TC01981

Appeal number:TC/11/05950

INCOME TAX – Taxes Management Act 1970, Section 12B - records to be kept for the purpose of returns – rental income, expenses from rental income and repairs in connection with a let property – whether sufficient records were kept and preserved – whether loss of tax brought about by carelessness – lack of evidence - Appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MRS SUSAN LARKIN **Appellant**

- and -

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

TRIBUNAL: W RUTHVEN GEMMELL WS, Judge
CHARLOTTE BARBOUR CA, CTA Member

Sitting in public at Edinburgh on 13 April 2012

Mrs Susan Larkin for the Appellant

Mrs Helen Durkin, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an Appeal by Mrs Susan Larkin ("SL") against assessments for the tax years 2000-2001, 2001-2002, 2002-2003, 2003-2004, a closure notice for the year ended 5 April 2005 (issued on 1 October 2010) and a penalty determination issued on 4 October 2010 issued by the Commissioners for HM Revenue and Customs ("HMRC") in respect of net rental income from 81 Huron Avenue, Howden, Livingston, West Lothian.

2. Concurrent with the dispute about net rental income there had been a dispute about Capital Gains Tax which had recently been accepted as payable at an amount of £70.

3. Inclusive of this amount of £70 for CGT, the total tax in dispute was £2067.38, in addition to which penalties were due of £520.25, making a total of £2,587.63.

4. SL disputed this figure and had offered, immediately prior to the hearing, to settle this liability for £1,200.

Facts

5. SL inherited the property at 81 Huron Avenue from her mother in July 2000.

6. SL decided to refurbish this property and then let it out which took place from December 2000.

7. Letting was arranged through a firm, Letting Solutions, who were instructed to find tenants for six month lets.

8. The rental from the lettings was to be paid direct to SL's bank account.

9. The properties were let from December 2000 until January 2004. Throughout this period, SL said she had tenants who did not stay for each six month tenancy with some staying for only four months. In addition, a number of the tenants badly treated the property which required renovation.

10. The property was refurbished after the last tenant left in January 2004 and was sold in May 2004.

11. The rental during the period was £450 per month.

12. In completing the tax return for the year ended 5 April 2005, when SL's agent was Paterson Accountancy of Uphall, Broxburn, West Lothian, the section relating to other property income was "deleted" and the words "ceased February 2004".

13. This alerted HMRC to the possibility that the property had been sold and, consequently, an enquiry took place, primarily with a view to ascertaining whether any tax was liable on the sale, which HMRC assumed had taken place.

14. The Tribunal noted that at one point, HMRC had calculated that there was an amount chargeable to Capital Gains Tax of £15,550, on the basis that HMRC would not accept that £25,000 had been expended on improving the property as no receipts or evidence had been put forward, but, in the interest of goodwill and compromise, had accepted an enhancement cost of £10,000 in the tax computation.

15. This was amended to allow for £11,000 of enhancement costs and a revised chargeable gain of £14,600 was accepted by SL and by her agent, Mrs Paterson.

16. SL then subsequently rescinded this agreement.

17. HMRC, following a review of the case, allowed a much higher base cost based on the District Valuer's estimate of the acquisition value of the property and a higher level of enhancement costs which resulted in a capital gain of £350 and a liability of £70 on which a penalty was charged at the rate of 30% resulting in a charge of a further £21.

18. This was agreed by both the parties.

19. HMRC concluded that SL had been negligent in submitting incorrect tax returns in relation to the rental income and, in addition, imposed penalties under Section 25 of the Taxes Management Act 1970 in relation to five incorrect tax returns from 2000-2001 to 2004-2005 whilst acknowledging that the omitted profits from rental income did not involve large amounts.

20. In relation to the amounts of rental income, SL signed, on 7 May 2010, a statement to HMRC which stated "the tax on the statement below is unpaid, wholly or in part, because of my failure to meet all my obligations under the Taxes Act". On the basis that no proceedings were taken against her for that tax or for the penalties, surcharge and interest on it, SL offered the sum of £4,175.

21. On 30 September 2010, HMRC reduced the penalty rate amount from 30% on the omitted rental income to 25%.

22. SL had taken out a loan on the property in 2002.

23. In the 2000-2001 assessment, the amount of rental income assessed by HMRC and declared by SL was the same. Finance costs of £1,082 were disallowed by HMRC as the loan was not created until 2002.

