[2019] UKFTT 0279 (TC)

TC07118

INCOME TAX – *loss deduction – profession - partnerships – whether entitled to carry forward* losses *against later profits – s 83 ITA 2007 – inaccuracy penalty – sch 24 FA 2007*

Appeal number: TC/2015/2384

FIRST-TIER TRIBUNAL

TAX CHAMBER

BETWEEN

Mr DOUGLAS SHANKS **Appellant**

-and-

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

TRIBUNAL: JUDGE PETER KEMPSTER

Sitting in public at Taylor House, London on 6 December 2018

Mr Bob Roberts for the Appellant

Ms Iona Stevenson (HMRC Solicitor's Office and Legal Services) for the Respondents

DECISION

Introduction

1. The Appellant ("**Mr Shanks**") appeals against closure notices for the tax years 2008-09 to 2010-11 issued on 14 March 2014 by the Respondents ("**HMRC**") and a consequent inaccuracy penalty. HMRC disallowed certain trading losses claimed by Mr Shanks.

2. The amounts of income tax charged by the disputed closure notices are:

    (1) Tax year 2008-09 £45,421.93

    (2) Tax year 2009-10 £59,406.85

    (3) Tax year 2010-11 £91,662.19

3. HMRC have decided not to pursue part of the 2010-11 closure notice liability; this relates to a separate dispute (concerning enterprise zone allowances) and does not affect the matters before the Tribunal in this appeal.

4. The amount of the disputed penalty (varied after formal internal review) is £55,104.84.

Background

5. Mr Shanks is a professional accountant. He has in the past (including the time relevant to this appeal) suffered from serious illness; it is not necessary to go into details, only to note that this may explain why his conduct of his professional and tax affairs fell short of that normally expected of an accountant, and I have taken that into account in evaluating the evidence.

Douglas Shanks LLP

6. From 14 April 2004 Douglas Shanks LLP carried on the profession of accountancy. The two members of Douglas Shanks LLP were Mr Shanks and Celestial Accounting Limited. Mr Shanks's evidence is that the only function of Celestial Accounting Limited was to provide the second member necessary for formation of an LLP, and that it was dormant; that Celestial Accounting Limited received no share of the profits or losses of the LLP, so that everything accrued to Mr Shanks; and that Mr Shanks was not a director or shareholder of Celestial Accounting Limited.

7. Douglas Shanks LLP filed its first partnership tax return for the tax year 2005-06 (covering the accounting period ended 30 April 2005) declaring a loss of £20,773.

8. Douglas Shanks LLP was dissolved on 13 October 2009.

9. No further partnership tax returns were filed until 11 October 2012 when an amended return for the tax year 2008-09 was submitted. (The partnership returns were not in the trial bundle and I was given no explanation why the 2008-09 return was described as "amended".) A further amendment to the 2008-09 partnership return was filed on 14 January 2014.

10. On 11 September 2014 Mr Shanks's accountants supplied to HMRC draft accounts of Douglas Shanks LLP showing losses of £254,246 for the year ended 30 April 2008, and losses of £58,970 for the four month period ended 31 August 2008.

After Douglas Shanks LLP

11. Mr Shanks ceased to practise with Douglas Shanks LLP on 30 June 2008. He has since practised with a succession of several firms; the dates seem to be broadly agreed between the parties. In 2014 Mr Shanks's former advisers wrote to HMRC that "some dates were not hard and fast due to the staggered nature of moving from one profession umbrella to another." I do not accept that explanation; for reasons such as professional liability insurance and practising licences (quite apart from remuneration issues) a financial services firm should hold clear and definitive records of who was on its staff and under its responsibility at any given time. I will use the dates provided to me as I do not think anything in this appeal turns on any minor discrepancies.

12. On 1 July 2008 Mr Shanks joined BTG Tax LLP. He left there on 11 May 2010.

13. On 1 June 2010 he joined Chancery (UK) LLP; on 1 April 2011 he joined Chancery Accounts & Tax LLP; on 19 April 2011 he joined Chancery Audit LLP. He left all three on 31 December 2011 (the leaving date for Chancery Accounts & Tax LLP is shown in the bundle as 21 December 2011, which may be a typographical error).

