



## NIGHTMARE TAX INVESTIGATION – A TRUE STORY

### This is a true story.

My client, let us call him Mr Green, is a self-employed on-course bookmaker by trade (the guys taking bets at the races) as was his father before him.

From a young age Mr Green was used to seeing large amounts of cash in the family. Nothing wrong with that. It was the way they lived.

As a bookmaker, he deals in cash every day. He has a cash float at all times – sometimes amounting to many tens of thousands of pounds.

Mr Green has never been one for traditional bookkeeping. He does though keep the detailed records of his daily bookmaking trading results plus a pile of receipts for his business expenditure which he lists and totals at the end of each year. His Tax Returns are prepared from these records.

His business and personal cash/bank transactions are not segregated.

October 2007: HMRC notified Mr Green that they were launching a Full Enquiry into his 2005/06 Tax Return.

Under Self-Assessment HMRC will process (not check) whatever we put on our Tax Returns. HMRC then has the right to make an Enquiry into our Returns – either looking at just one particular aspect of the Return, or a full books and records Enquiry.

I provided information and answers to HMRC's initial correspondence over the next few months. Mr Green took his bank statements and other records in to HMRC. As Mr Green's business and private affairs were not segregated HMRC was entitled to obtain all his personal bank and credit card statements.

HMRC invited Mr Green in for a meeting. As Mr Green had nothing to hide he was relaxed about going to a meeting with HMRC in order to clear things up as quickly as possible rather than insist that the whole process was dealt with by correspondence.

However, before the meeting date, something else cropped up.

### **Cash seizure**

March 2008: By coincidence, and completely unrelated to the HMRC Enquiry that was under way, an event took place that was to have major significance.

One day in March 2008 Mr Green and his parents were driving back from a trip to France when their car was stopped by Customs (HMRC Dover) for a routine inspection. Mr Green was asked "Are you carrying any cash?", to which he replied "Yes". "How much cash?" he was asked. "About £30,000" he replied. Not the answer the officials were expecting, but Mr Green could only tell the truth.

HMRC Dover confiscated his cash there and then, and subsequently notified him that it would not be returned until they were satisfied that the cash had come from a legitimate source, which he would have to prove to them.

Mr Green appointed solicitors to act for him in relation to the return of his cash.

April 2008: I wrote to HMRC Dover explaining Mr Green's need to hold large amounts of cash for business purposes and that this was well known by and on record with HMRC. (This point had been established in a previous HMRC Enquiry).

However, HMRC Dover would not budge and the lawyers set to work.

It was agreed that I would prepare an analysis proving that the cash held by Mr Green on the date of seizure did indeed come from legitimate sources.

### **The first meeting – main Enquiry**

July 2008: I attended a meeting with Mr Green and HMRC in relation to the Enquiry into his 2005/06 Return.

It was an ambush.



HMRC were represented by the case Inspector and her superior. The Inspector worked through a long, written script and asked Mr Green questions about his business and private life in 2005/06 plus detailed questions arising from her review of the records.

Mr Green couldn't remember key facts. HMRC could not understand how Mr Green's lifestyle could be supported by the low trading profits. The Inspector produced an analysis of the available information based on Mr Green's multiple bank accounts suggesting there was substantial undeclared income.

It didn't help that Mr Green had made some arithmetic mistakes in his lists of daily betting profits. Not many, but mostly mistakes that reduced the declared profits and thus feeding HMRC's suspicions about Mr Green. The Inspector suggested these were not innocent mistakes, but a deliberate downward manipulation of the figures and she intended to engage the services of a forgery expert to prove it (she never did).

The mistakes were not greatly significant in the context of this case, and they were readily admitted and the small tax adjustment accepted. But the Inspector was seeing them as part of a pattern.

HMRC pointed to clusters of bankings and withdrawals of cash across Mr Green's bank accounts for certain periods which, when looked at in a certain way, appeared to be suspicious. (Explanations were subsequently provided, but at the time of this meeting the blizzard of accusations was too much for Mr Green to respond to sensibly)

I won't go into the details, but HMRC placed the worst possible light on all the available information in Mr Green's bank and credit card statements for the period, drawing inferences about a possible alternative lifestyle fuelled by undeclared income.

