**TC01643**

**Reference no: TC/2011/00191**

*Income Tax - whether the Appellant was making loans as an investment or trading - whether interest income had been received - Appeal allowed*

**FIRST-TIER TRIBUNAL**

**TAX**

[redacted] **Appellant**

**- and -**

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

**TRIBUNAL: HOWARD M NOWLAN (Judge)**
**SIMON BIRD**

**Sitting in public at Vintry House, Wine Street, Bristol on 28 November 2011**

**Steve Theaker of UHY Peacheys, accountants, on behalf of the Appellant**

**John Davis of HMRC Appeals & Reviews office, on behalf of the Respondents**

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DECISION

***Introduction***

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1. This was a very unfortunate case. The Appellant, a gentleman in late middle age, who was far from wealthy, and who had also suffered depression and other health problems as a result of his involvement in the disastrous transactions at the heart of this dispute, had lost his life savings (£140,000) by his participation in the relevant

10 transactions. These transactions involved repeatedly lending money to a gun company to finance the purchase of guns, or alternatively participating in some form of trading joint venture with that company in making such purchases. Worse than the near total loss of his life savings, however, the Appellant was being assessed by HMRC for the tax on interest, allegedly received under those transactions in the tax

15 years 05/06, 06/07 and 07/08, the aggregate interest in all three years being £304,505. Although on one view the Appellant had clearly received that interest, it was nevertheless the case that, because the borrower's whole scheme was designed to lure investors into re-advancing everything re-paid and paid, at the end of the day the Appellant ended up incurring a total loss in respect of both his capital and the vast

20 amount of interest. Were the assessment to be confirmed, we were told that he would lose his house.

2. The transactions undertaken by the Appellant involved him, on HMRC's contention, in making a series of short-term undocumented loans (77 loans in total) to

25 a firearms company, earning high rates of interest, but invariably reapplying most of the proceeds (and generally, in the latter part of the period, all of the proceeds) repaid and paid as interest in further loans. Accordingly, on HMRC's approach, the Appellant was taxable on all interest received, regardless of the fact that it had been reinvested, and everything ultimately lost on the administration and insolvent

30 liquidation of the borrower company.

3. The Appellant contended that the director and part-owner of the firearms company had induced him to participate by suggesting that there would be a joint venture between the Appellant and the company in relation to identified and valuable

35 shotguns that the company proposed to buy, and expected to sell at a profit. It was accordingly claimed that his activity was a trading activity, either on a sole basis or in some form of partnership with the company. Were that contention sustained, then trading losses could of course be carried back, with the result that the eventual losses would eliminate the earlier profits. In addition, excess losses could be set against

40 other income in the year they were incurred.

4. Our decision is that the Appellant was not trading.

5. Reverting to the loan analysis, we accept that, in artificial form, interest was paid

45 on each maturity of the 77 loan transactions. We consider, however, that the reality of the transactions between the Appellant and the firearms company was that the director of the firearms company was from the start going to do everything in his power (by persuasion, and by offering ludicrously high interest rates) to ensure that the Appellant virtually always ploughed all repayments and interest back in the shape

50 of further loans such that, in reality, the arrangement had all the attributes of a

fluctuating loan where, in cash terms, the Appellant would extract nothing from the arrangements unless and until the loans could ultimately be repaid in full. In the event nothing, or virtually nothing, was paid in the insolvent liquidation of the company. Our decision is that it is appropriate to ignore the fictitious form of the individual transactions under which each loan, and each receipt of interest, was treated as a separate transaction. The realistic analysis is that the high interest was only paid to lure investors to re-advance everything transiently repaid and paid, and that the Appellant should only be treated as receiving interest, after full repayment of the principal advanced. Since at no time in the cycle of loans and further loans, did the Appellant ever in net terms get his £140,000 back and since, at the end of the day, he lost everything, we conclude that in realistic terms, no interest was received. In contrast to the trading analysis, this conclusion offers no opportunity for the Appellant to offset his loss in the final year against any other income, but it does discharge the liability for interest that in our view the Appellant never realistically received.

6. Whilst this analysis may seem slightly surprising, we will explain in full below why we reach this conclusion. It might immediately reveal something of the scale of the fiasco in which this fairly ignorant and gullible Appellant was involved, and reveal something of the persuasive powers of the director of the firearms company if we reveal at this point that the Appellant was not the only person duped into financing this company in this manner. In total there were 56 investors, though generally each thought he was the only investor, or possibly "one of a few". On average, each was involved in 50 deals. One of the investors lost £3 million. In total the debts owed to investors in the administration totalled £36 million and it was thought that the figure could rise to £50 million. We were told that one investor was more fortunate and that, on an initial investment of £360,000, this one investor received in cash £3.2 million, with a further claim for another £0.4 million in the administration. One of the individual loans advanced by this fortunate investor enjoyed interest at an annualised equivalent rate of 2000%. This, however, in the light of the total unsatisfied claims of somewhere between £36 and £50 million, was very far from the norm.

