Neutral Citation: [2022] UKFTT 00407 (TC)

Case Number: TC08633

FIRST-TIER TRIBUNAL
TAX CHAMBER

In public by remote video hearing

Appeal reference: TC/2020/03384
TC/2020/03385
TC/2020/03386

INCOME TAX – appellants trading as a partnership and through a company – date of transfer of business –April 2005 or August 2005 - involvement of Lunn & Co – lengthy delays –abuse of process - paucity of evidence – discovery amendments – validity – penalties – appeals allowed

Heard on: 26 and 27 September 2022
Judgment date: 07 November 2022

Before

TRIBUNAL JUDGE NIGEL POPPLEWELL
MR LESLIE HOWARD

Between

CLIVE KINGDON, TERRY STEAD & ANNE KINGDON

Appellants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mark Doodney of Doodney Tax Consulting Ltd

For the Respondents: Simon Bracegirdle litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. This case concerns income tax. The appellants (or the "**partners**") were partners in a partnership called Rota Rod ("**Rota Rod**" or the "**Partnership**"). The Partnership return for 2005/2006 has been amended by HMRC to reflect additional income which HMRC contends was earned by the Partnership in that tax year. In 2005, the appellants were also shareholders in a company which had been incorporated in or around October 2003, Rota Environmental Services Ltd (the "**Company**"). Some time in 2005, the business of Rota Rod was transferred to the Company. It is the appellants' position that the transfer took place on either 31 March 2005 or 1 April 2005. There was, accordingly, no partnership income for the 2005/2006 tax year. HMRC's position is that the transfer took place on 2 August 2005, and the profits of the Partnership which were generated between 6 April 2005 and 1 August 2005 should have been returned on the Partnership's return for that year. The knock on effect of this is that the appellants are subject to additional income tax for that tax year.

2. The major difficulty which faced us concerned the paucity of evidence on this point. Essentially HMRC rely on a letter dated 25 February 2011 in which the appellants' former advisers to HMRC stated that the Company took over the entire business of the Partnership on 2 August 2005. No one knows where this information came from. The partners also signed partnership returns and individual tax returns which are consistent with the Partnership having traded in the tax year 2005/2006. Against this the appellants point to a letter from HMRC to the Company dated 13 July 2007 in which the HMRC Officer indicates that she had been informed at a visit to the Company that the business activities of the Partnership were invoiced by the Company from around March 2005 which was borne out by the VAT returns of both registrations. And a letter dated 30 October 2009 from their former accountants, Pearlman Rose ("**PR**") to HMRC stating that the Partnership made no sales in 2005/2006. And that, frankly, is it.

3. Unsurprisingly, the appellants can remember very little about the circumstances of the transfer. It happened a very long time ago and in their oral evidence, recognised that they could not remember, with any certainty, the date on which the business of the Partnership transferred.

4. The reason for this delay is twofold. Firstly, the appellants had the misfortune of initially instructing the firm of Christopher Lunn & Co ("**Lunn**"). Its principal, Christopher Lunn, was found guilty of four counts of cheating the public revenue in December 2015. He received a custodial sentence. As part of the investigation into the affairs of Lunn, in June 2010, HMRC searched their premises and uplifted a very large number of documents. It took HMRC a considerable time to analyse these documents, and the location of the documents relevant to the affairs of the Partnership and the Company, has been something of a mystery. And until the disclosure stage of this appeal, the appellants had seen very few of Lunn's documents.

5. The second reason concerns HMRC's inordinate delay of more than six years in conducting their investigation into the appellants' affairs. PR had written to HMRC on 2 November 2011 about the appellants' tax affairs. Apart from a holding response in 2015, there was no communication from HMRC until their letter of 1 February 2018 which refers to the letter of 2 November 2011 and asks for apologies to be accepted for "the very lengthy delay in replying to your letter due to an internal reorganisation of the cases in the project".

6. The consequence of this delay is that the appellants' oral evidence about the date of transfer has little or no probative value. And the documentary evidence is virtually non-existent. We have therefore had to make bricks of fact without much, if any, straw of evidence.

7. The main issue that we have to decide is the date of transfer of the business from the Partnership to the Company. If we find that it took place before 6 April 2005, then the appellants must win this appeal. There was no partnership income in tax year 2005/2006 to be assessed. If we find that the date of transfer was 2 August 2005, then we must consider the validity of the discovery amendments, the extent of the profits omitted from the Partnership return for that tax year, whether HMRC gave an undertaking not to assess the appellants to income tax for that tax year, and whether the appellants are liable to penalties for negligently submitting their tax returns for that tax year.

8. Mr Doodley and Mr Bracegirdle made clear helpful and eloquent submissions, both orally and in writing. We are very grateful for those submissions which have helped us considerably, and we have taken those submissions into account (along with all of the evidence) even though, in reaching our conclusions we have not necessarily referred to each and every argument and item of evidence in detail.

THE EVIDENCE AND FINDINGS OF FACT

9. We were provided with a substantial bundle of documents. Mr Kingdon and Mr Stead both tendered witness statements and gave oral evidence on which they were cross examined. Mr Chris Harrop, Officer of HMRC, tendered a witness statement and gave oral evidence on behalf of HMRC on which he was cross examined. From this evidence we make the following findings of fact (although our finding of fact regarding the date of transfer of the Partnership's business to the Company is set out later on in this decision):

Background

(1) The Partnership was established by the appellants in 1993 and was based in Crowborough, East Sussex which is also where Lunn was established. The appellants instructed Lunn to act as the Partnership's accountants and their individual accountants, in about 1994. As far as the appellants were concerned, Lunn was a wholly competent organisation to whom they trusted their affairs and about whom they had few concerns until the General Commissioners meeting on 28 January 2009. Following that meeting, it was apparent to the appellants that Lunn seemed to be concerned only with having a fight with HMRC and were not necessarily acting in their best interests. They therefore terminated their relationship with Lunn and instead appointed PR as their accountants.