A dramatic point arrived in the meeting when the HMRC duo announced they would leave the room so that I could confer with Mr Green. When they returned they expected to hear whether my client was prepared to make an admission of undeclared earnings.

Alone with Mr Green he was absolutely clear that he has nothing to hide and had no undeclared earnings or other source of undisclosed income. Yet he could not remember/explain much of HMRC's apparent findings.

In the coming months and years I was to understand that the period HMRC was looking into was a painful and turbulent time for Mr Green which included a marriage break-up, a stressful purchase of a not very successful property investment abroad which he had to complete having placed the down-payment a couple of years earlier when it seemed a good idea and a spell of poor trading profits all funded by a re-mortgage on his home plus significant financial support from family members. I think he had quite literally put a lot of this out of his mind.

The HMRC officials returned to the room and I told them my client did not have any undeclared income and was not making any admission or disclosure to them.

I also explained that in my view what was needed was an overview showing how Mr Green's business and personal transactions could be shown to reconcile with his bank and cash holdings at the beginning and end of the year. I said I would prepare this for HMRC but it would take some time. This reconciliation would also be used to satisfy HMRC Dover and obtain a return of Mr Green's cash.

HMRC concluded the meeting by giving Mr Green a formal notice of Enquiry into his 2006/07 Return. They were convinced "something was going on". In order to protect HMRC's position they were going to:

- carry out a full books and records enquiry into Mr Green's 2006/07 affairs as well as 2005/06
- write to me formally setting out their questions and concerns, so that I could provide explanations, and
- raise assessments based on their findings in order to collect the tax which they believed was due

Why was Mr Green selected for Enquiry?

HMRC will never disclose the reason for launching an Enquiry.

It could be random, or it could be targeted – for example low profits, below industry norms.

Or they could be acting on "information".



Mr Green has an idea about who might have made a malicious report to HMRC that he needed “looking at”, but we will never know for certain.

HMRC have enquired into his tax affairs twice before. Once in the 1990s and then a few years before the current Enquiry. No significant adjustments to profits arose from the earlier Enquiries. It is possible that HMRC had simply regarded him as high risk – ie a cash based business with no formal bookkeeping system – and have decided to check him out every few years.

(we have had many discussions over the years with Mr Green about improving his bookkeeping)

### **2 cases running in parallel**

In the summer of 2008 we were dealing with 2 parallel cases – the HMRC Dover Cash Seizure and the HMRC Portsmouth Enquiries into Mr Green’s 2005/06 and 2006/07 Tax Returns.

Although they denied it, I believe that that the existence of the other case increased the level of suspicion in both HMRC Offices. It was never clear how much communication, if any, there was between these 2 offices.

### **The HMRC Assessments**

August 2008: HMRC Portsmouth wrote to me with pages and pages of questions. Basically, they wanted documentary evidence of every single bank transaction in every single bank and credit card account for 2005/06 and 2006/07. Most of Mr Green’s records had been lost during the lengthy divorce court proceedings, so copies of statements, paid cheques etc had to be obtained from the banks, and other documentation had to be found.

August 2008: When the HMRC Assessments arrived Mr Green didn’t know whether to laugh or cry. He actually laughed. Quite a lot. He thought the whole thing was a joke.

### **But HMRC were serious.**

When HMRC consider they have made a “discovery” they are entitled to invoke the principle of continuity. If they have a finding for one year they can claim that the under-declarations have been going on in past years. It is then up to the taxpayer to prove that this is not the case.

Clearly HMRC considered they were dealing with a case of massive dishonesty. They raised assessments going back 10 years, assessing additional profits over the 10 years of £2,683,969 with an assessment of £1,040,291 Tax and NIC plus interest and penalties.

There were detailed calculations for each of the 10 years. Pages of figures to wade through.

I prepared 10 appeal documents, formally appealing against each assessment, together with an application to postpone the tax demand for each year while we convince the Inspector that the assessments should be withdrawn and there was no tax to pay.