***The evidence***

7. Evidence was given by the Appellant himself, and by Mrs. Beverley Davies of HMRC on behalf of the Respondents. Both witnesses were plainly honest.

8. In giving his evidence, the Appellant was somewhat vague. We noted that in one or two e-mail exchanges with the director of the firearms company that we were shown, dating from 2007, he had been rather more "on top of the figures" than appeared to be the case at the hearing, but we concluded that the fact that he looked worried and bewildered by the events that had unfolded since 2007 was both genuine and understandable. We were told that he had suffered from depression and other health problems as a result of his losses and the tax problems that he now faced, and this was very evident during the hearing.

9. For her part, Mrs. Davies had undertaken careful and painstaking work in pursuing her enquiries, and we largely accepted the figures that she produced.

10. We will refer to all the material evidence in summarising the facts in more detail.

*The facts in more detail*

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*Background*

11. The Appellant had worked for a model company prior to the transactions with which we were concerned. His earnings had been in the range of £20,000 to
10 £25,000, and he had been made redundant by this company shortly before the relevant transactions. At the date of the hearing he was working for Barclaycard Merchant Services, and dealt in some way with the installation of the machines that shops and traders use in order to take payment by credit card. We were also told that he had inherited £50,000 from his mother.

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12. One of the Appellant's hobbies was target shooting. In pursuing that hobby he had often met Mr. Andrew Litt ("Mr. Litt"), the part owner and effectively managing director of D J Litt (Firearms) Ltd ("D J Litt"), a company that operated a gun shop in Newport. The Appellant trusted Mr. Litt. We were told that Mr. Litt
20 had a worldwide reputation in the gun world; that he had many customers for high class shotguns in America, and that he had a good knowledge of the price at which he would be able to sell such guns. He was also an accountant.

*The relevant transactions*

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13. Whilst it was not until several years later, when D J Litt was in insolvent administration that this was revealed, it eventually transpired that the company had been in some financial difficulties from as early as 2004. Mr. Litt was keen to trade out of the difficulties, and was endeavouring to generate sufficient turnover and profit
30 to enable the company to be sold to American buyers. In this regard, and being unable to secure any more bank finance, Mr. Litt approached the Appellant and suggested to the Appellant that they would operate in some form of joint venture. Nothing was recorded in writing as to precisely what was meant to happen, though the Appellant told us that Mr. Litt suggested that if the Appellant put up half the money
35 for the purchase of identified high-class shotguns, the Appellant would make handsome profits when the guns were sold, with a minimum return of 10%. It seems that the expectation was that when Mr. Litt had identified some suitable shotguns to purchase, he would ring up the Appellant and describe the guns, and the amount that the Appellant would have to provide. When the Appellant had then laid
40 out his contribution, the Appellant could go to the Newport shop and examine the purchased firearms. Not that we see any particular significance to this, we were told that he always met Mr. Litt in the back room of the shop, and not in the main display area, and that is where the newly purchased guns would be.

45 14. Whilst one of the points in contention in this case was whether the Appellant's transactions were loans, or whether he was effectively a joint purchaser of the guns, or was trading in some other way in a joint venture, we need to summarise the detail that we understand of the Appellant's transactions.

15. We accept that the Appellant was told that there would be some form of trading venture between him and D J Litt. We also record that the Appellant was far from an astute businessman; that he would not have noted the distinctions, subtle to him, between being a lender and some form of trader in a joint venture, and that he embarked on the venture simply because of total faith in both the integrity, and the knowledge and experience of Mr. Litt. The Appellant told us that Mr. Litt explained that whilst most of the transactions would be short-term transactions, at the end of the trading cycle (in perhaps three- or four-years time), there would be final adjustments to the trading profits between them. Mr. Litt also explained, something that the Appellant appears to have believed because Mr. Litt was an accountant, that the Appellant did not need to make any returns to HMRC in respect of profits, because the final profits would not be known until the end of the trading cycle. Quite what was meant by the trading cycle, and quite why it was assumed that the trading cycle would end after a period of about four years, and on what basis it was asserted that the Appellant had no need to report anything to HMRC in the meantime, is all something of a mystery. We accept however that the Appellant appeared sufficiently naïve and ignorant to have believed these claims by Mr. Litt, particularly as he knew that Mr. Litt was not only a well-respected trader in the high-class gun field but also an accountant.

16. Whilst we do not doubt that Mr. Litt did refer to there being some form of joint venture between the Appellant and D J Litt, and that the Appellant took some interest in particular guns the purchase of which he either financed or made on some form of joint basis, the actual form of the transactions appeared not to make the Appellant's return dependent on the sale and the profits made on the sale of the identified guns. We were initially told that whenever the Appellant paid money to D J Litt, the company issued post-dated cheques for particular amounts that would return the initial outlay and provide a profit. Taking the example of a payment made by the Appellant of £20,000 on 11 January 2006, it appears that this was linked to a payment by D J Litt to the Appellant of £22,500 paid on 31 March 2006, and we assume that by this point the payment on 31 March was made by the presentation of a post-dated cheque that D J Litt would have issued when the £20,000 was paid over on 11 January. Subject thus to the suggestion about some eventual "adjustment to profits", this particular return appears to have been fixed when the money was initially paid over, so that it had nothing directly to do with the actual profit made on the sale of any guns. It is also obvious that the level of profit was very substantial, in other words £2,500 on an outlay of £20,000, accruing over a period of 2 ½ months. Expressed as an annualised interest rate, therefore, the profit was in the region of 62.5%.

