



TC01592

Appeal number: TC/2010/07530

Income tax – self-assessment and discovery assessments – computation of taxable profits – whether takings properly recorded – on facts, no – whether various categories of expenditure deductible – held on facts that approach taken by HMRC reasonable in circumstances – no basis for adjusting assessments and amendments made – appeal dismissed

FIRST-TIER TRIBUNAL

TAX

ASSUNTINO PALMIERO

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS**

Respondents

**TRIBUNAL: JOHN CLARK (TRIBUNAL JUDGE)
PETER DAVIES**

Sitting in public at 45 Bedford Square, London WC1 on 23 September 2011

Eric Chee, Peter Bradley and Associates, Chartered Accountants, for the Appellant

John Corbett, Senior Officer of HM Revenue and Customs, for the Respondents

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DECISION

1. Mr Palmiero appeals against closure notices for the years 1998-99, 2002-03, 2003-04, 2004-05, and 2005-06, as well as extended time limit discovery assessments for the years 1999-2000 and 2000-01, and a normal time limit discovery assessment for the year 2001-02.

The facts

2. The evidence consisted of three bundles of documents, two of which were very substantial, and the other much smaller. Mr Palmiero gave oral evidence, and Richard Alexander, a Higher Officer of the Respondents (“HMRC”) gave evidence both by a witness statement and orally. The witnesses were not sworn.

3. Evidence was given in an informal manner, as the matters covered by the appeals were considered under a series of category headings, in the manner set out below.

4. From the evidence we find the following background facts; where matters were disputed, we consider them later in this decision.

5. Mr Palmiero’s business trades under the name “Toli Patisserie”. The business premises are located in Kentish Town Road, opposite the Underground station. The premises were described by Mr Palmiero’s previous accountants as consisting of the following:

- (1) A basement, containing toilets for use by customers, store rooms, and a small office used by Mr Palmiero;
- (2) The ground floor, consisting of a café/restaurant with a sitting area to the front and a kitchen area to the rear;
- (3) Upper floors divided into two flats, of which Flat A includes a bathroom/WC, a kitchen, bedroom 2, and a living room with stairs to bedroom 1 on the third floor, and Flat B includes a bathroom/WC, a kitchen, and a living room with stairs to bedrooms 1 and 2 on the third floor.

6. HMRC issued enquiry notices under s 9A of the Taxes Management Act 1970 (“TMA 1970”) on the following dates:

- (1) 6 October 2004, in respect of the years 1998-99 and 2002-03;
- (2) 1 December 2006, in respect of the years 2003-04 and 2004-05;
- (3) 21 December 2007, in respect of the year 2005-06.

7. HMRC undertook a “full records examination” into the 2002-03 return, which included the accounts of the business for the year ended 31 December 2002.

8. Mr Palmiero has been represented by three different accountants. Until January 2009, his accountant was Mr Tan of Richard Benjamin & Co. From January 2009 to June 2009, his accountant was Mr Miguel. From June 2009 onwards, his accountant has been Mr Chee.

9. On 26 October 2005 Mr Palmiero and Mr Tan attended a meeting with Mrs Patel and Mr Ginn of HMRC. Mrs Patel asked a series of questions relating to matters under enquiry. Mr Palmiero provided information on many of the matters raised, but in a letter dated 4 November 2005 enclosing the notes of the meeting for signature by Mr Palmiero, Mrs Patel asked for certain further information to be provided to her. There was no evidence that any copy of the notes was signed by Mr Palmiero, nor of any amendments of HMRC's notes being suggested either by Mr Tan or Mr Palmiero.

10. After further correspondence, Mrs Patel wrote to Mr Tan's firm on 26 February 2006. She considered that progress with the enquiry had been slow, and requested a meeting in order to move towards a settlement. On 17 May 2007, as there had been no response despite a statutory notice being issued and penalties being imposed for non-compliance, Mrs Patel wrote again seeking a settlement; she made certain proposals, but indicated that if she did not hear within 30 days, she would issue closure notices and discovery assessments based on the figures enclosed with her letter.

