Appeal number: TC/2014/06341

INCOME TAX – whether loss arising in trade any profits of which would have been subject to corporation tax could be set against profits subject to income tax – appeal against assessment allowed – PENALTY – whether reasonable excuse – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ENGLISH HOLDINGS **Appellant**

- and -

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

TRIBUNAL: JUDGE Barbara Mosedale

Sitting in public at the Royal Courts of Justice, London on 25 and 26 January 2016 with further submissions from HMRC dated 2 February 2016 and the appellant dated 5 February on the *Assange* case.

Mr M Firth, Counsel, for the Appellant

Mr D Yates, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Facts

1. The facts were not in dispute and are as follows. The appellant ('English Holdings') is a company registered in the British Virgin Isles ('BVI'). It is not resident in the UK. At the relevant time, it had a permanent establishment ('PE') in the UK through which it carried out its activity of trading in land situated in the UK. Had it made profits on this trade, the company would have been chargeable to corporation tax on those profits (see s5 and 19 CTA - §§16 & 46). In the year to 31 March 2011, however, it made a trading loss of over £2 million.

2. In addition to this trade, the appellant owned a number of investment properties in the UK on which it earned rental income. This letting business was not carried on through a PE with the result that the appellant was within the charge to UK income tax on the profits arising from this letting business. In the tax year (ended 31/3/10) the appellant made of profit of £1,015,219.73 on its investment properties which HMRC consider resulted in an income tax liability on the company for that year of £203,043.95.

3. The company claimed in its (late filed) tax return for 2009/10 to set off its loss arising out of the trading activities through its PE in year to 31/3/11 against its profit on its non-PE trading activities arising in the previous year (ie year to 31/3/10). The effect of the claim if valid would have been to reduce its income tax liability for year ended 5 April 2010 from £203, 043.95 to zero.

4. However, it now agrees with HMRC that that was wrong to make this claim in its 2009/10 tax return; HMRC have assessed it for the tax due for year ended 5 April 2010 of £203,043.95 together with a late filing penalty of £40,608. The appellant has withdrawn its appeal against the tax assessment, although the penalty remains under appeal.

5. Instead, as the appellant now agrees was correct, HMRC has treated the appellant as making a claim for tax relief outside a return, under Sch 1 B TMA 1970. HMRC opened an enquiry into this claim on 18 January 2013. HMRC rejected the claim to relief in the closure notice dated 16 December 2013. That closure notice is the subject of this appeal.

6. Due to the confusion over the correct procedure, the appeal against the closure notice was made out of time but HMRC do not take a point on this and I admitted it out of time.

7. In summary, the appellant appeals a rejection of its claim to relief from liability to income tax in the sum of £203, 043.95 and against the penalty imposed of £40,608 for late filing.

The dispute

8. The appellant considers that it is entitled to the relief claimed. It says this for two reasons:

(a) Ordinary rules of construction of English law;

(b) Application of the Treaty on the Functioning of the European Union ('TFEU') and in particular the right to free movement of capital.

English law (without reference to the TFEU)

Can a corporation tax loss be set against an income tax profit?

9. The appellant's claim is that it is entitled to offset a loss incurred in one trade against the profit made in another trade: and that it is entitled to do this even though the profit was within the charge to income tax while the other trade (if profitable) would have been within the charge to corporation tax, the reason for the different tax regimes being that the profitable trade was carried on other than through a PE while the loss making trade was carried on through a PE.

10. Without prejudging the issue, and only for sake of simplicity, I will refer to the appellant having an 'income tax profit' and a 'corporation tax loss'.

11. The appellant bases its claim on the wording of the income tax provision which allows losses to be set off, s 64 Income Tax Act 2007 ('ITA 2007'), which provides:

> (1) A person may make a claim for trade loss relief against general income if the person –
>
> (a) carries on a trade in a tax year, and
>
> (b) makes a loss in the trade in the tax year ('the loss making year')

12. The Appellant's point is that HMRC accept that in year 10/11 the appellant carried on a trade and made a loss in that trade in that year. (I will revert to the point that the tax year for income tax is not the same as for corporation tax below). The appellant therefore considers it is entitled to claim 'trade loss relief' against its general income (being income subject to income tax) because it had a corporation tax loss.

