[2015] UKFTT 0014 (TC)

TC04226

Appeal number: TC/2014/01119

CORPORATION TAX – self assessment – returns – penalties – potential lost revenue – substantial losses – whether no reasonable prospect of losses being used to reduce tax liability – burden of proof – extent of evidence – held, in absence of sufficient evidence, that requirement in para 7(5) Sch 24 FA 2007 not met – penalties due – no basis for suspension of penalties - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ELSINA LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN CLARK
MS ELIZABETH BRIDGE

Sitting in public at 45 Bedford Square, London WC1B 3DN on 11 November 2014

Michael Stean of Baker Tilly Tax and Accounting Limited, for the Appellant

Phillip Manley, Senior Officer of HM Revenue and Customs, for the Respondents

DECISION

1. The Appellant ("Elsina") appeals against two decisions made by the Respondents ("HMRC") and confirmed on review, to impose penalties on Elsina under Schedule 24 to the Finance Act 2007 ("Sch 24 FA 2007") in respect of the accounting periods ended 31 May 2010 and 31 May 2011.

The background facts

2. The evidence consisted of a bundle of documents; there was no oral evidence. From the evidence we find the following facts.

3. Elsina's financial statements show that it is an overseas company carrying on business in the UK through a London branch. This appeal relates to UK taxation in respect of the London branch income.

4. Following the submission at some earlier date of Elsina's Corporation Tax return for the period ending 31 May 2010, HMRC opened an enquiry pursuant to para 24 of Schedule 18 of the Finance Act 1998 ("Sch 18 FA 1998"). The HMRC officer dealing with the enquiry was Mr Manley. He indicated that the check into the return related to concerns which he held in the context of the £8.4 million loss on trading investments; he was seeking specialist advice from within HMRC.

5. In his subsequent letter dated 31 August 2012, Mr Manley said that he assumed that dividends had been excluded from Elsina's taxable income by virtue of Part 9A of the Corporation Tax Act 2009 ("CTA 2009"). He continued:

> "The financial statements appear to reflect an investment dealing business. Have you considered whether dividends should be subject to corporation tax by virtue of s931W?"

6. On 15 October 2012, Bruce Hunter, the Tax Manager of Rotch Property Group Ltd, responded to Mr Manley's queries. On the subject of investment income, he stated:

> "The dividends were excluded by virtue of Part 9A Corporation Tax Act 2009. I overlooked the application of section 931W Corporation tax Act 2009 and conclude that the dividends of £3.012,780 should now be included as part of the company's taxable income."

7. On 13 November 2012, Mr Manley sent Elsina a notice of enquiry under para 24 of Sch 18. He indicated that he would contact Mr Hunter for the information required. In a letter dated 28 November 2012 relating to both enquiries, he confirmed that the dividends for the earlier period would now be included as part of Elsina's taxable profit for that period, and asked for confirmation that for the later period the dividends were now taxable under s 931W CTA 2009.

8. On 10 December 2012 Mr Hunter replied, agreeing the adjustment for the year ending 31 May 2011 by which dividends received of £892,978 were accepted to be

taxable under s 931W CTA 2009. He stated that online amended returns for both years had been made on 28 November 2012.

9. On 19 December 2012 Mr Manley wrote to Mr Hunter to state that as a result he was considering charging a penalty for the late filing of an incorrect return for the period ending 31 May 2010, and also what level of penalty would be appropriate. He referred to the way in which a penalty was to be calculated. He asked for any representations which Mr Hunter wished to be taken into account on Elsina's behalf when considering a potential penalty.

10. In his reply dated 11 January 2013, Mr Hunter made various representations. (As these were part of the arguments before us, we deal with them later in this decision.) Mr Manley responded in two letters dated respectively 2 and 3 September 2013 relating to the two periods, having consulted HMRC's penalty consistency panel; that panel had confirmed the views which he set out in those letters.

11. After further exchanges of correspondence, Mr Hunter's letter dated 12 December 2013 appealing against the decisions to impose penalties and asking Mr Manley to reconsider the matter himself was treated by HMRC as a request for an independent review. (According to HMRC's skeleton argument, HMRC wrote to Elsina on 21 January 2014 to explain that a review would take the place of the penalty decision under s 49E of the Taxes Management Act 1970; as no copy of that letter was included in the evidence, we are unable to make any findings in respect of it.) On 31 January 2014, Gerald Beane, the HMRC Large Business Service Review Officer dealing with the matter, wrote to Elsina with the results of his review. His conclusion was that the notice of penalty assessment dated 27 August 2013 relating to both accounting periods should be upheld. He set out his reasons at some length.