(2) The Partnership's business was the investigation, clearance repair and installation of drainage systems for both the commercial and domestic markets. Mr Kingdon and Mr Stead were, in 2004/2005 working extremely hard in the business and had little time to concentrate on anything other than getting in new work and servicing it. They had been told by Lunn that it would be a good idea to establish the Company, the business rationale for that being that in the early 2000's, the Environment Agency had started emphasising the benefits of sewage treatment plants in order to ensure a higher quality of waste that was to be discharged into public waterways. However, the structuring and method of operation of the two entities was left entirely to Lunn. The appellants were not certain how those entities interacted. There was a single Sage software package for both entities, and information on that software was given to Lunn who processed it. The appellants were completely ignorant of the way in which that

information was processed nor any rationale for dividing income and expenses between the Partnership on the one hand, and the Company on the other.

(3) In a letter dated 25 October 2005 from Lunn to HMRC's Regional Registration Centre, on behalf of the Company, Lunn sent duly completed VAT forms to cancel one VAT number, and stated that another VAT number, "under Rota Environmental Services Ltd will continue to be used".

(4) When, in June 2006, Mr Kingdon was asked by Lunn to produce an invoice made out to the Company by the Partnership for £142,010, plus VAT of £24,851.75, in respect of consultancy services supplied by the Partnership to the Company "throughout the last year as required from time to time" (the "**June Invoice**"), he did so without question. He accepted that this probably did not reflect services which had actually been supplied by the Partnership to the Company.

(5) The minutes of the first meeting of the Company which was held on 1 July 2004 was chaired by Mr Dennis Lunn, who was appointed secretary of the Company.

(6) The Partnership's returns for 2005/2006, and 2006/2007 were submitted to HMRC on the basis that the Partnership were trading during those tax years. Furthermore, both Mr Kingdon and Mr Stead returned partnership profits on their personal tax returns for those tax years. These personal tax returns had been sent to them by Lunn on 12 July 2006 and had been signed by them. They had also been sent the Partnership tax return and Partnership accounts for 2006/2007 on 16 November 2007.

(7) The tax returns of the Partnership and the Company show that: in 2005, the turnover of the Partnership was £1,080,149 and in 2006 it was £142,010. The turnover of the Company for 2005 was £115,813 and in 2006 it was £1,066,263. The copy of the CT 600 in the bundle for the Company for the accounting period ended 31 March 2006 is unsigned but we find as a fact that it was completed by Lunn. The CT 600 for the Company for the accounting period ended 31 March 2007 was also completed by Lunn and is signed but not by an appellant.

(8) In a letter dated 13 July 2007 from Judie Struys of HMRC's Local Compliance South to Mr Kingdon acting for the Company, (the "**July letter**") the author indicates that she had received a letter from Lunn dated 25 June. She goes on to ask in which letter she had stated that the business was transferred from the Partnership to the Company as she had reviewed her correspondence and not found that statement. But she had been informed by Mr Kingdon at her visit that the business activities (primarily drain clearance) of the Partnership were invoiced by the Company from around March 2005, and this is borne out by the VAT returns of both registrations. She goes on to discuss the June Invoice and her decision to disallow the input tax on it.

(9) HMRC opened an enquiry into the Partnership's return for 2005-2006 on 23 November 2007 and then closed that enquiry without any amendment as evidenced by a letter to PR dated 17 May 2010.

(10) HMRC had also opened an enquiry into the Partnership return for 2004-2005. That Partnership return was considered at a meeting of the General Commissioners on 28 January 2009, the main issue before the Commissioners being the deductibility of various expenses. The Commissioners decided that some of the expenses claimed by the Partnership were not deductible for tax purposes. HMRC's letter of 17 May 2010 records the fact that the 2005 partnership enquiry had been closed the previous year, the notice has been issued and the

partners returns had been amended. The only outstanding issue concerned whether there might be penalties.

(11) Following that General Commissioners' meeting, the appellants dismissed Lunn as their advisers and appointed PR in their stead. PR attempted to obtain information about the appellants' tax affairs from HMRC (see letter from HMRC dated 22 July 2009 in which HMRC provided a certain amount of information regarding the enquiries into the Partnership's returns for 2004/2005 and 2005/2006). On 30 October 2009, PR wrote at some length to HMRC regarding the deductibility of round sum expenses in relation to the 2005/2006 enquiry. In that letter (the "**October letter**") PR reported the fact that during the financial year the accounting records of the business as a whole, "by which we mean the partnership and RESL were maintained using one dataset on Sage software". And that "We also understand from our discussions with the partners that the partnership did not generate any income in its own right and that all sales were actually invoiced by RESL….. However, since the assets used by RESL were owned by the partners, a certain amount of this income and some of the expenses were allocated to the partnership….". It also states that "the trading activities were predominantly carried out through RESL….".

(12) On 22 June 2010 HMRC Officers raided Lunn's premises and uplifted a very large number of documents including those relating to the Partnership and the Company. These documents included the client files containing copies of their accounts, annual spreadsheets and schedules submitted to Lunn detailing income and expenditure, and details of Lunn's contact with their clients.

(13) Officer Harrop was one of the officers responsible for reviewing that information. His evidence was that once they had identified clients of Lunn, they sent those clients a generic letter requesting that they review their tax affairs and seeking disclosure where such review disclosed an error. Where no disclosure was received, the clients and their new agents were contacted. In a letter dated 17 September 2010 from HMRC to the Partnership HMRC explained that they were intending to review the appellants' tax returns which HMRC thought might not be correct for a number of reasons, but that if the appellants thought that their tax returns were incorrect, they should contact HMRC and make full disclosure. HMRC also stated that copies of papers held by Lunn should be available for the appellants to access from 24 October 2010. To do so the appellants should contact Lunn.

