

What 'Presumption of continuity' means? (Lecture B1334 – 10.33 minutes)

Background

In an HMRC enquiry such as into an individual's self-assessment return, the enquiry might extend beyond the tax year of the enquiry and into other tax years. For example, this might happen if the enquiry has revealed understated profits of a self-employed individual.

In addition to assessing additional profits for the tax year of HMRC's enquiry, suppose that the enquiring HMRC officer considers that profits for other years have probably been understated in a similar way, and makes discovery assessments for earlier tax years. The taxpayer's agent should want to know HMRC's justification for reopening earlier tax years. The HMRC officer may well refer the agent to HMRC's practice of 'spreading', or the presumption of continuity.

Presumption of continuity

HMRC uses case law as authority for spreading additions into other years, based on the 'presumption of continuity'.

Probably the most well-known of the above cases is *Jonas v Bamford* [1973] STC 519, in which Judge Walton J expressed the presumption of continuity as follows:

"Once the inspector comes to the conclusion that, on the facts which he has discovered, the taxpayer has additional income beyond that which he has so far declared to the inspector, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer."

Note that Judge Walton was referring to the presumption of continuity applying to later years, not earlier ones.

Subsequent cases

The decision in *Jonas v Bamford* has been used by HMRC quite extensively in other cases. However, those cases have not all gone HMRC's way. The presumption of continuity does have its limitations.

For example, in *Barkham v Revenue and Customs* [2012] UKFTT 499 (TC), HMRC opened an enquiry into the taxpayer's tax return for 2004/05. Mr Barkham operated a car sales and maintenance business. Following the enquiry, HMRC raised an assessment increasing Mr Barkham's profits for 2004/05, together with assessments for 2001/02, 2002/03 and 2003/04. HMRC's enquiry into the taxpayer's accounts resulted in an addition to gross profit which represented a 58% increase in gross receipts for the tax year 2004/05. HMRC then applied the same percentage and increased gross receipts for the three earlier tax years, relying on the presumption of continuity to make assessments for those years. The tribunal dismissed the taxpayer's appeal against the 2004/05 assessment. However, on HMRC's assessments for earlier years, the tribunal found the 58% increase in the declared turnover to be "unfair and unreasonable", and "unrealistic" and suggested that the taxpayer and HMRC negotiate any adjustments between themselves.

The tribunal judge commented:

“The presumption of continuity alone does not justify increases in assessments; the initial onus is on HMRC to show evidence in support of the making of the assessments. This would therefore be a limitation of the use of the presumption of continuity where previous year’s accounts are sought to be opened.”

This was not the first time the tribunal had indicated limitations in the presumption of continuity. For example, in *Syed v Revenue and Customs* [2011] UKFTT 315 (TC), the tribunal said:

“In practice it will generally be reasonable and sensible to conclude that if there was a pattern of behaviour this year then the same behaviour will have been followed last year. Sometimes however that will not be a proper inference: there will be occasions when the behaviour related to a one-off situation, perhaps a particular disposal, or particular expenses; in those circumstances continuity is unlikely to be present.”

Business economics exercises

If the taxpayer’s business records are incomplete, HMRC may seek to assess additional profits by means of a business economics exercise.

For example, in *Chapman v Revenue and Customs* [2011] UKFTT 756 (TC), HMRC opened an enquiry into the taxpayer’s return for 2006/07. Due to the absence of adequate business records, HMRC conducted a ‘takings build-up’ exercise, which arrived at a shortfall in turnover for 2006/07.

HMRC considered that the retail price index should be applied to calculate a shortfall in declared income for 2004/05 and 2005/06, plus the later year 2007/08, based on the presumption of continuity. However, the tribunal noted that HMRC’s takings build-up turnover figure was “wholly unrealistic”, so the omitted sales figure for 2006/07 was reduced.

The tribunal also regarded HMRC’s takings build-up calculation for 2007/08 to appear arbitrary and reduced the assessment for that year to nil. In addition, HMRC had not produced a takings build-up for 2004/05 or 2005/06, so the assessments for those tax years were reduced to nil.

On the presumption of continuity and the *Jonas v Bamford* case, the tribunal in *Chapman* stated:

‘The presumption goes on until there is some change. The presumption as expressed in that case looks to the future and not the past. It is difficult to see how one can apply such a presumption based on the enquiry year to the earlier years.’

By contrast, in the subsequent case *Allan v Revenue and Customs* [2016] UKFTT 504 (TC), the tribunal stated:

“Once the threshold requirement is satisfied for there to be a ‘discovery’ of loss of tax, the presumption of continuity applies in the raising of assessments for earlier years”.

HMRC might point to the *Allan* case as authority to extend the scope of the presumption of continuity to earlier years. However, the decision in *Allan* doesn’t set a binding legal precedent. Having said that, the approach in *Allan* has subsequently been followed in other cases (e.g., *Whitlock v Revenue and Customs* [2021] UKFTT 167 (TC)).

Isolated inaccuracies

In the case of 'one-off' tax return inaccuracies, HMRC states (at EM3236):

“If there is only one under-declaration shown in only one year, additional evidence will be required to conclude that other years' figures may also be inaccurate...”

HMRC goes on to say: “Assessments should not normally be raised before HMRC have a case both for the existence of current year assessed liabilities and for the presumption of continuity.”

Practical issues

It might be tempting in an enquiry case to agree additions to business profits with HMRC, with a view to bringing the enquiry to an early conclusion. However, profit adjustments for the year of enquiry can result in adjustments for other tax years as well, based on the presumption of continuity. Thus, it is important to avoid agreeing any profit adjustments for the enquiry year without very careful thought.

Even if the presumption of continuity is considered appropriate and HMRC raises assessments to increase profits for earlier tax years, it should not be automatically assumed that the methodology used by HMRC is correct. If the taxpayer (or agent) can provide evidence to indicate that, on a balance of probabilities, HMRC's assessments are excessive, those assessments will need to be adjusted accordingly, or appealed against.

Contributed by Mark McLaughlin