12. On 21 February 2014 Elsina gave Notice of Appeal to HM Courts and Tribunals Service ("HMCTS").

Legislation

13. The relevant parts of para 7 Sch 24 FA 2007 are the following:

> "(2) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has not been wholly used to reduce the amount due or payable in respect of tax, the potential lost revenue is—
>
> > (a) the potential lost revenue calculated in accordance with paragraph 5 in respect of any part of the loss that has been used to reduce the amount due or payable in respect of tax, plus
> >
> > (b) 10% of any part that has not.
>
> (3) Sub-paragraphs (1) and (2) apply both—
>
> > (a) to a case where no loss would have been recorded but for the inaccuracy, and

> (b) to a case where a loss of a different amount would have been recorded (but in that case sub-paragraphs (1) and (2) apply only to the difference between the amount recorded and the true amount).
>
> (4) Where an inaccuracy has the effect of creating or increasing an aggregate loss recorded for a group of companies—
>
> (a) the potential lost revenue shall be calculated in accordance with this paragraph, and
>
> (b) in applying paragraph 5 in accordance with sub-paragraphs (1) and (2) above, group relief may be taken into account (despite paragraph 5(4)(a)).
>
> (5) The potential lost revenue in respect of a loss is nil where, because of the nature of the loss or P's circumstances, there is no reasonable prospect of the loss being used to support a claim to reduce a tax liability (of any person)."

Arguments for HMRC

14. As the burden of proof in respect of a number of matters falls on HMRC, the parties agreed with our suggestion that HMRC should present their arguments first.

15. Mr Manley referred to three areas relevant to the appeal, namely "reasonable care", the interpretation of para 7(5) Sch 24 FA 2007 in the context of losses, and the question of possible suspension of the penalty.

16. He argued that the actions of Mr Hunter were carried out for Elsina. Both Elsina and the Rotch Group, for which Mr Hunter worked, were under the same economic control. Further, Mr Hunter had signed the Notice of Appeal.

17. HMRC submitted that Elsina had failed to take reasonable care when completing its 2010 and 2011 returns. The burden of proof in respect of failure to take reasonable care fell on HMRC; Mr Manley argued that this burden was met. The question was whether a reasonable person would have done what Elsina had done.

18. The Rotch Group was primarily made up of property companies. Mr Manley submitted that it was reasonable to expect Mr Hunter to check the legislation relating to a financial trading company; it should be apparent that a company carrying on a different activity or trade from those companies carrying on property businesses might require different tax treatment.

19. Mr Manley referred to HMRC's Compliance Handbook Manual at CH81120. In the context of a careless inaccuracy, this explained what "reasonable care" was. It stated that what was necessary for each person to discharge his or her responsibility to take "reasonable care" had to be viewed in the light of that person's abilities and circumstances. HMRC would expect a higher degree of care to be taken over large and complex matters than simple straightforward ones. In HMRC's view it was reasonable to expect a person who encountered a transaction or other event with which they were not familiar to take care to find out about the correct tax treatment or to seek appropriate advice.

20. In the review letter, Mr Beane had stated that HMRC expected a greater level of knowledge and expertise from companies and large corporate groups with an element of complexity in their structure and activities than they did in respect of a small "singleton company"; Elsina was quite clearly in the former category. This, together with the fact that the same inaccuracy was evident in more than one return, indicated that reasonable care was not taken in submitting the two incorrect returns.

21. Mr Manley referred to the argument raised in correspondence, that Mr Hunter was an independent person to whom the task of dealing with the returns had been outsourced. Even if it were to be decided that this was the case, HMRC submitted that it was negligent of Elsina to fail to confirm that the accountant to whom it was outsourcing the task was knowledgeable in relation to the rules concerning a financial trading company. In HMRC's submission, the repeated error in the second return showed that Elsina should not have trusted him with the completion of the returns.

22. Mr Manley referred to *Wald v Revenue and Customs Commissioners* [2011] UKFTT 183 (TC). This made clear at [15] that the obligation to file a correct tax return was on the taxpayer, and the taxpayer could not transfer that obligation.

23. It followed from that decision that if a taxpayer (T) relied on an accountant to prepare a return for T, T would be responsible for errors in the return if the accountant was negligent on T's behalf.

24. For Elsina, it was argued that lack of knowledge on the part of both Mr Hunter and Elsina did not amount to failure to take reasonable care. In relation to Elsina's knowledge, it could not simply hand over the responsibility for filing a correct tax return. It was reasonable to say that whether the income in question was taxable or not would be within Elsina's knowledge.

25. Mr Manley pointed out that there were two separate penalties in Elsina's case, ie one for 2010 and one for 2011.

26. He also made reference to para 3(2) of Sch 24 FA 2007; as Mr Stean questioned whether it was open to HMRC to raise an argument not referred to in their skeleton argument, we deal with this below.

27. On the question of losses, Mr Manley referred to para 7 Sch 24 FA 2007; it is more convenient to consider together under a separate heading HMRC's arguments and the arguments put for Elsina.