(14) In response to that letter, in a letter dated 25 February 2011 to HMRC (the "**February letter**") PR rehearsed the history of the enquiry into the 2005/2006 tax return and confirmed that they had been instructed on 27 May 2009 as a result of the appellants' dissatisfaction with Lunn. They went on to explain that they had been instructed by the appellants to review the Partnership and the Company accounts and returns for the years 2007, 2008 and 2009. For this purpose, they were provided with the trial balances which had been prepared by their clients in-house bookkeeper. They then say "RESL took over the entire business of the partnership as from 2 August 2005 and commenced trading in its own right as from that date. Therefore, if the principle that was established by the General Commissioners in determining the amount assessable for 2005 were to be applied then only that part of the income and expenditure that related to the period up to 1 August 2005 would be assessable on the partnership and thereafter upon RESL".

(15) It appears that HMRC wrote to the appellants on 29 July 2011 since PR, in their letter of 5 August 2011 to HMRC, explained that PR acted as tax agents something of which HMRC were aware given the terms of the February letter.

(16) PR wrote again to HMRC on 2 November 2011 referencing HMRC's letter of 22 December 2011 and the February letter. PR stated that as mentioned in the February letter, there may be some irregularities in their client's tax returns for 2007, 2008 & 2009. They. explained that they only had access to limited information and not yet received Lunn's working papers. PR were not, at that stage, in a position to advise their clients to sign the declaration stating that disclosures were correct and complete. They had been provided with trial balances and might have been able to estimate some of the irregularities for 2007 and 2008 but not for 2009. They asked for any information that HMRC might have obtained from Lunn which might assist.

(17) In a letter dated 22 June 2015 to PR, DP Hurton of HMRC states that he was now dealing with the appellants' and the Company's affairs "in respect of the irregularities arising in the returns made to [HMRC]." He goes on to note that PR has been unable to obtain sufficient records to prepare disclosure, and that he had asked for copies of the information and documents obtained by HMRC's criminal investigation team and which had been uplifted during the raid. It went on to say "on receipt of the information and documents I will complete a review to identify any irregularities arising in each of your client's personal returns for the years 2006/07 to 2008/09 inclusive and in the company returns for the 3 years ending 31 March 2009".

The discovery amendments - process

(18) On 1 February 2018, HMRC wrote to PR (the "**discovery letter**") referring to PR's letter to them of 2 November 2011. HMRC stated that they had reviewed the case files and draft proposals for settlement of the various issues. It takes into account that, as set out in the February letter, the transfer date was 2 August 2005, and that income and expenditure will be assessable on the Partnership for the period to 1 August 2005, and on the Company, from that date. It apportions a revised profit to the Partnership of £95,388. It adjusts various expenses claimed by the Company. It adjusts the Company's profits. As a result of the expense adjustments, the Company's profits have been increased in certain years, and HMRC had treated these increased profits as distributions and provided the level of dividends attributable to the shareholders. It records that additional income and capital gains are attributed to the appellants. £28,193.11 to Mr Kingdon; £22,374.81 to Mrs Kingdon, £30,605.71 to Mr Stead and £6,505.56 to Mrs Stead. It also records the additional increase in Corporation tax for the Company of £8,598.23. It indicates that penalty and interest charges will be imposed, and then sets out the revised liability for the additional tax penalty and interest charges for the Company and the partners. It proposes that the liabilities are settled by contract settlement.

(19) Doodney Tax Consulting ("**DTC**") were appointed to act for the appellants in succession to PR on or around 15 May 2018. In a letter to HMRC dated 8 June 2018 they set out the background to the situation as far as they understood it and made the comment that "the partnership traded as contractors from the early 1990s until 2/8/05 when the whole of the trade was transferred to RESL". They went on to review the discovery letter and sought further information from HMRC in order to enable DTC to reconcile the various figures.

(20) Following correspondence between DTC and HMRC, on 15 March 2019 Mr Harris of HMRC, the author of the discovery letter, wrote to the appellants in their capacity as individuals, and to Mr Stead in his capacity as nominated partner of the Partnership and also as a director of the Company. It was in effect a revised view of the matter letter which reiterated, in short form, the issues and numbers set out in the discovery letter. It explained that he was

intending to issue tax assessments and penalty determinations within 7 days from the date of that letter. Those assessments and determinations were issued on 21 March 2019.

(21) On 2 April 2019, DTC applied to HMRC to enter the dispute into the ADR process. On 26 April 2019 HMRC sent a letter to DTC indicating that the dispute could not be entered into such ADR process.

(22) On 3 April 2019, DTC on behalf of the appellants, the Partnership and the Company appealed against the assessments and determinations and, in a separate letter of even date therewith, requested an internal review. DTC also, on 3 April 2019, sent a letter of complaint to the relevant complaints branch of HMRC in respect of the delay in progressing matters and the manner in which HMRC had conducted their enquiry. In response HMRC accepted that they had been responsible for some delay in this case and that they had not managed things well. The complaint was upheld in part.

(23) By letters dated 3 June 2019, Mr Wilkinson, the HMRC Officer who conducted the internal review, communicated the outcome of his review to the appellants and to DTC. It cancelled all of the assessments and the penalty determinations. One reason for this was that the discovery assessments had been originally issued under section 29 Taxes Management Act 1970 ("**TMA**"), when the correct legislation is in section 30B TMA.

(24) On 18 September 2019 HMRC issued revised view of the matter letters to the appellants, the Partnership, and the Company. These reflected revised assessments which were implemented by amendments to the appellants 2005/2006 self-assessment accounts.

(25) On 7 October 2019 DTC wrote to Officer Harrop, the author of the 18 September 2019 letters, raising a number of points. These included whether Lunn had acted deliberately; numerical adjustments for the 2005-2006 revised turnover of an additional £95,388 for the Partnership, and HMRC's revisions to the allowable expenses. It also made a without prejudice offer to settle.

(26) On 23 October 2019 Officer Harrop responded to that letter, indicating that it had been considered by the project lead, Officer Melia, and that consequential amendments had been made to each partner's self-assessment tax returns for 2005-2006, but the penalty determinations, previously raised, would remain in effect. The effect of those amendments to the returns is shown on the self-assessment account statements for each appellant which also reflected the calculations on account for succeeding years together with interest.

