

RETURN - self-assessment - power to call for documents for purposes of enquiries - accountant in sole practice - whether Inspector could reasonably require the production of documents relating to personal and undesignated clients' bank accounts - whether Inspector could reasonably require the preparation and furnishing of a balance sheet of the practice - appeal dismissed - TMA 1970 s 19A(2)(a) and (b)
THE SPECIAL COMMISSIONERS

ACCOUNTANT

Appellant

- and -

HM INSPECTOR OF TAXES

Respondent

SPECIAL COMMISSIONER: DR A N BRICE

Sitting in private in London on 5 May 2000

The Appellant in person

The Respondent in person

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ANONYMISED DECISION

The appeal

1. Accountant (the Appellant) appeals against a Notice dated 19 November 1999 given by the Respondent under section 19A of the Taxes Management Act 1970 (the 1970 Act).

The legislation

2. Section 19A(1) of the 1970 Act provides that the section applies where an officer of the Board gives notice under section 9A(1) to the taxpayer of his intention to enquire into the return on the basis of which a taxpayer's self-assessment was made. It was agreed that a notice under

section 9A(1) had been given to the Appellant and had been given in time.

3. Sub-sections 19A(2) and (6) provide:

"(2) For the purpose of enquiring into the return ... the officer may at the same or any subsequent time by notice in writing require the taxpayer, within such time (which shall not be less than 30 days) as may be specified in the notice -

(a) to produce to the officer such documents as are in the taxpayer's possession or power and as the officer may reasonably require for the purpose of determining whether and, if so, the extent to which the return is incorrect or incomplete ... and

(b) to furnish the officer with such accounts or particulars as he may reasonably require for that purpose. ...

(6) An appeal may be brought against any requirement imposed by a notice under subsection (2) above to produce any document or to furnish any accounts or particulars ."

The issues

4. In order to enquire into the Appellant's 1996/97 return the Inspector required the Appellant to produce statements relating to all interest-bearing bank and building society accounts for the year ending on 5 April 1997 and statements, paying-in books and cheque books for all bank and building society accounts used by the Appellant and his practice for the period from 1 September 1994 to 31 August 1996 inclusive. The Inspector also required the Appellant to prepare and furnish a balance sheet for the practice. The Appellant argued that he had no personal bank account; that his client account was a current account; and that a certificate of tax deduction from his bank was sufficient to check the interest on a general deposit account. He also argued that, as he had not prepared a balance sheet, he was not required to produce it.

5. Accordingly, the issues for determination in the appeal were:

(1) whether the Respondent could reasonably require the Appellant to produce documents relating to his personal and undesignated clients' bank and building society accounts; and

(2) whether the Inspector could reasonably require the preparation and furnishing of a balance sheet under section 19A(2)(b).

The evidence

6. Each party produced a small bundle of documents. The Appellant's bundle included a copy of the Inland Revenue Press Release dated 31 May 1996 entitled "Discovery and Disclosure under Self-Assessment" and a copy of a booklet entitled "Enquiries into Tax Returns by Local Tax Offices". The Appellant also provided copies of page 23 of Taxation Practitioner of December 1996; an extract from "Eyewitness" of January 1997; and paragraphs 393, 394, 395, 396, 402 and 403 of Inland Revenue Manuals.

The facts

7. From the evidence before me I find the following facts.

8. The Appellant is an accountant and registered auditor and practices on his own account at premises in London under the name of his firm.

9. Early in 1988 the Appellant raised with the Inspector of Taxes the question as to whether he was required to account for interest on his clients' accounts. The Inspector wrote to the Appellant on 3 March 1988 and his letter included the following paragraphs:

"With regard to the point raised about your clients accounts you may be required to account for interest in one of the two following ways:

(a) You may maintain a separate designated account for each client and account to them for interest.

or

(b) Pay to the client a sum equivalent to the interest which would be accrued if the money was deposited in a separate designated account. This method usually follows deposits of money into a general client deposit account.