28. In relation to the question of possible suspension of the penalties, he referred to the principles followed by HMRC and set out in their Compliance Handbook Manual at CH83151; they could suspend penalties where conditions could be set which were "specific, measurable, achievable, realistic and time bound". From the information available relating to the errors, HMRC had been unable to find conditions to set which would meet these requirements; the error was of such a nature that it would not be possible to occur again. Mr Hunter would now be aware of the existence of s 931W CTA 2009, and thus conditions could not be set. None of Mr Manley, the penalty

consistency panel, the review officer or Elsina and its advisers could offer any suggestion capable of meeting the HMRC criteria.

Arguments for Elsina

29. Mr Stean dealt first with the question of reasonable care. He emphasised particular wording in para 3(1)(a) Sch 24 FA 2007; an inaccuracy in a document was "careless" if the inaccuracy was *due to* failure by the relevant person to take due care. It was for HMRC to prove the cause of the inaccuracy. Mr Manley had said that Mr Hunter "did or failed to do". There had been no evidence as to what he did or failed to do; it was for HMRC to submit such evidence. Mr Hunter had explained the error in his letter dated 11 January 2013. It had arisen because he had been unaware of this particular rule.

30. What the present case concerned was the difference between knowledge and lack of knowledge. To use Donald Rumsfeld's third category, Mr Hunter had been unaware of his lack of knowledge.

31. The test had to be applied to Elsina. Whatever the relationship between Elsina and Mr Hunter, Elsina had no way of knowing the shortfall in Mr Hunter's knowledge. Thus Elsina was in the same position as Mr Hunter.

32. Mr Stean submitted that being unaware of a lack of knowledge was not in itself a failure to take reasonable care. If a person (X) was not aware, how could X act in respect of something of which X was unaware?

33. From Elsina's point of view, it relied on Mr Hunter as a tax professional with experienced credentials, someone whom it could reasonably expect to know the law. Elsina had had no knowledge of the relevant tax law.

34. Mr Manley had made assertions as to lack of experience, involvement with property companies and so on. There was no evidence to support these assertions.

35. In HMRC's skeleton argument, the error had been referred to as an omission. Elsina did not accept this characterisation. The dividend had not been omitted from taxable income; it had been expressly excluded by Mr Hunter from the taxable income because he thought this was the right thing to do. It was not correct to describe this as an omission.

36. Mr Stean distinguished the present case from the facts in the *Wald* case; in the latter, the taxpayer received a payment, knew about it, and omitted it from his return. The receipt was within his knowledge but he did not act on it. In the present case Elsina had received dividends, these had been included in its accounts, included in its tax return, and then excluded from that return in a conscious decision.

37. This had been a conscious decision which Elsina had reasonably thought to be correct, because it had been made on its behalf by an experienced tax professional. Up to this point, there had been no failure to take reasonable care; the error had resulted from an "unknown unknown" and not from any known omission.

38. Mr Manley had referred in argument to checks or lack of them. HMRC had asked no questions and had produced no evidence relating to checks or the lack of them. In one part of his letter dated 12 September 2013, Mr Hunter had said:

> "I am a tax professional with sufficient experience and suitable credentials for the company to have acted with reasonable care in outsourcing that role to me. Having done so, the question which then arises is to identify the (putative) failure on the part of the company to have taken reasonable care. The onus of proof in this respect rests with HMRC. Your letter appears to be silent on this point and does not appear to offer any identification or proof of something done or not done by the company which putatively represents a failure, on the part of the company, to take reasonable care.
>
> Grounds for my appeal against the imposition of the penalty therefore also extend to the absence of any identification or proof of actions (or absence of action) on the part of the company which (putatively) represented a failure of the company to take reasonable care."

39. Mr Stean referred to the correspondence. It was interesting that each time Mr Hunter appealed and asked the officer (Mr Manley) to consider matters, Mr Hunter never requested a review. The review which HMRC undertook was one which they had carried out unilaterally. Although Mr Hunter had referred to the need to have evidence and so on, all that HMRC had done had been to close the enquiry.

40. As Mr Manley had raised the question of para 3(2) Sch 24 FA 2007 without any advance indication in his skeleton argument, Mr Stean asked that the subject be deferred until later in the hearing.

41. He put his detailed arguments concerning the calculation of "potential lost revenue", considered below.

42. The question of suspension was a thorny one. In order to decide whether a penalty (if due) was capable of being suspended, it was necessary to know its cause. Until there had been a decision as to its cause, there would be no starting point. Because of the way in which things had unfolded, in the appeal process and in the Statement of Case HMRC had not pointed to a cause and effect. Mr Stean requested that if the Tribunal made a finding that a penalty was due, the matter should be remitted back to HMRC based on a finding of reasonable care.

