674.

*Cash drawings*

52. It is clear that the bookkeeping system employed at the time did not include any record of cash drawings, and that these cannot therefore have been included in the handwritten workings produced by Fiddaman & Co and referred to at [50] above. It is also clear that cash drawings were made from the business, by taking cash from the tin. This is confirmed by the notes of the December 2009 meeting and is also consistent with the approach taken in preparing the accounts, the workings for which show a balancing figure on the cash account treated as drawings. Little or no cash was drawn from private accounts and we infer that Mr and Mrs Lam funded their personal cash requirements by using cash takings in the business. We do not accept Mr Lam's evidence in cross examination that money was never taken from the tin.

53. The appellants' documentary evidence for the hearing included copies of schedules of drawings and "cash in hand" which were prepared by Fiddaman & Co using the software programme they employed to compile the annual accounts for the years to 30 September 2006 and 30 September 2005. None of these had been seen by Mr Corbett during the enquiry. The individual entries were not explained in detail but our understanding of the "cash in hand" schedule is that it was in effect a takings reconciliation. Apart from small opening and closing balances the entries showed recorded takings (in cash or otherwise) and compared that figure with the total of known cash expenditure and takings recorded as banked. The difference, which was £14,937.28 for the year to 30 September 2006 and £18,240.16 for the year to 30 September 2005, was treated by the accountants as cash drawings, on the basis that it reflected recorded takings that were neither banked (as cash or because originally paid by cheque or card) nor attributable to known cash expenditure. This is also consistent with correspondence from Wilkins Kennedy during the enquiry which explained that the approach taken in preparing the accounts was to treat the difference between cash banked and the takings figure as cash drawings.

54. The schedule of drawings for the year to 30 September 2006 picks up the same number: as well as reflecting amounts paid to personal bank accounts and some element of goods for own use, the £14,937.28 is included in the schedule as what must have been assumed by the accountants to be cash drawings. The approach for

the year to 30 September 2005 appears to be similar. In other words, the accounts did recognise a material amount in respect of unrecorded cash drawings.

*The Bank of East Asia accounts*

55. The information available for the Bank of East Asia London branch accounts shows three cash deposits of £5,000 each in the year to 30 September 2006. Mr Lam's evidence was that the first of these deposits, made on 28 November 2005, related to the previous financial year. The other two deposits were on 2 April and 31 July 2006. Mr Lam's witness statement also suggested that the April deposit included some cash from the preceding year, but without indicating how much. We could also see other deposits of varying amounts of up to £5,000 at other times before and after the year to 30 September 2006. The deposits for the following year, to 30 September 2007, comprised £5,000 into a fixed term deposit account on 12 February 2007, and another two amounts of £5,000 each to the main savings account on 2 April and 16 July 2007. The deposits for the preceding year totalled £8,000, being £5,000 on 1 November 2004 and £3,000 on 16 February 2005.

56. Mr and Mrs Lam have not always been consistent in their explanations of the source of funds for the Bank of East Asia London branch accounts. When first disclosed at the December 2009 meeting it was suggested that some money belonging to or given by Mr Lam's father was banked there, and this explanation was repeated in correspondence from Wilkins Kennedy in March 2010. However, it was subsequently confirmed at the November 2010 meeting and in correspondence from Mr and Mrs Lam in 2013, and we find, that all deposits in the account related to cash drawings from the business.

57. Clearly no information was available about any account at the Hong Kong branch. There was no reference to it in Mr Lam's witness statement and at the hearing Mr Lam denied any knowledge of such an account, as he had done at the May and October 2013 FTT hearings and in correspondence in 2012 and 2013. When asked why he was prepared to incur over £20,000 penalties in those circumstances, rather than authorise the bank to provide confirmation of the position, he denied any knowledge of the penalties.