13. HMRC say that the appellant is not entitled to this 'trade loss relief' under s 64 ITA because the legislation properly interpreted does not allow a s 64 claim on a loss which, had it been a profit, would have been within the charge to corporation tax under the Corporation Taxes Act 2009 ('CTA').

14. For this proposition HMRC rely on s 5 ITA:

> Section 3 of CTA 2009 disapplies the provisions of the Income Tax Acts relating to the charge to income tax in relation to income of a company…if-
>
> (a) the company is UK resident; or

(b) the company is non-UK resident and the income is within its chargeable profits as defined by section 19 of that Act…"

15. This is mirrored in s 3 CTA as follows:

3 Exclusion of charge to income tax

(1)The provisions of the Income Tax Acts relating to the charge to income tax do not apply to income of a company if –

(a)The company is UK resident; or

(b)The company is not UK resident and the income is within its chargeable profits as defined by section 19.

16. Section 19 of the CTA defines chargeable profits as including trading income which arises through or from the PE and income arising from property held by a PE. It makes no mention of losses. It was this section that would have resulted in any profits which the appellant made through the activities of its UK PE being taxable to corporation tax. But, of course, the appellant's profits arose through activities not undertaken by its permanent establishment so those profits remained within the charge to income tax and were not excluded from ITA by s 5 ITA and s 3 CTA.

17. HMRC's point is that 'provisions…relating to the charge to income tax', which is the phrase used in both s 5 ITA and s 3 CTA, would naturally not only include the taxing provisions but also the relieving provisions; therefore 'provisions…relating to the charge to income tax' must include s 64 ITA. While I think this is correct, it does not really help HMRC's case. All that happens is that s 3 CTA (or s 5 ITA) can be read as saying:

'[*s 64 ITA does*] not apply to income of a company if

….

(b) the company is not UK resident and the income is within its chargeable profits as defined by section 19.'

(*wording in italics substituted for words of legislation)*

18. The 'income' referred to in the first line is clearly 'the income' referred to in (b). Read like this, it is clear that 'the income' referred to does not, in this case, exist and so the exclusion is ineffective. The only income which the appellant has is income which is ***not*** caught by s 19 CTA as it does not arise through a PE. Therefore, s 64 *does* apply to the appellant's income within the charge to income tax as (by definition) this is income not generated through a PE.

19. I do not think that the word 'income' can be read as including losses, so that s 5 ITA/s 3 CTA prevent a 'corporation tax' loss being used against an 'income tax' profit. And even if 'income' is read as meaning 'income or losses' and 'the income' as 'the income or losses' HMRC would still have to show that the losses were within the company's 'chargeable profits as defined by section19'. But s 19 does not refer to losses. S 19 refers only to 'income' and 'gains'.

20. A literal reading of s 64 ITA is that the appellant is right: theoretically a taxpayer could set off against its trading profits subject to income tax a loss incurred in a trade which, if profitable, would have been subject to corporation tax. HMRC's position was, if I reached this conclusion, that either I should give s 64 a purposive reading and/or the effect of other provisions meant that the loss would have to be set at nil. I will revert to the question of literal and purposive readings below at §§38-59, but deal first with the legislative provisions to which I was referred.

Losses cannot be calculated

21. HMRC's case, as I understood it, was that if driven to say the 'corporation tax loss' could fall into s 64 ITA, nevertheless the effect of other legislative provisions was that that was a Pyrrhic victory for the appellant as the loss would have to be set at nil.

22. Their first reason for saying this was as follows. Section 5 ITA/s 3 CTA operate to disapply 'provisions…relating to the charge to income tax'. HMRC pointed out that that includes a disapplication of Part 2 of the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA') because s 3(1)(d) ITA defines Part 2 ITTIOA as an income tax charging provision. So Part 2 ITTOIA is disapplied by s 5 ITA/s 3 CTA. And Part 2 ITTOIA comprises sections 3-259 and therefore s 26 is one of those provisions which is disapplied by s 5 ITA and s 3 CTA. Section 26 sets out how losses ought to be calculated:

> **Section 26 losses calculated on same basis as profits**
>
> (1) The same rules apply for income tax purposes in calculating losses of a trade as apply in calculating profits.
>
> (2) This is subject to any express provision to the contrary.

