Neutral Citation: [2022] UKFTT 00420 (TC)

Case Number: TC08639

FIRST-TIER TRIBUNAL
TAX CHAMBER

Taylor House, London

Appeal reference: TC/2020/02125
TC/2022/02126

INCOME TAX – whether declared but withheld and unpaid dividends represent taxable income – no – validity of requirements for discovery assessment – would have been valid – appeal ALLOWED

Heard on: 6 September 2022
Judgment date: 22 September 2022

Before

TRIBUNAL JUDGE AMANDA BROWN KC
MS GILL HUNTER

Between

MR MARCUS JAYS
MRS KAREN JAYS

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr Keith Gordon, Counsel instructed by Stuart Ifield, Accountants

For the Respondents: Dr Jeremy Schryber litigator of HM Revenue and Customs' Solicitor's Office

DECISION

INTRODUCTION

1. These appeals concern discovery and penalty assessments issued to each of Mr Marcus Jays (**MJ**) and Mrs Karen Jays (**KJ**) (together **Appellants**) in respect of income tax said to have been under assessed on dividends declared by Questor Properties Limited (**QPL**) as follows:

(1) For MJ

(a) A discovery assessment issued by HM Revenue & Customs (**HMRC**) on 19 November 2019 pursuant to section 29 Taxes Management Act 1970 (**TMA**) for tax year ended 5 April 2016 in the sum of £14,254.93;

(b) A penalty assessment initially issued on 20 November 2019 pursuant to Schedule 24 Finance Act 2007 (**Sch 24**) in respect of the error assessed by the discovery assessment referred to at [1(1)(a)] above in the sum of £5,737.60. The penalty amount was determined on the basis that the error was made as a consequence of deliberate conduct by MJ. The penalty was subsequently amended on 21 July 2021on the basis that MJ's conduct was careless rather than deliberate. The amended penalty was in the sum of £2,128.23. The amended penalty was suspended.

(2) For KJ

(a) A discovery assessment issued on 19 November 2019 pursuant to section 29 TMA for tax year ended 5 April 2015 in the sum of £3,990.15;

(b) A discovery assessment on 19 November 2019 pursuant to section 29 TMA for tax year ended 5 April 2016 in the sum of £23,197.77;

(c) A discovery assessment on 19 November 2019 pursuant to section 29 TMA for tax year ended 5 April 2017 in the sum of £14,738.50;

(d) A penalty assessment initially issued on 20 November 2019 pursuant to Schedule 41 Finance Act 2008 (**Sch 41**) for the deliberate failure to notify a liability to income tax in respect of each of the tax years ended 5 April 2015, 2016, and 2017 in the sum of £16,875.67. The penalty was subsequently amended on 21 July 2021 on the basis that KJ's conduct was careless rather than deliberate. The amended penalty was in the sum of £8,385.28. The amended penalty was suspended.

2. The Tribunal had the benefit of a full day of detailed oral argument from the parties and the Appellant's skeleton argument. In reaching the decision in this appeal the Tribunal has taken account of everything referenced by the parties, in both written and oral submissions. It is, however, inevitable given the detail of the argument and the quantity of material that not everything in the appeal has been given specific mention in this judgment.

SUMMARY OF JUDGMENT

3. For the reasons set out in this judgment the Tribunal has concluded:

(1) In the most unusual factual circumstances in these appeals the dividends declared by QPL but retained as unpaid and inaccessible did not give rise to an enforceable right to receive the dividends as income in the relevant tax years or, in the end, at all.

(2) As such, and in accordance with the relevant case law, there was no charge to income tax on the declared dividend.

(3) It therefore becomes unnecessary to consider whether the burden resting on HMRC in connection with the discovery assessments was met but, for completeness, had a charge to tax arisen all discovery assessments would have been valid.

(4) The penalty assessments fall away.

PROCEDURAL MATTERS

4. On 1 September 2022 HMRC sought a postponement on the basis that their witness, Ms S Johnson, was unavailable to attend the hearing. On the basis that the Appellants formally accepted the witness statement and confirmed no need to cross examine Ms Johnson, Judge Fairpo refused the application.

5. Following the refusal HMRC sought to admit six additional documents (three in respect of each Appellant): an ADR exit agreement, penalty liability notification and amended assessment. The Appellants objected to the admission of the documents on the basis that they considered it impermissible to rely on the terms of the ADR exit agreement to meet the burden of proof on HMRC to satisfy the requirements of section 29 TMA. However, it was ultimately accepted by Mr Gordon that the overriding objective would be served if the Tribunal were to consider the documents concerning MJ but not KJ. The documents concerning MJ were therefore admitted.