(27) In a letter dated 5 November 2019 to Officer Harrop, DTC made a formal appeal against the penalty determinations and also against the consequential amendments. It was DTC's view that once those amendments have been put into effect, a finalised discovery assessment would be made by notice to Mr Kingdon as nominated partner for the Partnership.

(28) In a letter dated 27 November 2019 to Mr Kingdon as nominated partner for the Partnership, Officer Harrop indicated that in his opinion the Partnership statement for the year ended 5 April 2006 was wrong and indicated he intended to make amendments to make sure the right amount of tax is paid. It tells Mr Kingdon that the amendments will charge each partner the amount that he thinks they should pay to make good any loss of tax, and that he would do this "now" as a time limit allowing him to make a discovery amendment and the amendment to the partners tax returns for those years was ending soon. It also tells Mr Kingdon that by amending the Partnership tax return, it may mean that HMRC need to make amendments to the individual partners tax returns. Such amendments were made in letters dated

27 November 2019 to the appellants. Those letters refer to the previous correspondence and 18 September 2019 and 23 October 2019.

(29) DTC made a further appeal and request for internal review which concluded on 13 August 2020 (the review period had been extended because of Covid). HMRC concluded that the liability for 2003/2004 was to be cancelled, leaving only the 2005/2006 tax year to be assessed, and that the original discovery amendments had been correctly made as had the penalty determinations.

(30) The appellants appealed to the tribunal on 1 September 2022.

The discovery amendments- quantum

(31) Officer Harrop's evidence concerning the adjustments to the Partnership's and the Company's turnover and profits for 2005/2006, which was not challenged by Mr Doodney when Officer Harrop was giving evidence (albeit that he had made submissions about the numbers both in his correspondence with HMRC and to us) was as set out below.

(32) After the end of the accounting period, Lunn made adjustments to the 2005/2006 accounts for the Company by adding direct costs of £244,638; repairs of £1,000; accountancy fees of £6,268 and bank charges of £7,619. A total of £259,525.

(33) Lunn had originally apportioned £242,010 of direct costs to the Partnership which was revised down to £142,010 and shown as the sales figure for the Partnership. The other £100,000 is shown as being split as "£60K Labour and £40K M Ex." It was Officer Harrop's supposition that this was motor expenses.

(34) The declared net adjusted profit for the Company was £145,170. Adding back Lunn's adjustments increased this to £404,695.

(35) The Partnership return for 2005/2006 shows income of £142,010. It also shows expenses of £97,962. £6,000 of this is for accountancy fees, yet all of these fees were paid and claimed by the Company. This reduces the expenses to £91,962. The capital allowances claimed of £22,526 are also overstated by £7,368, thus he reduced them to £15,181.

(36) So, the adjusted profit for the Company of £404,695 is reduced by the Partnership expenses of £91,962 and the capital allowances of £15,181 giving a revised taxable profit of £297,575. This is then apportioned on a daily basis between the Partnership and the Company for the period between 6 April 2005 and 1 August 2005, giving an apportioned profit to the Partnership of £95,388. Profit of £20,074 had already been declared on the Partnership return, so the revised additional taxable Partnership profit was £75,313, which was apportioned equally between the three appellants.

(37) In practical terms, when credit is given for the tax already paid, and the additional Company profit, which is treated as a distribution, has been taken into account, the additional tax payable by Mr Stead is £12,360.43; by Mr Kingdon it is £11,619.73, and by Mrs Kingdon it is £13,451.60. In addition, penalties of 10% of those amounts have been assessed on each individual.

The oral evidence

(38) Neither Mr Kingdon nor Mr Stead had any experience in tax or accounting. The Partnership's basic in-house record system was maintained by a member of staff whose role mainly involved the logging of income and expenditure and passing the records in their raw form to Lunn.

(39) Lunn dealt with all aspects of the accounting side of their business including income tax, VAT, CIS, personal income tax returns and submissions. Lunn, as far as they were concerned, were the experts in these areas, which the appellants were not. They were concentrating hard on growing their business

(40) Although Mr Kingdon's witness statement said that his understanding was that the transfer of the business from the Partnership to the Company was concluded in early April 2005, in cross examination he said he could not really be sure whether it was at the beginning of April, or at the end of March. He was not confident that it wasn't 1 August 2005. He simply couldn't remember.

(41) They were becoming increasingly concerned with Lunn which culminated in the General Commissioners meeting. It seemed that Lunn wanted confrontation with HMRC to which the appellants were strongly opposed.

(42) The length of time which this enquiry has taken has left the appellants with poor mental health, has caused considerable emotional stress, and has been a traumatic experience.

(43) Neither Mr Kingdon nor Mr Stead could remember being sent the partnership return, nor their individual income tax returns, for 2005/2006 or 2006/2007, nor signing them.

(44) Neither Mr Kingdon nor Mr Stead knew where the information set out in the February letter (namely that the Company took over the entire business of the Partnership as from 2 August 2005) came from.

(45) Mr Kingdon thought that before sending a letter to HMRC, PR might have sent it to him to approve, but couldn't be certain. They had always been satisfied with the work undertaken by PR.

(46) Mr Kingdon thought that it would make sense for the transfer to have taken place at around 1 April 2005 because of other things that happened.

(47) Neither Mr Stead nor Mr Kingdon knew that the returns they were submitting were incorrect. As far as they were concerned, they had given all the information to Lunn, Lunn had compiled the returns, and they had therefore assumed that they were correct.

(48) Mr Stead could not recollect whether he been sent copies of the returns, nor whether he had checked them. It never crossed his mind to question why he was sent copies of the Partnership accounts after the date on which the Partnership appeared to have ceased trading.