58. We do not find Mr Lam's evidence to be credible on this issue. His denial of knowledge of the penalties certainly cannot be accepted given the history of the case, and that alone casts significant doubt on the credibility of his claim that no account existed. We accept Mr Corbett's evidence that the existence of a joint account at the Hong Kong branch of the Bank of East Asia was disclosed at the third meeting in November 2010. The notes of the November 2010 meeting, attended both by an (independent) interpreter and by Mr Jefferson of Wilkins Kennedy, are clear and specific on the subject of the account's existence, stating that the passbook was in Hong Kong, discussing difficulties in obtaining it and suggesting that some of the funds held in it belonged to Mr Lam's father's and were intended for repairs to the premises, which the father still owned. Mr Corbett's evidence was also clear on the point, both at the hearing of this appeal and at the May and October 2013 FTT hearings. We think it unlikely that there would have been any real misunderstanding

about the existence of the account among all the attendees at the November 2010 meeting. A copy of the meeting notes was also sent to Wilkins Kennedy two days after the meeting with a cover letter that referred again to the Hong Kong account. In the unlikely event that there had been a misunderstanding it would be very surprising for steps not to have been taken to correct it at that point. We also think it very unlikely, if the account had not existed, that this issue would not have been raised at or before the first FTT hearing in October 2011. Instead a number of other arguments were raised, including that the information was not reasonably required for checking the 2006-07 return.

59. Mr and Mrs Lam have had plenty of opportunities to demonstrate that no account existed had that in fact been the case. They could have supplied a mandate authorising the bank to supply information or they could have obtained some form of confirmation from the bank that they held no such account. They chose to do neither and instead incurred significant penalties.

60. We have concluded, as the FTT did at the October 2013 hearing, that Mr and Mrs Lam did have a joint account at the Hong Kong branch of the Bank of East Asia at the relevant times.

*HMRC's enquiry*

61. Mr Corbett's initial enquiries at and following the first meeting had indicated to him that recorded takings may not have been accurate. All recorded takings were in round pounds ending in a 5 or 0, a banking of £2,375 had been omitted from the cash book in June 2006 and a sample cash flow test for March 2006 indicated to Mr Corbett that there was negative cash (meaning that there appeared to be greater expenditure or drawings than apparently available cash). Wilkins Kennedy tested the same period and agreed that the result was negative, but a similar test carried out by them for June 2006 suggested positive cash. However, this did not take account of the unrecorded banking, the effect of which was also to mean that there was a negative figure in Mr Corbett's view. A review of personal bank accounts also suggested to Mr Corbett that little or no cash was being drawn.

62. No interpreter was present at the first meeting but Mr Corbett arranged for an independent interpreter to be present at subsequent meetings. We accept Mr Corbett's evidence that at the second meeting in November 2009 it was established that takings were indeed rounded, that cash drawings were not recorded and that the partnership return was therefore incorrect. This is reflected in the notes of meeting and was not challenged in cross examination, although the notes were disputed in correspondence in 2012. It was also at this meeting that it was disclosed that there was an account at the London branch of the Bank of East Asia. As already discussed, the existence of an account at the Hong Kong branch was disclosed at the third meeting in November 2010.

63. When it became clear that, despite significant penalties, Mr and Mrs Lam were not going to disclose details of any Hong Kong account, Mr Corbett concluded in discussion with colleagues that he would need to close the enquiry using a "best

judgment approach". It was clear that no additional information would be forthcoming and Mr and Mrs Lam had refused to provide any further co-operation.

*HMRC's approach- the closure notice*

64. Mr Corbett explained in evidence that the normal approach taken on this kind of enquiry where records were found not to be robust involved completing a review of personal financial information before moving on to the detail of how the business operated and how it benchmarked against other businesses. We accept that this was Mr Corbett's understanding of the normal procedure. This final step of looking at the business in detail had not been undertaken here: Mr Corbett did not consider the underlying business records beyond those viewed at the initial meeting and did not see the accountants' working papers. He also did not consider matters such as menu prices, opening hours, customer numbers or other factors such as employees or Mr Lam's health.

65. Mr Corbett explained that the normal order of events under which personal financial information is reviewed first is based on a view that HMRC would not be able sustain a position on the basis of business economics alone, and so needed to complete a review of the personal financial position of the partners first. The effect in this case was that the final step was not considered and no attempt was made at benchmarking, because the prior step had not been completed.