6. As a consequence of the partial settlement agreed between the parties at the ADR meeting the penalties, though under appeal, did not need to be resolved directly by the Tribunal. In the event that the Tribunal determined, as it has, that no additional income tax was due the penalties fell away. In the event that tax had been due the parties had agreed the basis on which penalties were relevant.

7. A procedural matter also arose in connection with all three of the witness statements before the Tribunal. Each of the witness statements failed to deal, in a material regard, with matters relevant to the hearing. On the basis that the Appellants had objected to a postponement on the basis of Ms Johnson's unavailability, thereby precluding HMRC from supplementing her witness statement with oral testimony, the Tribunal considered it only fair and just (in accordance with the overriding objective) to prevent either of the Appellants from supplementing their witness evidence. Both were called to the witness box and made available for cross examination as to the matters contained in their witness statements and for HMRC to put their case to the witnesses.

FACTUAL FINDINGS

8. The Tribunal was provided with a bundle of documents prepared by HMRC of 428 pages, including the authorities they considered relevant. The Appellants provided a supplemental bundle of documents and authorities of 108 pages. The Tribunal also admitted the additional documents referred to above.

9. Notably absent from the bundle was a copy of QPLs financial accounts for the accounting periods ended 31 December 2014, 2015, and 2016.

10. As indicated the Tribunal was provided with witness statements from Ms Johnson, MJ and KJ.

11. In the present appeals HMRC bear the burden of proving that the conditions for making a discovery assessment are met. The Appellants have the burden of proving that they are overcharged by the assessments. HMRC also bear the burden of proof as to the conditions for the imposition of the penalties. The standard of proof in each case is the balance of probabilities.

12. From the evidence available the Tribunal finds the following facts.

(1) MJ and KJ are shareholders of QPL, they hold the single issued share jointly.

(2) At the relevant time MJ was the sole director of QPL and KJ was the company secretary. MJ ran the business day to day.

(3) QPL is a property management company. In the late 2000s QPL entered a number of loans with Lloyds Bank Plc (**Lloyds**) in connection with property purchases made. It also purchased, through Lloyds, ten interest rate hedging products. Some of those products were accepted by Lloyds to have been mis-sold. However, with regard to a number of the others Lloyds rejected the mis-selling and associated consequential loss claims. As a consequence, QPL faced high interest costs with hedging products which were punitively costly to break. QPLs business was trading well with strong operating profits but the interest costs were so debilitating the business was at risk.

(4) MJ wanted to attract external equity investors into QPL and believed that showing strong dividend declarations would make the business attractive to such investors. However, Lloyds were unwilling to permit MJ and KJ to extract substantial profit from the business and wanted to limit the dividends paid.

(5) On 8 October 2013, the Appellants provided an undertaking to Lloyds in the following terms:

> "UNDERTAKING TO LLOYDS BANK ON BEHALF OF QUESTOR PROPERTIES LTD.
>
> On behalf of Questor Properties Ltd. hereby [sic] we hereby warranty [sic] and undertake that the following dividends only will be withdrawn/made available to the shareholders:

		M JAYS	K JAYS
		£	£
Accounts	YE 31/12/14	45,000	29,000
	YE 31/12/15	64,000	30,000
	YE 31/12/16	69,500	30,000

> We give an irrevocable undertaking that any additional dividends shown in the accounts of the company will not be made available and, as agreed, will be credited to blocked shareholder accounts and eventually written back in subsequent company accounts. In accordance with the acceptance by Lloyds Bank Plc of this undertaking and their understanding of the reasons for them, these intentions will be embodied in the company minutes."

(6) The form of the undertaking had been provided to MJ under cover of a letter from his solicitors which stated:

> "… I want you to appreciate that this is a covenant with the bank which is legally binding and if you breach this covenant, as with any other covenants, then the negotiations with the bank may be brought to a halt and the bank would be within their legal rights to suspend all borrowings and immediately call in the indebtedness. In the worst-case scenario, this would result in a forced sale and foreclosure of the company's properties. … I would point out that the bank will be requesting quarterly accounts as well as annual accounts, and so will be in a position to ascertain whether this covenant has been breached. …"

(7) When MJ recommended the declaration of dividends exceeding the amounts stipulated in the undertaking to Lloyds he was aware that the dividends could not be paid. He accepted, and the Tribunal finds, that he made a choice whether to declare dividends in excess of those stipulated amounts in that knowledge and with a view to attracting alternative investors.