Under (a) above, the interest is assessable direct on the client and when passed over you should advise your client of the amount of interest and that it should be included in his personal tax return. You should also retain details yourself and you may be required to forward a return under s 18 Taxes Management Act 1970.

Under (b) you will be assessable under Case III on the interest received less the amounts paid in lieu of interest to your clients. You should again maintain a complete record in support of any set off claimed and should advise the client to return payments to him in lieu of interest on his personal tax return as assessable under Case VI of Schedule D. As it is not interest, but is in lieu of interest, it

is not assessable on him under Case III."

10. The self-assessment return for the year ending on 5 April 1997 contained Q10 which asked for details of interest from United Kingdom banks, building societies and deposit takers where tax had been deducted. In his return the Appellant recorded that the gross amount of such interest before tax was £1,354.00; that the amount after tax had been deducted was £1,084.00; and that the amount of tax deducted was £271.00.

11. On 11 June 1999 the Inspector of Taxes wrote to the Appellant and said that he intended to make some enquiries into the Appellant's 1996/97 tax affairs. To enable him to commence those enquiries he asked to be supplied with certain information. The information was not supplied and on 14 July 1999 the Inspector wrote again to the Appellant. He referred to his letter of 11 June 1999 and said that he had not received the items listed. He gave notice under section 19A of the 1970 Act that the Appellant was required to produce the documents within 30 days. The documents were not supplied and on 19 November 1999 the Inspector wrote again to the Appellant giving notice under section 19A of the 1970 Act and requiring the production of the documents listed in the letter by 5 January 2000.

12. The documents listed in the letter of 19 November 1999 were :

"1. All business records relating to the accounts of the firm covering the period 1 September 1994 to 31 August 1996 inclusive, including all records of income and expenditure together with any invoices issued in respect of the turnover and invoices/receipts in respect of the expenditure claimed.

2. A profit and loss account for the period 1 September 1994 to 31 August 1996 together with a balance sheet as at 31 August 1996.

3. Bank/building society statements, passbooks etc. in respect of all interest-bearing accounts held for the year ended 5 April 1997.

4. Dividend counterfoils for the year ended 5 April 1997.

5. Bank statements, paying-in books and cheque book counterfoils and/or building society, etc. passbooks relating to all bank etc. accounts used by you, including the business accounts for the firm, covering the period 1 September 1994 to 31 August 1996 inclusive."

13. On 3 December 1999 the firm's bank sent the Appellant a certificate of deduction of income tax. That indicated that, for a business account in the name of the firm, and for the year to 5 April 1997, interest paid gross amounted to

£1,354.59; tax deducted amounted to £270.92 and net interest was £1,083.67.

14. On 17 December 1999 the Appellant appealed against the notice of 19 November 1999 on the grounds that some of the items mentioned fell outside section 19A.

Reasons for Decision

15. The arguments of the parties were addressed both to the specific issues in the appeal and also to some more general matters. It is convenient to consider the general matters first, as they relate to both issues, and then to consider the specific issues. The general matters were:

(1) whether the information required under section 19A was limited to existing documents;

(2) whether the information which could be required under section 19A was limited to that mentioned in section 12B so that the information required under section 19A was limited to documents used to prepare the return; and

(3) whether the information in section 19A was limited to documents which the taxpayer considered as most appropriate to check the return.

16. I consider each of these separately and then consider the specific issues in the appeal.

(1) Is section 19A limited to existing documents?

17. The Appellant argued that section 19A did not apply to documents which were not in existence and would have to be created especially to comply with the notice. He referred to the contents of two Inland Revenue Manuals being an "Enquiry Handbook" and an "Investigation Handbook" which indicated that it was not appropriate to ask the taxpayer to undertake work and that requests for extensive analyses were not appropriate at the opening stages of an inquiry. This argument related primarily to the preparation of the balance sheet.

18. The Respondent argued that under section 19A(2)(b) the Inland Revenue could ask for accounts and particulars, which were not in existence, to be prepared..

19. During this hearing reference was made on a number of occasions to Inland Revenue publications and to taxation journals. Although these are of undoubted interest this decision is based solely on the legislative provisions and on the legal authorities as applied to the particular facts of this appeal.