***The slight variations in the form of the transactions***

17. It actually appears that the Appellant's transactions fell into three categories, albeit that all were variations on the example that we have just given.

18. Although the Appellant initially claimed that post-dated cheques were issued to him on every occasion when he paid over money to D J Litt, it seems that on his very first transaction this could not have occurred, and indeed the first transaction differed from all others in that it was to operate over a much longer period than all the later ones. The first transaction involved a payment over to D J Litt of £80,000, paid on

1 November 2004, and the payments in the other direction were not paid until 12 separate payments, each of £10,000 were paid between 13 January 2006 and 31 March 2006.

19. The feature that the 12 payments of £10,000 each were unlikely to have been made by the presentation of post-dated cheques issued back in November 2004 was revealed by the production of a short letter sent by the Appellant to D J Litt in December 2005, in which the Appellant said that he was "now very concerned about my £80,000 investment". He went on to say "Please could you put my mind at rest and send the cheque ASAP so I can move my plans forward." The Appellant appeared confused in relation to the question of when the cheques to him were actually issued, but it appeared odd that the Appellant would have been worrying in December 2005 about the late payment to him, were he actually holding 12 cheques not due for payment until January to March 2006, and it would have certainly made no sense to be asking D J Litt to be "sending a cheque ASAP", if he was already in possession of the 12 cheques. We conclude therefore that the cheques were probably issued in response to this complaining letter of December 2005, and presented in the following months.

20. We were told that the long-term nature of the first transaction was accounted for by the fact that D J Litt were not simply buying second-hand shotguns, but placing an order with a Belgian firm for guns to be made, and that naturally takes a considerable time.

21. After that first transaction, the pattern became fairly regular in that the payments and returns operated over a much shorter period (often around 3 months), and were presumably always for the purchase of existing guns that Mr. Litt would have described to the Appellant. In these short-term transactions, the Appellant was invariably handed post-dated cheques at the point when he initially paid money to D J Litt for the acquisition of particular identified guns, the post-dated cheques indicating the later date when the cheques could be presented, and the amount payable naturally governing the rate of return on the particular transaction. We certainly accept that there were occasions when Mr. Litt described guns that D J Litt wished to buy, asking the Appellant to join in the particular transaction, and we also accept that on several or many occasions the Appellant went to the shop to see the relevant guns. There is of course no way in which we could verify whether the guns shown to the Appellant would have been purchased recently, or whether Mr. Litt might simply have described a couple of guns that he might have already had in the shop, but we accept that the Appellant periodically went to the shop and saw guns.

22. As the excerpt from the table of payments and return payments that we will produce below illustrates, the other absolutely critical feature of the Appellant's transactions was that he would constantly be receiving requests to pay over further monies (to use a presently neutral expression) whenever he got his return on an earlier transaction. The result of this practice was that, whilst the Appellant might have appeared to be making very large profits (particularly when expressed on an annualised basis) he never, in the course of all 77 transactions actually got his initial investment back in net terms. As the extract from the table of payments provided below will illustrate, as soon as the Appellant received his initial payment and profit back, he would either already have made a further advance, or would very shortly

make such a further advance, such that he never had the totality (or indeed "very much of") his original investment, in hand, in the form of real cash.

23. This takes us to the third form of transaction, which became very common in
5 2007. This was in substance identical to the second, save that when post-dated cheques were issued, when the date arrived for presentation of the cheques, the cheques would not be presented but would be set off against a new investment. For instance if £50,000 was due to the Appellant, and a new deal was available in which the Appellant might lay out £70,000, the Appellant would simply pay £20,000 and
10 either tear up or hand back the original cheque for £50,000.

***Some examples of the payments***

24. We were shown the list of the total payments from 2004 to 2007 between the
15 Appellant and D J Litt, but the flavour of the transactions, and most significantly the way in which repayments and profits were constantly re-invested is made clear by the first 27 entries. Those payments were as follows:

| Date | Payment to D J Litt | Payment to Appellant | Cumulative balance |
|---|---|---|---|
| 01/11/2004 | £80,000 | | £80,000 |
| 11/01/2006 | £20,000 | | £100,000 |
| 13/01/2006 | | £10,000 | £90,000 |
| 16/01/2006 | £15,000 | | £105.000 |
| 20/01/2006 | | £10,000 | £95,000 |
| 27/01/2006 | £40,000 | | £135,000 |
| 27/01/2006 | | £10,000 | £125,000 |
| 03/02/2006 | | £10,000 | £115,000 |
| 07/02/2006 | £20,000 | | £135,000 |
| 10/02/2006 | | £10,000 | £125,000 |
| 16/02/2006 | £15,000 | | £140,000 |
| 17/02/2006 | | £10,000 | £130,000 |
| 22/02/2006 | £10,000 | | £140,000 |
| 24/02/2006 | | £10,000 | £130,000 |
| 27/02/2006 | £10,000 | | £140,000 |
| 03/03/2006 | | £10,000 | £130,000 |
| 10/03/2006 | | £10,000 | £120,000 |
| 17/03/2006 | | £10,000 | £110,000 |
| 24/03/2006 | | £10,000 | £100,000 |
| 27/03/2006 | £25,000 | | £125,000 |
| 31/03/2006 | | £22,500 | £102,500 |
| 31/03/2006 | | £10,000* | £92,500 |
| 31/03/2006 | | £16,500 | £76,000 |
| 05/04/2006 | £20,000 | | £96,000** |
| 11/04/2006 | £27,000 | | £123,000 |
| 24/04/2006 | | £46,000 | £77,000 |

* last of the 12 payments of £10,000, in respect of the £80,000 outlay
20 **last payment in the tax year 05/06

25. We need to make the following points in relation to the information given in this table.

26. It will first be quite obvious that virtually whenever D J Litt makes a payment, including always a payment with a significant "paper" profit element, D J Litt very regularly presents the Appellant with an opportunity to reinvest, lured on by making a large, or even bigger, profit, such that the Appellant does not have the cash in hand reflecting the profit. Thus the Appellant, deriving confidence doubtless from the fact that he must have been handed 12 post-dated cheques in December 2005, offering a 50% profit on deal 1, pays over £20,000 before receiving anything in return, the £20,000 seemingly being matched by the receipt of £22,500 on 31 March, giving a profit of £2,500 over roughly a 10-week period, or a profit at an annualised rate of approximately 62.5%.

27. Once two £10,000 payments have been received in respect of the £80,000 outlay, such that the cumulative balance has fallen to £95,000, the Appellant is offered the deal in which £40,000 is paid over, putting the balance back to £135,000. The £40,000 is presumably to be matched with the receipt of £46,000 on 24 April, representing on this occasion a profit on the annualised basis of 75%.

28. The next point to note is that the funds paid over by the Appellant, ignoring payments paid out of receipts, amounted to £130,000 or £140,000.

29. The heading "Cumulative Balance" is slightly misleading, in that it does not reflect the amount actually owing to the Appellant. It simply monitors the net cash paid and received. The amount owing at any time includes in addition the accruing profits on the various new investments that have not been discharged. Accordingly, whilst throughout the entire period from 2004 to the end of 2007 the cumulative balance figures always indicate that in cash terms the Appellant has never at one point recovered the total cash initially laid out (and indeed by late November 2007, has either recovered nothing whatsoever or arguably about £10,000), the total debt then owing to the Appellant was about £380,000.

***The suspected problems in the latter part of the period***

30. Whilst the transactions, as understood by the Appellant, and as allegedly explained to him by Mr. Litt, involved the financing or participation in deals in relation to identified guns, we should mention that at times, and particularly as matters got more out of hand, it seems that two changes occurred. One was that money raised from one investor was sometimes simply applied in repaying another, such that the new investor was not participating in any way in relation to the purchase of new guns. There simply were no new guns in that situation. Furthermore, in the creditors' meetings in the administration, it emerged that other individuals had placed guns with D J Litt for sale on a "sale or return" basis, or possibly merely for storage and servicing, and it appeared that these guns might have been sold, without any proceeds being accounted for to the owners. Accordingly that would be a further example of the feature that even if the Appellant might have been shown guns, allegedly connected with his provision of funds, the funds provided would have had nothing to do with the guns displayed, because they would not have been purchased.

*The income returned, and then adjusted by HMRC, for tax purposes*

31. It can also be seen from the table in paragraph 24 above that the paper profit made in the tax year 05/06 (down in other words to the line marked with the double asterisk) was £44,000. In other words, deal 1 produced a payment of £120,000 in respect of an outlay of £80,000 (profit £40,000); deal 2 (the payment on 11 January of £20,000 matched with the receipt of £22,500 on 31 March) produced a profit of £2,500, and deal 3 (the payment of £15,000 on 16 January, matched with the receipt of £16,500 on 31 March) produced a profit of £1,500, making £44,000 in total.

32. Whilst the Appellant initially made no tax returns, having been told by Mr. Litt that everything would have to await the end of the trading cycle at the end of a four-year period, when HMRC met with the Appellant and demanded returns of income, the Appellant's then accountants produced returns based on the profits on those deals where cheques had actually been presented into the Appellant's bank account. This method of calculation thus ignored profits where cheques had not been cashed, but had simply been set off against new investments. In due course HMRC indicated that profits should be returned in the case of those offset cheques. The following table thus illustrates the taxable profit for the three relevant tax years, on the dual basis of paying regard solely to banked cheques, and secondly of aggregating banked cheques with automatically reinvested cheques that were either torn up or handed back to D J Litt. The relevant and rather staggering figures are as follows:

| Tax Year | Banked profits | Adding reinvested profits |
|---|---|---|
| 2005/2006 | £44,000 | £44,000 |
| 2005/2006 | £94,650 | £108,250 |
| 2007/2008 | £58,708 | £152,255 |

33. As we mentioned in paragraph 23 above, the practice of simply offsetting returns from D J Litt in funding new investments became common in the latter part of the period, explaining why the increase in claimed taxable profits was modest in 2005/2006, but very large indeed in 2007/2008.