(8) On 23 December 2014 QPL declared a dividend in accordance with the following resolution:

> "IT WAS RESOLVED that a provisional dividend of £45,000 be declared in favour of Mrs Jays but in view of the illiquidity of the company only £29,000 was to be made available at this point. The remaining £16,000 was to be credited to a blocked account and held in abeyance so that Mrs Jays would not be free to draw upon it or have it credited to her loan account until further notice."

(9) A dividend voucher was issued on 23 December 2014 in respect of the payment of an "Interim Dividend" of £29,000 payable to KJ. The Tribunal was not provided with a copy of the minute in respect of the dividend payable to MJ for accounting period ended 31 December 2014. However, a dividend voucher for MJ was dated 27 December 2014 and in respect of a payment of and "Interim Dividend" of £45,000.

(10) By reference to the unchallenged witness statement of Ms Johnson in respect of KJ's appeal, the Tribunal finds that the accounts for the year to 31 December 2014 show a declared dividend of £90,000. There was no direct evidence that the dividend was shown in the accounts as a final dividend; however, as noted in paragraph [11(19)] below in the accounts to 31 December 2017 the 2016 dividend by prior year comparison is shown as a final dividend. The Appellant did not contend that it was an interim dividend (despite the terms of the dividend vouchers). Accordingly, the Tribunal finds that £90,000 was declared as a final dividend.

(11) The trial balance shows £29,000 credited to KJ's directors' loan account and £16,000 as credited to an account named "directors blocked accounts". The Tribunal was informed and accepts as a fact that the sums shown on the directors' blocked accounts were included in the financial accounts within other creditors.

(12) All cash received by QPL by way of rents from properties in connection with which Lloyds had provided loans was paid into a Lloyds bank account from which QPL could not remove funds without the express consent of Lloyds. Only the cash dividends paid to MJ and KJ were paid from those accounts in accordance with the undertaking and with Lloyds' consent.

(13) The Tribunal finds as a fact that final dividend declared was, in the case of KJ, subject to the terms of the undertaking provided to Lloyds, the legal consequences of which are considered below in paragraphs [25 - 41].

(14) In respect of the accounting period ended 31 December 2015 a minute dated 12 December 2015 stated:

> "IT WAS RESOLVED that a dividend of £103,000 should be voted to favour Mr M Jays for the current accounting year of the company of which £39,000 is to be credited to a blocked directors account and not paid to or available to the director until it is mutually agreed that it in in the interest of both parties that it should be."

(15) The resolution in favour of the dividend to KJ dated 29 December 2015 stated:

> "IT WAS RESOLVED that a dividend of £103,000 should be voted to favour Mrs Jays but in view of the potential demands on the company only £30,000 was to be made currently available. The balance of £73,000 would be held in a blocked directors account so that Mrs Jays would not be free to draw upon it until further notice."

(16) A dividend voucher dated 27 December 2015 was issued to MJ in respect of an "interim dividend" of £45,000. The voucher for KJ was issued on 29 December 2015 regarding the "interim dividend" payment of £30,000. Again, by reference to the unchallenged statement from Ms Johnson in KJ's appeal, the financial accounts for the 2015 year showed a declared dividend of £206,000.

(17) As with the 2014 dividends, and for the reasons stated in connection with those dividends the Tribunal finds that the dividends were declared as final and, in the case of each of MJ and KJ, a proportion of the dividend was withheld subject to the terms of the undertaking provided to Lloyds.

(18) A minute dated 2 January 2017 stated:

> "IT WAS RESOLVED that a dividend of £69,000 should be voted to Mrs Jays of which £30,000 would be made available and £39500 credited to a blocked directors account which would not be available to her in any form until at until [sic] mutually agreed at some future date after 6th April 2017"

(19) A dividend voucher dated 29 December 2016 was issued to MJ in respect of an "interim Dividend" of £69,500. The voucher for KJ was issued on 2 January 2017 in the sum of £30,000 again for an interim dividend. As with the accounting periods ended 31 December 2014 and 2015 there was no copy of the annual accounts for accounting period ended 31 December 2016. However, in the prior year comparison as set out in the 2017-year end accounts the sum of £139,000 is shown as a final dividend. The Tribunal finds that the 2016 dividends were declared as final despite their being described as interim on the dividend vouchers. Again the Tribunal finds that the dividends so declared were subject to the terms of the undertaking given to Lloyds.