### **Questions and answers**

During the following months I provided explanations and documents to HMRC Portsmouth while working on the overall reconciliation of Mr Green’s personal and business figures.

I was also working with Mr Green’s solicitors on the Cash Seized case.

More questions were coming from HMRC Portsmouth. It seemed that each time we provided information or an explanation this would simply generate additional requests from HMRC for further information or documents.

### **The 3 year Cash/Funds statement**

January 2009: With Lesley Ambrose doing a lot of the detailed work in our office, in January 2009 we completed the 3-year Cash/Funds Statement. This showed the daily movement of cash from April 2005 to March 2008. The opening cash figure was based on a Statement of Assets signed by Mr Green at the conclusion of the earlier HMRC Enquiry. The closing cash figure was given to us by HMRC themselves – it was the amount of cash held by Mr Green in March 2008 when it was seized.

The figures linked with the Mr Green’s daily business profits and all his personal income and expenditure, as well as balancing to the bank and cash balances at the end of each year.



This was an extremely difficult piece of work. We had to get to know and understand every aspect of Mr Green's business and personal life in order to build up this detailed picture.

My conclusion was that this reconciliation demonstrated that there were no undisclosed earnings and I explained this in a report accompanying the detailed figures.

#### **Cash seized – outcome**

I attended meetings with Mr Green's Counsel in preparation for a Court case as HMRC Dover would not return his cash despite having received my Cash/Funds Statement and Report.

In April 2009 the case leader from HMRC Dover together with an HMRC Forensic Accountant spent most of the day in our office reviewing and checking our working papers supporting the Cash/Funds Statement. They left satisfied, and indeed were complimentary of our work.

March 2010: However, it took nearly a year for HMRC Dover (by then The Border Agency) to formally withdraw from the proceedings and to return the Cash to Mr Green, which they did in March 2010.

HMRC Dover paid Mr Green's costs of £26k (mostly legal). We heard that HMRC also had to pay their own legal costs of over £100k.

A complete waste of time and money.

#### **HMRC Enquiries into 2005/06 and 2006/07**

Meanwhile HMRC Portsmouth were continuing with their demands for information and refused to give any weight to our Cash/Funds Statement.

February 2010: In February 2010 I wrote to the Inspector stating that in my view she has enough information and evidence to close down the enquiry and withdraw the Assessments. I set out the reasons why she would be entitled to take this action.

The relatively small mistakes that had been made were admitted as was the extra tax arising (about £1,700), but beyond that there should be nothing further to pay.

#### **HMRC ignored my advice and ploughed on with further questions.**

September 2010: We had reached stalemate. All possible information and explanations had been provided to HMRC but the Inspector pointed to a list of questions that had not been answered to her satisfaction and was not prepared to close the case down.

At this point I formally requested that HMRC carry out a Review of the case. A Review is carried out by a member of HMRC staff not previously involved in the case.

October 2010: The Inspector produced a 22-page document setting out her conclusions and quantifying a figure of £140k additional taxable profits for 2005/06 based on matters which she considered had not been adequately explained, proved or documented. This result was rolled back to 1996/07 and forward to 2007/08 – ie the presumption being that the alleged under-declaration of profits had been going on for 10 years.

The resultant tax and NIC payable was £593,590 plus interest and penalties.

The Inspector did not accept the figures in my Cash/Funds Statement as there were aspects of the opening Cash balance she did not accept and in particular she did not accept that large amounts of cash had been provided to Mr Green by his father despite his father having provided a signed statement to that effect.

December 2010: HMRC quantified the penalties they would be going for as £296,796. Total tax and penalties claimed were therefore £890,386 plus interest.

February 2011: I had a preliminary exchange of information with the HMRC officer who had been appointed to carry out the Review of this case.

#### **Alternative Dispute Resolution**

March 2011: I received a phone call from a member of a new HMRC Alternative Dispute Resolution ("ADR") team. He offered to include Mr Green's case in a new pilot ADR program that HMRC was trying out.



The objective of the ADR is to use an experienced HMRC Facilitator to make it possible to settle disputes between HMRC and the taxpayer in cases which are deadlocked and heading towards the Tribunal.