*The other investors*

34. We have already indicated that, although the Appellant initially shared with other investors the belief that he was the only person cooperating with D J Litt in trading in guns and, after a time, he and others then believed that they were "one of a few", it actually emerged in the course of the administration that 55 other investors had been involved. Over 2000 transactions had thus been effected meaning that, on average, money was contributed by one or another investor on a more regular basis than on each and every day of the whole period between 2004 and 2007. We have also mentioned the extraordinary way in which one single investor managed to receive £3.2 million in cash, with a further modest claim in the eventual liquidation, all in return for an initial outlay of £360,000. We have also already mentioned that the eventual debt owing to investors was somewhere between £36 million and £50 million

### *The transactions from the perspective of the company*

35. It was not entirely clear, even in the administration, precisely how the company itself had booked the particular transactions, though it appears that the transactions with investors were recorded only in what was described as a "cash book", and did not emerge in any form into the company's actual accounts. It was said that in the cash book, which did record all the transactions, investor by investor, that the advances were treated in the cash book as sales, and the repayments, and the supplements paid on repayment, were treated as sales refunds. It seems, however, that there is little significance to how the transactions were treated in the concealed cash book, because the actual accounts of D J Litt recorded no debts owing to the investors, and recorded no sales and sales refunds. Had they recorded either, the accounts would have revealed massive deficits, whilst in fact they revealed a small profit.

36. It also appeared that no other directors were aware of what was going on, and seemingly the auditors were in the same position.

37. In short, Mr. Litt appeared to be the person, and the only person, controlling everything. In fairness, the investors could obviously not have been forced to participate, but very oddly 55 other individuals, in addition to the frankly naïve and ignorant Appellant, participated on a similar basis. It seems improbable that all were lured to participate solely because of the improbably enormous returns offered to them for short-term financings. It seems that the Appellant must have been right to say that Mr. Litt enjoyed an extremely good reputation in the gun world, and that he was a particularly plausible individual.

### *Whether, and at what stages, the transactions might have been fraudulent*

38. Mr. Litt was not present at the hearing, and whilst we were shown the Report by the Administrators, and the record of a creditors' meeting, we were obviously unable to reach any conclusion as to whether the transactions in this case were deliberately fraudulent from the outset or whether, in Maxwell-style, the transactions were undertaken in a misguided attempt to rescue the company, whereupon they very soon got out of hand. We consider that there is some significance to this issue. The reason why we consider there to be some significance to this issue is that we do not, and cannot, suggest that for tax purposes the tax liability on interest received by an individual would be eliminated merely because the interest is reinvested and subsequently lost. We do, however, consider that a different approach may be and, in our view, is tenable, if the transactions are always part of a scam, in which the borrower has a manifest plan, always to lure investors in to re-advance virtually everything repaid and paid under earlier transactions, particularly where in reality the borrower must know that the likelihood of being able to discharge any of the mushrooming debts at the end of the day is virtually zero. We will expand on these points in explaining our decision, but at this stage the question that we address is whether, at any stage, any of these transactions could fairly be regarded as genuine lending, possibly fairly risky lending, but nevertheless lending where the borrower did hope and expect to be able to discharge the loans.

39. In the context of that enquiry, we first note that Mr. Litt, an accountant, represented to the Appellant at the very outset that for a three- or four-year period, there was no need to return anything on tax returns, because everything would, or might, be adjusted at the end of the (roughly four-year) trade cycle. Nothing in relation to the trade cycle or the method of adjustment was made remotely clear, but whatever was meant in this regard was obvious nonsense, and not something that an accountant could possibly have represented on a *bona fide* basis.

40. The next highly significant two facts are that the transactions were always excluded from the company's accounts, and merely recorded in a seemingly secret "cash book", and neither the other directors nor the auditors appear to have been aware of what was going on. We are not concerned to question whether either were at fault for not having made enquiries. The significant fact is that Mr. Litt proceeded, from day 1 of the practice of raising finance from individual customers, in concealing what he was doing. He may have vaguely hoped at the start that the company's trading position would improve, or that in some way he would be able to sell the company to American buyers, without thereafter facing hopeless warranty claims. But even if he hoped that, he still proceeded on a basis of quite improper concealment.