20. Section 19A(2) has two parts. Subsection (2)(a) refers

to "such documents as are in the taxpayer's possession or power". Certainly documents which are in the taxpayer's possession will be existing documents. But it may be that a taxpayer does not have, say, a bank statement although he is entitled to ask his bank for one. That would be in his "power". Thus, section 19A(2)(a) relates only to producing documents which the taxpayer has, or can obtain, and does not require him to create new documents. However, the words "in the taxpayer's possession or power" do not appear in section 19A(2)(b) which is a pointer to the conclusion that, under that subsection, a taxpayer could be asked to create new documents. Another pointer is that the word "furnish" is used in section 19A(2)(b) whereas the word "produce" is used in section 19A(2)(a); the use of a different verb indicates that a different activity is in mind. In addition, section 19A(2)(b) is limited to "accounts and particulars". Finally, if an Inspector is to enquire into a return it would seem reasonable for his enquiries not to be limited to existing documents. (Support for the view that there is a contrast between a provision requiring the production of documents and a provision requiring the furnishing of accounts or particulars can be found in the decision in *R v O'Kane and Clarke, ex parte Northern Bank Limited* [1996] STC 1249 at page 1258c which authority was cited by the Appellant within the context of the first issue in the appeal.)

21. There appeared to be some confusion at the hearing of the appeal about the word "accounts" in section 19A(2)(b). In my view in the context of section 19A(2)(b) the word "accounts" does not include bank statements, because bank statements cannot be created by the taxpayer, but does include accounts such as an income and expenditure account or a balance sheet. Thus, although bank statements can be requested under section 19A(2)(a), a taxpayer can be required to prepare accounts such as income and expenditure accounts or balance sheets under section 19A(2)(b).

22. My conclusion is that section 19A(2)(a) is limited to existing documents in the possession of the taxpayer but documents in the power of the taxpayer can be also be requested under section 19A(2)(a). Under section 19A(2)(b) the taxpayer can be requested to prepare accounts such as income and expenditure accounts or balance sheets and also to furnish particulars which may not necessarily be contained in existing documents.

(2) Is section 19A limited to the documents mentioned in section 12B?

23. The Appellant argued that section 19A did not increase the duties to keep records set out in section 12B. Parliament had not intended section 19A to extend beyond the documents mentioned in section 12B. He referred to paragraph 395 of the Inland Revenue Manual which said

that there should normally be no difficulty in demonstrating that the records under section 12B can reasonably be required under section 19A. He argued that the converse followed and that, accordingly, section 19A only applied to documents which he had used to prepare his return. This argument also related primarily to the preparation of the balance sheet.

24. The Respondent did not agree that the section 19A was restricted to the documents mentioned in section 12B. Section 12B related to the records required for constructing a return whereas section 19A(2)(b) extended to documents not in existence. Also, section 19A could be used for checking whether a return was incomplete as well as whether it was incorrect.

25. Section 12B contains the provisions relating to the records to be kept for the purposes of returns. It provides that a person who may be required to make and deliver a return shall keep all the records as may be requisite for the purpose of enabling him to make and deliver a correct and complete return. It also provides that such a person shall preserve those records for a stated time. Section 12B(3)(a)(i) provides that, in the case of a person carrying on a trade, profession or business, the records required to be kept must include all amounts received and expended in the course of the trade, profession or business and the matters in respect of which the receipts and expenditure took place.

26. Section 12B appears in Part II of the 1970 Act which is called "Returns of income and gains". Section 19A appears in Part III of the Act which is called "Other returns and information". There is nothing in either section 12B or section 19A which indicates that the requirements of section 19A are limited to the records mentioned in section 12B. As there is a statutory requirement to keep the records mentioned in section 12B it will, in most cases, be reasonable of an Inspector to require production of them under section 19A. But that does not mean that it will not be reasonable for the Inspector to require other documents not mentioned in section 12B. Further, as I have already concluded that section 19A(2)(b) can extend to accounts and particulars not already in existence, it follows that section 19A cannot be restricted to the documents mentioned in section 12B. Also, information may be required under section 19A(2) "for the purpose of determining whether a return is incorrect or incomplete". In determining whether a return is incomplete it may well be necessary to consult documents which were not used in the preparation of the return.

