

Help yourself!

Mark McLaughlin warns that if taxpayers don't keep full and accurate records, HMRC could help themselves to additional tax that would not otherwise be due

Owners of cash-based businesses (e.g. market traders, hairdressers, etc) are a regular target for an HMRC enquiry. Some might say that such businesses are a 'soft' target for HMRC, on the basis that it is easier for the proprietors to 'pocket' takings instead of declaring them.

A likely story...

It must be said that some taxpayers do little to help their cause if they retain insufficient documentary evidence to prove their tax position.

HMRC cites (in its Enquiry manual at EM2104) *Kilburn v Bedford Ch D 1955, 36 TTC 262*. In that case, HMRC assessed a hairdresser for additional profits, whereas the taxpayer contended that the increases in his wealth were derived from betting winnings. The High Court upheld HMRC's assessment, commenting (Harman J): "He alleged that these were betting winnings. It was for him to prove that but he really made no serious attempt to do so..."

Of course, in the context of cash-based businesses the proprietors are not necessarily any less honest than owners of other businesses. Unfortunately, some business owners leave themselves open to challenge by HMRC; many of them keep inadequate records despite being required to do so by law.

There is a statutory record keeping requirement for persons carrying on a trade, profession or business. Taxpayers engaged in a property letting business are treated as carrying on a trade for these purposes (TMA 1970, s 12B(6)). The records to be kept and preserved broadly include the following (TMA 1970, s 12B(3)):

Records of all receipts and expenditure, "and the matters in respect of which the receipts and expenditure take place".

Records of all sales and purchases of goods in the course of the trade (for trades involving dealing in goods).

Further information about record-keeping for self-employed individuals can be found on the Gov.uk website (www.gov.uk/self-employed-records).

The statutory business records of a self-employed individual are generally required to be maintained for at least five years after 31 January following the end of the relevant tax year. Taxpayers who fail to comply with their statutory record keeping obligations potentially face a penalty of up to £3,000. This penalty can apply to each tax year of default (s 12B(2), (5)).

It ain't necessarily so...

Poor record keeping alone is insufficient reason for HMRC to challenge them on the basis that business income has been understated in the owner's accounts and tax returns. HMRC must demonstrate that the records are inaccurate as well.

This point is acknowledged in HMRC's own guidance (at EM2795): "The credibility of the return and the supporting accounts can be challenged by showing that the books and records upon which they are based are inaccurate and incomplete. *It is not enough to simply show that the accounts are unreliable*" (emphasis added).

Cash is king

Taxpayers who have declared all their business income should not be afraid to challenge attempts by HMRC to estimate increases in turnover and profits for tax purposes simply because HMRC considers that they ought to be higher.

Some taxpayers have successfully challenged such assertions by HMRC. For example, in *Newell & Anor (t/a Tanya's Takeaway) v Commissioners for Revenue and Customs [2013] UKFTT 742 (TC)*, the taxpayers were partners in a takeaway business. Following an enquiry into the partnership's 2006/07 tax return, HMRC increased the partnership profits for the tax year of enquiry, plus the following four tax years up to and including 2010/11. Penalties were added. The partners appealed. HMRC contended that the business records were 'broken' and that the profits declared were unreliable. The taxpayers argued that it was impossible for their small takeaway business to have generated the extra profits assessed by HMRC.

Fortunately, the First-tier Tribunal (FTT) agreed with the taxpayers and concluded that their reported profits did not require any amendment.

Best judgment?

If HMRC considers that business turnover has been understated, it may seek to make tax return amendments or raise discovery assessments, possibly based on a business economics exercise. The initial onus is on HMRC to identify the quantum of the assessment accurately. However, if the records are incomplete and unreliable, this task may prove difficult. In those circumstances, HMRC instructs its staff as follows: "However, there will be times when it is not possible to identify the quantum accurately. If this happens the officer can use their best judgment to determine the amount of tax due and issue the assessment" (EM3251).

An assessment (including an amended assessment) will 'stand good' unless the taxpayer establishes that it is wrong (TMA 1970, s 50(6)). On an appeal against a discovery assessment to the tribunal, the onus is therefore generally on the taxpayer to prove that the assessment is inaccurate. However, in *Cussens v Revenue and Customs* [2019] UKFTT 543 (TC), the FTT reminded HMRC that it must bear the onus of establishing that the discovery assessments were made on a reasonable basis in the first place.

Where HMRC successfully jump that hurdle, case law has established that the onus is then on the taxpayer not only to assert that an assessment is incorrect, but also to provide evidence to support the amounts being put forward as more accurate assessments (e.g. see *Haythornthwaite & Sons Ltd v Kelly* (1926-27) 11 TC 657 and *Nicholson v Morris* [1977] STC 162). These requirements can seem onerous. Nevertheless, taxpayers (and their advisers) should be prepared to challenge HMRC's figures if they seem unrealistic or excessive.

Too high

For example, in *Turner v Revenue and Customs* [2020] UKFTT 512 (TC), the taxpayer was a self-employed taxi driver. He failed to submit self-assessment returns for the tax years 2009/10, 2010/11 and 2011/12. HMRC opened an investigation into his tax affairs. Subsequently, discovery assessments were issued in October 2014. HMRC assessed the taxpayer's profit (i.e. 2009/10 at £23,696; 2010/11 at £26,513; and 2011/12 at 20,721). The taxpayer submitted tax returns for 2007/08 to 2015/16 between July and September 2016. However, HMRC considered that the returns did not displace the discovery assessments. The taxpayer appealed.

The taxpayer had needed help preparing his returns. He met with someone from an HMRC support unit ('NES') with his records. A lady from HMRC's NES unit completed his tax returns. She accepted some of the taxpayer's figures but rejected others. She also estimated the taxpayer's outgoings. The FTT noted that the 37% figure used by HMRC was far too low, based on the taxpayer's circumstances. The FTT took the view that, notwithstanding the taxpayer's failure to supply evidence at the hearing, it was likely that he provided more comprehensive evidence to the lady from HMRC's NES unit in 2016, and she would have tested the information provided rather than accepting it at face value. The FTT concluded that the discovery assessments were valid, but that the taxpayer's taxable profits were: £14,946 for 2009/10; £16,579 for 2010/11; and £7,458 for 2011/12. The taxpayer's appeal was allowed to that extent.

Prevention is better than cure!

While it may be possible to challenge HMRC assessments in respect of cash businesses and/or small businesses with incomplete records, the outcome of FTT hearings are often unpredictable, and it is by no means certain that the taxpayer's assertions will be accepted by the tribunal.

The importance of maintaining full and complete business records, and keeping them for at least the statutory retention period, should therefore not be underestimated.

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