14. On 18 November 2011 he joined DSC Metropolitan LLP.

Mr Shanks's tax returns

15. On 11 October 2012 Mr Shanks filed his personal tax returns for the tax years 2008-09, 2009-10 and 2010-11.

16. The 2008-09 return included partnership pages for Douglas Shanks LLP claiming a current loss of £221,667 and total carry-forward losses of £235,298. He declared self-employment profits from Begbies Traynor Group (presumably that is BTG Tax LLP).

17. The 2009-10 return declared self-employment profits from Begbies Traynor Group; it contained no partnership pages but made a "white space" disclosure:

> "My arrangements have changed over the years but I have always acted as a professional accountant with a constant client base. The arrangements can be summarized as follows – To 30 June 2008 Douglas Shanks LLP [tax ref given] 1 July 2008 to 1 June 2010 Begbies Traynor Group [tax ref given] 1 June 2010 to beyond 5 April 2011 Chancery (UK) LLP [tax ref given]. My income is treated as one profession throughout the time in the returns and should be treated as a continuation of the same profession. …"

18. The 2010-11 return also contained no partnership pages but declared self-employment profits from Begbies Traynor Group and Chancery LLP (presumably that is Chancery (UK) LLP). It contained the same white space disclosure as the previous year.

19. Mr Shanks claimed to deduct the brought forward losses sustained in Douglas Shanks LLP against his income in the tax years 2009-10 and 2010-11. There were other entries on the returns that do not relate to the matters before the Tribunal in this appeal.

20. On 19 September 2013 HMRC opened enquiries into the three returns for 2008-09 to 2010-11 (s 9A TMA 1970 refers). On 12 March 2014 HMRC issued closure notices for all three years (s 28A TMA 1970 refers) and assessed an inaccuracy penalty (sch 24 FA 2007 refers). Mr Shanks requested a formal internal review and the review

conclusion letter (20 February 2015) upheld the closure notices but the penalty was reduced (from a rate of 70% of the potential lost revenue to 47.25%).

21. Mr Shanks now appeals both the closure notices and the penalty to this Tribunal.

Appellant's case

22. Mr Roberts submitted as follows for the Appellant.

23. It was accepted that Mr Shanks's tax compliance had been late and his affairs had been in a mess – that was due to his ill health. He had since put his life in order.

24. It was accepted that the Douglas Shanks LLP returns were submitted late, and that there is no statutory provision for an extension of time. After dissolution, the LLP had no reporting requirements; that did not normally concern HMRC as any tax liabilities were due from the members, not the LLP – it was different from the situation of a limited liability company where HMRC would usually object to the dissolution of the company if HMRC felt there were unsatisfied tax obligations. The question here was whether a member of the LLP could submit a return on behalf of the LLP. Mr Shanks had a duty to report his liabilities, even if the LLP failed to comply with its reporting requirements.

25. Mr Shanks had a single source of consultancy income throughout his professional career, providing the same services to a continuing and consistent body of clients. Losses sustained in earlier years could be carried forward and offset against profits in later years.

26. It was accepted that if Mr Shanks had been a partner/member in BTG and/or Chancery then each frim would represent a different business for income tax purposes – see *RCC v Vaines* [2018] STC 297 – and thus losses incurred in Douglas Shanks LLP would not be available to carryforward against profits arising from the other firms. However, the information provided to HMRC by BTG had been inaccurate. Mr Shanks never signed a partnership agreement (or similar document) in respect of his relationship with BTG (see s 4 Limited Liability Partnerships Act 2000). BTG's filings with Companies House did not record any appointment of Mr Shanks (see s 9 LLPA 2000). Mr Shanks was consistent in reporting his earnings as self-employment income. If a re-analysis was required then it could be that the income from BTG belonged to Douglas Shanks LLP; alternatively, that Mr Shanks was an employee of BTG (in which case HMRC's proper recourse was to BTG under the PAYE assessment provisions).