(20) The accounts prepared for the year to 31 December 2017 were originally dated 17 September 2018. However, they were restated on 28 February 2019. In the restated accounts dividends to the value of £167,950 were written back to the accounts.

(21) KJ did not render tax returns for the tax years ended 5 April 2015, 2016, or 2017, her only source of income being the dividends received.

(22) MJ rendered his tax return for 30 January 2017. He declared income from dividends of £64,000.

RELEVANT LEGISLATION

13. So far as relevant Income Tax (Trading and Other Income) Act 2005 (**ITTOIA**) provides:

> *Section 383(1)*
>
> "Income tax is charged on dividends and other distributions of a UK resident company."
>
> *Section 384(1)*
>
> "Tax is charged under this Chapter on the amount or value of dividends paid and other distributions made in the tax year."

14. The relevant provisions of Taxes Management Act 1970 are:

> *Section 7*

"(1) Every person who—

(a) is chargeable to income tax or capital gains tax for any year of assessment, and

(b) falls within subsection (1A) or (1B),

shall, subject to subsection (3) below, within the notification period, give notice to an officer of the Board that he is so chargeable.

(1A) A person falls within this subsection if the person has not received a notice under section 8 requiring a return for the year of assessment of the person's total income and chargeable gains.

…

(3) A person shall not be required to give notice under subsection (1) above in respect of a year of assessment if for that year—

(a) the person's total income consists of income from sources falling within subsections (4) to (7) below,…

…

(6) A source of income falls within this subsection in relation to any person and any year of assessment if all income from it for that year is—

(a) income from which income tax has been deducted; …

and that person is not for that year liable to tax at a rate other than the basic rate, …"

Section 29

"(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment–

(a) that any income which ought to have been assessed to income tax, … or

(b) that an assessment to tax is or has become insufficient, or …

the officer or, as the case may be, the Board may, subject to subsection … (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

…

(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above–

(a) in respect of the year of assessment mentioned in that subsection; and

(b) in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

(4) The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer …

(5) The second condition is that at the time when an officer of the Board–

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; …

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above."

Section 118(2)

"For the purposes of this Act, …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."

WAS THERE AN INSUFFICIENCY

15. As far as relevant in this appeal. in order to make a discovery assessment, an officer of HMRC must discover that any income which ought to have been assessed to income tax has not been assessed or that an assessment to tax has been insufficient. HMRC contend that KJ failed to assess dividend income and that MJ's self-assessment to income tax in connection with dividend income was insufficient. The Tribunal must therefore first determine whether there was such a failure/insufficiency.

16. The Tribunal has found as a fact that QPL declared final dividends for accounting period ended 31 December 2014 of £90,000, for accounting period ended 31 December 2015 of £206,000 and for accounting period ended 31 December 2016 of £139,000. However, in each case subject to the terms of the undertaking given to Lloyds which precluded QPL from distributing any declared dividend exceeding the amounts specified in the undertaking as signed on 8 October 2013.

Parties' submissions

Appellant's submissions

17. By virtue of s384(1) ITTOIA in order for dividends to come within the charge to income tax they must be paid as dividends or have otherwise been made as a distribution in the relevant tax year.

18. The Appellant accepts that, in accordance with the judgment of High Court in *In re Severn and Wye and Severn Bridge Railway Company* [1896] 1 Ch 559 (***Severn***) when a dividend is declared it generally gives rise to an enforceable right to payment. However, by reference to the judgment of the High Court in *Potel v Inland Revenue Commissioners* (1970) 46 TC 658 (***Potel***) where the declared dividend is subject to a stipulation as to the terms or time when it is actually paid the charge to tax arises only when that stipulation is removed and the debt in fact becomes enforceable.

19. By reference to the terms of the undertaking given to Lloyds and the individual terms of the minutes, the Appellant contends that there was no enforceable debt associated with the portions of the declared dividend which were withheld. This, they say, is precisely in accordance with HMRC's own guidance.