11. The closure notices and discovery assessments in respect of all the years except 2005-06 were issued on 11 July 2007. On 18 September 2007 Mr Tan wrote to Mrs Patel to make a formal appeal against all the assessments "for the tax years 2000 to 2005 inclusive". No grounds of appeal were stated in his letter. Very much later, on 30 July 2008, Mr Palmiero wrote to Mrs Patel making a late appeal in respect of the year 1998-99. He explained that the problem he was in had accumulated for years without his knowledge; if he had been aware of it right at the outset, it would have been much easier for him to tackle it.

12. On 24 October 2007, Mr Palmiero and Mr Tan attended a meeting with Mrs Patel and Mr Yarde of HMRC. Mrs Patel dealt with various specific matters relating to the accounts, and requested further information, stating that if this was not received within two weeks, the case would have to be listed for a personal hearing at the next General Commissioners' meeting.

13. On 12 March 2008, Mrs Patel wrote to Mr Tan to indicate that although she did not accept certain figures, she had decided on a without prejudice basis not to pursue those points; she enclosed a revised schedule of figures for acceptance, and in the absence of a response, she would assume his agreement.

14. On 1 April 2008 Mr Tan telephoned Mrs Patel about her letter. He explained that although he could agree the proposed figures, Mr Palmiero now did not accept them, having seen the amount of tax which he would have to pay. Mr Tan explained that if Mr Palmiero now wished to dispute the figures, he (Mr Tan) would no longer act for Mr Palmiero.

15. Further correspondence did take place between Mr Tan and Mrs Patel. By early 2009, however, Mr Tan was no longer involved. On 10 February 2009, Mr Palmiero and Mr Miguel attended a meeting with Mr Alexander and Mr Turner of HMRC. Following that meeting, Mr Alexander wrote to Mr Palmiero to set out proposals for settling the outstanding matters.

16. Following the appointment of Mr Chee, Mr Alexander wrote to him on 26 June 2009 enclosing copies of the relevant correspondence since the enquiry started. Correspondence relating to the various years under enquiry continued.

5 17. After exchanges of correspondence, Mr Alexander wrote to Mr Chee on 19 November 2009, explaining that an agreed settlement looked unlikely; it seemed that a formal review and/or a Tribunal hearing would be necessary. Mr Alexander attached a schedule setting out the basis for the revised profit figures which he was proposing. He set out detailed explanations for his conclusions.

10 18. On behalf of Mr Palmiero, Mr Chee made a late appeal on 9 April 2010 against the 2005-06 assessment made on 10 June 2009, on the grounds that it had been raised “incorrectly”.

15 19. A late request for review of the appeals for all the years in question was accepted by Mr Alexander on 13 July 2010. He pointed out that no appeal had been made against a penalty determination issued on 8 February 2010, and asked that if Mr Palmiero wished to make a late appeal, this should be dealt with immediately.

20 20. On 16 August 2010 the review officer, Mr Agg, wrote to Mr Chee’s firm enclosing a copy of the letter of the same date to Mr Palmiero setting out the results of the review. In the covering letter, Mr Agg noted that no appeal had been received against the penalty determination, which had therefore become final and conclusive. It had not therefore been included in the review. Mr Agg’s conclusion was that the various decisions under appeal should be amended to the amounts set out in Mr Alexander’s letter of 19 November 2009. Mr Agg set out the detailed reasons for the changes, and his comments on them.

25 21. On 16 September 2010, Mr Chee gave Notice of Appeal to the Tribunals service. Subsequently, further correspondence was exchanged between Mr Chee and HMRC to try and negotiate a settlement, but HMRC’s final adjustments remained as set out in the letter from Mr Alexander dated 19 November 2009. As no agreement was reached, the appeal proceeded. The grounds and the detailed matters raised in the course of the hearing are considered below.

30 **Arguments for Mr Palmiero**

35 22. Mr Chee explained that he had previously acted for Mr Palmiero for a number of years until April 2000, when Mr Chee had retired from practice and retired from providing accountancy work and taxation services. Mr Palmiero had met Mr Chee at a funeral a couple of years ago, and Mr Palmiero had asked for Mr Chee’s help because Mr Palmiero’s previous accountant had “let him down”.

40 23. It had not been possible to obtain from the accountant the data required to support the various items of expenditure claimed in the accounts. Attempts had been made through the professional body to which that accountant belonged to make arrangements for the supply of the relevant information. Mr Chee was sure that, once the information was forthcoming, the allowability of the items of expenditure could

be determined. For the purposes of the appeal hearing, Mr Chee had to reserve his comments at this point in time, until the previous accountant could be forced by his professional body to produce the information.