27. In relation to the penalty, Mr Shanks should not be liable to a penalty at all. The fact that a return contains inaccuracies does not automatically render the taxpayer's behaviour as careless. If a taxpayer submits a return believing it to be correct, even if it should transpire following enquiry that there has been an error, it is at that point that one has to consider the nature of the behaviour. The penalty was imposed because HMRC considered that Mr Shanks had sought to mislead HMRC over the nature of his income from his professional activities, representing them as profits and losses from sole practice rather than from the carrying on of a business in partnership. HMRC say that the wrong supplementary page were completed by Mr Shanks and that he should have completed partnership pages instead of self-employment/sole trader pages. The information contained in either page would have reflected the same numbers in terms of income but there would clearly be a divergence in the treatment of the losses which are the subject of the first part of this argument. Mr Shanks did not intend to deceive or mislead HMRC in completing the return. He incorporated a note in the white space explaining clearly the principles he adopted in completing the return - they may have been incorrect principles but it cannot be said that the basis of the completion of the return had not been disclosed. The

fact that the return included a white space note showing what the entries represented and why he had treated them in that way was a clear invitation for HMRC to challenge the treatment. There was no attempt to conceal. It would have been careless had no thought gone into the presentation of the entries but that was not the case. Mr Shanks is clear that it was done for the sake of clarity, it set out his thinking which may or may not have been misguided but because he pointed it out HMRC had the opportunity to disagree, which they did.

28. Further, Mr Shanks should have been entitled to a special reduction of penalties under para 11 sch 24 for reasons which he set out in a written statement to HMRC on 11 April 2014, giving details of his accommodation problems, difficulties with business partners and associates, and depression brought on by divorce and financial difficulties. The accumulation of these many things coupled with his medical condition have a significant bearing. This is not a question of an individual not being bothered about getting things right. He had attempted to resolve some of the business issues by joining a larger firm which should have ensured a regular income stream and removed much of the administrative burden.

29. Accordingly, Mr Shanks seeks the withdrawal of the penalty assessment or, failing that, his claim to a special reduction.

Respondents' case

30. Ms Stevenson submitted as follows for the Respondents.

<u>The closure notices</u>

31. The adjustments in the closure notices were made because:

(1) The loss relief claim for 2008-09 is not allowable.

(2) The losses cannot be carried forward against the profits of other LLPs.

The loss relief claim for 2008-09 is not allowable.

32. The deadline filing date for the Douglas Shanks LLP partnership tax return for the tax year 2008-09 was 31 January 2010. The deadline filing date for an amendment of that return was 31 January 2011 (s 12ABA Taxes Management Act 1970). The amended 2008-09 return was filed on 11 October 2012.

33. The amended return was out of time. The amended return was filed around three years after the LLP had been dissolved.

34. Draft accounts of the LLP were not filed until 11 September 2014 – around five years after dissolution, and around two years after the amended tax return was filed. No finalised accounts have been submitted – probably because, having been dissolved in 2009, there was no legal entity in existence to finalise financial statements.

35. For all those reasons the purported losses were unsubstantiated. This was not analogous to *King & Others* [2016] UKFTT 0409 (TC), where the partner's return was correct but the partnership's return was wrong; here both returns tallied but the figures were unsubstantiated with no contemporaneous evidence (such as primary records) to support them.

The losses cannot be carried forward against the profits of other LLPs.

36. The carry forward of trading or professional losses is governed by s 83(3) Income Tax Act 2007.

37. The trade of Douglas Shanks LLP was separate from that of the other partnerships (BTG Tax LLP and Chancery (UK) LLP). Therefore any losses from the former could not be carried forward against profits from the latter. This was supported by the Upper Tribunal and Court of Appeal decisions in *Vaines*. A deemed partnership trade was separate from any actual trade carried on by the individual.

38. Mr Shanks was included as a partner on the partnership tax returns of BTG and Chancery. The Limited Liability Partnerships Act 2000 did not require a new member to join by any written document (s 4); the failure to notify matters to Companies House was just a breach of s 9 and did not nullify the accession of the member.

39. The argument that Mr Shanks may have been an employee was a new one, and appeared to be contradictory to Mr Shanks's other contentions – if the Tribunal considered it relevant then HMRC would wish the opportunity to make further submissions.