HMRC's submissions

20. HMRC contend, as accepted by the Tribunal, that the dividends in each year in question were final dividends, recommended by MJ as director of QPL and as voted by the shareholders in the resolution to that effect. As such, they submit, by reference to the judgment in *Severn,* that an enforceable debt was created in favour of the Appellants on which the Appellants could have sued. They further contend that the crediting of the Appellants' "director's blocked accounts" represented payment of the dividend or the making of a distribution in the Appellants' favour in exactly the same way as the crediting of the more conventional directors'

loan account; as, in each case, the entries recognised a reduction in the distributable reserves of the company and an increase in the assets of each shareholder, who were shown as other creditors in the financial statements.

21. HMRC drew an analogy to the deposit made by a guarantor. The funds so deposited remain the legal property of the guarantor but act as security for the debt guaranteed. It was contended that the Appellants had simply agreed for the declared dividend to be used by the company to satisfy the cash restrictions imposed by Lloyds and that each of the Appellants, as appropriate, was simply agreeing to not take the cash until QPL could afford for them to do so. HMRC did not consider the terms of the minutes or the undertaking itself represented a legal restriction precluding access to the dividends.

22. HMRC also did not accept that the terms of the undertaking and the minutes could be assimilated to a statement regarding deferral of payment as considered in *Potel*.

23. An unpleaded argument was also raised that, as the Appellants were the joint shareholders of a single share, there was no legal basis on which to declare a dividend payable to one of them but not to the other (recognising that the restriction imposed on KJ's dividends were, in each year, more significant than those imposed on MJ's).

24. HMRC's position on the writing back of the dividend in 2019 was, in the first instance, that the write back had occurred after the accounts were filed and after the enquiry regarding the dividend payments had begun. HMRC considered that the write back was properly to be treated as a capital contribution by the Appellants.

Discussion

25. In *Severn* dividends had been declared and not paid. When the company went into liquidation the shareholders sought to assert that the dividends were sums held by the company on trust on their behalf. Romer J noted that "the entry in the books of a debtor of a liability to a creditor does not constitute the debtor a trustee" as such, the debt arising was one to which the statute of limitations applied. The determination that the debts were thus unenforceable was predicated on a conclusion that the dividends were enforceable upon declaration. There is no analysis as to the basis of that latter conclusion.

26. *Potel* concerned the declaration of interim rather than final dividends. In that case the dividends were declared on the basis that they were payable at a later date. The shareholders sought to avoid a charge to surtax in the tax year 1965/6 on the basis, and by reference to *Severn*, that as the dividends were enforceable from declaration they were not to be treated as forming part of the shareholders' taxable income in the year of payment. Brightman J summarised the effect of the relevant statutory provisions in that case as: "in the case of a United Kingdom dividend, such dividend forms part of total income of a person for a year of reference … in which the dividend becomes due. The question in issue on this appeal, therefore, is whether the dividends in question 'became due' … when the dividends were declared or … when they were paid".

27. Brightman J when on to evaluate the issue as follows:

> "(1) … directors who recommend a final dividend have power at the same time to stipulate the date on which such dividend shall be paid: *Thairlwall v Great Northern Railway Co.* [1010] 2 K.B 509. (2) If a final dividend is declared by a company without any stipulation as to the date for payment, the declaration of the dividend creates an immediate debt: [*Severn*]; (3) If a final dividend is declared and is expressed as payable at some future date a shareholder has not right to enforce payment until the due date for payment arises. This was assumed to be correct in *In re Kidner* [1929] 2 Ch. 121, and … it is clear, in my view, beyond doubt."

28. He went on to consider that no substantive difference arose between the analysis in respect of final dividends and the interim dividends at point in that case.

29. Having determined that the declaration of the dividends which were subject to a stipulation for later payment did not give rise to an enforceable debt until the stipulation had expired he went on:

> "… I come to the question on which of these [i.e. date of declaration or date stipulated for payment] the dividend became due … There is some guidance as to the meaning of 'becomes' due in *In re Sebright* [1944] Ch. 287. I think it is beyond reasonable argument that a dividend declared in 31st March and directed to be payable on 29th May and in fact paid on 29th May is not in arrear and belatedly paid when the company pays the dividend on the date on which it is expressed to be payable. A dividend cannot be said, in my view, to have 'become due' until payment therefore is actually enforceable. If a dividend is expressed to be payable at a future date payment is in my view plainly not enforceable until that date. … Even if I had not formed the view that the payment on 29th May was an integral part of the resolution … I would still have concluded that the dividends in question were part of the total income of the taxpayer for that year, and for the following reasons. There is a difference between declaring a dividend and paying a dividend. The declaration of a dividend by a company in general meeting creates a debt enforceable immediately or in the future, according to whether the dividend is or is not expressed to be payable at a future date. The payment of the dividend is a different operation. It is an actual distribution of part of the assets of the company. The two processes, declaration and payment, are quite separate."