5 24. Mr Chee reviewed the various items of expenditure in dispute, as well as the records of the takings of the business. If there had been any mistakes with the recording of the takings, these were genuine mistakes.

10 25. Mr Chee produced photographs of the state of the building. As these did not constitute formal agreed evidence, we looked at them and handed them back; the photographs did not contain any identifying marks or other means of linking them specifically to the premises at which the business operated.

26. Mr Chee explained that once he had received and examined the bundles, he had concluded that there was a great deal which he could not understand without the additional data being sought from the previous accountant, so he wanted to reserve the issue. We commented on this at the hearing; see below.

15 27. Mr Chee contended that Mr Palmiero had not been negligent; his declarations had been accurate, based on his takings. The accounts had been prepared by a professional accountant. There was no merit in Mr Palmiero not declaring income. Any mistakes that had been made were accidental, and attributable to employees, whom Mr Palmiero could not control for every minute of their working time.

20 28. He emphasised that Mr Palmiero was open to co-operation; HMRC could visit his premises at any time.

29. Mr Chee and his client were adamant that the repairs should be an allowable expense; Mr Palmiero had been working on the shop, which was why he had not completed the work on the flats.

25 30. Apportionment of the expenditure was strongly opposed; the only items relating to the flats were the roof, and double glazed windows to prevent weather damage to the whole property. The upstairs had not been flats when bought; it had not been possible to get into the upstairs except through the shop. Initially there had been no stairs.

30 31. He referred to Mr Palmiero's financial position and lifestyle; we comment on these matters below. Mr Chee submitted that, if anything, Mr Palmiero had been a victim of circumstances and bad accountancy.

Arguments for HMRC

35 32. In relation to the seeking of the information from the previous accountant, Mr Tan, Mr Corbett pointed out that Mr Chee had not contacted the professional body concerned until 18 September 2011. Mr Chee intervened to explain that Mr Tan had been promising to forward the papers, but that he (Mr Chee) had ultimately decided that there was no choice but to go to that body, which was now investigating the matter.

33. Mr Corbett explained that Mr Alexander had prepared the assessments on the basis of the same records as those held by the previous accountants. He questioned why the previous accountants had not noticed the drawings. There might be a question of a negligence claim, but this was nothing to do with the appeal before the Tribunal.

5 34. Mr Corbett reviewed the disputed items of expenditure and the recording of takings. In the course of his presentation of HMRC's case, he put questions to Mr Palmiero and to Mr Alexander on these issues (considered below).

35. The legislation in question was s 74(1) of the Income and Corporation Taxes Act 1988 ("ICTA 1988"), subsequently s 34(1) of the Income Tax (Trading and Other
10 Income) Act 2005 ("ITTOIA 2005"). HMRC also relied on s 29 of the Taxes Management Act 1970 ("TMA 1970"). The time limits for "discovery" assessments were set out in s 36 TMA 1970. Mr Corbett submitted that there was negligent conduct; the records were not robust enough to show the income, and various items claimed as business expenditure did not qualify under the statutory test. A revised
15 figure was proposed for the assessment for the year ending 5 April 2003, but all the other years' assessments should remain unchanged.

Discussion and conclusions

36. Mr Chee referred to the additional information being sought from Mr Tan, the previous accountant. Mr Chee wished to reserve the position at this stage pending the
20 obtaining of that information. However, as we explained at the hearing, the appeals are before us for determination, and our powers are limited. Under s 50(6) and (7) TMA 1970, if the Tribunal decides that an assessment overcharges or undercharges the taxpayer, the Tribunal must reduce (or increase) the assessment,

“. . . but otherwise the assessment or statement shall stand good.”

25 37. It is therefore the task of Mr Palmiero and Mr Chee, his adviser, to satisfy us that there are reasons for reducing the assessments. In other words, the onus of proof falls on the taxpayer. The standard of proof is the ordinary civil standard, ie the balance of probabilities. Unless there is evidence to establish the existence of any such reasons, we are not in a position to adjust the assessments. We have considered whether this is
30 an appropriate case for the appeal hearing to be adjourned to enable that information to be obtained. Our conclusion is that it is not; the enquiries have already continued for an extended period, and the appeals need to be determined at this stage rather than being subjected to further delay. We therefore consider the appeals in the light of the evidence put before us.

