Neutral Citation: [2024] UKFTT 00303 (TC)

Case Number: TC09132

FIRST-TIER TRIBUNAL
TAX CHAMBER

Manchester Employment Tribunal

Appeal reference: TC/2022/11132

INCOME TAX – whether income accrued whilst in prison taxable – yes – whether negligent failure to notify – yes – penalties, whether reasonable excuse that estate agent did not deal with tax matters – no – appeal dismissed

Heard on: 16 November 2023
Judgment date: 10 April 2024

Before

TRIBUNAL JUDGE ANNE FAIRPO
TRIBUNAL MEMBER SHAMEEM AKHTAR

Between

STANLEY AUGUSTINE HERRMANN

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

The appellant appeared in person

For the Respondents: Ms Lawrence, litigator of HM Revenue and Customs' Solicitor's Office

DECISION

Introduction

1. This is an appeal against discovery assessments and penalties originally issued on 21 February 2020 for the tax years 2002/03 and 2004/05 to 2017/18. Discovery assessments and penalties had also been issued for the tax years 2001/02 and 2003/04, but HMRC accepted subsequently that there was no liability for those tax years on receipt of relevant information.

2. The amounts assessed, following review, were:

Tax year	Assessment provision	Amount assessed
2002-03	Section 29 TMA 1970	£124.08
2004-05	Section 29 TMA 1970	£286.04
2005-06	Section 29 TMA 1970	£1,530.04
2006-07	Section 29 TMA 1970	£1,642.56
2007-08	Section 29 TMA 1970	£1,655.72
2008-09	Section 29 TMA 1970	£1,661.80
2009-10	Section 29 TMA 1970	£1,706.80
2010-11	Section 29 TMA 1970	£1,752.00
2011-12	Section 29 TMA 1970	£1,682.60
2012-13	Section 29 TMA 1970	£2,800.00
2013-14	Section 29 TMA 1970	£2,465.80
2014-15	Section 29 TMA 1970	£2,040.00
2015-16	Section 29 TMA 1970	£732.40
2016-17	Section 29 TMA 1970	£975.40
2017-18	Section 29 TMA 1970	£882.40

Tax year	Penalty provision	Amount of penalty
2002-03	Section 7(8) TMA 1970	£31.02
2004-05	Section 7(8) TMA 1970	£71.51
2005-06	Section 7(8) TMA 1970	£382.51
2006-07	Section 7(8) TMA 1970	£410.64
2007-08	Section 7(8) TMA 1970	£413.92
2008-09	Section 7(8) TMA 1970	£415.45
2009-10	Schedule 41 FA 2008	£392.56
2010-11	Schedule 41 FA 2008	£402.96
2011-12	Schedule 41 FA 2008	£387.00
2012-13	Schedule 41 FA 2008	£644.00
2013-14	Schedule 41 FA 2008	£567.13
2014-15	Schedule 41 FA 2008	£469.20
2015-16	Schedule 41 FA 2008	£168.45
2016-17	Schedule 41 FA 2008	£224.34
2017-18	Schedule 41 FA 2008	£132.36

Background

3. HMRC opened an enquiry into Mr Herrmann's tax affairs on 3 May 2019, as they believed he had received property income which has not been declared. Mr Herrmann agreed that he had purchased three properties each on 10 November 2000, 12 November 2001 and 16 November 2001 and that he had received rental income in respect of the properties at various times. He had subsequently lived in one of the properties, after renting it out.

4. Following correspondence, including a request by HMRC for Mr Herrmann's best estimates given the absence of records, HMRC issued the discovery assessments and penalties. These were appealed to HMRC. Mr Herrmann then provided some additional information which resulted in revised calculations being issued on 15 December 2020. Further mortgage information was later provided and the calculations were revised again to allow mortgage interest on a rental property between 2002 and 2012.