23. So HMRC say, if I have understood the argument correctly, that s 26 provides how losses have to be calculated if they are to be set off against income tax profits; but s 26 is excluded by s 3 CTA/s 5 ITA so far as the losses the appellant wishes to utilise are concerned. Therefore, say HMRC, the losses cannot be calculated and must be taken as nil.

24. I cannot agree with the second part of this proposition. S 26 ITTOIA is excluded by s 3 CTA/s 5 ITA but the effect of that is not what HMRC say:

> '*[s 26 ITTOIA does]* not apply to income of a company if
>
> ….
>
> (b) the company is not UK resident and the income is within its chargeable profits as defined by section 19.'
>
> (*wording in italics substituted for words of legislation)*

25. Firstly, s 26 is excluded in any event as s 26 ITTOIA applies to losses and on its face s 3 CTA applies only to income. Secondly, as I have said, s 3 CTA cannot be read as referring to income *and losses* because (a) s 3 CTA does not say so and (b) s 3

CTA clearly defines the income as being within s 19 and s 19 applies only to income and not losses (§19).

26. The effect is that s 26 is not excluded in so far as losses are concerned, even losses of a trade which would have been within section 19 if profitable. So the appellant's losses can be calculated. (And even if s 26 did not apply I do not necessarily agree with the proposition that that would mean they would have to be set at nil, but I do not need to consider this point).

27. (I note, in passing only as neither party suggested this, that the effect of s 26 is to treat provisions relating to the calculation of profits for income tax purposes as if they related to the calculation of losses. If s 3 CTA was regarded as a provision relating to the calculation of profits, the application of s 26 ITTOIA would appear to mean that s 3 CTA should be read as applying to losses:

> (1)The provisions of the Income Tax Acts relating to the charge to income tax do not apply to *losses* of a company if –
>
> (a)….
>
> (b)The company is not UK resident and the *loss* is within its chargeable profits as defined by section 19.
>
> (*words in italics substituted for legislative provisions)*

However, that would create a circular situation: if s 26 applies to put the losses into s 3 CTA, then s 3 CTA disapplies s 26 from the losses…and so on. It would also fail to deal with the problem that s 19 CTA applies only to profits and not losses. A much better view, I think, is that s 3 CTA/s 5 ITA are not provisions which *calculate* the profits but provisions which merely *identify* which profits are subject to income or corporation tax.)

Impossible to calculate?

28. Putting aside s 26 ITTOIA, there is another reason why HMRC say that any 'corporation tax loss' which is theoretically a loss within s 64 ITA must be set at nil and that is because, HMRC say, the loss has no basis period. Section 61(2) ITA defines a loss as being:

> "for the purposes of this Chapter any reference to the person making a loss in the trade…in a tax year is to the person making a loss in the trade…<u>in the basis period</u> for the tax year" (my emphasis)

29. Section 61(2) applies to s 64 as 'this Chapter' of ITA incorporates s 64 which is the section under which the appellant claims relief. So HMRC's point is that being able to rely on s 64 is useless to the appellant unless the appellant can show a loss in the trade <u>in the basis period</u> for the tax year.

30. Section 61(4) ITA brings in Chapter 15 (ss 196-220) of Part 2 of ITTOIA for the definitions of basis periods. Firstly, S 197 ITTOIA sets out the meaning of

'accounting date' which is the date in a tax year to which accounts are drawn up. The appellant drew its accounts up on 31 March each year. The appellant's position is therefore that the year to the accounting date forms the 'basis period' under s 198 ITTOIA and that therefore its 'corporation tax loss' has a basis period.

31. HMRC do not agree: they rely on s 18 ITTOIA. This provides:

> **Effect of company starting or ceasing to be within charge to income tax**
>
> (1)This section applies if a company starts or ceases to be within the charge to income tax under this Chapter in respect of a trade.
>
> (2)The company is treated for the purposes of this Part –
>
> (a) as starting to carry on the trade when it starts to be within the charge, or
>
> (b) as permanently ceasing to carry on the trade when it ceases to be within the charge.