41. The Administrator's report reveals that D J Litt was in financial trouble when the particular form of raising funding began; that it had regularly exceeded its overdraft limit; that it could no longer borrow from banks, and that it thus faced a serious trading position. The Appellant's first transaction delivered a return of 50%, slightly less on an annualised basis, but the annualised rates of return on the vast majority of the transactions were so high that nobody could have thought that a company already facing financial problems was going to solve them by raising money at exceptionally high interest rates. The annualised rate of 2000% in one of the transactions undertaken by the investor who walked away with a staggeringly handsome profit, may have been at the extreme end of the scale, but we were told in relation to that particular investor, who was not believed to be a "connected person", that the annualised return on all transactions with that investor ranged from 116% to 2000%.

42. We consider it inconceivable that Mr. Litt and D J Litt could have considered there to be any possibility of repaying the relevant loans, and we consider that that conclusion applies or, at the very least, should have been self-evident from the very first transactions onwards. The reality therefore is that D J Litt paid "funny-money" paper returns on monies borrowed, in the knowledge that it would lure and cajole investors to reinvest virtually everything that they received. Against the charge by HMRC that D J Litt had no way of securing that investors would definitely have reinvested, we point out that through high promised returns, credibility and persuasion, Mr. Litt indeed succeeded in achieving just that objective. The early transactions, that we recorded in full in paragraph 24 above, demonstrate that this pattern of reinvestment commenced from the very outset, and we conclude and "find as a fact" that it must always have been Mr. Litt's plan that the Appellant would never actually recover his initial outlay in net terms, let alone genuinely take and keep interest. Not only the Appellant, but countless other of the 55 other investors ploughed their paper profits back in the same way. That feature, and the ever-spiralling implicit rates of interest as time went on, coupled with the fact that no

investors appreciated that numerous others were involved in a similar manner, explains both why the transactions were able to run for a period of three years, and why 2000 or more transactions could be undertaken, and it explains why the overall deficit was in the range of £36 to £50 million.

43. We consider that Mr. Litt's plan was utterly flawed from the start and that, from the very outset it was of the essence of the plan that the profits given to investors would be pure paper profits, and that invariable reinvestment was always contemplated, and indeed utterly vital.

***The contentions on behalf of the Appellant***

44. We have already indicated that,when HMRC met with the Appellant and demanded that he make returns of his profits in the relevant tax years, his first firm of accountants produced figures of "interest received" by reference to the Appellant's bank account records, and so produced the figures in the middle column of the table set out in paragraph 32 above. When HMRC responded and claimed that further interest had been received in all cases where interest received was set-off against new investments without the cheques being banked, the figures in the assessment went up to those in the third column set out in paragraph 32 above, and the Appellant then engaged his current firm of accountants that represented him at the hearing.

45. The prime contention at the hearing was that the Appellant had not made loans at all, but that he was trading in some form of joint venture with D J Litt. It was suggested (somewhat in conflict with our understanding of the facts) that there could not be loans because there could only be loans and interest where interest was calculated over a period of time. It was suggested that the Appellant had profit shares geared to the sale of firearms, and thus returns inherently payable only when sales were made. It was certainly true, we accept, that we were told that on a few occasions Mr. Litt asked the Appellant to delay presenting a cheque on the date stated on the post-dated cheques, but we concede that we fail to understand how the contention that the returns were not calculated by reference to a "tract of time" was actually consistent with the fact that the basic form of transaction was for post-dated cheques, with definite dates on those cheques and higher amounts payable than the amount initially paid over, and with those post-dated cheques being issued in return for the initial payment.

46. The regularity of transactions, and the high-risk nature of the transactions, was all said to support the trading analysis.

47. The Appellant also relied on a particular statement in the report from the administrators, Deloitte & Touche LLP, which we have highlighted in the following paragraph from the report. We will refer later to why we have quoted the whole paragraph. The paragraph read as follows:

> *"It is for this reason that [Mr. Litt] discussed the possibility of investment in the Company with various personal contacts. These contacts were usually wealthy individuals and connected to the gun trade in some way, or good customers of the Company ("the Investors"). The format of the "deal", as it was often referred to by [Mr. Litt], was that the Investor would advance a sum*

*of money to the Company, and this would be returned, with interest after an agreed period (usually between two and six months). At the outset, [Mr. Litt] would normally inform the Investor that he was borrowing the money to buy specific guns that he could get an excellent return on in a short timeframe, but he was unable to borrow the money from the bank.* ***The profit made on the guns was split equally between the Company and the Investor.*** *This arrangement eventually transformed into loan agreements with interest payable. The rate of interest offered by [Mr. Litt] to the Investor was much higher than was commercially available, often being 10% return over 2 months (annualised return of at least 77%). Some Investors have received substantially higher rates of interest of up to 40% over a two month period".*

48. While Mr. Litt had clearly referred, in initial discussions with the Appellant, to there being some form of joint venture between the Appellant and D J Litt, we believe that the Appellant's "trading" contention was essentially that the Appellant himself was trading on a sole basis with the company, and not that he was engaged in any form of partnership trading. We will however consider the various possible forms that sole or joint trading might have taken.

***The contentions on behalf of the Respondents***

49. It was contended on behalf of the Respondents that the Appellant's transactions were loans. It was contended that the calculation of interest received should include not only the interest element in respect of each transaction when cheques were credited to the Appellant's bank account, but it should also include the interest element in cheques that were offset against further investments.