35 38. The matters in dispute can be divided into two broad areas. The first is whether there was omission of income as a result of inaccurate or incomplete recording of takings. The second is whether various items claimed as business expenditure are allowable in computing the taxable profits of Mr Palmiero's business. We consider each of these areas in detail.

Recording of takings

39. At the meeting with Mrs Patel and Mr Ginn of HMRC on 26 October 2005, Mrs Patel asked Mr Palmiero who did the cashing up at the end of each day and whether the “Z” reading was reconciled with the cash in the till. Mr Palmiero said that he usually cashed up at the end of the day, and that he would compare the Z reading to the cash in the till. He said that the two usually did agree; there were occasions when they did not, but the difference was normally a few pounds. On occasions the difference could be more than £40, but this was very rare. Mr Palmiero said that he put such discrepancies down to errors in keying the prices into the till. Where there was a discrepancy, Mr Palmiero would change the figure on the Z reading by hand, and therefore the figures entered into his diary record were correct. He did not keep records of these discrepancies.

40. At the hearing Mr Chee explained that Mr Palmiero was not knowledgeable enough on the subject of Z readings to be able to reconcile the readings with the takings. It would be necessary to go through the whole of the records. Instead, Mr Palmiero counted the cash every day to match the total takings for each day. The first machine had been faulty and had been replaced; the Z total on the second machine had never been cleared when Mr Palmiero had begun to use it, nor had it been cleared every day or every week.

41. Mr Corbett asked Mr Palmiero about annotations on the Z readings included in the evidence. Mr Palmiero explained that these had been added two years ago when he had found out about an “over-ring”. He and Mr Chee both stated that when the relevant button on the till was pressed in order to obtain an “X” reading, this put the day total number up and so affected the Z reading.

42. Mr Corbett explained to us the distinction between the Z and the X keys. The Z readings were not tied to time; they would usually be taken at the end of the day. There were two types of Z reading. X readings were interim readings, which had their own sequence of numbers; they were not Z readings.

43. Mr Palmiero stated that he used the cash takings figure “religiously”, but in response to our question, indicated that he did not look at the Z readings; he only reconciled the “Total” figure with the cash.

44. When asked whether some of the “TL” readings were missing, he said that he had produced as much as he could.

45. Mr Alexander indicated that missing till rolls implied missing takings, and gave detailed examples of cases where there had been scope for undeclared takings to have been made in periods between the dates and times of some of the till rolls provided. The records showed a cumulative discrepancy. The period in January 2002 had been chosen because it was the period for which there were the most takings readings; he therefore considered it reasonable to use that month. For that month the figure declared in the records was the same as that shown by the recorded Z reading, so this suggested to Mr Alexander that there was no difference between the reading and the cash counted by Mr Palmiero.

46. Mr Alexander stated that Mrs Patel had showed Mr Palmiero a schedule of Z readings for the month of January 2002 and that the missing Z readings over the month had totalled £2,500; she had expressed the opinion that takings had therefore been omitted. She had said that not all Z readings had been retained despite Mr Palmiero having been asked to do so following an earlier enquiry in 1997; Mr Palmiero had stated that he had “lost” those which he had not been able to provide.

47. In Mr Alexander’s letter dated 19 November 2009 to Mr Palmiero explaining the position which HMRC would take in a Tribunal hearing, Mr Alexander had expressed his concerns in relation to the omitted Z readings and explained why he could not accept the explanations which had been put forward by Mr Palmiero and his advisers. Mr Palmiero stated that the transactions covered by the omitted Z readings were all either staff theft or staff mis-keying amounts on the till. Mr Alexander had not found this credible, as he would have expected Mr Palmiero to have noticed such a level of theft (£2,500 a month) occurring at specific times where Z readings were missing.