27 The conclusion is that section 19A is not limited to the documents mentioned in section 12B

(3) Is section 19A limited to documents which the taxpayer

considers to be appropriate?

28. The Appellant argued that section 19A did not apply to documents required to check the return if a more appropriate document was available. This argument related primarily to the request for bank documents where the Appellant argued that the certificate of deduction of income tax of 3 December 1999 should be sufficient. The Respondent argued that section 19A was not restricted to documents which the taxpayer decided were most appropriate for checking the return.

29. Sub-sections 19A(2)(a) and (b) refer to such documents "as the officer may reasonably require". It does not refer to such documents as the taxpayer considers are appropriate.

30 The conclusion is that section 19A is not limited to documents which the taxpayer considers to be appropriate.

31. In the light of those conclusions I now consider the specific issues in the appeal.

(4) Was it reasonable to require bank documents ?

32. The first issue in the appeal is whether the Respondent could reasonably require the Appellant to produce documents relating to his personal and undesignated clients' bank and building society accounts.

33. The Appellant argued that the information required had to be relevant to the entries in his tax return. He argued that the word "etc." in the Notice of 19 November 1999 did not apply to his clients' account and in any event was too general in nature and nothing to do directly with his return. The words "by you" in item 5 of the Notice could encompass various things including his private bank statements. He did not have a personal bank account. He had a current client account and also a deposit account which generated interest. The current client account could not affect his return and, in any event, a requirement to produce it raised ethical issues. He referred to the decision in *R v Inland Revenue Commissioners, ex parte Kingston Smith (a firm)* [1996] STC 1210 which raised the question as to whether the Inspector was looking for other information. He also referred to the decision in *O'Kane and Clarke*. If the Inspector wanted disclosure of the interest received on the deposit account the letter from the bank was sufficient to enable the Inspector to check the return.

34. The Respondent said that he was not asking to see bank statements relating to designated clients' accounts. He was only asking to see bank statements relating to undesignated clients' accounts and private and business accounts. The Appellant had only recently said that he had no personal bank account. The Inland Revenue did not

know what sort of accounts existed and they were all under the control of the taxpayer. The Appellant had declared in his return the interest on the deposit account which was in his name and section 19A(2) was wide enough to include that. He agreed that the certificate of tax deduction verified the amount of the interest but he was looking beyond the interest and there was nothing on the bank's letter to show that the money was only clients' money. It was possible for the Appellant's own money to be put into that account. He distinguished the decision in Kingston Smith which related to section 20 of the 1970 Act and not to section 19A; however that decision did indicate that statute could give a power to examine material regarding third parties. He distinguished O'Kane v Clark which concerned section 20(3) of the 1970 Act and not section 19A. Finally, the Respondent referred to an Article in Taxation on 25 March 1999 at page 644.

35. In considering the arguments of the parties I first refer to the authorities cited. Kingston Smith concerned a warrant to enter and search the premises of accountants. The warrant was granted by a circuit judge under the provisions of section 20C of the 1970 Act on the ground that there was reasonable grounds for suspecting an offence involving serious fraud in connection with tax in relation to two named persons. The legal issue was whether the Inland Revenue should have ceased their search when ordered to do so by the court. The extent of their powers was not considered in the reported judgment and so I do not find it to be of help in this appeal

36. O'Kane and Clarke on the other hand did concern the extent of the powers of the Inland Revenue but under notices under section 20(3) of the 1970 Act. The notices were served on a bank requiring it to provide certain information about identified customers. One of the arguments was that the notices referred to classes of documents, and documents whose existence was conjectural, and that section 20(3) could not be used to impose on a "mere witness" an obligation to search through its records. Ferris J held that the section did not permit a notice to be given in respect of conjectural, as distinct from actual, documents. At page 1262b he said:

"Accordingly, in my view, it would be permissible for an inspector, by means of a section 20(3) notice, to require the delivery of 'all correspondence between the bank and X' between specified dates, where X is an identified individual. I consider that it would also be permissible to require delivery of 'all [the taxpayer's] bank statements' in respect of an identified account for a specified period, ...