The penalty

40. HMRC considered that Mr Shanks had given HMRC a document containing an inaccuracy leading to an understatement of liability to tax, and that inaccuracy was made as a result of deliberate behavior on his part: para 1 sch 24 FA 2007.

41. While there was no statutory definition of deliberate behavior for these purposes, the Tribunal in *Auxilium Project Management* [2016] UKFTT 0249 (TC) stated,

> "a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test. The question is not whether a reasonable taxpayer might have made the same error or even whether this taxpayer failed to take all reasonable steps to ensure that the return was accurate. It is a question of the knowledge and intention of the particular taxpayer at the time."

42. Mr Shanks knew that losses sustained by one partnership could not be offset against profits of a different partnership. He intentionally chose to include profit shares for the later partnerships on the self-assessment pages of his return and not through the partnership pages, despite at the time believing himself to be a member of those partnerships. He deliberately submitted a loss relief claim that he knew he was not entitled to, so as to effect a deduction for loss relief for which he was not entitled.

43. The review officer had properly considered whether there were special circumstances under para 11 sch 24 but concluded there were not. The review officer significantly increased the reduction of penalty on account of disclosure, from 0% to 65%.

Consideration and Conclusions

44. I shall deal first with the closure notices and then with the penalty.

Closure notices

45. I do not accept Mr Shanks's description of his professional activities as being some form of freelance consultant who supplies his services under the "umbrella" (as Mr Shanks's advisers put it in correspondence with HMRC) of various firms. In relation to Douglas Shanks LLP I understand it is accepted (and if it is not accepted, I so find) that Mr Shanks was a partner (strictly a member, as it was an LLP) in that firm; he was not a sole practitioner; he was entitled to a share of the profits or losses according to any partnership agreement (not evidenced in the trial bundle) or else in accordance with the provisions of the Partnership Act 1890 (and see s 850 ITTOIA 2005). The income tax position is as stated by s 852 ITTOIA 2005 - the LLP has an "actual trade" and Mr Shanks has a "notional trade":

> "**Carrying on by partner of notional trade**
> (1) For each tax year in which a firm carries on a trade (the "actual trade"), each partner's share of the firm's trading profits or losses is treated, for the purposes of Chapter 15 of Part 2 (basis periods), as profits or losses of a trade carried on by the partner alone (the "notional trade").
> (2) A partner starts to carry on a notional trade at the later of—
> (a) when becoming a partner in the firm, and
> (b) when the firm starts to carry on the actual trade.
> This is subject to subsection (3).
> (3) If the partner carries on the actual trade alone before the firm starts to carry it on, the partner starts to carry on the notional trade when the partner starts to carry on the actual trade.
> (4) A partner permanently ceases to carry on a notional trade at the earlier of—
> (a) when the partner ceases to be a partner in the firm, and
> (b) when the firm permanently ceases to carry on the actual trade.
> This is subject to subsections (5) and (6).
> (5) If the partner carries on the actual trade alone after the firm permanently ceases to carry it on, the partner permanently ceases to carry on the notional trade when the partner permanently ceases to carry on the actual trade.
> …"

46. I do not agree with HMRC that where a firm is dissolved before filing a partnership return reporting the results of its actual trade, then that somehow disqualifies the partners in that firm from reporting the results of their notional trades. HMRC can, of course, enquire into those individual returns, require evidence supporting the reported notional trade figures, and if not satisfied then adjust accordingly. But the firm's filing failure does not eliminate the notional trades of the partners. As I put it to Ms Stevenson in the hearing, if the firm was in fact profitable but was dissolved before filing the results of its actual trade, then I doubt HMRC would be impressed by a partner claiming to be under no obligation to report his/her notional trade results. Mr Shanks is entitled (and required) to return the results of his notional trade, and he reported a loss for 2008-09. I note that conclusion is in line with the caselaw helpfully summarised by this Tribunal (Judge Brooks) in *King & others* at [58-68].