48. In addition, it did not seem reasonable to Mr Alexander that every transaction in the omitted Z readings could be a result of mis-keying. The fact that all of the declared takings for January 2002 matched the recorded Z readings suggested that there were no mis-keyings or thefts in those periods. In his opinion, it was reasonable to say that the omitted Z readings did reflect undeclared takings. Some of the missing readings followed on from times where the previous Z reading had been taken before the café closed. This meant that there was scope for takings to have been made during the time covered by the missing Z readings (and recorded on those readings), and therefore to go undeclared. Although Mr Palmiero explained at the hearing that he had started to take Z readings earlier in the day as no customers were coming in later (he had started to close at 5 pm rather than staying open until 7 pm) and that any later takings would go into the takings for the next day, we do not find that to be a sufficient explanation for the gaps between the Z readings provided.

49. Mr Alexander explained in his letter that he would use the earlier finding by Mrs Patel that £2,500 had been missed for January 2002, which would give £30,000 for the year.

50. Mr Chee had previously challenged that conclusion on the grounds that if Mr Palmiero and his family had had the use of an extra £30,000, they would not have had to live with his parents. In his letter, Mr Alexander referred to a cash control account which he had prepared for the relevant year based on the business income and spending, which included the declared drawings of £9,369; this showed a cash shortfall of over £11,000 just to meet the declared spending. Thus not all of the £30,000 had been taken by Mr Palmiero for his own personal use.

51. The revised gross profit ratio (GPR) for 2002-03 on the basis of Mr Alexander’s figures was now 66 per cent. Mr Alexander stated that this should be applied to all the years, as the figures which Mr Palmiero had declared in his returns showed this GPR to be achievable; Mr Alexander felt that this gave realistic business results.

52. At the hearing we reviewed in detail the relationship between various Z readings for the month of January 2002. Taking in to account the results of that review and our examination of the evidence since the hearing, we conclude that the method used by HMRC for arriving at the revised profit figure for that month was a reasonable approach to adopt, in particular having regard to the comparison between the GPR for that month and the GPR achieved for other periods. We do not propose to set out in detail in this decision any record of the process of reviewing the relationship between the till roll readings, as this process took place at the hearing in the presence of the parties. We confirm that as a result of that process, we are satisfied that the missing till rolls included takings which were not included in the profits declared in Mr Palmiero's 2002-03 return. We accept Mr Alexander's description of the discrepancy of £30,750 for that year as "a conservative figure", and therefore consider it to be reasonable.

Disputed expenditure

53. The first category of expenditure was repairs to the property. Mr Palmiero had stated to Mrs Patel in October 2005 that he had bought the property in January 1998 and that this was the whole property, ie shop and flats. In a letter to HMRC dated 9 January 2006, Mr Tan had stated that the last receipts of rent were in September 1999.

54. After this, the flats had been "taken back to a shell", and Mr Palmiero had spent time when available on refurbishment. The flats were not in an inhabitable state during the period covered by the assessments (and we understand that they remained incomplete as at the time of the hearing). Both gas and electricity had been turned off.

55. Mr Palmiero stated at the hearing that the rooms upstairs were always connected to the downstairs premises; they were used for storing rubbish and stock. The gas and electricity had been turned off ten years ago; he had been hoping that they would be ready in 2009, but he had never managed to finish them. The rooms were not fit for living in; there was no kitchen and no water. When they were finished, he intended to use them as part of his business, and let a room. On occasions employees had used the flats to stay in. It had been his intention to live in the upstairs part of the premises, but he had continued to live with his father. He stated that he was investing all his money in the building.

56. Mr Corbett submitted that the flats had been expected to be let for a combined rent, and that they were investment properties; the intention had been to let them once complete. The premises were distinct and had a separate entrance at the back; what Mr Palmiero had bought was a business with two investment flats.

57. All the expenditure on the building had been claimed as expenditure of the business. In 2007 Mrs Patel had disallowed two thirds of the expenditure on repairs on the basis that it related to the flats and therefore was not business expenditure. This had been her best estimate in the absence of all invoices and any evidence from Mr Palmiero that the repairs related to the café. Subsequently Mr Tan sent a letter enclosing a schedule breaking down the expenditure and allocating it to the respective parts of the building, the proportion claimed as attributable to the café being 62 per

cent. HMRC did not ultimately accept this proposal. Attempts from October 2007 until June 2009 to reach some form of agreement on the issue were unsuccessful.