50. Whilst the point did not influence the figures, HMRC conceded that when each of the 12 cheques for £10,000 each was paid, it was appropriate to treat the first 8 as representing repayments of the principal originally advanced, with the last 4 representing the payments of interest. Since the first transaction was the only one where the return was documented by more than one single cheque, and since in any event all 12 cheques had been credited to the Appellant's bank account in the tax year 2005/2006, this particular confirmation by HMRC did not actually affect the calculation of tax for any year, but it is of some significance in the context of our decision.

***Our decision***

***The trading contention***

51. We start by referring to the highlighted sentence in the Deloitte & Touche report in the paragraph that we quoted in paragraph 47 above.

52. We simply fail to understand the meaning of the highlighted sentence. The very same full paragraph has already explained that the form of the transactions was of "advances of money [to be returned] with interest after an agreed period (usually between two and six months)". It was implicit in those mechanics that the amount of the return was fixed at the outset, and it was calculated to be the return for an advance of money for a particular period of time.

53. The highlighted sentence is not only in conflict with the earlier statements in the same paragraph, but it is in total conflict with the entire description of the facts in which there was no dispute between the parties to the effect that, with the exception of deal 1 (for £80,000), deals always took the form of money being handed over by the Appellant, in return for post-dated cheques, issued when the money was handed over. Since the date for presentation of the cheques and the amount payable under each cheque governed the Appellant's return on each transaction, and the period over which the return was earned, we simply fail to understand how Deloitte & Touche referred to the profit on gun purchases and sales being shared on a 50/50 basis. This was manifestly not what happened.

54. The Appellant can hardly dispute the summary of the form of the deals that we have just given in the previous paragraph when the extract from a schedule of money movements that we quoted in paragraph 24 above was taken from a schedule actually presented to us by the Appellant. Nothing referred in that schedule to returns being dependent on waiting until particular guns had actually been sold, and to then calculating the actual profits between the actual purchase price and sale price of those particular guns.

55. We should also refer to a letter sent on 14 October 2010 by Mr. Litt himself to UHY Peacheys, in which Mr. Litt sought, it seems to us, to support the Appellant's trading contenton. He said in this letter that:

> "As far as [the Appellant] was concerned each transaction was for the purchase of a share of a specific batch of firearms or accessories.
>
> *The profit sharing was agreed on each deal [and] was normally between 25%-30% and was divided equally after any admin costs.*
>
> *Based on my knowledge of the market I was able to agree a minimum profit of 10%, provided the items sold, but this did vary from deal to deal.*
>
> *Because sales would be expected to be reasonably quick, [the Appellant] was repaid with post-dated cheques, and sometimes I would ask him to delay the dates these were paid into his bank, because of delays or because I could advise him of a new deal".*

56. We simply reject the suggestion in this letter. It conflicts with the whole of the form of the transactions that both parties appear to have accepted. It conflicts with the fact the returns were generally pre-agreed and were vastly higher than 10%, either on a "per deal" or "annualised" basis. Were it true to say that the Appellant received 25% - 30% of actual profits, then D J Litt would have made enormous profits. As it was, it was in financial difficulties in 2004; it had then exceeded its overdraft limits and was refused further bank finance; and far from making enormous profits, by the end of 2007, its accounts had been revealing modest profits, and taking into account the transactions with investors, excluded from the accounts, it had a deficit of between £36 and £50 million. We can appreciate that, having lost the Appellant his capital of £140,000, Mr. Litt might have had a good reason to seek to

support the trading contention advanced on behalf of the Appellant, and so eliminate a tax liability of itself more than £100,000, but the critical claim that actual profits were shared was simply untenable.

57. We observe, finally, in relation to this contention that the measure of return was geared to actual deal-by-deal profits, and that returns were paid when guns were actually sold, that whilst one sentence in the Deloitte & Touche report was oddly consistent with this claim, the entire balance of a long and excellent report always referred to investment by Investors, and interest rates, and maturities fixed in advance by the dates on the post-dated cheques.

58. We now consider the Appellant's trading contention in the different manner of considering whether the Appellant was in partnership with D J Litt in one form or another or whether, on any basis, his actual transactions, in the form that we have now decided, could rank as the trading transactions of a sole trader.

59. There can obviously have been no total partnership between the Appellant and D J Litt, and this was not even contended by the Appellant. Quite apart from the fact that there was even no joint interest in the profits in those transactions where the Appellant was allegedly involved in D J Litt's transactions, the Appellant had no conceivable interest in all the company's other transactions, including all those involving the 55 other investors.

60. We also reject any suggestion along the lines that D J Litt might have been involved in 56 partnerships, one with each of the investors. Beyond being far-fetched in the extreme, the absence of shared interest in profits, at least on the facts as regards this particular Appellant, undermine any such extraordinary contention. In any event even this contention was not seriously advanced, albeit of course that the initial representation by Mr. Litt was that there would indeed be a joint venture between the Appellant and D J Litt.