32. HMRC rely on this provision in conjunction with the rules on basis periods. Special rules for basis periods apply when a company starts or ceases a trade: s 199 and 202 ITTOIA.

33. It seems to me that the natural reading of s 18 ITTOIA is that it has no application to the trade in question (being the one carried on by the PE and which would have been within the charge to corporation tax if profitable) because the appellant never starts or ceases to be within the charge to income tax in respect of that trade. The effect of that is that s 199 and 202 ITTOIA do not apply through the deeming effect of s 18. HMRC's case is that the result is that there is no basis period, but I cannot understand that. If s 199 and 202 do not apply, the default position is s 198(1):

> **198 General rule**
>
> (1) The general rule is that the basis period for a tax year is the period of 12 months ending with the accounting date in that tax year.
>
> (2)This applies unless a different basis period is given by one of the following sections-
>
> Section 199 (first tax year)
>
> …
>
> Section 202 (final tax year)
>
> ….

34. It appears s 199 and 202 would apply if the trade had actually started or ceased, as well as if it was deemed to do so, but no one suggested that it had done so at any relevant time so I proceed on the basis that this is not the case. Even if it was, the effect is simply a different basis period. HMRC's suggestion that there is no basis period is wrong: the effect of the general rule in s 198(1) is that there is always a basis period. If no basis period is given by one of the following sections, such as s

199 or 202, then the default position, as per s 198, is the basis period of 12 months to accounting date.

35. Even if s 18(1) is read as applying to the 'corporation tax trade', on the basis that it should be regarded as within the charge to income tax because the loss in it could be set off against profits subject to income tax as per s 64 ITA, then again it is difficult to understand HMRC's case that there was no basis period. S 202(2) would appear to apply as the trade would be deemed to start and stop in the tax year, thus giving the trade a basis period. But if HMRC's point is that it is impossible to work out the deemed start and stop date under s 18, then if they are right, all that means is that the general rule in s 198 applies.

36. In other words, a loss will always have a basis period under Chapter 15. Either it will have a special basis period calculated under ss 199-202 or it will have the default basis period of s 198(1). It is not possible for a loss not to have a basis period.

37. My conclusion is that consideration of s 64 ITA and the rules on basis periods is that the appellant is right that reading the legislation literally it is entitled to set its 'corporation tax loss' against its trading income within the income tax regime.

Is a purposive reading possible?

38. HMRC, needless to say, do not consider, even if I reach that conclusion, that that is the end of the matter. They consider that a purposive reading is possible and that purposive reading would exclude the 'corporation tax loss' from s 64 ITA. I move on to consider these issues.

39. The appellant's position is that no purposive reading of s 64 is possible. It says that HMRC has failed to suggest an alternative reading of the words used by Parliament.

40. I agree with the appellant that that the cannons of construction only permit the Tribunal to choose between meanings that the statutory language is reasonably capable of bearing; only where there is at least two such meanings should resort be had to Parliament's presumed intentions in order to choose between them. Where the words used can only reasonably bear one interpretation, there is no need to resort to Parliament's presumed intention. The Tribunal cannot effectively amend the legislation by giving it a reading it cannot reasonably bear in order to fit it in with Parliament's presumed intention. The authority for this includes *Pepper v Hart* [1992] STC 898 where Lord Browne-Wilkinson said:

> The court cannot attach a meaning to words which they cannot bear, but if the words are capable of bearing more than one meaning why should Parliament's true intention be enforced rather than thwarted.
>
> (p 919 a-b)

41. In the more recent case of *Chilcott* [2011] STC 456 the taxpayer appeared to be caught by the clear words of legislation by a charge to tax on a benefit that they had not received (or to the extent it was received, had paid back). The taxpayer's case

was that it was absurd and unjust and could not have been intended. While the Court of Appeal accepted that the provision was capable of injustice, considered Parliament had intended what it said. The charge to tax was upheld. Sedley LJ said at §28:

> I would add that it has been a new experience, for me at least, to listen to an argument that, although the words of the statute are plain and unambiguous, they should be construed as not meaning what they say, without any proposed remedial or alternative construction being put forward.

