



TC01786

Appeal number: TC/11/04175

Income Tax; Enquiry into Self Assessment Return; Amendments to Return; whether deductions should be made for invoices rendered by Appellant's limited company; whether services actually performed by that company and if so, when performed; principles of generally accepted accounting practice; accruals basis of accounting; computation of profits in accordance with such practice; Finance Act 1998 s42; decision in principle in favour of Respondents in principal outstanding issue in appeal.

FIRST-TIER TRIBUNAL

TAX

WILLIAM CRAIG

Appellant

- and -

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

Respondents

**TRIBUNAL JUDGE: J Gordon Reid, QC., F.C.I.Arb.,
Member: Charlotte Barbour, CTA**

Sitting in public at George House, 126 George Street, Edinburgh on 12 January 2012

**Andrew Howat CA, Howat Andrew & Co, Chartered Accountants, Irvine, for the
Appellant**

Mrs J Ballingall for the Respondents

DECISION

Introduction

1. This appeal raises the question whether the sums specified in two invoices amounting in total to £110,000, which bear to be for services provided by a limited company, of which the Appellant and his wife are the directors and shareholders, to the Appellant as a sole trader, carrying on business under the name Apex Groundcare or Apex Landscapes, fall to be treated as deductible expenses for the purposes of computing the Appellant's taxable profits in his trading year from 1 May 2005 to 30 April 2006 and his Self Assessment return for the tax year 2006/2007. Certain other issues in the appeal were resolved as we explain below at paragraph 47 although the question of a consequential penalty determination remains outstanding.

2. Andrew Howat, CA, of Howat Andrew CA, Irvine, appeared on behalf of the Appellant. He led the Appellant in evidence. Mrs J Ballingall appeared on behalf of HMRC (the "Revenue"). She led the evidence of Andrew Orrock ACCA, an experienced accountant. He is a Local Compliance Accountant employed by the Revenue at Edinburgh. Mrs Ballingall also led the evidence of Ms Isobel Ford, a Higher Compliance Officer with the Revenue, based at Glasgow, and who conducted the enquiry to which this appeal relates. A bundle of documents was produced. There was no dispute about the authenticity (except the two invoices), transmission and receipt of the documents.

The Appeal

3. On 4 February 2011, Ms Ford, on behalf of the Revenue, issued a Closure Notice under s28A (1)& (2) of the Taxes Management Act 1970. In summary, she amended the Appellant's Self Assessment Tax Return for the year ended 5 April 2007 to reflect her conclusion that instead of showing tax due of £9,108.39 it should show tax due of £48,534.97 an increase of £39,426.58. A Penalty Determination in the sum of £13,973 was issued on 3 February 2011 under s95(1)(a) of TMA 1970 for negligently delivering an incorrect return under s8 TMA for the year 2006/07.

4. In a separate letter, also dated 4 February 2011, accompanying the Closure Notice, Ms Ford explained that the main area that had not been agreed was whether the Appellant could move the income for *work done prior to the limited company coming into existence, out of the accounts of Apex Landscapes*. Under the Heading *Penalties* Ms Ford stated *You would have been aware that the work was undertaken by you as sole trader and not done by the company, Wild Bill Ltd. The submission of a return which declared a reduced profit as a result of this, would be considered to be negligent, thereby attracting penalties on any understated tax/nic.*

5. The grounds of appeal in the Appellant's Notice of Appeal (submitted on his behalf by Mr Howat) simply state that *Additional income assessed by HMRC has been accounted for through limited company operated by sole trader. Corporation tax already paid*. While in a sense that ground has been made out, it is not necessarily a complete answer to the amendments made to the Appellant's Self Assessment Return.

6. We set out the facts, issues and arguments under the following headings and thereafter explain our decision.

Trading Background

5 7. The Appellant has carried on the business of grounds maintenance and landscaping for over ten years. Some of the documents in the Bundle refer to the Appellant as trading as Apex Groundcare and others as Apex Landscapes. The difference, if any, was not discussed or founded on by either party.

10 8. Until at least about 2005, the Appellant acted mainly as a sub-contractor to a company named Russell Landscapes Ltd (“Russell”), a larger entity carrying on a similar business, owned and operated by a Mr Russell. The work consisted principally of contracts, enduring for two or more years, with large bodies such as Health Boards, Housing Associations, Historic Scotland and other institutions. The Appellant had a number of employees and some plant and equipment. While working
15 as sub-contractor to Russell, however, he and his own employees often used larger grass-cutting equipment and vehicles, owned by Russell and often kept on site.