66. The way in which Mr Corbett arrived at the additional profits of £67,981 was explained in a letter from Mr Corbett to Mr Feng dated 27 January 2015. The substantive section of the letter reads as follows:

> "Thank you for your letter dated 9 January 2015 concerning the closure of this enquiry and how the figures for each of the years 2000/01 to 2007/08 have been arrived at. Rather than respond to your letter point by point I feel it would be easier if I gave you an overview of the position as I see it.
>
> At a meeting held on 21 December 2009 with your clients and their previous agent I discussed record keeping in respect of their business Sunlight Takeaway Meals they confirmed to me that the way in which they had kept their business records had been the same for all years of trading since they took over the business from Mr Lam's father. They also accepted that they had been at the very least careless in their record keeping as takings had been rounded and did not represent the total of the meal tickets issued.
>
> Furthermore it was demonstrated that following a cashflow test on the business records negative cash was achieved and your clients had failed to record bankings correctly. It was at this point that I extended my enquiry into the partner's personal returns and asked to see all private bank, building society and savings accounts held in their own names or in joint names with others. A review of these accounts showed that little or no cash had been drawn. In later discussions with your clients' they told me that they did not record cash taken from the business for themselves.

Your clients also then disclosed at interview that they held accounts with the bank of East Asia London branch and they also stated that they held an account with the same bank but at the Hong Kong branch, the passbook being with Mr Lam's father in Hong Kong.

The London accounts showed cash lodgements which were said to be the unrecorded cash taken from the business along with transfers to other accounts. I have not seen the statements in respect of the Hong Kong account as your clients have failed to provide them despite being directed to by the First Tier Tribunals.

Your clients have incurred substantial penalties for not providing these statements and from an HMRC perspective the case cannot drag on and needs to be brought to a head and closed.

The HMRC position is this.

Your client's 2007/08 partnership return is incorrect, an offence under S95 TMA 1970. The record keeping was the same for all earlier years trading and there is a presumption of continuity (Jonas v Bamford) by HMRC for these earlier years.

I have discovered that not all income has been returned S29 TMA 1970. Also, your clients have not provided the documents that would allow an accurate assessment of omissions so best judgement has to be used S29 TMA 1970.

You ask how the figures have been arrived at. I have taken the actual lodgements into the London account for the years 2001 to 2008. I have assumed lodgements of £50k into the Hong Kong account for 2008 and used the Retail Price Index (RPI) to scale these back to 2001. I have also assumed that not all cash would have been banked and have added back a further £100 per week to represent this for 2008 and again using the RPI have scaled this back to 2001.

| Year | London a/c £'s | Hong Kong a/c £'s | Cash £'s | Total £'s |
|---|---|---|---|---|
| 2007/08 | 12,000 | 50,000 | 5,200 | 67,200 |
| 2006/07 | 15,000 | 47,990 | 4,991 | 67,981 |
| 2005/06 | 15,000 | 45,911 | 4,774 | 65,682 |
| 2004/05 | 8,000 | 44,766 | 4,655 | 57,421 |
| 2003/04 | 11,700 | 43,387 | 4,512 | 59,599 |
| 2002/03 | 12,000 | 42,336 | 4,402 | 58,738 |
| 2001/02 | 3,000 | 41,051 | 4,269 | 48,320 |
| 2000/01 | 21,200 | 40,443 | 4,206 | 65,849 |

The totals were then split 50/50 between the partners and will be assessed.

I will be issuing the closure notices and discovery assessments along with penalty determinations shortly. No doubt you will let me have your appeals in due course."

67. In summary, Mr Corbett concluded that there were insufficient recorded drawings to meet the partners' needs. He assumed an amount of additional cash drawings to take account of this. He also took account of actual deposits into the Bank of East Asia London branch account. The approach in relation to the Hong Kong account was different and was more rough and ready. Mr Corbett explained at the hearing that in the absence of any information about the account, and after discussion with colleagues, he had based his approach on the fact that Mr and Mrs Lam appeared willing to incur penalties in excess of £20,000 rather than provide details of the account. At a 40% tax rate this suggested to Mr Corbett that there was a minimum of £50,000 taxable profit at stake.