58. In his letter of 19 November 2009 Mr Alexander indicated that there was no evidence of staff living in the flats, and that the last known residents as shown by the electoral roll were non-employees. He rejected the claim that the flats were being used to store stock and business records, as he could not accept that thousands of pounds in repairs would have been spent for this reason. He also explained that Mr Palmiero's intentions for the flats were also a factor in deciding whether expenditure on repairs should be allowed. Mr Chee had previously said that Mr Palmiero was "undecided" as to whether the flats would be let commercially. On that basis, Mr Alexander said that the intention of the repairs could not be said to be "wholly and exclusively" for trading as a café. He concluded that disallowing two thirds of the balance (after adjusting for repairs which could be specifically identified as having been carried out to the café or the flats respectively) appeared to be reasonable in line with the facts, and that this approach would apply to all the years, as the repairs had been ongoing since 2000. In his witness statement he indicated that this remained his view.

59. The two thirds/one third split referred to by Mr Alexander needs to be qualified. For 2002-03, expenditure was incurred on repairs to the roof of the premises. HMRC accepted that 50 per cent of this expenditure was attributable to the flats and 50 per cent to the café. This was taken into account in the adjustments made by HMRC. At the hearing a revised total of allowable repairs was put before us; this amounted to £9,988 for that year.

60. At the hearing, Mr Palmiero indicated that he had been able to function straight away with his business; he had opened straight away, and carried out some refurbishment later. He stated that he had had to concentrate on the business, and when he could, he had worked on the upstairs. In relation to the café, he had extended the back and installed an oven. In the basement he had refurbished the toilets. He had worked on building up the floor. He had dealt with the ceiling, plasterboard and walls. He had put in a mezzanine sitting area. The extension had been built out with a flat roof. There was a new kitchen, new equipment and counters. The roof to the whole building had had to be replaced. He put the percentage of the expenditure attributable to the business at 80 per cent.

61. He was unable to produce invoices for anything other than the plasterboard and timber. There had been three ceilings to knock down. In response to Mr Corbett's comment that there had been no reference to this in any of the correspondence, Mr Palmiero said that all the expenditure was shown on invoices.

62. On the basis of the evidence before us, and despite Mr Palmiero's indications at the hearing, we do not think that the case for an alternative split between the expenditure on the café and that on the flats has been made out; far more detailed and specific evidence would have been necessary to establish this. Further, we are not satisfied that the repairs to the upstairs part of the premises were wholly and exclusively for the purposes of Mr Palmiero's business. The flats were held as investment properties at the time of his original purchase, and no sufficient evidence

has been established of any change to the premises justifying a conclusion that their character was changed by the subsequent work carried out on the upstairs part of the premises. We do not consider that Mr Palmiero has established any alternative basis for allocating the expenditure, and therefore we accept the allocation made by HMRC as reasonable in all the circumstances, given the difficulty of establishing what specific items of expenditure were incurred on particular parts of the premises; Mr Alexander pointed out that many of the invoices were “generic”, which we find unsurprising given that much of the work was carried out by Mr Palmiero personally and that to a large extent the invoices related to the supply of materials.

63. The second category of expenditure was that incurred on the mortgage loans. Mr Alexander explained that in the accounts for the year to 31 December 2002, mortgage interest of £9,638 had been claimed. At the meeting in October 2005, Mrs Patel had stated that from reviewing the mortgage statement, the claimed mortgage interest was based on the whole property, and not just the café. She explained that it would have to be apportioned so that only the interest relating to the café was included in the café accounts. Mr Alexander commented that the percentage relating to the flats could not be claimed for as it was not “wholly and exclusively” used for business purposes.

64. Following the appeals against the assessments and amendments to assessments, attempts were made over a period of 18 months to agree an apportionment. On 10 June 2009 Mr Alexander closed his check of the 2005-06 return and disallowed mortgage interest on the same basis as for the accounting year to 31 December 2002.

65. In his letter dated 19 November 2009 to Mr Palmiero and Mr Chee, Mr Alexander explained HMRC’s position relating to the mortgage interest. At the meeting in October 2007, Mr Palmiero had explained that two loans had been taken. The original loan was to buy the whole property in the first place, and the second was obtained in 1999 to fund the repairs. Mr Tan had agreed that the interest should be split 50-50, so that one half would be allowable. In Mr Alexander’s later consideration of the position as set out in his November 2009 letter, he concluded that on the basis of the division of the floor space between the café and the flats (as indicated by Mr Palmiero), a 50-50 split was justifiable, so that half of the interest payments on the original loan could be allowed in the café accounts.