43. Reverting to the subject of para 3(2) Sch 24 FA 2007, Mr Stean referred to the chronology in the context of the 2011 tax return. The enquiry into the 2011 return had been opened in November 2012; this had been prior to receipt of a letter challenging the position for the second year. It could not be inferred that Mr Hunter would know, without checking, that there was an error in the accounts for the second year. Mr Hunter had volunteered to check; this was not an unreasonable course of action.

44. Paragraph 3(2)(a) Sch 24 FA 2007 required that Mr Hunter discovered the inaccuracy at some later time. There was no evidence before the Tribunal as to when

Mr Hunter discovered the inaccuracy. He had remedied the position before he received the letter from HMRC in December 2012.

Discussion and conclusions

45. For a penalty to be payable under Sch 24 FA 2007, two conditions must be fulfilled. Condition 1 is that the document provided to HMRC contains an inaccuracy which amounts to or leads to an understatement of the person's liability to tax, or a false or inflated statement of a loss made by that person, or a false or inflated claim to repayment of tax.

46. In Elsina's case, the effect of omitting the dividend income from the computation of its trading income was to inflate the amount of the loss for the accounting period ended 31 May 2010 and to understate the taxable trading profit for the period ended 31 May 2011 against which trading losses brought forward were set. As a result, Condition 1 is fulfilled.

47. Condition 2 is that the inaccuracy was careless or deliberate, within the meaning of para 3 Sch 24 FA 2007. Under the latter, an inaccuracy is "careless" if it is due to failure by the relevant person to take reasonable care.

48. There is no definition of "reasonable care" in Sch 24. It is clear that what is reasonable will vary depending on the context. HMRC's interpretation of the term is set out at CH81120. They state:

> "Every person must take reasonable care, but 'reasonable care' cannot be identified without consideration of the particular person's abilities and circumstances. HMRC recognises the wide range of abilities and circumstances of those persons completing returns or claims.
>
> So whilst each person has a responsibility to take reasonable care, what is necessary for each person to discharge that responsibility has to be viewed in the light of that person's abilities and circumstances.
>
> For example, we do not expect the same level of knowledge or expertise from a self-employed un-represented individual as we do from a large multinational company. We would expect a higher degree of care to be taken over large and complex matters than simple straightforward ones.
>
> HMRC expects each person to make and preserve sufficient records for them to make a correct and complete return.
>
> A person with simple, straightforward tax affairs needs only a simple regime provided they follow it carefully. But a person with larger and more complex tax affairs will need to put in place more sophisticated systems and follow them equally carefully.
>
> In HMRC's view it is reasonable to expect a person who encounters a transaction or other event with which they are not familiar to take care to find out about the correct tax treatment or to seek appropriate advice.

. . .”

49. Although that interpretation does not amount to a statement of the law, we consider it to be helpful guidance in following the process of deciding whether a person has taken reasonable care. It is clear that in the case of a substantial and sophisticated operation such as a company like Elsina, it is reasonable to expect an appropriate degree of expertise in carrying out tax compliance tasks.

50. Mr Stean’s argument is that lack of knowledge of the particular statutory provision in question (s 931W CTA 2009), both on the part of Mr Hunter and Elsina, did not amount to failure to take reasonable care. The logical consequence of this argument would be that a company would be subject to less risk of a penalty if it relied on advice given by less knowledgeable (or even possibly by incompetent) advisers than if it relied on sophisticated and expert advisers.

51. In our view, the obligation to submit a correct and complete return requires that the return should be in accordance with the applicable legislation. The present case does not involve a difference of view as to the interpretation of legislation, and we make no comment on the question of penalties in the context of such a dispute. Here, the returns were submitted on the basis of the incorrect assumption that the dividends did not form part of Elsina’s taxable income. The consequence was that the returns contained an inaccuracy.

52. The reason for the inaccuracy was a failure by Elsina’s adviser, Mr Hunter, to consider whether the treatment of the dividends in the corporation tax computations was correct. We find that, given the context of Elsina’s tax affairs, involving a substantial and relatively complex operation, Mr Hunter should have taken greater care to ensure that those computations took account of the relevant law, s 931W CTA 2009. We further find that he did not take reasonable care, as he simply assumed that the dividends fell within the general rule so as not to form part of the profits subject to corporation tax.

53. We accept that Elsina relied on Mr Hunter to prepare the computations and returns on the correct basis. However (as Mr Manley submitted), the obligation to submit correct and complete returns falls on Elsina as the entity subject to corporation tax. As shown by *Wald*, that responsibility cannot be transferred to some other person. Despite Mr Stean’s submissions to the contrary, Elsina cannot escape its obligation to take reasonable care in preparing and submitting returns by seeking to rely on its absence of knowledge of the relevant law. There is ample authority to show that, in general, ignorance of the law does not excuse a person from a statutory duty.