There seemed nothing to lose so we agreed to go through the ADR process as did the Inspector.

July 2011: We had a meeting at the HMRC office around a big table. The ADR Facilitator was at the top end. The Inspector and an HMRC colleague were on one side. On our side were Mr Green, his father and myself.

The meeting got nowhere. The Inspector was not changing her mind and Mr Green was not going to volunteer to pay additional tax when he had not done anything wrong (apart from the few small mistakes which were admitted and agreed).

There was a farcical discussion about a possible negotiated settlement. Mr Green might be prepared to agree to a few thousand pounds additional tax simply to close the case – on the basis that his continued costs might be something like this. HMRC was looking for six figures.

I was waiting for common sense to break out on HMRC's side of the table, but to no avail.

After the meeting I had further telephone conversations with the Inspector about a possible settlement but we could not reach agreement.

### **The Review**

We returned to the standard process and the designated HMRC officer carried out a formal Review of the case.

November 2011: The conclusion of the Review was that the decisions made by the Inspector should be upheld in full. We had 30 days to appeal to the Tribunal.

Next stop the Tribunals Service.

### **Tribunal Appeal**

December 2011: I lodged a formal appeal to the Tribunals Service.

### **Specialist help**

I recommended to Mr Green that he obtains the services of a Tribunals Specialist to represent him at the forthcoming Tribunal hearing. Mr Green agreed to this.

March 2012: I made contact with Martyn Arthur, Forensic Accountant, Tribunal Appellant. We discussed the issues and he agreed to meet with me and Mr Green to discuss the case.

April 2012: We met with Martyn Arthur. Martyn agreed to take on the case. He is clearly on a mission to help clients in just this sort of situation. While he could give no guarantee of winning, this was a case that he felt simply had to be won if justice was to be served.

Our strategy was that Martyn would deal with Tribunal procedures and tactics, effectively he would mastermind and run the Tribunal Hearing, while I would present the Cash/Funds Statement and related matters at the Tribunal.

### **The Tribunal process**

The Tribunal is completely independent of HMRC. Proceedings are informal. As you can see from Martyn's website he is a great fan of the Tribunal system.

It took a while to get a firm Tribunal date. The diaries of all participants had to line up with available court dates.

February 2013: We were all geared up for the Tribunal Hearing, but it was cancelled the day before the hearing because one of the participants fell ill.

### **The Tribunal Hearing – February 2014**

The day of the Tribunal Hearing arrived, held in the Southampton court buildings in February 2014.

HMRC had reduced their claim for tax and penalties to £485,783 (plus interest) – having reduced the "roll-back" of additional profits to 2002/03.



I turned up with a suitcase full of files. Both sides waited in separate rooms until the moment we were “called in”.

### **The tables were getting bigger.**

The Judge and a lay-person were seated on one side of an enormous table. On the other side were me, Martyn and the HMRC advocate (the HMRC advocate was not the Inspector on the case, but a specialist in making the case at Tribunals, much as Martyn was acting for Mr Green).

Behind us sat the witnesses. As this was an open session anyone could have come in to hear the case and sit at the back. A few people drifted in and out – generally officials related to the case.

In the corner of the room were 2 Tribunal staff, sitting at their desks and looking after the administrative arrangements.

There was quite a bit of legal and procedural discussion to start with. The setting was indeed informal, for example from time to time the Judge would speak to Mr Green sitting at the back to clarify or explain a point.

Martyn and the HMRC advocate presented their cases in outline. There was discussion about whether they could fit in the first witness before lunch. Yes there would be time, so let’s have the first witness – yours truly.

Before I got going the Judge wondered whether I should stay sitting where I was to give my presentation (which I had up to that point understood was the plan) or instead be sworn in and go to the end of the table to the spot where witnesses give evidence. Would I mind giving evidence under oath, as a witness? “No, of course I wouldn’t mind” I heard myself say.

So I proceeded to the end of the table was sworn in and off I went.

I took the judge through the work we had done on the 3 year Cash/Funds Statement, talked him through all the figures in outline and explained my reasoning and the conclusions I had come to as set out in my Report. The Judge asked a few questions as we went along as did the lay-person and it all seemed to go OK.