68. As can be seen from the letter, Mr Corbett used 2007-08 as his starting point and scaled back the £100 per week and £50,000 amounts using RPI. This is the reason why the additional profits reflected in the closure notice reflect slightly lower amounts for these items, together with £15,000 lodged in the London branch account. As previously mentioned, despite the letter indicating that each of the tax years between 2000 and 2008 would be the subject of a discovery assessment or closure notice we are aware of none being issued apart from the closure notice for 2006-07 which is the subject of this appeal.

69. We do not entirely follow Mr Corbett's calculations of the amounts deposited into the Bank of East Asia London branch account. We suspect that he has used the amounts deposited in each tax year rather than the amount deposited in the financial year in question, and has also double counted one entry for 28 November 2005 which appears twice on the printed statements. As it happens these points make no difference to the total of £15,000 for 2006-07 but they do make a difference for other years. We have not reviewed the position for all years, but our review of the bank statements for the years 2004-05, 2005-06 and 2007-08 inclusive on a financial year basis indicates totals of £11,000, £8,000 and £15,000 respectively.

70. For completeness we should also mention that the 27 January 2015 letter followed on from earlier correspondence which included letters to each of Mr and Mrs Lam dated 17 December 2014 in which Mr Corbett set out, by way of information, precise details of the additional tax claimed to be due from each of them for the relevant years as a result of the enquiry. Although we do not think that this is particularly relevant and we have not relied on it in reaching any of our conclusions we have included it in our findings bearing in mind Mr Feng's submissions about the alleged defects in the closure notice process.

71. A final point to make clear is that HMRC have not made an allegation of fraud either during the enquiry or at the hearing, although the issue of carelessness was raised during the enquiry. The questions raised for decision at this hearing do not require us to make a finding on either point. However, Mr Feng relied on the absence of any allegation of fraud as supporting his clients' position that profits were correctly recorded.

**Submissions on the level of profit**

72. Mr Feng's submissions can be summarised as follows:

(1) HMRC could not rely on the presumption of continuity: no enquiries or discovery assessment had been made in respect of 2007-08, Mr Corbett had viewed no records for that year and no evidence was available in respect of it. It was inappropriate to use 2007-08 as a base year and scale back to arrive at numbers for 2006-07. The letter of 27 January 2015 set out HMRC's view of the matter and the Tribunal's role was limited to deciding the correctness of that approach.

(2) Mr Corbett had not conducted any detailed enquiry into the business and its operation. If he had he would have concluded that the nature of the business, including the number of employees it had, the (modest) menu prices, the opening and busiest hours, the size of the gas bills and the impact of Mr Lam's health issues, meant that the business could not generate the profit claimed. To generate an additional profit of £67,981 an additional 20,917 items at an average price of £3.25 would need to be sold, or 69 per day. If each dish took 10 minutes to prepare this would require an additional 3,486 hours, which was more than the annual opening hours which Mr Lam took to be 38 hours a week for 50 weeks, a total of 1,900 hours. The level of stock purchases and gas bills would also not support these figures. The reported profit was correct.

(3) HMRC were not alleging fraud. HMRC also did not challenge substantial parts of Mr Lam's evidence.

73. Mr Goulding for HMRC submitted as follows:

(1) HMRC was entitled to enquire into the 2007-08 return under the discovery rules. In any event its conclusions in respect of 2006-07 were based on its review of records and findings for that year. It used 2007-08 as the base year for RPI purposes as it was the latest year under enquiry, but its findings in respect of the Bank of East Asia London branch account in fact related to 2006-07. A presumption of continuity was also appropriate given Mr Lam's confirmation at the meeting in December 2009 that the business and record keeping had not changed.

(2) The evidence demonstrated that accurate records were not kept, negative cash flow had been shown and there were unrecorded cash drawings. Details of the Hong Kong account had not been disclosed despite significant penalties. Mr Lam's evidence was challenged insofar as it was relevant to HMRC's conclusions. The onus of proof was on the appellants and they had not discharged it.