61. The possibility that the joint venture took the form of each of the Appellant and D J Litt being involved together but each having a sole trade is perfectly possible and cogent. Had the facts been that the Appellant did genuinely have some percentage interest in actual profits on the purchase and sale of identified guns, with the capital and profit being distributed only when the guns had been sold, and the profit calculated, the conclusion might well have been that the Appellant was then participating in gun trading, and that his profits would be trading profits. But plainly that was not what was happening.

62. The last possibility is that the regularity of transactions, and the high risk, leads to the conclusion that the Appellant was trading in the manner that it is accepted that a bank or moneylender are trading. In this context we note that the Appellant was only ever advancing his original capital, or fictitious profits that he had already made. He was not undertaking the other transactions commonly undertaken by banks, namely those of borrowing and lending. He was simply lending. Furthermore he was only lending to one single borrower. The reality was that, lured on by ludicrous promised returns, he was financing the trading of one single company, simply advancing his capital and fictitious profits at agreed interest rates, with a view to earning interest on his capital.

63. We conclude that the Appellant was not trading in any way. We can well appreciate why the trading contention has been advanced, because the availability of loss relief would produce a fair and just result in this case. We believe, however, that the assumption underlying the entire Deloitte & Touche report (the one sentence apart) is correct and that investors, generally wealthy investors, were indeed investing to make very high interest returns, lured on by their faith in Mr. Litt, and his very high reputation in the gun world.

***The calculation of interest on the basis that the Appellant was not trading***

64. Our decision in this case is that it is appropriate to ignore the fictitious form of the individual transaction under which interest was paid in theory, but inevitably reversed by the investors being lured into reinvesting virtually everything received. We should make it clear, however, that if that approach is held to be wrong on appeal, and the interest can only be calculated by accepting the pure form of the transactions, then on one point, the Respondents are clearly right. There would equally have been a receipt of interest, where a post-dated cheque was either torn up or returned to D J Litt, along possibly with additional cash in order to fund a new investment. There would clearly have been a receipt of interest in that situation.

65. We entirely accept that interest is taxable when it is received or receivable. We equally accept that in general the tax liability in respect of interest received would not be undermined by the feature that the investor might re-advance the amounts paid back, including interest, under one transaction in making a new investment (possibly with the same borrower) and the new investment results in a total loss. The initial interest would still be taxable, and the later loss would not change that position.

66. In this case, we do not quite conclude that Mr. Litt intended any sort of fraud on the investors, or more relevantly that he intended a fraud from the start. The reasons given in paragraphs 38 to 43 above, the initial false claims about ignoring tax returns until the end of the trading cycle, the feature that the "investor deals" were also "off balance sheet", and "off the accounts" in every sense of the expressions, and that it was manifest that the company in trouble could not trade out of its difficulties, and ultimately repay debt by financing its deals at astronomic interest rates, makes it absolutely clear that it was the essence of Mr. Litt's plan from the very outset that any amounts paid back to investors by D J Litt would have to be returned to the company as new investment. Failing the endeavour to simply circulate "funny money" in this manner, the company would immediately have been unable to repay its debts. It was only able to repay its debts in Ponzi style transactions under which it either derived the funds to repay one debt either from money raised from other investors, or more simply from the self-same investor being repaid.

67. The respect in which we say that this reality precludes the analysis that interest was actually received or receivable when each investment was technically discharged was that the interest paid at that point was only paid in an utterly fictitious manner. We accept that if a particular investor had got cold feet in 2005 or 2006 (rather earlier perhaps than the one lucky investor who received the £3.2 million and who took recoveries through 2007 but refrained from making new advances) then the interest received would plainly have been received. But when, as was almost invariably the

case with this Appellant, and perhaps with many other investors, the returns were immediately re-invested, it must have been known to Mr. Litt that the Appellant would never genuinely receive his interest. By some point, well before the end of 2007, it would have been clear to Mr. Litt that most of the investors would not only not receive their interest in reality, but would almost certainly lose most, if not all, of their original capital. The deceitful scheme was only able to operate as it did if investors were lured into re-lending, and notably if each investor was totally unaware that 55 other investors were being manipulated in a similar manner. Mr. Litt could keep the ball rolling only because of these two critical facts. If one investor got cold feet and refused to re-invest, it was clear that the scheme could only then roll on, without the ever mounting deficit being detected, if that investor was indeed paid back with money raised from the less suspecting investors. That had to be the intention, because there was absolutely no chance that the astronomic returns could genuinely be furnished to all even back in 2004 and 2005.

68. Our conclusion is that utterly fictitious receipts of interest, invariably matched by reinvestments, when the borrower knows that the borrower company is inevitably heading for a catastrophic collapse in which the investors will never receive any return and will probably lose everything, all in a Ponzi style transaction, are not relevant receipts of interest for tax purposes.

***Costs***

69. This was a case brought under the new regime and there is no opportunity to award costs.

***Right of Appeal***

70. This document contains full findings of fact and the reasons for our 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.

**HOWARD M. NOWLAN (Tribunal Judge)**

**Released: 9 December 2011**