THE LAW

10. Such legislation as is relevant to this case is not in dispute. It is set out below.

The Discovery amendments

11. Section 30B (1) TMA states relevantly:

> *"*Where an officer of the Board or the Board discover, as regards a partnership statement made by any person (the representative partner) in respect of any period—
>
> (a) that any profits which ought to have been included in the statement have not been so included, or
>
> (b) that an amount of profits so included is or has become insufficient, or (c) that any relief or allowance claimed by the representative partner is or has become excessive, the officer or, as the case may be, the Board may, subject to subsections (3) and (4) below, by notice to that partner so amend the partnership return (including anything included in the return by virtue of section 12ABZB(7)(b) (amendment of partnership return following reference to tribunal)) as to make good the omission or deficiency or eliminate the excess".

12. Section 30B (2) TMA states relevantly:

> *"*Where a partnership return is amended under subsection (1) above, the officer 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 amendments of the partnership return"

13. Section 30B (3) TMA provides that no amendment can be made unless one of the conditions set out at sub-section 5 or 6 are met.

14. Section 30B (5) TMA states:

> "The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by —
>
> (1) the representative partner or a person acting on his behalf, or
>
> (2) a relevant partner or a person acting on behalf of such a partner".

15. The general time limits for issuing amendments to partnership statements is four years from the end of the year of amendment. This limit had expired for all years prior to the assessment being issued.

16. Section 36 (1A) TMA sets out extended time limits. These provide that where a loss of tax is brought about deliberately by the person then assessments may be made not more than 20 years after the end of the year of assessment.

17. Section 36 (1B) provides that reference to a loss brought about by the person include losses brought about by a person acting on behalf of the person.

Penalties

18. Section 95A TMA states that where a partner fraudulently or negligently delivers an incorrect partnership return each relevant partner shall be liable to a penalty not exceeding the additional tax payable by them.

19. Section 100 TMA states that the penalty shall be set at an amount which in the opinion of an authorised officer of the board is correct or appropriate.

BURDEN AND STANDARD OF PROOF

20. HMRC accept that the burden of proving that they have made a valid in time discovery amendment rests with them. And this includes the burden of establishing that the transfer of the business from the Partnership to the Company took place on 2 August 2005. The standard of proof is the balance of probabilities or more likely than not. HMRC also have the burden of proving that the penalty determinations are valid in time determinations. This includes establishing that the appellants were negligent when submitting their returns. The standard of proof is the same.

21. If HMRC have established that the transfer took place on or around that date, and that they have made a valid in time discovery amendment, then the burden of proof shifts to the appellants who need to show, again on the balance of probabilities, that the extent of the profits which had been attributed to the Partnership by dint of the discovery amendments is incorrect. They also have the burden of establishing, to the same standard, some other defence, for example, that the passage of time has rendered it impossible for them to have a fair hearing; or that HMRC have undertaken not to assess either the Partnership or the appellants to additional profit for the year 2005/2006.

DISCUSSION

Submissions

22. In summary Mr Doodley submits as follows:

(1) The best evidence of the transfer taking place at the end of March 2005 is the July letter. This shows that Mr Kingdon had told an HMRC Officer, at that time, that that was the date of transfer. This is supported by the October letter which clearly states that from PR's discussions with the appellants, the Partnership generated no sales income during the 2005/2006 financial year. The Sage report which was presumably the one which PR was relying noted that at 31 March 2006, the whole of the turnover of the combined businesses was the figure shown in the Company accounts.

(2) There is no evidence of the basis on which PR subsequently changed its view and in the February letter indicated that the transfer date was 2 August 2005. The fact that this date was repeated in the DTC letter of 8 June 2018 is an error. It is clearly not correct and reflected no independent analysis, and simply repeated what was in the February letter.

(3) HMRC's delay means that the appellants cannot remember, with any certainty, the date of transfer nor what they might have said to, or been told by, Lunn. This means that they cannot get a fair trial which amounts to an abuse of process – see *Nuttall v HMRC* [2022] UKFTT 192 ("***Nuttall***").

(4) The appellants have no accountancy or tax training. They relied exclusively on Lunn for advice in these areas. They simply did what Lunn asked them to do. They trusted Lunn with their affairs. They did not have the relevant knowledge or experience to check whether what Lunn was doing was correct.

(5) In their letter of 22 June 2015 HMRC gave what amounted to an undertaking that they would not assess the appellants to tax for 2005-2006, and that their recovery would be restricted to the years 2006/2007 to 2008/2009 taxes years. They should not now be permitted, in light of that undertaking, to recover tax for 2005/2006.

(6) There is nothing intrinsically wrong with individuals running their business through two independent entities, for example a partnership and a company. These were not sham entities. The fact that Lunn was apportioning the income and expenditure between those two entities does not automatically mean that Lunn were behaving deliberately improperly. In principle there is nothing wrong with apportioning turnover and expenditure to two trading entities.

(7) Whilst the appellants accept that the discovery was probably made on or around 1 February 2018, they do not accept that the amount of profit which has been added to the Partnership for the period to 1 August 2005 is correct. It has been extremely difficult to obtain the primary documents in order to undertake an analysis of HMRCs adjustments. Indeed it was not until disclosure in this appeal that Mr Doodney obtained the 4,000 or so documents held by HMRC following the raid on Lunn's premises. It seems that the allowable accountancy costs are too low, and the amount to be deducted for capital allowances is £23,974, not that used by HMRC in their adjustments.

(8) Nor do they accept that either they, or Lunn's behaviour is deliberate.

(9) Furthermore, the discovery amendment was technically deficient. HMRC's letter of 18 September 2019 to the nominated partner was intended to amend the partnership return but did not refer to the legislation or provide information about a right of appeal. It did not therefore meet the statutory criteria for a discovery amendment.

(10) The consequential amendments to the partners returns do not meet the statutory criteria either. Furthermore, HMRC's letters of 23 October 2019 referred to the consequential amendments, yet there is no indication of what they are consequential to. They could not be consequential to HMRC's amendments of 18 September 2019, since these were defective.