5. Mr Herrmann disputed the calculations because:

(1) employment income had been included for the 2002-03 tax year, and he stated that he was not in employment between 2002 and 2014;

(2) pensions had been included and he did not receive a state or civil service pension during the period 2002 to 2014. He provided documentation which showed that although his civil service pension had become payable in November 2002, the pension fund had not had any payment or bank details for him until April 2007. HMRC revised their calculations to include the civil service pension for the 2005/06 tax year onwards.

6. Mr Herrmann further contended that the periods assessed included periods in which he was in prison (December 2002 to December 2012) and therefore could not be liable. He was not permitted to conduct business from prison. He should not be responsible for the failures of his agent to deal with tax matters and should not be penalised for his inability to provide documentary evidence in these circumstances.

Validity of the assessments

7. The burden of proof in respect of the validity of the assessments is on HMRC.

8. It was agreed that Mr Herrmann was not served with a notice to file a tax return under s8 TMA 1970 for any of the years under appeal. s7(1) TMA 1970 requires that a person who has not received a notice to file but nonetheless is subject to income tax or capital gains tax in a tax year must notify HMRC of that liability within six months of the end of that tax year.

9. s29 Taxes Management Act 1970 (TMA 1970) allows HMRC to make an assessment for a tax year if they discover that income has not been assessed.

10. Officer Williams' evidence was that HMRC had established that Mr Herrmann owned property from which it was believed he had rental income and the discovery that there was unassessed income was made on 20 June 2019 when Mr Herrmann replied to confirm that he had received rental income which had not been taxed between 2002 and 2018.

11. s36(1A)(c) TMA 1970 provides that, where a person is required to notify HMRC of a tax liability in accordance with s7 TMA 1970 and does not do so, assessments may be raised in respect of such tax liability at any time not more than 20 years after the end of the year of assessment to which it relates.

Tax years 2009/10 and later

12. For the reasons set out below, we find that Mr Herrmann had a liability to income tax which he should have notified to HMRC in accordance with s7 TMA 1970. Mr Herrmann did not dispute that he had not notified HMRC of a liability to tax; his submissions were generally that the failure had been due to a third party and that he had not been aware of the obligation, as set out below. As there was a failure to notify, the assessments for the tax years 2009/10 and later were made in time as they were made within twenty years of the end of each of the years of assessment.

Tax years 2008/09 and earlier

13. Article 7 of SI 2009/403 provides that s36(1A)(c) of TMA 1970(e) does not apply to tax years 2008-09 or earlier, unless the assessment arises due to the taxpayer's negligence or the negligence of a person acting on his behalf. This is a transitional provision ensuring that the changes in Finance Act 2008 only allow the extended time limits in s36(1A)(c) to apply if the assessment could have been made under the previous rules, which required negligent conduct.

14. The test of negligence was set out in *Anderson (deceased)* [2009] UKFTT 206 at [22]:

> "The test to be applied … is to consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done."

15. As already noted, we find that Mr Herrmann had a liability to income tax which he should have notified to HMRC in accordance with s7 TMA 1970. The question therefore was whether his failure to notify was due to negligence of Mr Herrmann or anyone acting on his behalf.

16. Mr Herrmann stated that he had appointed an agent, Mr Martin, to deal with everything to do with his properties whilst he was in prison and that he had presumed that Mr Martin would deal with tax matters on his behalf. We note that Mr Martin died in 2014. Mr Herrmann contended in his grounds of appeal that Mr Martin had been "authorised to conduct/transact and comply with obligations therein".

17. HMRC contended that there was no evidence that Mr Martin was engaged to deal with any tax matters. They had no record of his being appointed as a tax agent for Mr Martin on their systems.

18. In a letter dated 31 July 2019, Mr Herrmann stated to HMRC that Mr Martin, of Homefinders, was "given authority to secure tenants, obtain rent, provide maintenance, insurances etc for the properties plus to deposit in my account any surplus rent after expenses". In another letter dated 9 March 2020, he stated that Mr Martin was given authority to manage the properties; in a following letter of 26 March 2020, he stated further that "Mr Martin was also given authority to receive rent and pay expenses and any surplus income to be deposited into Barclays Bank." In September 2020, Mr Herrmann stated that Mr Martin had been given power of attorney to enter and perform all necessary duties relative to the banks, traders (maintenance repairs) and tenants to collect rent and disburse expenses as he deemed appropriate.