When I finished my presentation Martyn asked me a few questions by way of clarification, and I was then cross-examined briefly by the HMRC Advocate, which also went OK.

My evidence was over and the Tribunal broke for lunch.

In the afternoon Mr Green and his father both gave their evidence as did the HMRC Inspector who had by then retired from HMRC but still had to come to the Tribunal and appear as a witness.

‘Never take a knife-fighter to a gun-fight’. Wise words. Martyn Arthur is one of the fastest guns around and was just the man to have on your side in this particular gun-fight. Imagine a quietly spoken Rottweiler and you will get the picture.

Martyn gave the HMRC Inspector a good grilling in the witness chair. Martyn was well prepared and at the top of his game. It is tempting to think it would be easy to have a go at representing someone in a Tribunal – but believe me, when you are in that room it is awfully difficult to collect your thoughts and deal with issues as they arise.

The Tribunal was adjourned and would re-convene in the morning for final arguments.

Overnight both sides prepared final submissions which were handed to the Tribunal in the morning.

Final arguments etc lasted just an hour or so, and then the Tribunal was over.

The Judge said he would aim to issue his Decision before Easter.

We were all soaked by a dramatic hailstorm as we walked away from the building. A portent for someone perhaps.

If HMRC had won the case Mr Green would be bankrupt.

If we had won the case, Mr Green could resume normal life after six years of anxiety.

**It was now up to the Judge.**



Martyn said that we (me, Mr Green and Mr Green's father) were among the best witnesses he had worked with and if there is any equity in this world Mr Green should win the appeal.

### **The Judge's Decision**

March 2014: Martyn said that in all his experience he had never seen a judgement like it.

13 pages of carefully reasoned argument and then the decision. "...we allow the appeals in part and direct that the parties use their best endeavours to determine the figures in respect of the assessments, amendments and penalty determinations in the light of our findings...."

We could go back to the Tribunal if we were unable to reach agreement with HMRC within 90 days.

Eh?

### **So did we win or not?**

As I read and re-read the 13 page decision I gradually realised that yes, we had won.

Within his decision the Judge made 2 key findings.

He found that Mr Green's father was truthful about the cash loans made to Mr Green and therefore that aspect of the Cash/Funds Statement should be accepted (and not rejected/ignored by HMRC), and

The opening Cash figure in the Cash/Funds Statement should be accepted (and not rejected/ignored by HMRC).

April 2014: I wrote to HMRC with my analysis of the Judge's decision and asked for their agreement.

I stated that HMRC now have to accept that the Cash/Funds Statement proves that "...there were no additional business profits in the period and that all Mr Green's cash and bank funds were derived from legitimate sources.....and that additional profits are not just unlikely they are impossible"

Therefore HMRC's additional assessments must all be withdrawn and we return to the relatively small additional amount of tax arising from the admitted few mistakes in Mr Green's workings as set out in my letter to the Inspector back in October 2008.

As the HMRC Inspector on the case has now retired, another Inspector had been assigned to the case.

24 April 2014: After reviewing the case the new HMRC Inspector phoned me. He agreed with my analysis of the Judge's decision as set out in my recent letter. All additional assessments would be withdrawn for all years, leaving the small amount of tax arising on the mistakes plus a 40% penalty based on this small amount payable.

The assessments originally standing at over £1m tax have gone.

Life returns to normal for Mr Green.

### **Mr Green**

Mr Green has stood up to this Enquiry very well, being of the firm belief that in the end it would just have to "go away" as he has known all along that he hasn't done anything wrong.

Others could be crushed by such an experience. Being chased for over half a million pounds of tax for over 6 years when you don't owe it is unpleasant and stressful.

### **Conclusions**

- Make sure your business bookkeeping is perfect.

- Keep your business affairs separate from your private affairs. Don't pay business expenses from your private bank account. Don't pay personal expenses from your business account. Don't mix up your business and private cash. Don't bank business cash into a private account. Remember, if your business bookkeeping is perfect then HMRC will not be able to "break your business records" and therefore they will not be entitled to look at your personal bank statement and personal records generally.