47. HMRC have conducted a s 9A enquiry into Mr Shanks's 2008-09 return and have issued a closure notice. My understanding (from paragraph 4 of the closure notice) is that HMRC have, in effect, disallowed the entire loss for that tax year. That disallowance was on two grounds (paragraph 3 of the closure notice); first, the dissolution of the partnership, which I have addressed above; and second, that the firm "failed to provide any accounts information". While the firm did so fail to provide, Mr Shanks did provide (in September 2014, around nine

months after the issue of the closure notice) some draft accounts for the LLP. The explanation provided by the HMRC review officer (in February 2015) on this point was: "I do not consider that we should accept either of the losses as claimed by the amendments or the draft accounts submitted by your accountant because they were received out of time and they are for a LLP that had already been dissolved." The reference to receipt out of time concerns the expired deadline for an amendment to the partnership 2008-09 return (and I agree that deadline had expired). What the review does *not* address is that, in my view, HMRC should have given consideration to the draft accounts in the context of their enquiry into Mr Shanks's 2008-09 personal return. As I have noted, the draft accounts were not presented to HMRC until nine months after the conclusion of that enquiry, but were available to the review officer. In relation to Mr Shanks's appeal against the 2008-09 closure notice, I need to determine whether the review officer's failure to refer to the draft accounts has resulted in Mr Shanks being overcharged by the closure notice (s 50(6) TMA 1970 refers). My conclusion is that the draft accounts do not demonstrate any overcharge. First, the accountants emphasised that the accounts were draft – there is no explanation or justification for that position given that the accounts purport to report results from six years earlier; the implication seems to be that the accountants and/or Mr Shanks have some reservations about the accounts. Secondly, there is scant information in the draft accounts – the profit and loss account merely states figures for turnover, "administrative expenses", and interest payable/receivable; there is no attempt at an analysis to justify a loss claim of around a quarter of a million pounds. For those reasons, the appeal against the 2008-09 closure notice must be dismissed.

48. It follows from my conclusions on the draft accounts that the purported losses claimed as carried forward to subsequent years are also unsustainable, and so the appeals against the 2009-10 and 2010-11 closure notices must also be dismissed. As I heard full argument on those later years I shall, however, address those arguments.

49. First, as already stated, I do not accept Mr Shanks's analysis that he was not a partner in the firms where he worked after leaving Douglas Shanks LLP. The partnership tax returns filed by those firms account for him as a partner/member. The firms were sizeable firms of professional accountants and financial advisers; I do not find it credible that they could have somehow mistakenly reported him as a partner in the firm's own partnership tax return when that was not the case. Accordingly, I agree with HMRC's view that Mr Shanks's earnings from the other firms are his share of the relevant partnership profits.

50. Secondly, s 62 ITA 2007 explains partnership losses:

> "**Partners: losses of a tax year etc**
> (1) This section applies if a trade or profession is carried on by a person as a partner in a firm.
> (2) Any reference to a person making a loss in a trade or profession in a tax year is to the partner making a loss in the partner's notional trade in the basis period for the tax year (as to which, see sections 852 and 853 of ITTOIA 2005).
> (3) Further—
> (a) any reference to a person making a claim for relief for a loss made in a trade or profession is to the partner making a claim for relief for a loss made in the partner's notional trade,
> (b) any reference to a basis period for a tax year is to the basis period for the partner's notional trade for the tax year,
> (c) any reference to the profits or losses of a partner's notional trade of a tax year is to the partner's share of the firm's profits or losses of the trade or profession treated for the purposes of Chapter

15 of Part 2 of ITTOIA 2005 as the profits or losses of the partner's notional trade in the basis period for the tax year,

(d) any reference to a person starting to carry on a trade or profession is to the partner starting to carry on the notional trade in accordance with section 852(2) or (3) of ITTOIA 2005, and

(e) any reference to a person permanently ceasing to carry on a trade or profession is to the partner permanently ceasing to carry on the notional trade in accordance with section 852(4) to (6) of ITTOIA 2005.

(4) In this section a partner's "notional trade" has the same meaning as in Part 9 of ITTOIA 2005.

…"

51. Section 83 ITA allows carry forward of trade losses against subsequent trade profits and s 83(3) states "But a deduction for that purpose is to be made only from profits of the trade." It is well-established, and is common ground, that this means the *same* trade.