19. Mr Herrmann explained in the hearing that he had not had time to "get to grips with" HMRC requirements between acquiring the properties (in November 2000 and November 2021) and going to prison in December 2002. He stated that he had given power of attorney to an estate agent (Mr Martin) to do what was required for the properties but he had not gone into much detail as to the legal requirements. Mr Herrmann thought that Mr Martin, as a business man, would have had capacity to submit tax payments. He could not say why Mr Martin did not deal with the tax obligations whilst Mr Herrmann was in prison.

20. Mr Herrmann also stated that he did not know that he had to instruct someone to deal with his tax affairs as well as the letting. He had assumed that general instructions "to keep the house afloat" would be enough.

21. We consider it is clear that Mr Martin was an estate agent and not a tax agent or accountant. There was no evidence that he had been specifically engaged to deal with Mr Herrmann's tax affairs nor that he held himself out as being able to do so. Mr Herrmann's correspondence with HMRC refers only to Mr Martin having been authorised to manage the properties. We do not consider that an estate agent would regard that as including undertaking

tax compliance duties for the property owner. We do not consider, therefore, that there was any negligence on Mr Martin's part.

22. Considering Mr Herrmann's evidence, we find that he did not take any steps to establish what his tax obligations were. In the hearing he said that he had not had time to get to trips with tax obligations in respect of rental income before going to prison. In his letter to HMRC of 9 September 2020 he explained that he was "now catching up with what is required … and my responsibilities and obligations regarding tax issues … I was and still am totally ignorant and naive on matters of HMRC requirements until [the start of the enquiry] brought out what was required of me".

23. We consider that a person owning three properties which he intended to rent out in these circumstances would have made enquiries as to the tax obligations on them as landlord before HMRC contacted them and further, knowing that they would be unable to deal with those obligations personally for a period of time, would make enquiries as to how to ensure that an appropriate person had authority to comply with those tax obligations on their behalf.

24. As Mr Herrmann did none of these things, we find that he was negligent and that this negligence led to the failure to notify HMRC of his tax liability. Accordingly, the extended time limits of s36(1A)(c) TMA 1970 apply such that the assessments for 2002/03 to 2008/09, made in February 2020, were made in time.

Quantum of the assessments

25. Mr Herrmann raised various objections to the contents of the assessments. As we have found that the assessments were validly raised, the burden of proof to displace the quantum of those assessments (provided that the quantum is fair and reasonably assessed in the circumstances) moves to Mr Herrmann.

Employment income

26. Mr Hermann contended that he was not in employment between 2002 and 2014 and so the assessments should not show any amounts of income tax or national insurance for any of those years. He did not put forward any evidence in support of this contention.

27. HMRC's records showed that an employer had notified them of pay and employment tax deductions in 2002/03. These had been included in the computation, with credit given for the tax deductions, to ensure that undeclared income had been taxed correctly. The employment income had not been assessed a second time.

28. We find that Mr Herrmann has not established that the amounts assessed should be amended. We consider that HMRC's records are correct and properly took the employment income and tax deductions into account when assessing Mr Herrmann's liability to tax for the relevant years.

Pensions

29. Mr Herrmann contended that he was not in receipt of either the state pension or a civil service pension between 2002 and 2014. He did not put forward any evidence in support of this contention.

30. HMRC records showed that payments had been made and tax deducted for 2005/06 onwards in respect of a civil service pension and so these payments and credit for the deductions had been included in the assessments to ensure that tax on undeclared income was correctly calculated. The pension income had not been assessed twice.

31. In correspondence, a schedule provided to Mr Herrmann by the civil service pension provider confirmed that he had been entitled to payments during the period although they were

unable to confirm any details of when payments were made before 2007 as they did not still have those records.