42. Here, the appellant complains that HMRC have not put forward an alternative reading of s 64. The provisions of s 64 are:

> (1) A person may make a claim for trade loss relief against general income if the person –
>
> (a) carries on a trade in a tax year, and
>
> (b) makes a loss in the trade in the tax year ('the loss making year')

43. If HMRC's case is that 'trade' must be read as limited to a trade within the charge to income tax then there is nothing in s 64 which would permit this wording to be read into it. I have already said why s 3 CTA can't be read as excluding a corporation tax loss from s 64, and also why the basis period argument doesn't get HMRC anywhere. There is always a basis period.

44. I note that s 64 requires the loss to be in a 'tax year' but I do not see this as helping HMRC. A tax year is defined in s 4(2) ITA as 'a year for which income tax is charged'. There is no requirement in s 64 for the loss to arise in a trade which is charged to income tax, merely to arise in a trade which took place in a year for which income tax is charged.

45. Nevertheless, for sake of completeness, I move on to consider HMRC's case that a purposive interpretation would favour their position.

Mutually exclusive regimes?

46. HMRC's first ground for saying that a purposive construction would be one which prevented the appellant setting its corporation tax loss against its income tax profit was that Parliament intended the income tax and corporation tax regimes to be mutually exclusive. For this proposition they referred me to s 5 CTA which provides:

> **5 Territorial Scope of charge**
>
> (1) A UK resident company is chargeable to corporation tax on all its profits wherever arising.
>
> (2) A non-UK resident company is within the charge to corporation tax only if it carries on a trade in the UK through a permanent establishment in the UK.

> (3) A non-UK resident company which carries on a trade in the UK through a permanent establishment in the UK is chargeable to corporation tax on all its profits wherever arising that are chargeable profits as defined in section 19 (profits attributable to its permanent establishment in the UK)
>
> (4) Subsections (1) and (3) are subject to any exceptions provided for by the Corporation Tax Acts.

47. HMRC's case is that the legislation has a clear scheme under which the appellant is entitled to relief for what HMRC see as a corporation tax loss. S 37 CTA allow a company to set trading losses against profits liable to corporation tax which arise in the same accounting period or immediately preceding period of 12 months. (S 37 does not itself refer to profits liable to corporation tax: s 37(3) refers to 'total profits' which are defined in s 1119 CTA 2010 as (by ref to s 4(3) and 4(4)) profits for which the company is chargeable for the period under the charge to corporation tax).

48. HMRC point out that income tax is charged in relation to tax years while corporation tax is charged in relation to accounting periods. There are also differences in policy between corporation tax and income tax on losses: income tax losses can be carried back or used in the current year at the option of the taxpayer; in corporation tax losses must be used in the current year before they can be carried back.

49. The loss which the appellant seeks to claim against its income arising in the same year is not necessarily lost if it loses the appeal: if it cannot be carried back, under s 45 CTA 10 it can be carried forward.

50. Moreover, it is not possible to set income tax losses (ie losses arising in a trade subject to income tax) against profits subject to corporation tax: this is because of s 36(3) Corporation Tax Act 2010 ('CTA 10') which provides, in the chapter of that Act which provides for relief for trade losses,

> In this chapter references to a company carrying on a trade are references to the company carrying on the trade so as to be within the charge to corporation tax in relation to the trade.

51. HMRC say, therefore, it is implicit corporation tax losses can't be set against any other profits: but the income tax legislation does not have a mirror provision to s 36(3) CTA, so it is not possible to say that Parliament did not intend corporation tax losses not to be utilised against income tax profits. There could have been a mirror provision, but there isn't.

52. Taking all this into account, it is not obvious to me that Parliament intended that taxpayers in the unusual position of having two trades, one subject to corporation tax and one subject to income tax, would not be able to set a corporation tax loss against an income tax profit (although it is clear they could not set an income tax loss against an corporation tax profit). Ordinary taxpayers are able to set losses arising in one trade against profits arising in other trades.