30. In the present appeal the Tribunal is required to determine whether the terms of the minutes declaring each of the affected dividends represents the payment of a dividend or the making of a distribution on the date of declaration.

31. The judgment of Brightman J is binding on the Tribunal. He was clear that:

(1) Provided that the directors act in accordance with the articles of association directors have the power to make stipulations as to the payment of declared dividends.

(2) The process of declaring a dividend is separate from its payment.

(3) There is no enforceable debt in connection with a declared dividend which is subject to a stipulation as to the date of payment.

(4) It is only once a payment is enforceable that the assets of the company are distributed to the shareholders.

32. The task of this Tribunal is therefore to construe the terms of the minutes and determine whether there is a stipulation as to the date on which the declared dividend is to paid and/or if there is some other stipulation how the *Potel* judgment is to be applied to the stipulation.

33. Each minute is set out in full in paragraph 12(8), 12(14), and 12(18) above. The terms of those minutes provided that:

(1) KJ's 2014 dividend was to be "credited to a blocked account and held in abeyance so that [she] would not be free to draw upon it or have it credited to her loan account until further notice." (emphasis added)

(2) MJ's 2015 dividend was to be "credited to a blocked directors' account and not paid to or available to the director until it is mutually agreed that it in in the interest of both parties that it should be." (emphasis added)

(3) Of KJ's 2015 dividend "only £30,000 was to be made currently available. The balance of £73,000 would be held in a blocked directors' account so that Mrs Jays would not be free to draw upon it until further notice." (emphasis added)

(4) Of KJ's 2016 dividend "in view of the illiquidity of the company only £29,000 was to be made available at this point. The remaining £16,000 was to be credited to a blocked account and held in abeyance so that Mrs Jays would not be free to draw upon it or have it credited to her loan account until further notice."

34. The Tribunal determines that in each case it is clear that the shareholder in question has no immediate right to enforce the identified part of the dividend at the point at which it is declared, and that payment was deferred "until further notice" in the case of all KJ's dividends and "until mutually agreed" in the case of MJ's dividend. The deferral in each case was in consequence of the terms of the undertaking given to Lloyds. Those terms, as described by the solicitor, represented a covenant which, if breached would mean that Lloyds would be "within their legal rights to suspend all borrowings and immediately call in the indebtedness. In the worst-case scenario, this would result in a forced sale and foreclosure of the company's properties." The terms of that covenant did not legally prevent QPL from declaring any such dividend as was chosen nor did it prevent payment being made of the declared dividend (as a breach of the covenants would not have undermined the legality of the declaration or payment of the dividend). However, acting in the best interests of the company and the shareholders and otherwise in accordance with his fiduciary duties as a director, MJ recommended the declaration of dividends subject to stringent stipulations which, in the view of the Tribunal, had the legal effect of deferring the date on which the stated proportion of the dividends was payable. This conclusion is not, in the Tribunal's view, precluded because of the absence of a date to which payment is deferred, in each case there was a mechanism by reference to which the date was to be determined (on further notice or as mutually agreed).

35. It is not therefore necessary to determine how *Potel* would be applied in the event that the stipulation is not one as to the date on which payment is to be made.

36. On this basis, and consistently with the judgment in *Potel*, it is clear that the dividend was not paid for the purposes of section 384(1) ITTIPA.

37. Neither does the Tribunal consider that a distribution was made. HMRC did not contend that there was a distribution that was not a dividend. However, and in any event, the Tribunal forms the view that, by reference to *Potel*, the making of a distribution also requires that the recipient has an enforceable right to the assets of the company. For the reasons given neither MJ nor KJ had an enforceable right against the company in respect of the deferred dividends until a time mutually agreed (for MJ) or notice was given (for KJ).

38. Dealing with HMRC's unpleaded submission that as there was a single share it was impermissible for QPL to stipulate an unequal deferral. It is to be noted (due to the lateness of the raising of the issue) the bundle did not include the articles of association and HMRC had otherwise pleaded and argued that the dividend had been lawfully declared. As the Appellants rightly submitted, if the dividend had not been declared in accordance either with company law or the constitutional documents of the company there would have been no declaration of a dividend at all and thereby no income within the charge to tax (either in respect of the part paid or the deferred part). In any event, on the basis of Brightman J's judgment, the Tribunal is of the view there is no legal basis to conclude that a company may not make such stipulation as to the payment of a dividend as it determines appropriate. A shareholder might have an equitable action but would be most unlikely to have a contractual or statute based right of action.