32. The state pension was included in calculations from 2012/13 onwards, when information from the Department of Work and Pensions showed that Mr Herrmann became entitled to and received the state pension after his release from prison. HMRC had not included any amount in respect of the state pension before that year as the state pension is not payable to persons who are in prison. This restriction on payment of the state pension does not apply to occupational pensions.

33. We find that Mr Herrmann has not established that the amounts assessed should be amended. On balance we consider that HMRC's records are correct and that Mr Herrmann was paid his civil service pension from 2005/6 onwards and his state pension from 2012/13 onwards and, as such, the pension payments (with credit for tax deductions made in respect of those payments) were properly taken into account when assessing Mr Herrmann's liability to tax for the relevant years.

Rental income - liability

34. Mr Herrmann contended that he should not be taxed on the rental income because he was in prison and so could not be liable to tax. He considered that prison rules did not allow business to be transacted from prison.

35. HMRC contended that taxpayers still have an obligation to deal with their tax affairs whilst in prison.

36. We consider that it is clear that statute contains no exemption from tax for persons in prison and we note that any prohibition contended for by Mr Herrmann is on the conducting of business from prison; this does not (and did not) prevent a business being conducted on his behalf by an agent. Mr Herrmann had appointed an estate agent to deal with his properties whilst he was in prison and continued to be beneficially entitled to the income obtained from those properties.

37. There was no submission that there is any restriction on prisoners being beneficially entitled to income whilst incarcerated and, indeed, Mr Herrmann stated in correspondence that Mr Martin was instructed to pay net rent after expenses into Mr Herrmann's bank account. The fact that Mr Herrmann may not have been permitted to access these funds whilst in prison does not mean that he was not beneficially entitled to the income as it arose.

38. We conclude that Mr Herrmann was taxable on income (including rental income) earned whilst he was in prison.

Rental income - quantum of assessments

39. Mr Herrmann purchased a property in November 2000 and two further properties in November 2001. It was accepted that the properties required work to bring them into order after purchase, and so were not let out immediately. Once work was completed, two of the properties were let on an unfurnished basis and the third was let partly furnished. One of the unfurnished properties had been occupied by Mr Herrmann since April 2014.

40. In correspondence with HMRC, Mr Herrmann had provided information which HMRC took into account in raising the assessments. Records were, however, missing as the business had closed when Mr Martin died and Mr Herrmann thought that the records had been disposed of. Mr Herrmann was asked to provide his best estimates where records were not available. He also explained that many of the repair and similar costs had been paid in cash and no documentary evidence was available.

41. HMRC contended that they took into account all of the information provided by Mr Herrmann but, as this was not complete, had estimated amounts where necessary. For example, they had allowed a deduction of 15% for expenses in years where no evidence of expenses was available. They submitted that they had made fair and reasonable assessments, based on the information available.

42. Mr Herrmann stated that he disagreed with the amounts assessed but did not provide any particular reasoning as to why they were incorrect, other than to say that there had been difficulties in collecting rent in some cases and that the rental income barely covered the costs of the properties, including the mortgage on the property into which he subsequently moved. We note that mortgages on privately used properties are not deductible for tax purposes; the fact that Mr Herrmann had overall expenses in respect of three properties which were barely covered at times by the rental income from two of those properties does not mean that the assessments are incorrect.

43. Having reviewed the correspondence in the bundle, we find that HMRC have made fair and reasonable assessments and that Mr Herrmann has not satisfied the burned of proof on him to show that the amounts assessed are incorrect.

Conclusion as to assessments

44. For the reasons set out above, we conclude that the assessments were validly raised and that the quantum has been fairly and reasonably assessed.

Penalties

45. The penalties were issued on the same day as the assessments. HMRC submitted that they were validly issued with the permitted time limits. There was no dispute as to this and we find that they were validly issued subject to consideration of mitigation and reasonable excuse, as set out below.

46. For tax years 2008/09 and earlier, s7(8) TMA 1970 enables HMRC to charge a penalty where there has been a failure to notify changeability and the relevant tax liability has not been paid before 31 January next following the end of the tax year.