54. Nor can Elsina escape that obligation by relying on the lack of reasonable care on Mr Hunter’s part. By using his services (and we do not find it necessary to analyse in detail the precise capacity in which he was acting for Elsina when dealing with the corporation tax returns) Elsina was delegating the task of preparing the returns. What it could not do was to absolve itself of its own compliance obligations; these remained with it despite the delegation of part of the process. We are satisfied that in this context a taxpayer cannot “hide behind” an adviser where the latter has not exercised the appropriate level of care.

55. Mr Stean referred to the burden of proof, and argued that HMRC had not shown evidence to establish that the inaccuracy was due to failure by the relevant person to take due care. His arguments were based on the state of mind of the relevant person.

56. We do not interpret the provisions of Sch 24 FA 2007 as requiring proof of the state of mind of the person in question. In our view, Sch 24 lays down a series of objective tests:

(1) Was the document given to HMRC within the list in the Table?

(2) Did it contain an inaccuracy leading to understatement of tax liability or overstatement of a loss?

(3) Was the inaccuracy careless, or deliberate?

(4) If potentially within the "careless" category, was the inaccuracy due to failure by the relevant person to take reasonable care?

57. We are satisfied that the first three of these tests are fulfilled, with the inaccuracy falling within the "careless" category. In relation to the fourth, we consider that the incorrect corporation tax returns are themselves proof that reasonable care was not taken in relation to their preparation and submission, and consequently that the inaccuracy was due to the failure of both Elsina and its adviser Mr Hunter to take reasonable care. As we have indicated, the test relating to reasonable care must take into account the context in which it is being applied, in order to establish what is or is not reasonable in the particular circumstances.

58. Mr Stean also referred to the words "due to" in para 3(1)(a) Sch 24 FA 2007; he argued that it was for HMRC to prove the cause of the inaccuracy. Again, we consider that the test is objective. Were the returns inaccurate? Clearly they were. Why were they inaccurate? The reason was that they failed to take account of s 931W CTA 2009, requiring the dividend income received in relation to the investment trading business to be treated as part of the taxable profits of that business. That failure was due to the lack of reasonable care taken to ensure that the returns complied with the relevant legislation. We find that the test is fulfilled, and that it is not necessary for HMRC to provide any form of additional proof of the causal linkage.

59. We do not think that it makes any difference whether the errors in the returns are characterised as "omissions" or as something else; the returns contained an inaccuracy, as the dividend income was not treated as part of the taxable profits. We agree with Mr Manley's submission that the inaccuracies in the returns consisted of omissions from Elsina's taxable profits.

Para 3(2) Sch 24 FA 2007

60. Mr Manley raised the question of para 3(2) Sch 24 FA 2007. This provides:

> "(2) An inaccuracy in a document given by P to HMRC, which was neither careless nor deliberate on P's part when the document was given, is to be treated as careless if P—

(a) discovered the inaccuracy at some later time, and

(b) did not take reasonable steps to inform HMRC."

61. Mr Manley argued that at the time it submitted the return for the period ended 31 May 2011, Elsina had known the position in relation to the previous accounting period. The enquiry notice in relation to 2011 had been issued on 13 November 2012, and the amended returns for both periods were filed on 28 November 2012.

62. Mr Stean referred to the chronology. In relation to the 2011 return, the enquiry into it was opened in November 2012; this was prior to receipt of the letter challenging the position for the second year. It could not be inferred that Mr Hunter would have known, without checking, that there was an error in the return for the second year. Mr Hunter had volunteered to check; this was not an unreasonable course of action.

63. Paragraph 3(2)(a) required that Mr Hunter discovered the inaccuracy at some later time. There was no evidence before the tribunal as to when Mr Hunter discovered the inaccuracy. He had remedied the position before he received HMRC's letter dated 28 November 2012 (received on the same date as his letter to HMRC explaining that he agreed the adjustment for the year ended 31 May 2011 and stating that online amended returns had been made on 28 November 2012).

64. Our response to the parties' arguments in relation to para 3(2) Sch 24 FA 2007 is that it only applies in circumstances where the inaccuracy in the document was neither careless nor deliberate at the time when that document was submitted to HMRC. We have already found that the returns each contained an inaccuracy when they were submitted, as they failed to take account of s 931W CTA 2009, and that inaccuracy was careless on Elsina's part. As a result, para 3(2) does not affect the position in Elsina's case.

Para 7 Sch 24 FA 2007

65. Under Sch 24 FA 2007, penalties are calculated by reference to the "potential lost revenue" (sometimes referred to as "PLR"). Elsina argues that as a result of para 7(5) Sch 24, the potential lost revenue is nil. On that basis, there would be nothing by reference to which the various factors applied by HMRC to adjust the amount of the penalty could be applied. In other words, if one of the multipliers is nil, the result will be nil.

66. We have set out para 7 Sch 24 FA 2007 at [13] above; Elsina relies in particular on the words in para 7(5):

> ". . . there is no reasonable prospect of the loss being used to support a claim to reduce a tax liability . . ."