39. Whilst superficially attractive HMRC's analogy with a guarantor's deposit is inapposite. It is not for the Tribunal to analyse the legal and beneficial entitlements which might arise in such a situation. The Tribunal has applied the binding guidance given by the High Court to determination of whether the minutes gave rise to an enforceable debt between the Appellants and QPL as regards the unpaid portion of the dividend and has determined there was no such debt. The accounting treatment of the blocked accounts as other creditors does not affect that conclusion. A bank which makes a loan to a company is a creditor of the company, but the loan capital does not represent an enforceable debt unless and until the company defaults on the terms of the loan.

40. Having reached the conclusion reached the Tribunal also does not consider it necessary to consider the legal or accounting consequences of the write back of the unpaid portion of the dividends.

41. For these reasons the Tribunal concludes that:

(1) The self-assessment included within MJ's return for the year to 5 April 2016 in respect of the dividends declared was not insufficient; and

(2) On the basis that the dividends paid to KJ were a source of income from which income tax had been deducted and the total income from such dividends did not render her liable to tax at a rate other than the basic rate, KJ was not liable to notify under section 7 TMA and there was no income which ought to have been assessed which was not assessed; accordingly,

(3) There is no basis for discovery assessments to be issued to the Appellants.

CONDITIONS FOR A DISCOVERY ASSESSMENT

42. Were the Tribunal to be wrong in that conclusion it is uncontested that HMRC made a discovery regarding the dividends.

MJ's assessment

43. In accordance with the requirements of section 29 TMA HMRC bear the burden of showing that either:

(1) any insufficiency in a return for which no enquiry was opened was brought about carelessly or deliberately by the taxpayer or someone acting on his behalf; or

(2) at the time at which the enquiry window closed a hypothetical officer of HMRC could not have been reasonably expected to have been aware of the insufficiency by reference to the return and accompanying documents as specified in section 29(6) TMA.

44. The recent judgment of the Upper Tribunal in *Hargreaves v HMRC* [2022] UKUT 34 (TCC) has confirmed that the purpose of section 29(5) TMA is "to test the adequacy or otherwise of the taxpayer's disclosure". Included within the bundle were the copy entries into MJ's 2015/16 tax return. It is plain that MJ entered the amount of £64,000 as dividends received by him in that year. There is no entry in what is known as the white space. By reference to the return itself there is nothing to indicate that any disclosure was made by reference to which the hypothetical officer might have been aware that QPL had declared dividends of £206,000 shared equally between the Appellant but in respect of which tax on only £64,000 had been bought into account by MJ.

45. Mr Gordon manfully sought to argue that by reference to the two prior year tax returns (documents listed in section 29(6) TMA) and/or QPL's tax return and accounts (documents which Mr Gordon considered were within scope of sections 29(6) and (7) TMA) a hypothetical

officer could, potentially, have been reasonably expected to have been aware of the actual insufficiency.

46. It is a very low threshold for HMRC to show that they could not have been reasonably expected to be aware of the insufficiency. By reference to the analysis in *Hargreaves* and the cited case the burden on HMRC is a slight misnomer. HMRC will only be precluded from issuing a discovery assessment by reference to section 29(5) TMA where the taxpayer has made a complete disclosure of all the circumstances on which the return has been filed together with the contrasting view HMRC might take of it. Put another way the hurdle of adequacy of disclosure by a taxpayer is extremely high, at the time of filing and/or within the enquiry window the taxpayer will either have provided the disclosure or they will not, there is therefore little for HMRC to prove.

47. Accordingly, absent any indication in the white space and applying the *Hargreaves* analysis HMRC would not have been precluded from making a discovery assessment by reference to section 29(5) TMA.

48. Having reached that conclusion, were there to have been an insufficiency, HMRC would have been entitled to raise a discovery assessment and it is not necessary to consider whether the putative insufficiency was bought about by careless or deliberate conduct. HMRC pleaded both in the alternative.

49. HMRC presented no evidence of either deliberate or careless behaviour. They made bold assertions in their statement of case, but Ms Johnson's evidence did not touch on the issue of MJ's conduct.