Double counting

53. However, I think it is obvious that Parliament would not have intended any taxpayer to obtain relief twice for the same loss. And, say HMRC, if the appellant is right, what is to prevent the appellant claiming relief for the same loss twice, once against income tax profits and once against corporation tax profits (assuming that its corporation tax trade moves into profit)? S 63 ITA prevents the same loss being used more than once against different income streams liable to income tax but it is difficult to see how it would apply in this situation:

> **63 Prohibition against double counting**
>
> If relief is given under any provision of this Chapter for a loss or part of a loss, relief is not be given for –
>
> (a) the same loss, or
>
> (b) the same part of the loss,
>
> under any other provision of this Chapter or of the Income Tax Acts.

54. On its face, s 63 only prevents a loss used against a profit subject to income tax being used against any other profit subject to income tax because it refers to 'this Chapter' of ITA or 'the Income Tax Acts'.

55. The appellant's reply is that the Income Tax Acts include the Corporation Tax Acts in so far as they 'relate to income tax': this is Schedule 1 of the Interpretation Act 1978:

> 'the Income Tax Acts' means all enactments relating to income tax, including any provisions of the Corporation Tax Acts which relate to income tax.

The Corporation Tax Acts include CTA 2010. The appellant's position is that s 37 CTA 2010 relates to income tax if the loss which the taxpayer seeks to claim under s 37 has already been used against profits liable to income tax.

56. It is very hard to follow the appellant's position on this. It seems to be saying that because the 'loss' referred to in s 37 (on the scenario it wins this case) would be a loss already used against income tax profits, that makes s 37 relate to income tax. But at best it is the loss that relates to income tax, not s 37.

57. So I do not think s 63 ITA does prevent double relief in the situation the subject of this appeal: is there any provision of the Corporation Taxes Acts that prevents double counting? Oddly, there does not appear to be a section which duplicates s 63 ITA. It seems it is merely implicit in s 37 that only one claim can be made under it for the same loss. But that is of no relevance here where the concern is whether, having made a claim under s 64 ITA, the appellant then makes a claim under s 37 in relation to the same loss.

58. So my conclusion is that if a purposive interpretation of the legislation is possible, the legislation either ought to be read as preventing a taxpayer claiming relief for the same loss twice or to prevent the possibility of the appellant claiming its

corporation tax loss against its income tax profits because, otherwise, it appears it could claim the loss twice. The difficulty, as already explained, is that HMRC do not propose an interpretation of s 64 ITA or the basis period rules that would achieve this purpose: what they wish me to do is to read in a qualification that is not there. And as I have said, I cannot do that.

Conclusion on English law (without consideration of ECA 1972)

59. There seems to me to be no obvious reason why Parliament would have intended taxpayers in the appellant's situation to be unable to set a loss from one trade against a profit from another trade, but every reason to suppose they did not intend any taxpayer to get relief twice for the same loss. If a purposive construction of the relevant provisions is permissible, it seems Parliament's purpose could be achieved equally by a purposive interpretation of s 63 ITA as of s 64 ITA or the basis period rules. In any event I am of the view that it is not possible to give a purposive interpretation of any of these provisions such that the appellant's claim is blocked. The appeal against the assessment is therefore allowed. I do not need to go on to consider the submissions on EU law as HMRC did not suggest EU law assisted their case.

The penalty

60. Section 93 TMA provided at the relevant time:

> (1) This section applies where –
>
> (a) any person (the taxpayer) has been required by a notice served under or for the purposes of section 8 or 8A of this Act …. to deliver any return, and
>
> (b) he fails to comply with the notice.
>
> (2) The taxpayer shall be liable to a penalty which shall be £100.
>
> (3) [not relevant]
>
> (4) If –
>
> (a) the failure by the taxpayer to comply with the notice continues after the end of the period of six months beginning with the filing date, and
>
> (b) …., the taxpayer shall be liable to a further penalty which shall be £100.
>
> (5) Without prejudice to any penalties under subsections (2) to (4) above, if –
>
> (a) the failure by the taxpayer to comply with the notice continues after the anniversary of the filing date, and
>
> (b) there would have been a liability to tax shown in the return,
>
> the taxpayer shall be liable to a penalty of an amount not exceeding the liability to tax which would have been so shown.
>
> (6) [not relevant]

(7) [not relevant]

(8) On an appeal against the determination under section 100 of this Act of a penalty under subsection (2) or (4) above that is notified to the tribunal, neither section 50(6) to (8) nor section 100B(2) of this Act shall apply but the Tribunal may –

(a) if it appears…that, throughout the period of default, the taxpayer had a reasonable excuse for not delivering the return, set the determination aside; or

(b) if it does not so appear….confirm the determination.