47. For the tax years 2009/10 and later, similarly worded provisions enable a penalty to be charged are set out in Schedule 41 Finance Act (FA) 2008.

48. There is no requirement that the failure to notify be negligent or careless before a penalty can be charged; the penalty requires only that there be a failure to notify and consequent failure to pay the relevant tax liability in time.

49. For the reasons already set out above, we find that Mr Herrmann had failed to notify HMRC of his tax liabilities. It was not disputed that he had not paid the relevant tax liabilities in time.

50. We find therefore that HMRC were entitled to raise penalties on Mr Herrmann for the relevant years.

51. The penalties were calculated on the basis that the disclosure was prompted, because Mr Herrmann did not tell HMRC about the failure before they wrote to him about it, and further that Mr Hermann had not deliberately failed to notify his liability.

52. For 2009/10 to 2016/17, HMRC have given reductions for the quality of assistance provided, resulting in an overall penalty percentage of 23%.

53. For the 2017/18 tax year, the penalties were calculated on the basis that disclosure had been made within 12 months, which means that a lower penalty basis applies. The same mitigation was given. The penalty percentage was therefore 15%.

54. For the tax years before 2009/10, the penalty was set at the minimum penalty of 25%. HMRC considered that they could not give any further reduction as Mr Herrmann had not replied to their opening letter and they had had to issue an Information Notice.

55. Having considered the details of mitigation set out in the penalty explanation letters we do not consider that there is any reason to disturb the mitigation given and the penalty percentage calculated by HMRC for each of the relevant years.

Reasonable excuse

56. The law states that liability to a penalty in this context does not arise if the taxpayer satisfies the tribunal that there is a reasonable excuse for the act or failure. Where the taxpayer had a reasonable excuse for the relevant act or failure but the excuse has ceased, the taxpayer is to be treated as having continued to have the excuse only if the relevant act or failure is remedied without unreasonable delay after the excuse ceased.

57. Mr Herrmann contended that he should not be charged penalties for the income which accrued whilst he was in prison, as he thought that HMRC should have written to his agent at the time. We also took his submissions as to the appointment of his agent as being submissions in respect of whether he had a reasonable excuse for the failure through his reliance on the agent.

58. HMRC contended that this did not amount to a reasonable excuse. They submitted that a person acting with reasonable care and due diligence would, on purchasing rental properties, have taken appropriate steps to establish and comply with their tax obligations.

59. The term "reasonable excuse" is not defined in the legislation, but the Upper Tribunal in *Perrin* [2018] UKUT 156 (TCC) held that "to be a reasonable excuse, the excuse must not only be genuine, but also objectively reasonable when the circumstances and attributes of the actual taxpayer are taken into account" (at [75]). The Upper Tribunal also set out the test that should be applied (at [81]):

> "When considering a "reasonable excuse" defence, therefore, in our view the FTT can usefully approach matters in the following way:
>
> (1) First, establish what facts the taxpayer asserts give rise to a reasonable excuse (this may include the belief, acts or omissions of the taxpayer or any other person, the taxpayer's own experience or relevant attributes, the situation of the taxpayer at any relevant time and any other relevant external facts).
>
> (2) Second, decide which of those facts are proven.
>
> (3) Third, decide whether, viewed objectively, those proven facts do indeed amount to an objectively reasonable excuse for the default and the time when that objectively reasonable excuse ceased. In doing so, it should take into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times. It might assist the FTT, in this context, to ask itself the question "was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?
>
> (4) Fourth, having decided when any reasonable excuse ceased, decide whether the taxpayer remedied the failure without unreasonable delay after that time (unless, exceptionally, the failure was remedied before the reasonable excuse ceased). In doing so, the FTT should again decide the matter objectively, but taking into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times."

