

Gambling winnings and other client explanations (Lecture P1425 – 15.05 minutes)

This article considers explanations of non-taxable sources that may be given by clients to explain shortfalls in their expenditure requirements, or when asked to identify the source of bank deposits. The situation may arise as a result of investigation work by the adviser, or in response to queries from HMRC.

Background

During the course of an HMRC enquiry, the investigating officer may ask the client to explain the source of deposits to their private bank accounts, or the client might be asked to explain a shortfall in their expenditure requirements. Alternatively, the adviser may be undertaking analysis of these issues, in anticipation of queries from HMRC.

Where the client has been diverting takings, or otherwise extracting funds from their business, they might provide a “cover story”. The adviser should test such explanations before responding to queries from HMRC. Failure to do so can undermine the credibility of other explanations provided to the inspector.

Whatever the explanation given by the client, it is important to verify the claimed source, and establish what supporting documentation is available. Advisers will appreciate that the position is more difficult, and even more likely to be challenged by HMRC, when the funds involved have been received in cash.

“I won it on a horse”, and other betting/gambling winnings

The basic position is that betting and gambling do not constitute trading (the profits are not taxable, and losses are not allowable). That position was established in the case of *Graham v Green* [1925] 9TC309, and is acknowledged by HMRC in their Business Income Manual (see BIM22015). The position has been confirmed in subsequent cases, and the principle remains, even with the evolution of new forms of gambling, including spread-betting (although there are some exceptions – see HMRC’s BIM22020).

There are circumstances in which the gambling winnings of professional gamblers are taxable, but that is outside the scope of this session.

An explanation frequently given is that the relevant amount was won on a horse, or was obtained from other betting or gambling activity. HMRC are highly suspicious of such explanations and will want supporting evidence. In the absence of documentary evidence, HMRC will want full details including, in the case of a claimed winning bet on a horse race, the horse, the event, date and time of the race, the amount of the bet, and the name of the bookmaker. HMRC will also want details of how the bet was placed, and the source of funds for the stake. Even with that information, they may still not accept the explanation.

Where there are a series of claimed winning bets, HMRC will want the details for each race, and details of other bets placed, including losses. HMRC take the view that, over a period of time, the bookmaker will always win. HMRC’s guidance on this topic says, at EM2077, “Any suggestion that a taxpayer, as an individual punter, has been able ... to beat the professionals regularly and consistently at their own game, is highly improbable”. The guidance goes on to say that the explanation should not be accepted without “compelling evidence”. There may be little in the way of

supporting documentary evidence, and the adviser will need to establish what evidence might be available, and re-assess the client's position.

Depending on the nature of the betting or gambling activity, there may be a greater likelihood that supporting evidence is available, and the adviser needs to consider the particular client's circumstances. Winnings from gambling are, generally, not taxable, as noted above, although there are exceptions, including in relation to professional bookmakers. However, the onus is on the taxpayer to demonstrate that the relevant amounts have originated from gambling. Many cases have not succeeded at the tribunal because the taxpayer failed to provide supporting evidence. The case of *Simon McMillan v HMRC* (2019) bucked that trend, as, although the taxpayer had disposed of the records relating to his betting activities, which were conducted in cash, he was successful at the First-tier tribunal. Mr McMillan was considered a credible witness, and there were a number of witness statements, and the tribunal accepted that evidence.

Loans

When a client indicates that they have received a loan, it is important to establish whether there is a loan agreement. Although it might be unusual to have such an agreement for loans between family members, particularly close relationships (from a parent, or sibling, for example), where the loan is from a business associate or friend, it would be reasonable to expect that the transaction was documented. There might not be a formal loan agreement, but, at the very least, you would expect to see an email exchange confirming the position.

In addition to a loan agreement, it would be prudent to obtain evidence of receipt of the loan by your client into their bank account, and a copy of the corresponding bank statement from the lender, showing the payment out of their account. It would also be helpful to obtain copies of bank statements showing evidence of loan repayments by your client, if there have been any such payments. Copies of the corresponding bank statements from the lender will help to complete the audit trail. Whether it is possible to obtain copies of all the relevant bank statements is another matter.