(9) references in this section to a liability to tax which would have been shown in the return are references to an amount which, if a proper return had been delivered on the filing date, would have been payable by the taxpayer under section 59B of this Act for the year of assessment.

(10) [not relevant]

61. The penalty of £40,608 was levied under s 93 TMA. £100 of it was levied under s 93(2) (first penalty for late filing of return), another £100 under s 93(4) (second penalty for late filing which has continued for six months) and the bulk of it under s 93(5) (tax geared penalty for late filing which has continued for more than twelve months).

62. I was not really addressed on the facts relating to the penalty. I am aware of the recent decision of the Upper Tribunal in *Burgess and Brimheath Developments* [2016] STC 579 that it is not only for HMRC to prove that a penalty has been incurred, but that it must do so even if the matter was not disputed by the appellant. However, I do not think that the case is a radical departure from established principles of litigation but should be seen as an application of them.

63. In that case, HMRC had maintained that due to (alleged) fraudulent behaviour by the appellants, it was entitled to make a discovery assessment and one which was outside the normal time frame. In their skeleton argument, the appellants denied the alleged fraudulent behaviour and thereby ought to have been taken as challenging HMRC's right to make a discovery assessment and to do so in the extended time limit. In the hearing, however, HMRC did not go on to address the issue of fraud and took the stance that only the liability to tax and not the validity of the assessment was in issue. The appellant said nothing on the issue of the validity of the assessment and the Tribunal made no findings on it: it's decision dismissing the appeal was overturned in the Upper Tribunal on the basis it was wrong in law to dismiss the appeal when HMRC had failed to prove a crucial part of its case which had not been conceded by the appellant.

64. So as a matter of fact in that case that appellant had disputed (even if not particularly clearly) a crucial element in HMRC's case that the assessment was valid. Here, it is clear that the appellant accepts that it was prima facie liable to the penalties. Its own skeleton appeared to admit that the tax return was filed late as it said: 'if a

return had been submitted….' and went on to argue why the penalty should be reduced. Its skeleton also said 'the facts relevant to this appeal are relatively simple and there is no dispute about them.' In the hearing, the appellant's counsel expressly accepted the return was late and its liability to the £200 penalty. The appellant accepted failure to file a return lasted for longer than a year.

65. Neither party referred in the hearing to the claim in HMRC's skeleton that this late return was simply one in a series of late returns. On the face of the documentary evidence it was clear that penalties for late returns had been raised in earlier years: it was also clear on the documents that the appellant had not disputed its liability to those penalties. So, in so far as it is relevant, I consider HMRC have shown that this was far from the first late return delivered by the appellant.

66. The documentary evidence before the Tribunal also showed that the penalty was charged at 20%. The maximum penalty was 100% of the tax. The penalty had been reduced by 20% for disclosure (the maximum under HMRC guidelines), by another 40% for cooperation (also the maximum reduction under HMRC guidelines), and 20% to reflect seriousness (half of the HMRC guidelines which gave a maximum reduction of 40%: seriousness referred to the amount of tax at stake and the gravity of the situation).

67. Having accepted its liability to the £200 fixed penalties, the appellant did dispute its liability to the remainder of the penalty of £40,408 being 20% of the tax assessed.

68. While I have accepted its entitlement to make the claim which was denied by the closure notice, it remains liable to pay the assessment to tax for the previous year. This was because, as explained above, and as accepted by the appellant, it had no right to make the claim in its 9/10 tax return. It ought to have accounted for the £203,043.95 albeit on my findings of law it was entitled later to have it back.

69. This point is critical because s93(5) provides:

> the taxpayer shall be liable to a penalty of an amount not exceeding the liability to tax which would have been so shown.

What liability 'would' the tax return have shown?