60. We do not agree with Mr Herrmann's contention that HMRC should have written to his agent whilst he was in prison. The law is clear that the obligation to notify is on a taxpayer. There is no obligation on HMRC to locate non-compliance taxpayers in this context and so there can be no reduction in penalties for a non-compliant taxpayer simply because HMRC might have undertaken detective work to find them, or someone appointed as their estate agent, earlier. We also note that, as Mr Herrmann had not appointed Mr Martin as his tax agent, it would not have been possible for HMRC to write to Mr Martin even if they had become aware of Mr Herrmann's non-compliance during his time in prison. This does not provide Mr Herrmann with a reasonable excuse for the failure.

61. As noted above, Mr Herrmann accepted that he had not established what his tax obligations would be in respect of the rental properties between acquiring them (in 2000 and 2001) and going to prison (in December 2002). Although he had appointed an estate agent to deal with the properties whilst he was unable to do so, he had not gone into any particular detail as to what he wanted the agent to do and had not specifically asked the estate agent to act as his tax agent.

62. Mr Herrmann stated that when he was released in December 2012, he had caught up with the agent as to what was happening, although his ability to do so was limited for the first year as he was obliged to remain in a hostel some distance away. The estate agent had subsequently died in June or July 2014 and Mr Herrmann had been unable to access any business records held by the estate agent after that date. He said that it was only after the HMRC letter arrived in 2019 that he caught up with what had and hadn't been done. Mr Herrmann was asked why he did not contact HMRC after his agent had died. He stated that he was trying to grapple with gaps in what had or had not been done and trying to work out what to do.

63. We consider that, viewed objectively, Mr Herrmann has not established that he had a reasonable excuse.

64. Mr Herrmann had owned the first rental property for two years at the point at which he went to prison yet had not, on his evidence, made any efforts to understand what his tax obligations would be as a landlord. Although the property was not rented in that period, as it was being repaired and made suitable for letting, we do not consider that this is objectively reasonable in the circumstances as Mr Herrmann was intending to let the property out. We note that, on becoming aware that he would be in prison, he appointed an estate agent to deal with the properties and consider that he was therefore capable of also appointing a tax agent. We do not consider that it was objectively reasonable for Mr Herrmann to assume that the estate agent would deal with his tax affairs when Mr Herrmann had not made any mention of this in instructions to the agent.

65. Even if Mr Herrmann's reliance on Mr Martin might have been able to amount to a reasonable excuse, we note that a failure must be remedied without unreasonable delay once the excuse has ceased. Mr Herrmann appears not to have discussed tax compliance with Mr Martin at any time; he states that he was not fully able to catch up with Mr Martin before he died as he had to spend time in a hostel after being in prison. It is not clear why this prevented him from speaking with Mr Martin on the telephone nor why he did not discuss matters with Mr Martin as soon as he was able to move from the hostel. It was not particularly clear from Mr Herrmann's evidence whether he had in fact spoken to Mr Martin at all after he was released from prison.

66. Further, Mr Martin died in mid-2014; by May 2019 Mr Herrmann still had not made any attempts to establish what his tax position was or to make any alternative arrangements to deal with tax compliance. He gave no good reason for this, other than that he was trying to grapple with gaps and work out what to do. This is not a complex area of tax, and we consider that,

even if Mr Herrmann might have had a reasonable excuse, it was not remedied without delay when it ceased.

Special circumstances

67. The law enables HMRC to make a special reduction in a penalty where circumstances permit. HMRC considered whether the circumstances, including Mr Herrmann's time in prison, ignorance of the law and appointment of an agent who subsequently died, amounted to special circumstances which merited a reduction in the penalty. They concluded that the circumstances did not merit a reduction in the penalty. We do not consider that this was an unreasonable conclusion.

Conclusion

68. For the reasons set out above, we find that the assessments were validly raised and the quantum as amended on review was reasonable. We also find that the penalties were validly raised. We find that Mr Herrmann did not have a reasonable excuse for the failure to notify. We find that HMRC's conclusion that there were no special circumstances meriting a reduction in the penalty was reasonable.

69. Accordingly, we uphold the assessments and penalties in full. The appeal is dismissed.

Right to apply for permission to appeal

70. 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.

ANNE FAIRPO
TRIBUNAL JUDGE

Release date: 10th APRIL 2024