If it is not possible to obtain copies of the bank statements and there isn't a loan agreement, the only documentary evidence your client may be able to obtain is a statement from the lender confirming the position. Whether HMRC will accept a statement without other corroboration will depend on the circumstances, and the facts of the case, but it would not be uncommon for the officer to resist any such claims.

In the absence of any supporting evidence, HMRC may ask for the name and address of the lender, so that they can undertake internal checks. They will determine the lender's ability to provide the funds. However, advisers should note that HMRC may not be prepared to undertake such checks, and put the onus firmly on the client to support his position.

Gifts, inheritances and windfalls

The position for claimed gifts, inheritances and windfalls is the same as for loans, in that HMRC will want supporting evidence. In relation to gifts, a copy of the corresponding bank statement from the donor may suffice. For an inheritance, it should be possible to get documentation, or correspondence, from the solicitor, if there is one, administering the estate. Where there is a claimed windfall, as with a lottery win or similar payment, you should consider obtaining confirmation of the source from the provider, if none was given with the payment. As with the other scenarios discussed in this session, it is important for the adviser to get the client's comprehensive explanation, and for that explanation to be robustly examined.

Similar considerations apply when clients claim that bank deposits arise from cash hoards, or the sale of furniture or other personal effects.

Practical considerations

It is important for advisers to pre-empt HMRC queries, where possible, and ensure that any bank statements or other documents sent to the inspector are reviewed if they have not previously been provided by the client. If it is not possible to review the statements, perhaps on grounds of cost, the adviser should ensure that the client understands the consequences if there are deposits to the bank account which cannot be explained or documented. The same considerations apply when reviewing the client's means' position, and their ability to fund personal expenditure, if that is being examined by HMRC (usually after a deficiency in the accounts or tax return has been established).

The circumstances should be established with the client, such that the source of the receipt(s) is identified. Advisers should be prepared to explore the explanations given by the client. It is important to determine the position, and ensure, as far as possible, that explanations are obtained before documents are sent to HMRC. The credibility of other explanations given to HMRC will be undermined if stories of, for example, betting winnings are later found to be false. The adviser's position is more difficult if the client's explanations relate to cash receipts.

When an explanation has been provided, such as those discussed in this session, it is important to establish what supporting evidence there is, and whether that will be sufficient to satisfy HMRC, or, ultimately, the tax tribunal. Consideration should be given as to what further documentation can be obtained. Evidence can be presented at the tribunal, if HMRC does not accept the explanations and the officer issues an assessment. However, my view is that if there is evidence available, or that can be obtained, it should be presented to the HMRC officer rather than wait for the matter to be escalated such that there is a tribunal hearing, with the associated delay in reaching a conclusion and the increase in associated costs.

Where the client provides an explanation that is not supported, or that the client subsequently accepts is not correct, advisers should consider whether the client needs to make a voluntary disclosure (for which see my session on that topic).

Advisers need to be aware that questions on bank deposits or the client's means' position may also arise at a meeting with the inspector. If the above advice has been followed, the adviser will have reviewed bank statements provided to HMRC, and explored any potential weaknesses. However, if the adviser agrees to take his client to a meeting with the enquiry officer, he should ensure that such matters have been addressed, and that the client is suitably prepared.

HMRC's Enquiry Manual does not provide the adviser with much assistance in this area. Most of the content regarding betting and claims of non-taxable sources is withheld because of exemptions in the Freedom of Information Act 2000. Advisers should note that HMRC can be expected to robustly challenge any claims of non-taxable sources, including in relation to bank deposits or shortfalls in personal expenditure requirements. Officers are advised, at EM2053, that they "should not accept such claims unless you are satisfied that they are correct". This will involve HMRC examining the available evidence, seeking to question the client in person, and considering the client's credibility and behaviour during the enquiry.

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