I have had rather more hesitation concerning the propriety of a requirement for delivery of all the taxpayers' bank statements for unidentified accounts (such as 'all accounts at any branch of the bank'). In the end I have concluded

that this would be impermissible. It is a requirement which can only be complied with after the accounts have been identified. If the identification is to be carried out by the recipient of the notice rather than the inspector who serves it such a request becomes, at least to a significant extent, a requirement to produce information rather than documents."

37. At first sight this decision appears to support the argument of the Appellant that the Notice of 19 November 1999 was not sufficiently specific. However, that ignores the fact that the appeal in O'Kane and Clarke concerned the obligations of a third party (a "mere witness") and not, as in this appeal, the taxpayer himself. The taxpayer does not have to search through his records to find out what bank or building society accounts he holds. If he has a bank or building society account he will have statements or pass-books, paying-in books and cheque books and these will be in either his possession or power. It follows that he is not being asked to provide information but to produce documents.

38. I have also referred to the decision of the Special Commissioners in *Mother v Inspector of Taxes* [1999] STC (SCD) 278 which also came to the conclusion that an inspector has authority under section 19A enabling him to request bank paying-in books and cheque book stubs within the taxpayer's possession or power.

39. The Appellant disputed the right of the Inspector to ask for documents relating to three specific accounts. First, he said that he did not have a personal bank account. Secondly, he said that he had a general deposit account into which he placed clients' monies. And, thirdly, he said that he had a current client account.

40. If the Appellant does not have any sort of personal bank or building society account then there will be no statements, paying-in books or cheque book stubs in his possession or power and he does not have to produce documents which have never existed and which have never been in his power. However, that does not mean that the Notice when it was given was unreasonable.

41. As far as the general deposit account is concerned I note that this was described by Barclays Bank as a "business" account and not a client account. Also, the Appellant is liable for tax on the interest. Further, the interest is declared on the return. The Appellant said that it contained clients' monies and that that raised ethical issues. Here I have been assisted by the decision in *R v Inland Revenue Commissioners, ex parte Taylor* (No 2) [1990] STC 379. That appeal concerned the provisions of section 20(2) of the 1970 Act rather than section 19A but the principles it established are of general application. The appeal concerned a notice given to a solicitor requiring him

to produce all documents in his possession or power relating to the solicitor's business and private accounts, agreements, contracts and correspondence. The solicitor argued that some of the documents might contain information which was protected by his duty of confidentiality to his clients. At page 384b Bingham LJ referred to the other provisions of section 20 which preserved legal professional privilege and continued:

"But there is no preservation of legal professional privilege and no limited protection where the notice relates to a lawyer in his capacity as taxpayer who is served with a notice under section 20(2). The clear inference is, in my judgment, that a client's ordinary right to legal professional privilege, binding in the ordinary way on a legal adviser, does not entitle such legal adviser as a taxpayer to refuse disclosure. That is not, to my mind, a surprising intention to attribute to Parliament. In different circumstances the Court of Appeal has held that The Law Society is entitled to override a client's right to legal professional privilege where investigating a solicitor's accounts. ... It is, as I think, altogether appropriate that the Revenue, being charged with the duty of collecting the public revenue, should enjoy a similar power."

42. In this appeal the Appellant is being required to produce documents in his capacity as taxpayer. The general deposit account is covered by both Item 3 and Item 5 of the Notice of 19 November 1999 and the Appellant has to supply the information required. I adopt the following passage from *Mother v Inspector of Taxes* at page 281h:

"With regard to records of the taxpayer's business which may reveal information concerning other taxpayers, such documents must nevertheless be supplied, providing as little information concerning other taxpayers as is compatible with the requirement to produce documents relating to the taxpayer's business."