50. Following the ADR it was asserted that HMRC understood MJ to have accepted that his conduct was careless. However, the terms of the exit agreement did not support that conclusion. HMRC had apparently concluded that it was appropriate not to pursue penalties on the basis of deliberate behaviour and to reduce them on the basis of careless behaviour. The Tribunal would not have accepted the terms of the exit agreement or the amendment of the penalty as direct evidence of careless conduct. In the absence of any other evidence HMRC would not have satisfied the burden on them to show deliberate or careless conduct.

51. However, for these reasons stated, had there been an insufficiency in MJ's self-assessment, the Tribunal would have considered that HMRC had met the conditions for raising a discovery assessment by reference to the s29(5) TMA condition.

KJ's assessments

52. KJ had not rendered tax returns for any of the tax years for which discovery assessments were issued and, as consequence, HMRC do not need to meet the conditions referred to in paragraph [43] above. Thus, provided that HMRC make a discovery of an error and raise the assessment within 4 years of the end of the tax year in question, there is no inhibit on the making of the assessment.

53. However, pursuant to section 36(1A) TMA, where a loss of (inter alia) income tax attributable to a failure to comply with the obligation to notify under section 7 TMA, HMRC have 20 years in which to raise an assessment to recover that tax.

54. The discovery assessments issued to KJ were all dated 19 November 2019. As they related to tax years ended 5 April 2014, 2015, and 16 the assessment for 2014 was for a period more than 4 years earlier and, as such, HMRC must establish that KJ had failed to comply with an obligation under section 7 TMA in order for that assessment to be valid.

55. As far as relevant, section 7 provides at subsection (1) that every person chargeable to income tax shall give notice to HMRC that they are so chargeable. That is unless (under

subsections (3) and (6)) in respect of the year in question the person's total income is from sources from which income tax has been deducted and the person is not liable to tax at a rate other than the basic rate.

56. KJ's only source of income is the dividends. On the basis that she was only liable to tax on the dividends paid there was no liability to notify. As identified on the dividend voucher the dividends were paid after deduction of basic rate tax. The dividends paid were all amounts less than the threshold for higher rate income tax. However, on the hypothesis that income tax was due on the full declared dividend KJ was liable to notify. In such circumstances the provisions of section 36(1A) TMA would apply unless, by virtue of section 118(2) TMA, KJ could show that she had a reasonable excuse for the failure to notify.

57. The test for reasonable excuse is well established in the context of penalties (in respect of which there are a number of statutory exclusions). However, in the recent case of *William Archer v HMRC* [2022] UKUT 61 (TCC) (***Archer***) the Upper Tribunal adopted the same general approach to establishing whether a taxpayer has made out a reasonable excuse for section 118(2) TMA purposes as for the penalty regime. In this regard and applying the test as set out in *Christine Perrin v HMRC* [2018] UKUT 0156 (TCC) the tribunal accepted that when considering reasonable excuse it is necessary to:

(1) Establish the facts which the taxpayer asserts give rise to a reasonable excuse.

(2) Decide if those facts are proven.

(3) Decide whether, viewed objectively, those proven facts amount to an objectively reasonable excuse for the default taking account of the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time.

58. The *Archer* case concerned whether Mr Archer had a reasonable excuse for non-payment of a closure notice in circumstances in which he was challenging whether the closure notice contained a valid assessment. The Upper Tribunal considered that the FTT had acted entirely reasonably in requiring that in order to sustain a contention that he had a reasonable excuse Mr Archer needed to give evidence as to his reasons for non-payment and in particular to establish whether, and if so on what basis, he believed that he was not required to make payment.

59. In the present appeal KJ's witness statement included no evidence on the question of reasonable excuse. The position is simply asserted on her behalf in the Appellant's skeleton argument. For the reasons set out in paragraph [7] above it was inappropriate to permit KJ to give evidence as to the circumstances of her reasonable excuse. Thus, there was simply no evidence before the Tribunal to determine whether she had a reasonable excuse or not. As a consequence, had there been a charge to tax the Tribunal would have upheld the discovery assessments.

PENALTIES

60. Following the ADR the penalties were not an issue to be determined by the Tribunal. As there is no tax due the penalties fall away in any event.

DISPOSITION

61. For the reasons stated the appeals are allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

62. 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.

AMANDA BROWN KC
TRIBUNAL JUDGE

Release date: 22nd SEPTEMBER 2022