67. Elsina submits that the burden of proof in relation to para 7(5) falls upon HMRC; in other words, it is for HMRC to establish that there is no reasonable prospect of the loss being used. The basis of this submission is *Jussila v Finland* [2009] STC 29, in which the ECHR determined that the imposition of penalties and

surcharges with a deterrent and punitive purpose involved a “criminal” process for the purposes of the European Convention on Human Rights so as to bring proceedings relating to such penalties and surcharges within the scope of Article 6 of the Convention.

68. Elsina relies on Article 6(2):

> “Everyone charged with a criminal offence shall be presumed innocent until proved guilty according to law.”

Elsina submits that Article 6(2) imposes a burden on HMRC to show that a penalty is due, and also relies on the standard guidance published by HMCTS:

> “In most Penalty Cases the burden of proof is on HMRC, who must satisfy the Tribunal that the penalty is due.”

69. In support of its submission, Elsina refers to First-tier Tribunal cases, in particular *Jeffrey Marshall* [2012] UKFTT 34 (TC), *Hector McDonald* [2011] UKFTT 795 (TC), and *Corballon Limited* [2011] UKFTT 798 (TC).

70. In the alternative, if the burden of proof is held to rest with Elsina, it submits that the representations made by Mr Hunter, together with implausibility on the facts of the proposition that sufficient resources would be deployed into this trading activity so as to utilise the losses, are sufficient to shift onto HMRC the burden of showing that such a proposition is reasonable.

71. In respect of the issue of the burden of proof, Mr Manley accepted that in relation to penalty hearings, the starting point was that the burden of proof fell on HMRC. However, the question whether there was any reasonable prospect of the loss being used was the second stage of a two-step process; once it had been established that a penalty was in principle due, the burden shifted to the taxpayer. HMRC therefore submitted that the burden of proof was on Elsina to show that there was no reasonable prospect of the loss being used.

72. We do not interpret the decision of the ECHR in *Jussila v Finland* as shifting the entire burden of proof in relation to penalty proceedings onto HMRC. We agree with Mr Manley’s submission that a two-stage process is involved. The cases cited by Elsina concern the initial question whether it had been established that the conditions for imposing a penalty had been demonstrated by HMRC. They do not relate to circumstances where those conditions have been established and, as a result, further factual issues have to be resolved.

73. Article 6(2), which was not directly in point in *Jussila*, provides that a person charged with a “criminal offence” (words which, *Jussila* shows, extend for these purposes to penalties and surcharges with a punitive purpose) is to be presumed innocent until proved guilty. It has been established that the standard of proof in the context of penalties, surcharges and similar matters is the balance of probabilities rather than the standard required for criminal offences; we do not set out in this decision details or citations of the cases decided by the Upper Tribunal and the courts

which set out the reasoning for use of the civil standard of proof in relation to tax matters of the type under consideration in this case.

74. We consider that Article 6(2) amounts to a form of "gateway condition" in relation to the question of burden of proof. It is for that reason that HMRC have to demonstrate that a person is, in principle, liable to a penalty. We do not think that the same reasoning applies to a form of "defence" against a possible penalty liability. Our interpretation is that once liability in principle has been established, as in Elsina's case, it is for the person liable in principle to provide evidence sufficient to show, on balance, that the penalty should be reduced or eliminated by some available relieving provision.

75. Thus we do not accept Elsina's submission that the burden of proof in respect of para 7(5) Sch 24 FA 2007 falls on HMRC (ie that HMRC must prove that there is a reasonable prospect of the losses being used to reduce a tax liability). Instead, it is for Elsina to show that there is no reasonable prospect of the loss being used to support a claim to reduce a tax liability, either of Elsina itself or of some other person.

76. In correspondence with Mr Manley, Mr Hunter raised the question of the meaning of the words "the loss" and "used" in para 7(5). Mr Hunter used an illustration; if a loss of 100 had been incorrectly recorded as a loss of 103, he argued that the potential lost revenue was based on 3, the difference between the two amounts, and not the entire 103. He gave his reasoning:

> "This is because the paragraph (Paragraph 7), read as a whole, is seeking to measure the causative effect of the error."

77. We are not entirely convinced by this reasoning, and prefer to express it in the following way. Paragraph 7(2) is referring to the whole of a loss that has been wrongly recorded as a result of an inaccuracy. It distinguishes between any part of the loss that has been used to reduce a tax liability, in which case the PLR is the amount so used, and any part that has not; in the latter case, the PLR is 10 per cent of the unused part of the loss resulting from the inaccuracy. Paragraph 7 has to be read in the context of para 5; para 7 is dealing with the method of calculating PLR where losses are involved, and PLR is calculated by reference to the inaccuracy.