**Discussion**

74. We need to decide whether the appellants have demonstrated, on a balance of probability, that the profits for 2006-07 as increased by the closure notice were excessive. If they have demonstrated that then we need to decide what the amount of

the reduction should be. We are not limited to considering the correctness or otherwise of HMRC's reasoning: it is not the case that a flaw in that reasoning means that we must allow the appeal. We disagree with Mr Feng that we are in some way restricted to a consideration of the reasoning set out in the 27 January 2015 letter: the question we need to decide is whether the amended profits were excessive. The scope of the appeal is defined by the closure notice, which as already discussed concluded that profits were understated in the amount indicated. That is the subject matter of the appeal.

*Presumption of continuity*

75. In this case we do think there were flaws in the approach taken by Mr Corbett as set out in his letter dated 27 January 2015. The reference to a presumption of continuity applying by reference to 2007-08 was in our view inappropriate. There was no basis to use 2007-08 as the starting point when it had not been the focus of the enquiry. Mr Corbett's investigation of the business related to 2006-07 and he did not consider any business records for other years. Although his letter of 23 March 2010 referred to extending his enquiries under the discovery provisions, those rules do not provide for any formal enquiry process in the way seemingly suggested in Mr Goulding's submissions, and more importantly the actual enquiries after that time appear to us to have related solely to Mr and Mrs Lam's personal financial positions, their bank accounts and cash positions. If, having investigated the business for 2006-07, HMRC then sought to extrapolate from that year to other years on the basis that the business had been carried on in the same manner, then the question of presumption of continuity might have been relevant to those other years. But that is not the situation here: we are concerned solely with 2006-07.

76. We therefore do not think that any question about a presumption of continuity is relevant to 2006-07, and so it is not necessary to consider cases that discuss it in any detail. However, we should mention some of them briefly. HMRC relied on *Jonas v Bamford* [1973] STC 519. In that case Walton J said at page 540:

> "… once the Inspector comes to the conclusion that, on the facts which he has discovered, the taxpayer has additional income beyond that which he has so far declared to the Inspector, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer."

That related in a situation where HMRC had made out its case for earlier years, which is not the position here in relation to 2007-08.

77. A number of First-tier Tribunal cases have made the point that the presumption referred to by Walton J is not a principle of law, but a rebuttable presumption of fact: see in particular *Dr I Syed v HMRC* [2011] UKFTT 315 (TC) at [38]. Mr Feng relied in particular on *Easinghall v HMRC* [2016] UKUT 0105 (TC). However, we do not consider that case to be of particular assistance. The point in dispute there was whether HMRC could open an enquiry in circumstances where a discovery assessment had been made in respect of the same matter in reliance on the

presumption of continuity, but had been cancelled on a review which found that there was insufficient evidence to support the view that there had been an understatement of takings. The discussion in that case does not consider the use of the presumption of continuity in any detail but instead discusses whether HMRC was procedurally bound by the cancellation of the discovery assessment. Rose J found that the subject matter of the agreement deemed to arise from the review process was that there was no understatement, and that point could not be reopened. (The case also does not assist Mr Feng's argument that we are in some way restricted by the 27 January letter: there is nothing in *Easinghall* that casts doubt on our conclusion that the subject matter of the appeal is whether the amended profits were overstated.)

*Cash spend and the London branch account*

78. Although we do not consider that any presumption of continuity is in point for 2006-07 we do agree with Mr Goulding that the approach set out in the 27 January letter was in fact informed by the conclusions of Mr Corbett's enquiry into 2006-07. Mr Corbett relied on an assumed cash spend of £100 per week based on his investigation of the records relevant for 2006-07 and his analysis of Mr and Mrs Lam's affairs. In fact, by applying that number to 2007-08 and scaling back from that year the effect was to include a slightly lower amount in the closure notice than his own reasoning might have suggested. The figures for the Bank of East Asia London branch deposits were the actual numbers for the year (both on a tax year and financial year basis), so no issue arises there as regards any presumption of continuity. The position in relation to the Hong Kong branch account is discussed below.