(11) HMRC's letter of 27 November 2019, the amendments which are under appeal, and which were notified to the nominated partner, do contain the correct information, but the letter sent to each partner, on the same date, refer to the intention to make that amendment which suggests it would be made in the future. The legislation is clear that amendments to individual partners returns can only be made after an amendment has been made to the partnership return.

(12) On the authority of *Sean Kelly* v HMRC [2021] UKFTT 162 ("***Kelly***"), the amendment made on 18 September 2019 which was understood by the appellants to be a discovery amendment is a valid discovery amendment, and so the amendment made on 27 November 2019 is a second amendment which falls foul of the prohibition on raising two discovery amendments in respect of the same discovery.

(13) The appellants agree that the test for negligence, as regards the penalty, is set out in *Blyth v Birmingham Waterworks Co* 1856 11 Ex 781 ("***Blyth***"), namely that "Negligence is the omission to do something which a reasonable man, guided upon those considerations which

ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence if, unintentionally, they omitted to do that which a reasonable person would have done or did that which a person taking reasonable precautions would not have done".

(14) In this case it was entirely reasonable for the appellants to rely on Lunn. There was no indication that Lunn was not competent, and once it became apparent that Lunn was not acting in the appellants' best interests, they were dismissed. Even if Lunn were negligent or had behaved dishonestly, that could not be attributed to the appellants.

23. In summary Mr Bracegirdle submits as follows:

(1) The appellants' oral evidence regarding their recollection of the event is clearly wholly unreliable. They signed partnership returns and individual tax returns reflecting income to and from the Partnership for not just the tax years 2005/2006 but also for 2006/2007.

(2) The July letter, relied upon by the appellants, as indicating that the transfer had been accepted by HMRC is taking place in March 2005, does not say that.

(3) It is clear that PR had been instructed to undertake a piece of work separate from that in relation to the enquiry into the 2005/2006 tax returns, when they were asked to review Lunn's work. PR had originally thought that having spoken to the partners, the Partnership had not traded in 2005/2006. That is evidenced in the October letter. But in the February letter, they had clearly changed their mind and stated that the Company took over the entire business of the Partnership as from 2 August 2005. They must have done this on the basis of some empirical evidence. It is likely that they were told this by the appellants.

(4) This date was also asserted as being the date of transfer in the DTC letter of 8 June 2018.

(5) Mr Doodney did not challenge Mr Harrop's figures when Mr Harrop was giving evidence. Any submissions, therefore, made by Mr Doodney as regards the figures should be ignored.

(6) It is clear that only one business was carried out by the Partnership and by the Company. The real position was not, as portrayed by Lunn that there were two businesses being carried on at the same time, by the Partnership, and the Company. At some stage there was a transfer of the single business from the Partnership to the Company. Lunn took the single set of figures provided by the appellants, whether on behalf of the Partnership, or on behalf of the Company and split them across the two businesses irrespective of the underlying reality of the activities undertaken by the entities. The figures did not reflect genuine commercial activity, as evidenced by the June Invoice. It is clear that Lunn did not think that the transfer had taken place in March or the beginning of April 2005 since they continued to submit partnership returns.

(7) Lunn were clearly acting on behalf of the appellants and the Partnership. They presented to HMRC a position which they knew to be wrong. They knew that there was only a single business and that there was intended to be a transfer. But they ignored that and presented to HMRC that there were two businesses being carried on concurrently by the Partnership and by the Company.

(8) The returns submitted by Lunn, therefore contained deliberately inaccurate statements since Lunn knew them to be incorrect. This is deliberate behaviour and thus justifies the 20-year limitation period.

(9) The letter of 22 June 2015 does not include an undertaking, by HMRC, not to seek to recover tax for that period 2005/2006. It simply indicates that once HMRC had further information, it would consider whether there were any irregularities for the three tax years 2006/2007 to 2008/2009.

(10) There are no technical deficiencies with the discovery amendment process, nor the notification of the discovery amendments to the appellants. The letter of 18 September 2019 is not a discovery amendment, it simply sets out what HMRC is intending to do, and the revised partnership figures. The only discovery amendment which fulfils the statutory description is that of 27 November 2019 which is what is under appeal now. Furthermore, if we were to find that there had been a discovery in September 2019, then the discovery amendment of 27 November 2019 was not seeking to replace an amendment that had previously been withdrawn. Whilst the letter of 27 November 2019 speaks of a notice being given to the partners, and these might have been sent, before 27 November, on 23 October 2019, those amendments are not under appeal. It is the amendments made on 27 November which are under appeal.

(11) What matters is that the discovery amendment was made in time, and it was made on 1 February 2018, which is within the 20-year time period.

(12) As regards the penalties, and whilst it is reasonable to rely on professional advice, each appellant does have a residual responsibility to check what his or her professional agent is doing. In this case that required a simple mathematical exercise and it should have been obvious that the direct costs required a substantial adjustment. This did not require any specialist technical tax or accounting knowledge, and was well within the competence of the appellants.

Approach to evidence

24. There are a number of cases which, over the last decade, have considered the approach to be taken in respect of oral evidence received, particularly concerning facts and matters which occurred sometime before the giving of the evidence. These cases have been comprehensively reviewed in the judgment of Judge Brooks in *Hargreaves v HMRC* [2019] UKFTT 244.

25. So far as material in the present appeal the Tribunal notes, from that judgment, that a certain degree of caution is to be taken because:

> "26. ……
>
> (1) memories are fluid and malleable, being constantly rewritten whenever they are retrieved …
>
> (2) the process of … litigation … subjects the memories of witnesses to powerful bias …..
>
> (3) witnesses, especially those who are emotional, who think they are morally right, tend very easily and unconsciously to conjure up a legal right that did not exist….".

26. The judgments summarised by Judge Brooks conclude that:

> "The best approach from a judge is to base factual findings on inferences drawn from documentary evidence and known or probable facts. "This does not mean that oral testimony serves no useful purpose… But its value lies largely… in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth".