66. In relation to the further loan of £90,000, Mr Alexander decided that as the repair receipts had not been seen and therefore it was not clear exactly what the additional loan had funded, he would allow one third of the interest in the café accounts, in accordance with his comments on “repairs”.

67. Having considered the information and arguments put forward in correspondence by Mr Palmiero and his advisers and the limited information provided on the subject at the hearing, we find that there was nothing to justify departing from the apportionments of mortgage interest arrived at by Mr Alexander. We consider the approach adopted by him to be reasonable in the circumstances, given the absence of sufficiently specific information on the detailed nature of the repair work undertaken. We also accept that the overall 50-50 split approach based on the respective floor areas of the café and the flats was reasonable in respect of the original loan, and that

for the later loan, the attribution of two thirds of the interest to the flats and one third to the café was also reasonable.

5 68. The next category of expenditure was rent and rates. At earlier stages these had been dealt with on an accruals basis, but Mrs Patel found that in the accounts for the year to 31 December 2002 they had been claimed on a “paid” basis. As this would have included amounts claimed for earlier years, she requested calculations of the claims for the earlier years to 31 December 2001. As it had not been possible for Mr Tan’s firm to establish how those claims had been calculated, Mrs Patel calculated the amounts to be allowed for all years in accordance with the figures set out in a letter
10 from Mr Tan’s firm dated 9 January 2006.

69. In his letter dated 19 December 2009 Mr Alexander gave details of the amounts considered by HMRC to be allowable. These were the figures allowed by Mrs Patel, but adjusted to allow water rates in accordance with a letter from Mr Tan’s firm dated 8 November 2007.

15 70. We do not consider that there is any evidence to justify departing from the approach set out in Mr Alexander’s letter.

71. The next category is expenditure on insurance. In the accounts for the year to 31 December 2002, an amount of £3,354 was claimed for insurance premiums. On consideration of the detailed documentation, Mrs Patel concluded that premiums paid
20 for life, accident and sickness cover could not be claimed for, as they were personal rather than business expenses. She further concluded that only 50 per cent of the buildings insurance was allowable, as only half of the premises was used for trading as a café. Mr Alexander followed this approach in respect of 2005-06.

72. At the hearing, Mr Palmiero stated that he had had to pay the premiums for the
25 insurance covering life, accident and sickness, as otherwise the bank would not have lent the money. Although we accept that this was the case, the expenditure still has to be subjected to the statutory test; was it wholly and exclusively for the purposes of the business? We find that it was not. In particular, it was partly attributable to the element of the loan applied to the work on the flats. Further, any proceeds of the
30 insurance would not normally be expected to be included in the profits of the business. The fact that in practice the insurance was an essential step in obtaining finance is not in itself enough to establish that the statutory test is met.

73. We consider HMRC’s approach to the deductibility or otherwise of the insurance premiums to have been a reasonable one to adopt.

35 74. In relation to telephone expenditure, Mrs Patel had disallowed 40 per cent. Mr Alexander had reconsidered this and concluded that a disallowance for private use of 10 per cent was appropriate, taking account of Mr Palmiero’s own view as expressed to Mr Tan’s firm. We therefore accept this as a suitable basis for apportioning the expenditure.

40 75. One item which had been claimed as a business expense in the accounts to 31 December 2001 was a bad debt of £9,589. Mr Alexander explained that this was owed

to Mr Palmiero by a company named TNT Records Ltd, with which Mr Palmiero had been involved. He had incurred costs, and the company had then ceased trading owing him this sum. Mrs Patel stated in August 2006 that as the debt was not related to the café business, it could not be claimed for in the latter's accounts. Attempts were made
5 to agree proposals for a settlement of the disputed deductibility claim, but these were unsuccessful, and Mr Alexander's view remained that the debt was not allowable. At the hearing, Mr Palmiero conceded that the debt related to a separate activity. We therefore find that it was not deductible in computing the profits of the café business.

76. A further category of expenditure was additional wages not claimed for. At the meeting in February 2009, Mr Palmiero showed Mr Alexander the diary for the year
10 to 31 December 2002 into which he had written down wages paid out. The diary showed that wages had been paid to people hired to carry out the repairs to the building. This totalled £5,294, but the costs had not been claimed in the accounts.