78. The difficulty with para 7 is that at times it is referring to the whole loss (in Mr Hunter's example, 103) and at other times it refers to the part of the loss resulting from the inaccuracy. The net result is that the PLR is based on the 3 in Mr Hunter's example. Paragraph 7(5) does not make it clear whether the "no reasonable prospect" test applies only to the element resulting from the inaccuracy or to the whole of the loss; it does not use the words "no reasonable prospect of all or any part of the loss being used . . ." We leave this question to one side in order to examine the other issues concerning para 7(5).

79. HMRC's calculation of the PLR in Elsina's case is based on para 7(2)(b); this accepts that no part of the loss has been used to reduce the amount due or payable in respect of tax.

80. The amounts of Elsina's London Branch carried-forward losses at the close of the periods ending 31 May 2010 and 2011 respectively were £125,266,917 and £112,032,893. For the first period, the dividend income from trading investments was £3,012,780. For the second period, the dividend income from such investments was £892,978.

81. As a result of applying the 10 per cent factor under para 7(2)(b), the PLR for the first period was £301,278 and the PLR for the second period was £89,297.

82. Mr Manley referred to HMRC's application in Elsina's case of the 10 per cent factor in para 7(2(b). HMRC accepted that the factor could be nil if the conditions of para 7(5) were met. He submitted that there were two steps. First, was there a factual or legal reason leading to inability to use the loss? Secondly, was there a reasonable prospect of the loss being used? He referred to HMRC's Compliance Handbook Manual CH82371. He submitted that in applying the "reasonable prospect" test, there was no time limit, and that future profits were a reasonable prospect.

83. He referred to the respective penalties; these had been dealt with as two separate issues by HMRC. For 2010, the losses brought forward had been approximately £117 million, and further losses of £7.9 million had been incurred in that year, leaving about £125 million to be carried forward. As at 3 September 2013, HMRC had received two more returns from Elsina, ie for the periods to 31 May 2011 and 2012. As at the end of the latter period, Elsina's losses carried forward were approximately £113 million. The reason for the reduction in the losses was mainly a large profit in the 2011 period of approximately £14 million.

84. In his submission, it followed that at the date of the 2010 penalty, not only was there the reasonable prospect of the losses being used, but also there had been actual use of £14 million of losses for 2011. Thus while the penalty question had been under discussion, it could be seen that approximately 12 per cent of the losses were being used in a single year alone. Even recognising the loss of £1.5 million for 2012, he argued that there was the prospect of using the loss.

85. In relation to the 2011 penalty, the decision was the same; there were no further accounts, and it had to be decided that there was a reasonable prospect of the losses being used.

86. Mr Stean's primary argument on para 7(5) was that the burden of proof fell on HMRC. We have already concluded that we do not accept this argument. Leaving that argument to one side, he made two points. The first was that the converse of *a* reasonable prospect was *no* reasonable prospect. He submitted that HMRC had applied the wrong test in law, because the converse of a possibility was no possibility at all. The correct test, the converse, was that there was *a* reasonable prospect.

87. He argued that HMRC had to prove that there was a reasonable prospect that the loss would be used. Bearing in mind that the loss was at all times in excess of £100 million, it followed that HMRC must show that there was a reasonable prospect of

making profits in the same trade of over £100 million, and HMRC had to demonstrate that this was a reasonable prospect.

88. Mr Manley had drawn attention to the profit of £14 million in 2011, but this had been made in the course of liquidating the portfolio to repay bank loans, as referred to in the correspondence. Elsina had been left with perhaps £2 million. There was no reasonable prospect of this recurring, because the profit had been made from liquidating a much larger portfolio.

89. Mr Hunter had commented twice on correspondence as to Elsina's lack of capacity to continue. In his letter dated 1 January 2013 he commented:

> "Elsina Limited's trading activities declined by more than 90% during the year ended 31 May 2012 (see attached draft accounts). The level of activity since 31 May 2012 has declined still further. At the current time there is no prospect whatsoever of there being any available form of finance for this company to undertake trading activities in line with past levels. As at 31 May 2010 the company had a trading loss carried forward of £118,029,632. This loss would need to be used before the adjustment of £3,012,780 could give rise to an actual loss of revenue to HMRC.
>
> . . . At the moment it is inconceivable that the loss of £118,029,632 could ever be used; there is simply no money available to the company from either third parties or from any related companies to carry out trading activities."

90. In his letter dated 12 September 2013 he referred to Elsina's circumstances; the scope of its trade was diminishing in order to repay bank borrowings to the lending bank, which was itself in administration and looking to recover its loans.

91. Mr Stean commented that it had been made plain to HMRC that there were not assets within Elsina or related companies to enable it to carry on trading at the kind of level sufficient to use the losses. He submitted that there was an inherent commercial question as to plausibility; there was no evidence either way. He questioned whether activities would be redirected into a company (in any event, at a substantial level) when it had been eminently so unsuccessful.