43. Turning to the current client account, as that is not an interest-bearing account it is not covered by Item 3 in the Notice of 19 November 1999. However, it is an account "used by" the Appellant within the meaning of Item 5 of the Notice. Having regard to the particular facts of this appeal I conclude that it is not unreasonable for the Respondent to require production of documents relating to that account.

44. I conclude that the Respondent could reasonably require the Appellant to produce documents relating to his personal and undesignated clients' bank and building society accounts.

(5) Was it reasonable to require a balance sheet?

45 The second issue in the appeal is whether the Respondent could reasonably require the preparation of a

balance sheet under section 19A(2)(b).

46. The Appellant argued that there was no legal requirement to submit accounts with a return. At the time he had prepared the 1996/97 return he had not prepared accounts. Section 12B(3)(a)(i) only referred to amounts received or expended in the course of the trade. He had recently prepared an invoice and expenditure account for the period from 1 September 1994 to 31 August 1996. No other account would give the Inspector additional information to check the tax return. Before self-assessment he used to prepare balance sheets but they were of no use to the Inspector because they did not portray any figures necessary to assess the taxability of the practice and there was no movement from one year to the next. There had been no change in his fixed assets since 1981 and the only change in his current assets was the change in his bank balance. After self-assessment he had not prepared a balance sheet because he did not consider it necessary to keep a record of his drawings and had not done so. A record of drawings was not necessary to enable the Inspector to calculate the assessable profits of the practice. The amount of drawings was a private matter for which he did not have to account to the Inspector. He could do a balance sheet without drawings. The Appellant referred to an Article in the December 1996 issue of Taxation Practitioner which indicated that balance sheets would not normally be required for traders with small turnovers.

47. The Respondent agreed that the balance sheet may not have been required to render the return but section 19A went wider than that. The Inland Revenue had the power to ask for accounts and particulars in order to determine whether the return was incomplete or incorrect. The balance sheet would help to do that. It was a useful indicator of the disposal or acquisition of assets and that was relevant to capital gains tax. Even though the Appellant may not have kept a record of his drawings he was a chartered accountant and would not find it difficult to prepare a balance sheet. He (the Respondent) would accept a balance sheet prepared to the best of the Appellant's ability. Also, it was not correct to say that the drawings figure was not required by the Inland Revenue. This was an enquiry into a personal tax return as well as into a business tax return. The Inland Revenue might need to enquire into personal savings. Section 19A was not restricted to business-related items.

48. The notice of 19 November 1999 asked for one balance sheet as at 31 August 1996. It is not already in existence and will have to be prepared. However, it is an "account" within the meaning of section 19A(2)(b) which subsection is not limited to existing documents. Although a balance sheet is not within the class of documents mentioned in section 12B(3)(a)(i) I have already concluded that section 19A is not limited to documents mentioned in section 12B.

I conclude that a balance sheet would assist the Inspector in determining whether the return is incomplete or incorrect because it will indicate movements in capital assets. Further, drawings figures are relevant to the personal tax position of the Appellant and the return does not relate only to his practice.

49. Clearly the Appellant cannot be asked to do the impossible. However, I am sure that a person with his qualifications will not find it difficult to prepare one balance sheet. If there are insuperable difficulties in identifying a figure for drawings then he should prepare it to the best of his ability.

50. I therefore conclude the Respondent could reasonably require the preparation of a balance sheet under section 19A(2)(b).

Decision

51. My decisions on the issues for determination in the appeal are:

(1) that the Inspector could reasonably require the Appellant to produce documents relating to his personal and undesignated clients' bank and building society accounts; and

(2) that the Inspector could reasonably require the preparation and furnishing of a balance sheet under section 19A(2)(b).

52. Under the provisions of section 19A(9) I confirm the Notice of 19 November 1999. Under the provisions of section 19A(10) the notice has effect as if it had specified 30 days beginning with the determination of this appeal.

NUALA BRICE

SPECIAL COMMISSIONER

Date of Release: 8th June 2000

SC 3008/00