77. In his letter dated 19 November 2009, Mr Alexander confirmed that he would
15 allow one third of that amount as additional expenses; the one third reflected the percentage of repairs to be attributed to the café business. On the basis that wages would have been paid since the repairs started at some time around 2000, Mr Alexander stated that he would also allow similar amounts in the accounts for all years for which a Tribunal appeal might apply. This remained his view. We accept
20 this approach as fair and reasonable in the circumstances.

78. The remaining category of expenditure is drawings claimed as wages. At the meeting with Mrs Patel on 26 October 2005, Mr Palmiero explained that in his petty cash book he recorded "wages", which included not only wages paid to employees but also his own drawings from the business. Mrs Patel proposed adjustments to 2002-03
25 and to other years. Following correspondence, Mr Alexander accepted that the only year requiring amendment to take account of this was the accounting year to 31 December 2002 (ie 2002-03).

79. At the hearing Mr Palmiero stated that he "invested" all his money in the building. We are satisfied that the percentage of expenditure deductible as "repairs" is
30 one third, as explained above. Whatever Mr Palmiero's cash flow position, we do not consider that there is any justification for additional expenditure over and above what we have accepted above as allowable. We agree that the conclusion reached by Mr Alexander in respect of drawings for the year ending 31 December 2002 is reasonable in the light of the circumstances and the information available.

35 *Conclusion on expenditure*

80. Our overall conclusion relating to the expenditure is that there is no evidence to suggest that the approach taken by HMRC should be adjusted in any way.

81. At the hearing there was some consideration of the expenditure on the café part of the premises and whether any of the items might be capital in nature. In the interests
40 of settling a long outstanding matter, we consider that the treatment of the expenditure should remain as already taken into account in arriving at the amounts of the

assessments and adjustments. Reopening the question of the nature of the expenditure would open up the further question whether, if it was capital, any expenditure would have qualified for capital allowances. We do not consider such a revision to be appropriate at this stage.

5 *Conclusion on level of income*

82. We are satisfied that the calculation of the income of the café business has been carried out by HMRC in a manner justifiable in the circumstances. We do not consider that any evidence has been established to disturb the approach adopted.

10 83. Reference was made to Mr Palmiero's general financial position, and to the facts both that he has continued to live at home, and that he does not own a motor car. Without a great deal of background financial information, we do not consider that we can arrive at any conclusions based on his statements as to his position. In relation to the question of the car, we note that in the accounts to 31 December 2002, there is an item in the profit and loss account for a modest amount in respect of depreciation of a motor car, which is shown in the balance sheet as having cost £1,200, and after
15 depreciation is included at £540, and that in the income tax computations the private use of the motor car is shown as 25 per cent. As we have not seen accounts for other periods (because they were not included in the already substantial documentary evidence), we have no way of establishing whether that vehicle was disposed of, or, if
20 it was, whether at any subsequent point a replacement was acquired. This question illustrates the difficulty of arriving at conclusions as to Mr Palmiero's financial position and lifestyle in the absence of sufficient financial information. We therefore make no findings as to his general financial position.

Overall conclusions

25 84. We find that the assessments and adjustments to assessments were properly made by HMRC, and that there is no evidence justifying our making any adjustments to the amounts assessed as set out on the last page of HMRC's Skeleton Argument. (We do not reproduce here the table setting out in respect of all the relevant years the amounts originally assessed, the revised amounts of the assessments, and the differences
30 between those amounts for each year concerned.) However, Mr Corbett did state that the assessment for the year to 5 April 2003 required to be revised from the amount set out in the closure notice dated 11 July 2007. The amount should be amended from £19,125.99 to 18,760.44, the amount originally assessed being shown as £0.00.

35 85. We agree that the discovery assessments were justified on the basis of the "presumption of continuity", as referred to by Walton J in *Jonas v Bamford* (1973) 51 TC 1 at 25. We also accept that there was a loss of tax and negligent conduct on Mr Palmiero's part, in that his returns did not truly reflect the profits made in his business.

86. In the light of our findings, Mr Palmiero's appeal is dismissed.

Right to apply for permission to appeal

87. 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.

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JOHN CLARK

TRIBUNAL JUDGE

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