92. Another aspect was the nature of Elsina's activity, of share dealing; there could be no presupposition that continuation of activity would cause losses to go down rather than up.

93. The basic proposition was one of evidence. If the submissions for Elsina on the burden of proof were wrong, it contended that the various factors put to the Tribunal were sufficient to shift the burden onto HMRC. The flaw in HMRC's approach was to point to theoretical possibilities only: this was not enough to discharge the burden on them, given the very high level of this hurdle amount.

94. In addition to considering the parties' arguments, we have reviewed the financial statements for Elsina's London Branch for the three years ending 31 May 2010, 2011 and 2012. These, and the arguments put by Mr Stean, appear to show that

if Elsina's activities continue on the reducing scale shown, it will take an extremely long time before a significant reduction can be achieved in the amount of the losses carried forward.

95. However, this amounts to speculation on our part. Mr Manley referred us to HMRC's Compliance Handbook Manual at CH82371. We emphasised to him that this is merely guidance provided by HMRC, and does not necessarily amount to a statement of the applicable law. As this guidance was the basis for the approach which Mr Manley took in arriving at the amount of the penalties, it is at least of assistance in explaining that approach:

> "The circumstances where the nature of the loss means there is no reasonable prospect of the loss being used will be limited.
>
> . . .
>
> You should not regard the loss as having no reasonable prospect of being used simply because the person currently has no source of income or gains that could produce a liability the loss could reduce. This decision will depend on the nature of the loss and the person's individual circumstances.
>
> Where a company is a member of a group of companies, you should take account of the group's potential to reorganise its operations and structure to make effective future use of surplus reliefs arising within the group."

96. In order to escape penalty liability by taking itself out of para 7(2)(b) Sch 24 FA 2007 and bringing itself within para 7(5), Elsina needs to establish that there is no reasonable prospect of the loss being used. The evidence provided to us is very limited; all we have is the London Branch financial statements for three years. The comments made in correspondence by Mr Hunter as to Elsina's future prospects do not amount to evidence as such. We are aware from the financial statements that Elsina has a London Branch, but there is no evidence as to its activities elsewhere, and therefore no means of establishing what if any commercial resources it may have available to allocate from other activities to its London Branch.

97. In the same way, we have no information about the structure of the Rotch Group and are therefore unable to establish whether there is no prospect of activities within that group being reorganised in such a way as to enable Elsina's scale of trading activity to revert to a level which would ultimately utilise the losses.

98. Thus, despite Mr Stean's cogent arguments to the contrary, we are unable to arrive at a finding that there is no reasonable prospect of the losses being used to support a claim to reduce a tax liability, whether of Elsina or of some other entity.

Calculation of penalties

99. In calculating the penalties, Mr Manley allowed a 95 per cent factor in arriving at the disclosure reduction. He did not allow 100 per cent, as Mr Hunter did not make a full disclosure at the point when challenged on the 2010 return, in particular that a

similar adjustment would be required for 2011. This had necessitated opening an enquiry into the latter return. We see no reason to make any change to the 95 per cent reduction.

100. The maximum penalty percentage was 30 per cent, and the minimum 15 per cent. As a result, the factor of 95 per cent was applied to the difference of 15 per cent, meaning that the disclosure reduction was 14.25 per cent. Thus the balance (30 – 14.25 = 15.75) per cent was applied to the 2010 PLR of £301,278, so that the penalty was £47,451.28.

101. For 2011, the resulting penalty percentage (15.75 per cent) applied to the PLR of £89,297.80 produced a penalty of £14,064.40.

102. We make no alteration to the amounts of the respective penalties.

Suspension

103. On the question of suspension, Mr Stean argued that in order to decide whether a penalty was capable of being suspended, it was necessary to know its cause. Because of the way in which events had unfolded, both in the appeal process and in HMRC's Statement of Case, HMRC had not pointed to a cause and effect. Mr Stean requested, in the event that the Tribunal found that penalties were due, that the matter should be remitted to HMRC based on a finding of reasonable care.

104. Even if we were persuaded by Mr Stean's submissions, we would be unable to take such action. Our powers are limited by para 17(4) Sch 24 FA 2007. The only action which we can take, on an appeal against a decision not to suspend a penalty, is to order HMRC to suspend a penalty. However, we can only do that if we consider that HMRC's decision was flawed.

105. We do not consider that HRMC's decision was flawed. We agree with HMRC's view, as expressed in argument by Mr Manley, that it would not be possible to set suspension conditions which would meet the appropriate criteria. As a result, it would not be appropriate to suspend the penalties.

Outcome of the appeal

106. Elsina's appeal against HMRC's decisions to impose both penalties and against their decision not to suspend either penalty is dismissed.

Right to apply for permission to appeal

107. 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.

JOHN CLARK
TRIBUNAL JUDGE

RELEASE DATE: 14 January 2015