79. Having considered all the evidence carefully, we have concluded that the appellants have established that the amended partnership profit figure is excessive insofar as the adjustments relate to assumed cash spend and the London branch deposits. In our view the accounts and supporting working papers, which were not reviewed by Mr Corbett during the enquiry, clearly reflect unrecorded cash drawings in the profits made, in an amount of £14,937.28. No explanation was available as to how this could be reconciled with Mr Corbett's calculations suggesting negative cash for certain periods, but the accountants' working papers are clear. Accordingly, Mr Corbett's assumption that the returned profits reflected little or nothing for cash taken out of the business was incorrect. On that basis adding both £15,000 for Bank of East Asia London branch deposits and a further £4,991 for other cash spend, a total of £19,991, cannot be justified.

80. We have considered Mr Lam's evidence that part of the £15,000 reflected profits for the prior year. However, he has neither been specific as to the amount beyond the first £5,000 nor given evidence as to whether the pattern repeated for later years, such that one or more deposits made after 30 September 2006 also reflected drawings for that year. We consider it more likely than not that if Mr Lam did make deposits after the 30 September 2005 year end which reflected prior year performance then this pattern was repeated in the following year. In the circumstances, and bearing in mind our finding that £15,000 was also deposited in the following financial year ended 20 September 2007, we do not think that any specific adjustment is appropriate to reflect this point.

81. In our view it was appropriate for Mr Corbett to assume that some cash would be required by Mr and Mrs Lam for their personal needs, in addition to the amounts deposited at the Bank of East Asia London branch. We consider that the appellants have not shown that Mr Corbett's approach of assuming that they took just under £100 per week for personal cash requirements was wrong. No evidence was provided by the appellants of what their cash needs were or how they were met. In the absence of any evidence on these points or any suggestion that the cash requirements were funded from any source apart from the business, we have concluded that Mr Corbett's approach on this issue was reasonable.

82. Taking these points together we think that Mr Corbett's approach of adding £19,991 to reflect cash spend and the Bank of East Asia London branch deposits made is in principle a reasonable one, but that the amount needs to be adjusted by deducting the cash takings and drawings that the appellants have demonstrated were reflected in the reported profits, namely £14,937.28. This results in a net addition of £5,053 to the reported profit on a rounded down basis.

*The Hong Kong account*

83. The position in relation to the Hong Kong branch account is different. We have found that the account existed and we have not accepted Mr Lam's evidence in respect of it. Mr and Mrs Lam should either have complied with the relevant Schedule 36 notices or produced evidence, which would have been straightforward to do if they were prepared to cooperate, to support the assertion that no account existed. They did neither. Mr Lam's witness statement made no mention of the existence or otherwise of the account and Mr Lam not only denied its existence in cross examination but claimed to deny knowledge of the penalties charged. Instead the evidence in chief Mr Lam gave was restricted to limited points about menu prices, busiest hours, employees, gas bills and Mr Lam's health. We have been unable to derive sufficient support from these points to find, as the appellants argued, that there were no unrecorded business takings, or to find that no such takings were deposited in any Hong Kong account.

84. Mr Lam's evidence left us with no real understanding of the scale of turnover, the size of the premises, the level of custom (for example, an average number of customers per hour at different periods) or the degree to which Mr and Mrs Lam worked personally in the business in addition to the two employees, but we do not consider it unreasonable in the circumstances to deduce that both Mr and Mrs Lam spent considerable periods working in the business and that the relatively low menu prices were intended to attract a significant number of customers. A rapid turnover would also be likely given that no deliveries were undertaken and all meals were sold on a takeaway basis. Those features would also limit overheads. Although Mr Feng's written submissions asserted that Mr Lam gave oral evidence that each dish took five to ten minutes to prepare we do not recall this point being made and it is not reflected in our notes. We also find it unlikely to be correct for the most popular dishes, which we would have expected to be prepared in larger batches. We are therefore doubtful about Mr Feng's suggested calculations (see [72] above) and do not find them to be of particular assistance in the absence of clear information about how many individuals

worked at any particular time and how dishes were prepared. We have already indicated that we also did not find the level of gas bills to be of any real assistance in the absence of further evidence. And whilst we also accept that additional turnover would typically require additional stock purchases the appellants have adduced no evidence as to the cost of stock required for any particular level of sales.