24. Similarly, a claim of £1,000 for capital allowances was disallowed, as capital allowances cannot be claimed against furnished lettings income.

25. In the 2001-2002 assessment, HMRC, in the absence of any evidence, assessed the income as being for 12 months and not ten months as declared by SL, disallowed finance costs of £2,164 and capital allowances of £750. The wear and tear allowance was increased from that submitted by SL being 10% of the revised higher rental income.

26. In the 2002-2003 return, HMRC allowed 11 months of rental income as opposed to ten months claimed by SL and disallowed SL's claim for finance charges of £2,164 once it had been clarified that this was a capital and interest mortgage and that this figure included capital payments substituting only the interest payments of £764. No capital allowances were allowed and the wear and tear allowance was increased to represent 10% of HMRC's assessment of the income.

27. In 2003-2004, HMRC agreed the ten month rental period because the return had stated that the tenancy ceased in February 2004 and as in the previous year, only the

interest element of the loan was allowed and the capital allowance claim was disallowed.

28. An independent review was requested and carried out by HMRC on 10 March 2011.

29. This in large part dealt with the Capital Gains Tax issue and considered a letter from the buyer of the property setting out a number of improvements which had been carried out to the property. HMRC were prepared to accept £11,000 allowable leaving a balance of £14,000 unrelieved but with a mind to settling the matter were prepared to split the difference and allow a further £7,000.

30. In SL's letter of 25 November 2010 requesting the appeal, SL stated that she felt Letting Solutions had erred in destroying any paperwork and noted that the paperwork kept by her was shredded after the sale of the property.

31. SL stated that rental payments would have been paid into her bank account and would prove that in the years 2001-2002 and 2002-2003, the rental incomes were only for ten months of each year rather than, respectively, 12 and 11, as assessed by HMRC. The difference, therefore, amounted to three months in the assessment of rental income between HMRC and SL. The Tribunal was not provided with any evidence of the bank statements.

32. As part of the review, therefore, the Capital Gains Tax for 2005 was assessed at £70, there was no change to the 2000-2001 and 2001-2002 assessments but there was a reduction in the assessments for tax years 2002-2003 and 2003-2004.

33. A penalty of 30% was assessed on the Capital Gains Tax liability and 25% on the rental liability.

Legislation

34. **The Taxes Management Act 1970 Section 12B**

Records to be kept for purposes of returns

[(1) Any person who may be required by a notice under section 8, 8A. . . or 12AA of this Act . . . to make and deliver a return for a year of assessment or other period shall—

(a) keep all such records as may be requisite for the purpose of enabling him to make and deliver a correct and complete return for the year or period; and

(b) preserve those records until the end of the relevant day, that is to say, the day mentioned in subsection (2) below or, where a return is required by a notice given on or before that day, whichever of that day and the following is the latest, namely—

(i) where enquiries into the return . . . are made by an officer of the Board, the day on which, by virtue of section [28A(1) or 28B(1)] of this Act, those enquiries are . . . completed; and

(ii) where no enquiries into the return . . . are so made, the day on which such an officer no longer has power to make such enquiries.]

(2) The day referred to in subsection (1) above is—

(a) in the case of a person carrying on a trade, profession or business alone or in partnership or a company, the fifth anniversary of the 31st January next following the year of assessment or (as the case may be) the sixth anniversary of the end of the period;

(b) [otherwise], the first anniversary of the 31st January next following the year of assessment ...

[or (in either case) such earlier day as may be specified in writing by the Commissioners for Her Majesty's Revenue and Customs (and different days may be specified for different cases)]

. . .

[(2A) Any person who—

(a) is required, by such a notice as is mentioned in subsection (1) above given at any time after the end of the day mentioned in subsection (2) above, to make and deliver a return for a year of assessment or other period; and

(b) has in his possession at that time any records which may be requisite for the purpose of enabling him to make and deliver a correct and complete return for the year or period,

shall preserve those records until the end of the relevant day, that is to say, the day which, if the notice had been given on or before the day mentioned in subsection (2) above, would have been the relevant day for the purposes of subsection (1) above.]