27. This approach is relevant in the present appeal.

Date of transfer

28. We deal first with the date of transfer which is clearly the fundamental issue. As mentioned above, there is very little direct evidence. The appellants' oral evidence has little or no probative value due to the lengthy delay between the hearing and the date of transfer, and the involvement of Lunn to whom the appellants devolved responsibility for all the tax and accounting matters arising from their trading entities. There are no documents of transfer, no partnership minutes, no board minutes, nothing which might give us a direct handle on transfer date.

29. We simply have the July letter, the October letter, the February letter, and the fact that the Partnership and the individual appellants, as partners, signed tax returns in which there was no recognition of a cessation of the Partnership's activities in the 2005/2006 tax year, and recognised income from the Partnership's activities accruing during that year. There were also, incidentally, partnership and individual tax returns recognising income from the Partnership's activities in 2006/2007, which even on HMRC's case that the transfer took place on 2 August 2005, are surely incorrect.

30. It is clear that as a basic proposition, the figures in the accounts and tax returnsof both the Partnership and the Company, should reflect underlying commercial reality. It seems pretty clear to us that, as submitted by Mr Bracegirdle, this is not the case. It seems to us that the single set of financial information set out in the Sage package was sent by the partners to Lunn who simply apportioned the income and expenses between the two entities as Lunn thought fit. There is no evidence that Lunn undertook any sort of verification of the real commercial activities undertaken by the two entities. The evidence of the June Invoice makes it very clear that Lunn were unconcerned about the reality of the commercial transactions. That invoice was simply a paper exercise. We do not know their motives, but a clue might be gleaned from the evidence of the appellants that it became clear to them at the General Commissioners meeting, that Lunn's interest was not in looking after them, but in doing down HMRC. And it may well be that Lunn simply took the data and apportioned it without thought of the consequences to the appellants, but with a view to minimising the tax payable to HMRC.

31. Be that as it may, what is clear to us is that the documents prepared by Lunn on behalf of the Partnership and the Company have very little probative value when it comes to considering the actual business activities carried out by the two entities.

32. We wholly accept HMRC's point that the appellants have submitted returns which do not indicate a cessation of business in 2005/2006, which clearly should have been the case had the Partnership transferred its business to the Company on 1 April 2005. If this is right, there would be no income to declare on the 2005/2006 partnership tax return, nor should the

individuals have declared any income on their individual tax returns, something which they did.

33. But equally, Lunn prepared returns for 2006/2007 for both the Partnership and the individuals on which income from the Partnership was declared, something which was equally inconsistent with the transfer of the business on 2 August 2005.

34. The June Invoice is, to our mind, a sham document. It is simply a paper exercise. It is for an amount of the Partnership's turnover recorded in the tax return of the Partnership for 2005/2006. We accept Mr Kingdon's evidence that it probably did not reflect any real commercial activity. We reject it as evidence that the Partnership was trading between 16 June 2005 and 16 June 2006 (the date of the June invoice) and thus that the Partnership did not cease trading on 1 April 2005.

35. This is further reason for treating the documents prepared by Lunn but signed by the appellants and submitted to HMRC, with an evidential pinch of salt. They do not reflect the underlying commercial reality, and are, frankly, inconsistent with submissions that the business of the Partnership was transferred on either 1 April 2005 or 2 August 2005.

36. It is both parties' submissions that there was a single business carried on first by the Partnership and then, following a transfer, in succession to the Partnership by the Company. Neither party suggested that the business was being carried on at the same time, in parallel, by both entities. We cannot see why this might not be a possibility but are more than happy to accept the parties agreement on this point.

37. So it boils down to a choice between the July letter and the October letter on the one hand and the February letter on the other.

38. In the October letter, PR make it clear that they had discussed the position with the partners and that it was on the basis of that discussion they were able to tell HMRC that the Partnership did not generate any income in 2005/2006 and that during that period all sales were invoiced by the Company.

39. Yet eighteen months later, PR sent HMRC the February letter which contradicts this statement and declares that the transfer took place on and from 2 August 2005.

40. We accept HMRC's point that the evidence shows that PR had been separately instructed to undertake an exercise into the accounts and tax returns made by the Partnership and the Company. And that this was an exercise separate from the work they were doing in connection with the ongoing enquiries.

41. But unlike the October letter, which clearly identifies the source of information as being the partners, there is no indication in the February letter regarding the provenance of the date of 2 August 2005. Mr Bracegirdle submits that it was likely to have been the partners. But we do not agree. Having indicated the source of information as being the partners in the October letter, we think it is more likely than not that they would have identified the source of information as being the partners in the February letter, if that had indeed been the case. We do not think it was the partners who told PR that the transfer had been made on and from 2 August 2005 which PR then reflected in the February letter.

42. The source of information in the February letter is also to be contrasted with the July letter in which the HMRC Officer records the fact that Mr Kingdon had told her that the Partnership's activities had been invoiced by the Company from or around March 2005. Furthermore, there was some empirical confirmation of this in that this was reflected in the VAT returns.

43. Both the October letter and the July letter record that the partners were the source of information that the Partnership has ceased trading on or around March 2005 and that it had generated no income in the year 2005/2006. This is to be contrasted with the lack of identification of the source of information which enabled PR to say that the date of transfer was 2 August 2005 in the February letter.

44. The importance of the partners being the source of information is clear. It is they who were carrying on the real business, irrespective of how Lunn divided up the income and expenditure between the Partnership and the Company. If they were able to say when, in their view, the business transferred, then that is the best source of that information (even if that might have been told to them by Lunn). They clearly cannot say that now given that their memories have faded. But it seems clear from the foregoing letters that they were able, in 2007 and 2009, to say that the business transferred in or around 1 April 2005.

45. Furthermore, the October letter and the July letter are more contemporaneous with the date of transfer in 2005 than the February letter.

46. For these reasons we prefer the evidence and information in the October letter and the July letter, that the transfer was on or around 1 April 2005, to the evidence and information in the February letter and the signing and submission of returns submitted to HMRC that the transfer was on and from 2 August 2005.