85. In circumstances where the relevant HMRC officer has insufficient information to reach a clear conclusion about the correct amount of taxable profits, he or she has no choice other than to make an estimate. The onus is on the taxpayer to show on a balance of probability that the profits assessed are excessive. Otherwise the partnership statement must "stand good" under s 50(6) TMA. As Walton J said in *Johnson v Scott*, as approved by the Court of Appeal in that case at [1978] STC 476 at 484 to 485:

> "Indeed, it is quite impossible to see how the Crown, in cases of this kind, could do anything else but attempt to draw inferences. The true facts are known, presumably, if known at all, to one person only, the taxpayer himself. If once it is clear that he has not put before the tax authorities the full account of his income, as on the quite clear inferences of fact to be made in the present case he has not, what can then be done?"

86. In this case we have found that the appellants have shown that the revised profit was excessive insofar as it did not take account of unrecorded cash drawings reflected in the accounts. They have not otherwise demonstrated that HMRC's approach was incorrect. Where it is shown that the profit is excessive s 50(6) TMA requires the profit to be reduced "accordingly". The question arises as to whether the adjustment is limited to the amount the appellants have shown to be excessive (as a natural reading of the legislation might suggest), or whether in those circumstances we should effectively start afresh rather than follow HMRC's approach in relation to the Hong Kong account.

87. In *Rouf v HMRC* [2009] STC 1307 (a Court of Session case) Lord Osborne, delivering the judgment of the court, commented as follows on s 50(6) TMA at [29]:

> "In understanding the effect of those provisions, in our opinion, it is helpful to recall the observations made by Lord Hanworth MR in *T Haythornthwaite & Sons Ltd v Kelly (Inspector of Taxes)* (1927) 11 TC 657 at 667. There he said:
>
> 'Now it is to be remembered that under the law as it stands the duty of the Commissioners who hear the appeal is this: Parties are entitled to produce any lawful evidence, and if on appeal it appears to the majority of the Commissioners by examination of the Appellant on oath or affirmation, or by other lawful evidence, that the Appellant is over-charged by any assessment, the Commissioners shall abate or reduce the assessment accordingly; but otherwise every such assessment or surcharge shall stand good. Hence it is quite plain that the Commissioners are to hold the assessment standing good unless the subject- the Appellant- establishes before the Commissioners, by

> evidence satisfactory to them, that the assessment ought to be reduced or set aside.'
>
> Thus the general onus to show an overcharge lay upon the appellant. If the appellant had succeeded in showing that he had been over-charged, then it would have been the responsibility of the commissioners to make their own judgment, upon the evidence before them, as to the proper level of the assessment, to which the assessments would have required to have been reduced accordingly. As was recognised by Walton J in *Bookey v Edwards (Inspector of Taxes)* [1982] STC 135n at 139, 55 TC 486 at 491, that might have required commissioners to make the best estimate that they could in the face of an unsatisfactory evidential position. However, before the commissioners in this case came under an obligation to make the best judgment that they could of the appellant's liability, on the basis of the evidence, plainly they had to be satisfied that the appellant had been overcharged in the assessments made."

88. Although on the facts of this case we think that a case could be made out for limiting the adjustment to the particular amount that the appellants have shown to be excessive, we propose to follow the guidance in *Rouf* and make the best estimate we can of the correct amount of the profits. This does not prevent us from following HMRC's approach if we think that it represents the best judgment available.

89. On the facts available we are not persuaded that there is any alternative approach to HMRC's that should be preferred. The inclusion of additional profit in respect of deposits in the Hong Kong branch account appears justified and we are not persuaded that the amount included, £47,990, should be reduced. This case is very different to, for example, *Newell and Newell v HMRC* [2013] UKFTT 742 (TC) which was relied on by Mr Feng: in that case the Tribunal was able to find that HMRC's adjustment to the profits of a takeaway should be cancelled entirely, but they did so with the benefit of clear and detailed evidence from the partners, whose evidence was accepted in full, about exactly how the business was run.

90. In the absence of any evidence about the scale of deposits into the Hong Kong account we do not think that it is an unreasonable approach to use the amount of the penalties as a starting point to estimate the tax lost, and work back from that to a figure of £50,000 of additional profit. As already mentioned, the appellants have if anything slightly benefited from 2007-08 being used as the starting point, so that the amount included for 2006-07 figure is a scaled back number.