52. It follows from my conclusions above that any losses incurred in Douglas Shanks LLP would not be available to carryforward against profits arising from the other firms, and Mr Shanks accepts that position (see [26] above). I do not need to expand on this in relation to the closure notices but will return to say further in the context of the penalty, to which I now turn.

Penalty

53. HMRC consider that the inaccuracies in Mr Shanks's self-assessment returns arose from deliberate but not concealed action. That gives a starting point for the penalty of 70% of the potential lost revenue (para 4 sch 24 refers). Paragraphs 9 & 10 sch 24 give reductions for disclosure by the taxpayer; originally no reduction was given but on formal review the penalty rate was reduced from 70% to 47.25% (the statutory minimum for this category being 30%: para 10(2) sch 24). HMRC took the view that no special circumstances existed for a reduction under para 11 sch 24.

54. I agree with the statement of this Tribunal (Judge Greenbank & Mr Bell) in *Auxilium* (at [63]): "In our view, a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test."

55. Mr Shanks fell behind in filing his returns and submitted three together in October 2012. On both the 2009-10 and 2010-11 returns he made the white space disclosure described at [17] above, including the statement, "My arrangements have changed over the years but I have always acted as a professional accountant with a constant client base. … My income is treated as one profession throughout the time in the returns and should be treated as a continuation of the same profession. …". That has continued to be Mr Shanks's main contention and was advanced before me by Mr Roberts on his behalf at the hearing. I have found above that the contention is not correct, and Mr Shanks was instead a partner/member in a succession of partnerships. So the basis on which Mr Shanks reported his income in those returns has proved to be incorrect. Does that behavior amount to a deliberate inaccuracy? Did he knowingly provide HMRC with tax returns that contained an error with the intention that HMRC should rely upon them as accurate documents? I consider the plain answer is that there was no such intention - when Mr Shanks submitted his returns he took a view on how his income should be reported; that view was not spurious or fanciful; he followed that view accurately, and he explained to HMRC (via the white space) exactly what he had done and why. When he

provided the documents he subjectively believed they were accurate. The outcome of these proceedings is that his view has proved incorrect, but the inaccuracy was not deliberate.

56. Having concluded that there was not a deliberate inaccuracy, there remains the possibility that a penalty is chargeable because the inaccuracy was careless – which attracts a penalty under sch 24 but at a lower rate (para 4 sch 24 refers). A careless inaccuracy occurs due to the failure by the taxpayer to take reasonable care - see para 3(1)(a) sch 24 and *Harding v HMRC* [2013] UKUT 575 (TCC) at [37]. There are two important concerns that I take into account here. First, all the caselaw referred to in this decision notice concerning the tax treatment of partnerships post-dates Mr Shanks's submission of his returns in October 2012 – *Vaines* was reported by the First-tier Tribunal in October 2013 (and was reversed by the Upper Tribunal in January 2016, before progressing to the Court of Appeal in January 2018); *Auxilium* was reported in April 2016; and *King & others* in June 2016. So none of that judicial comment was available to Mr Shanks when he decided how to report his income on his returns. Secondly, Mr Shanks did take considerable care in reporting the information; he made an explicit white space statement of what he had done and why he took his view. Again, the outcome of these proceedings is that his view has proved incorrect, but the inaccuracy was not due to him failing to take reasonable care. He took a considered view, which has subsequently proved (per my findings here) to have been incorrect. On that basis, no penalty for carelessness is chargeable.

57. For completeness, if relevant I would agree with HMRC that no special reduction was available under para 11 sch 24. Mr Shanks, although operating under personal difficulties at the relevant time, was able to carry on a demanding profession and so was in the same (if not better) position as most taxpayers to file accurate self-assessment tax returns.

58. Accordingly, I consider no penalty is chargeable for either deliberate action or carelessness, and I shall allow the appeal in respect of the penalty (only) and dismiss the penalty charged.

Decision

59. The appeal is ALLOWED IN PART so that:

(1) The closure notices for the tax years 2008-09, 2009-10 and 2010-11 are confirmed; but

(2) The penalty is removed in full.

Right to apply for permission to appeal

60. 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.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 26 APRIL 2019