(3) In the case of a person carrying on a trade, profession or business alone or in partnership—

(a) the records required to be kept and preserved under subsection (1) [or (2A)] above shall include records of the following, namely—

(i) all amounts received and expended in the course of the trade, profession or business and the matters in respect of which the receipts and expenditure take place, and

(ii) in the case of a trade involving dealing in goods, all sales and purchases of goods made in the course of the trade; …

Cases referred to

Regina v General Commissioners of Income Tax (ex parte Knight) [1973] STC 564

Nicholson v Morris [1977] STC 162

Hurley v Taylor [1999] STC 1

SL's Submissions

35. SL states that the income for the tax years in question was returned correctly. Consequently, SL states that three months of income have been assessed to tax when they should not be.

36. SL states that she acknowledges that some tax is payable but does not accept the figure of £2,587.63 and, prior to the hearing, offered a settlement in the region of £1,200.

37. SL also made a number of submissions in relation to the inaccuracy of the assessments made previously by HMRC which HMRC had considerably reduced following correspondence between SL and HMRC.

38. SL says that "if they were wrong with that figure then they may be wrong with this figure".

39. SL states that the correct amount of income from the lettings should be disclosed in her bank statements and that HMRC were given a mandate to obtain these bank statements. No bank statements were produced at the hearing by either party.

40. SL says that as her figures are correct there should be no penalties due.

41. SL said she did everything she could to try and provide evidence including providing a mandate for HMRC to obtain paperwork from Letting Solutions.

42. SL said that the matter took up a great deal of her time and that as HMRC were so persistent that she was prepared to settle at different figures throughout the dispute.

HMRC's Submissions

43. HMRC says that the onus is on SL to provide evidence and to keep such records as may be required for the purpose of enabling her to make and deliver a correct and complete return each tax year, in accordance with Section 12B of the Taxes Management Act.

44. HMRC say, that based on the errors they found, SL was negligent in that she had not acted in a manner that any reasonable person would do and taken due care to submit complete and corrected self assessment tax returns when required to do so.

45. HMRC say that they have correctly applied the law in relation to the deductions from the rental income.

46. HMRC say that as a consequence of SL's negligent conduct, penalties are applicable under Section 95 of the Taxes Management Act.

47. HMRC say that SL was prepared to pay £4,000 when the tax liability was approximately £8,000 and, therefore, should be prepared to pay the current assessment.

48. HMRC say that the current offer of £1,200 indicates an attitude by SL to try and agree as low a figure as possible.

49. HMRC say that they have looked at the bank statements but they do not lead them to believe that their assessment of the rental income for the years from 2000 to 2004 inclusive are incorrect. In any event, HMRC say that the onus is on SL to provide evidence to refute the assessment.

50. HMRC say that this negligence is equivalent to carelessness; that records are scant; that no evidence has been produced for the enhancements; that there is no evidence to support rental income; that mortgage interest was claimed for two years prior to the loan even being in existence and that capital allowances are in any event not allowable as a charge against rental income, but yet were claimed by SL.

Reasons for the Decision

51. The Tribunal were, given the agreement of the parties on the Capital Gains Tax position, dealing only with the issue of rental income, rental expenses and penalties.

52. Throughout the dispute between HMRC and SL, it was clear that there was a greater onus on the issue of the Capital Gains Tax liability and so throughout there was less evidence of any kind in relation to the rental income and rental expenditure.

53. The Tribunal consider that SL had been unfortunate in her dealings with Letting Solutions and in destroying her own records to the extent that no evidence could be produced to evidence the level of income or any of the specific amounts of expenditure.

54. Although reference was made to a list of improvements, this related essentially to the Capital Gains Tax liability rather than to the Income Tax liability.

55. There was no evidence before the Tribunal to refute the assessments made by HMRC of rental income and the Tribunal noted that in the year 2002-2003, HMRC had not assumed a 12 month rental but only an 11 month rental.

56. HMRC had set the penalty levels at the lower end of the scale having reduced them from previous higher figures.

57. SL, as a result of there being no documentation, either retained by her or by Letting Solutions, was unable to provide records requisite for the purpose of enabling her to make and deliver a correct and complete return for the periods. This was contrary to the statutory provisions of Section 12B of the Taxes Management Act 1970. Accordingly, the Appeal is dismissed.

58. 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.

TRIBUNAL JUDGE

RELEASE DATE: 27 April 2012