47. Mr Bracegirdle, correctly in our view, accepts that the burden of establishing that the date of transfer was 2 August 2005 rests with HMRC. It is our judgment that HMRC have failed to discharge that burden. We find that it is more likely than not that the date of transfer was not 2 August 2005 but was at the end of March, or 1 April 2005.

48. On the basis of this finding, we allow the appeal, as there was no partnership income to be returned for the tax year 2005/2006, and thus the discovery amendments to the Partnership return for that year are incorrect. However, we consider that other points raised by the parties in their respective submissions given that they were fully argued before us.

49. We agree with HMRC that the letter of 22 June 2015 does not include any form of undertaking, which binds HMRC, from making the discovery amendments, and restricting recovery of tax to periods other than 2005/2006. This is clear from the terms of the letter which we have set out at [9(17)].

50. We also agree with HMRC that Lunn knew that the information submitted on behalf of the appellants to HMRC was incorrect. As we have said, in our view Lunn undertook no analysis of the underlying commercial activities of the respective trading entities and simply apportioned the income and expenses between them as Lunn thought fit. There was no verification undertaken as regards the reality of the position. In our view Lunn set out to deceive HMRC. This is deliberate behaviour for the purposes of the discovery. We also accept HMRC's point that given there was a single business which was carried out consecutively by the trading entities and not concurrently, Lunn made deliberately inaccurate statements to the contrary in the returns which it had filed on behalf of the appellants.

51. We also accept Mr Bracegirdle's submission that the discovery amendment is not technically deficient. We agree that the letter of 18 September 2019 is not a discovery amendment (it does not contain the relevant information and simply sets out what HMRC intends to do along with some adjusted figures), and the relevant discovery amendment is that of 27 November 2019 which is the amendment which is currently under appeal. We find that this was a valid amendment. And to the extent there has been at best some confusion, but at worst (as far as HMRC is concerned) failure to properly notify the appellants of the knock-on

effect of that amendment on their personal circumstances, that does not invalidate the discovery amendment in the first place.

52. On the question of quantum, we prefer Officer Harrop's evidence and follow his numerical logic. We accept that Mr Doodley raised misgivings regarding those calculations regarding accountancy costs and capital allowances in both his correspondence with HMRC and in his submissions to us. But we found the evidence supporting those misgivings is inconclusive, and furthermore, they were not put to Officer Harrop when he was giving evidence. We accept, therefore, that had the transfer date been 2 August 2005, the quantum of the discovery amendments was correct.

53. It is clear, as evidenced in *Nuttall*, that we have jurisdiction to consider the appellants' argument of abuse of process on the basis that the delay caused by HMRC's investigation into the affairs of Lunn has prevented the appellants having a fair hearing. And that if we find this to be the case, our case management powers would allow us to bar HMRC from defending this appeal. The basis of this submission is that had HMRC prosecuted their enquiry into Lunn and into the affairs of the appellants with greater alacrity, the appellants' memories would have been clearer as to what actually happened in or around April and August 2005, and as regards the evidence they might have given to PR regarding the date of transfer, and in those circumstances they could have given better evidence that the date of transfer was 1 April 2005.

54. We are sympathetic with this submission, but we do not accept it. It seems to us that there is clearly an issue with the memory of the appellants, but a greater issue is their understanding of what Lunn was actually doing as regards the financial information with which they were provided. As we have mentioned above, it is our view that Lunn's reflection of the figures in the returns that it made to HMRC bore no resemblance to the underlying commercial transactions undertaken by the Partnership and the Company. And the appellants clearly did not understand what Lunn was doing as evidenced by their oral testimony, and the fact that it was likely that the June Invoice did not reflect real services. This lack of understanding would not have been cured had the trial proceeded in, say, 2014. Whilst the appellants' memories might have been clearer, they would have had no greater insight into what Lunn was doing, and thus would not have been able to paint a clear picture, to the tribunal, of the date of transfer. We accept that they might have had a better recollection of the basis on which PR suggested that the transfer date was 2 August 2005. But to our mind this is insufficient to bar HMRC from defending this appeal on the basis of abuse of process.

55. Finally, as regards the penalties, we do not think that the appellants have acted negligently. They put their financial and tax affairs in the hands of an ostensibly competent firm of local accountants and tax advisers (Lunn), who initially demonstrated no lack of competence or ability. Once it became the appellants' view, at the time of the General Commissioners meeting on 28 January 2009, that Lunn were not acting in their best interests, they sacked Lunn. The appellants have expertise in relation to drainage systems but none as regards financial, accounting, and tax matters. By placing those matters in the hands of Lunn they were behaving wholly responsibly, and with a view to their duties to the tax system, and to HMRC. This responsible behaviour continued when they sacked Lunn. They were entitled to rely on Lunn to act in their best interests as regards the compilation of returns and their submission to HMRC. There was no need, nor duty, to question Lunn's competence.

56. In truth, they simply signed whatever Lunn put in front of them, but, as we say, they were entitled to do so subject to checking, to the extent of their personal abilities, the information contained in them. Mr Bracegirdle suggested that the returns for 2005/2006 could be checked without any technical expertise. We disagree, it is clear from the information that we have been presented with that the extent of the allowable expenses, for example, for both the Partnership

and the Company is not at all clear. As mentioned above, Mr Doodney took us through a number of documents suggesting why Officer Harrop's financial analysis was incorrect. This was way beyond the capacity of the appellants. They were entitled to rely on Lunn's expertise to submit accurate financial information to HMRC. They cannot be impugned for what essentially amounts to a fiscal frolic by Lunn.

DECISION

57. For the reasons given above, we find that it is more likely than not that the transfer of the Partnership's business to the Company took place at the end of March 2005 or 1 April 2005. We therefore allow these appeals.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

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.

NIGEL POPPLEWELL
TRIBUNAL JUDGE

Release date: 07th NOVEMBER 2022