70. This is actually defined in s 93(9) as cited above:

> (9) references in this section to a liability to tax which would have been shown in the return are references to an amount which, <u>if a proper return had been delivered on the filing date,</u> would have been payable by the taxpayer under section 59B of this Act for the year of assessment. *(my emphasis)*

71. The appellant's case is that the return which was filed late actually showed a nil liability as it (wrongly) claimed the relief which should have been claimed later. Had that return been filed on time, a nil liability, says the appellant, 'would' have been shown.

72. HMRC disputes whether this is correct pointing out that there was nothing to show that at the date that the tax return ought to have been filed the appellant had even thought of the possibility of setting a corporation tax loss against an income tax profit.

73. I don't think this speculation is either here nor there: it seems quite clear to me that it would make a nonsense of s 93(5) to interpret it as referring to a hypothetical incorrect tax return: it can be interpreted and should be interpreted as referring to a hypothetical but correct tax return. S 93(9) refers to a 'proper' return. I reject the appellant's case that 'proper' in this context referred to a procedurally correct (ie on time) return. Clearly the rest of the phrase deals with whether the return was on time, so the 'proper' ought to be understood as referring to whether the return was correct. So the tax return would have shown a liability of £203,043.95 and under s 93(5) that figure was therefore the maximum possible penalty.

Just a timing difference

74. The appellant's next position was that a 20% penalty was excessive for what was merely a timing difference: they accepted that the return should have been delivered on time and the tax paid. But in view of their case (and my ruling) that they were entitled to the relief in the next period, all HMRC had been deprived of was the tax for a limited period. The appellant's opinion was that 20% was an excessive rate of interest.

75. I do not accept the premise on which this is based: penalties are intended to be punitive and not compensatory. They do not have to bear any resemblance to a rate of interest even where HMRC have simply been deprived of the money for a limited period. Indeed, it is normally the case with late filing and late payment penalties that HMRC is only deprived of the tax for a period: the taxpayer pays the tax late.

76. So there is nothing in this ground of appeal to persuade me it should be reduced on this basis.

Reasonable excuse?

77. It was accepted, I think correctly, that if the appellant could demonstrate a reasonable excuse it would be excused the penalty. This is because s 118(2) TMA provides:

> "…and where a person had a reasonable excuse for not doing anything required to be done he shall be deemed not to have failed to do it unless the excuse ceased, and, after the excuse ceased, he shall be deemed not to have failed to do it if he did it without unreasonable delay after the excuse had ceased….

The appellant's case on this was that, even if it lost its substantive appeal (which it has not), it had taken a reasonable view of the law and that amounted to a reasonable excuse.

78. I cannot agree. The appellant was liable to file a return by the due date and it failed to do so: its view of the law on its right to claim an income tax relief is obviously nothing to do with its failure to file its return on time. It cannot have caused the failure to file on time and indeed I was offered no reason why it failed to file on time. Even if it was, at the time the tax return was due, intending to claim the relief, that is no explanation of why it did not file the return, claiming the relief.

79. Moreover, the appellant does not suggest that it was a reasonable view of the law to claim the relief in its 9/10 return, so even if the point made in the above paragraph had not already conclusively determined this against the appellant, the fact is that its claim for an income tax relief was properly nothing to do with is 9/10 return.

80. I agree witih HMRC that the appellant has never explained its failure to file its return on time and in the absence of finding the cause for the failure to file on time, the Tribunal cannot find that the appellant had a reasonable excuse for its failure to file on time.

Reduction?

81. I accept, and I do not think it was in dispute that s 100B TMA applies to the penalty and that under s 100B(2)(b) that means that the Tribunal has power to uphold, set aside or vary the penalty (up or down).

82. My view is that the penalty appears to be appropriate and not excessive or insufficient. It was reduced to the maximum extent in accordance with HMRC's policy for disclosure and cooperation: it was half reduced for seriousness. This seems right: there was a substantial amount of tax at stake and there was a pattern of late or non filing.

83. In conclusion, I see no grounds to interfere with the penalty and I dismiss the appeal against it.

84. 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.

BARBARA MOSEDALE

TRIBUNAL JUDGE
RELEASE DATE: 20 JUNE 2016