91. We have considered whether HMRC's approach in this case was flawed by a failure to undertake a full review of the business, as Mr Corbett described would normally be done after obtaining clarity about the partners' personal finances. We do not think that we can or should disregard HMRC's conclusions simply on that basis. Mr Corbett clearly considered that a detailed review of business economics would not provide a sufficiently clear basis to mount a case, and this was why personal finances were considered in priority. In any event the appellants withdrew their cooperation so any detailed review would have been difficult.

92. Our own rough and ready calculations do not demonstrate that the additional profit claimed by HMRC, after adjustment for the drawings already accounted for, is wholly unrealistic. The reported sales were £124,025. At an average of say £12 per order and operating for 44 hours a week for (say) 50 weeks a year, this would suggest an overall average of 4.7 customers per hour. If additional sales of £53,043 are added (comprising £5,053 plus £47,990) then the average number of customers rises to 6.7. Admittedly this is without any addition to cost of sales, but the scale of the addition is not obviously unrealistic.

93. We should make it very clear that we are reaching a conclusion in respect of 2006-07 and not in respect of any other year. The penalties imposed related to Schedule 36 notices issued in respect of that year, but the period for which information was requested ran from 1 October 2000 to 30 September 2008, that is eight years. Mr Corbett's logic of comparing the penalties with tax lost would appear to break down when applied to other years since the aggregate tax assumed lost would then be a multiple of the penalties.

94. We have considered carefully whether this point should affect our decision in relation to 2006-07 and have concluded that it should not. We think it is a matter that should be considered if and when discovery assessments are made in respect of any of the other years in question. At this stage we have no means of determining which (if any) other years will be the subject of the discovery procedure, and if so in respect of what amounts, and so we do not think that there is any rational basis to reduce the amount reflected in the 2006-07 closure notice. We accept that HMRCs approach is reasonable in the circumstances and the appellants have not discharged the burden of proof to displace this.

*Did HMRC fail to challenge evidence?*

95. As a final point we should address Mr Feng's submissions that HMRC did not challenge significant parts of Mr Lam's evidence. These related in particular to what Mr Lam's witness statement said about menus, prices, busiest hours, the customers being local residents, gas bills, the fact that HMRC had not alleged fraud (which, Mr Lam said, vindicated his position), the amounts of net sales for the relevant VAT quarters and year to 30 September 2006, the amounts of cash drawings said to be made, Mr Lam's alcohol problem and the amount of profit.

96. We have no doubt that HMRC did successfully challenge Mr Lam's evidence so far as relevant to our conclusions. It does not follow from the fact that no allegation of fraud was made that the reported profits were correct, and HMRC were right to point out in cross examination that the absence of a fraud allegation does not mean that the appellants are vindicated. HMRC did not challenge evidence in relation to menus, prices, busiest hours, the customers being local residents and gas bills because it was not relevant to the basis on which they put their case. We have accepted that evidence so far as it goes, but as already discussed it is in our view insufficient for the appellants to prove their case. HMRC did not challenge Mr Lam's statement about his alcoholism, but we have made our own findings in relation to Mr Lam's health issues

at the relevant time based on the documentary evidence provided and their relevance to the appeal.

97. It is clear that Mr Goulding did challenge Mr Lam's evidence about the correctness of the reported profits, whether cash was taken from the tin and in relation to the manner of bookkeeping generally.

**Disposition**

98. We allow the appeal in part, by reducing the partnership profit from £108,654, the amount stated in the closure notice, to £93,716. This represents the reported profits of £40,673, with the addition of £5,053 in respect of cash spend and deposits in the Bank of East Asia London branch account (after allowing for unrecorded cash drawings already taken into account in the reported numbers), and the addition of £47,990 in respect of additional unreported profits assumed to be deposited in the Hong Kong branch accounts.

99. 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.

**SARAH FALK**

**TRIBUNAL JUDGE**
**RELEASE DATE: 23 SEPTEMBER 2016**