20 9. In about 2005, Mr Russell fell ill and was unable to attend full time to his business. By agreement with Mr Russell, the Appellant, in effect, took over much of Russell’s work. Russell continued to finance the various grounds maintenance contracts on its books but the Appellant carried them out. The Appellant’s turnover was thus substantially increased. However, the contracts between Russell and the various institutions remained in place.

25 10. In about 2006, Mr Russell decided that he could no longer continue with the foregoing arrangement. Mr Russell did not wish to terminate his grounds maintenance contracts as he would have put his company in breach of contract and exposed Russell to claims from their institutional employers. Moreover, if the contracts were lost, the Appellant would lose business and he would have to pay off his men, which he did not wish to do. Both Mr Russell and the Appellant were therefore keen that the Appellant should take over these contracts. Eventually, after
30 considerable difficulty and negotiation, these institutions or some of them were prepared to and did allow their contracts with Russell to be assigned to the Appellant. No documentation was produced in relation to these matters but it was not disputed that, in broad terms, this is what occurred. According to the Appellant’s evidence, this occurred in about 2005 to 2006. He could not be more precise.

35 11. The Appellant thus effectively took over from Russell. At one stage, at some unspecified point after various contracts had been assigned to him, the Appellant considered it would be prudent to carry on his business through the medium of a limited liability company and thus benefit from reduced tax rates on the increased turnover being generated; operating through the medium of a limited company also
40 had the advantage of eliminating any claims against him as an individual arising from the activities of his business. (According to Mr Howat’s letter to the Revenue dated 11 December 2009, he had been advising the Appellant since 2004 to trade through

the medium of a limited company). However, in light of the difficulties the Appellant had in persuading the various institutions to allow their contracts with Russell to be assigned to him he was unable to persuade these institutions to allow their various contracts with him as an individual to be assigned to a limited company which he proposed to establish.

12. The Appellant also considered mitigating his tax liabilities by making pension contributions but decided against that course as he wished to have circulating capital available for his expanding business. He bought substantial plant and equipment which was the subject of a disputed capital allowances claim, which claim has now been resolved in his favour (see paragraph 47 below).

Wild Bill Limited

13. The Appellant did however set up a limited company, Wild Bill Limited (“WB”). It was incorporated on 15 March 2006 and, according to its Corporation Tax Return for the period 1/4/06 to 31/3/07, it began trading on 1 April 2006.

14. The Appellant and his wife are the directors and the sole shareholders. Mrs Craig is also the company secretary. The objects of the company were not disclosed in evidence but it appears to have been set up to carry out some form of consultancy work in the landscaping/grounds maintenance business. WB’s Financial Statements dated 31 March 2007 (signed by the Appellant’s wife on 17 December 2007) contains a Directors’ Report which states that the principal activity of the company was the *provision of management consultancy services*. WB has no other employees.

15. Even after WB was established, many of the Appellant’s contracts were still running in his name either because they had not run the full course of their two or three year duration or because they had an option to extend them for a further year which the Appellant reasonably decided to exercise.

16. WB rendered an invoice, bearing the date 30 April 2006 (the “April 06 Invoice”), to Apex Groundcare i.e. the Appellant, in the following terms:-

To Professional Fees- year ended 30 April 2006. Consultancy costs in respect of Russell Landscape Contracts with a local health authority/housing association.

17. The amount of the invoice was £59,000. There was no VAT added. WB was not registered for VAT.

18. WB rendered an invoice, bearing the date 1 May 2007 (the “May 07 Invoice”), to Apex Groundcare i.e. the Appellant, in the following terms:-

To Professional fees- year ended 30 April 2006 and 30 April 2007. Consultancy costs in respect of Russell Landscape Contracts with a local health authority/housing association.

19. The amount of the invoice was £51,000. There was no VAT added. VAT is not an issue in this appeal. The total of the two invoices is £110,000. They overlap to some extent. Both cover *inter alia* the period between 1 April 2006 and 30 April 2006. No explanation for that was given in evidence.

5 20. In evidence, the Appellant was unable to explain how these sums were made up or how they came to be created and issued. He could not specify the hourly rate charged (if any) for consultancy services provided by WB. He did not identify the detail of the work or when it was carried out. He felt he could charge what he thought fit. Ultimately, he said that the WB invoices represented the extra income he earned
10 through Russell. It was for him, he said, how to attribute it. There was no other evidence about the invoices apart from the terms of the invoices themselves.

The Appellant's accounts and Self Assessment Return

15 21. During the period with which this appeal is concerned, Mr Howat appears to have been acting as the Appellant's accountant. The scope and timing of his instructions, and all the advice he gave, were not the subject of evidence. In general, it is reasonably clear that the Appellant disclosed to Mr Howat, the true facts and circumstances relating to his trading activities, kept proper books and records and spread sheets (although he has no formal accounting or book-keeping training) and passed them to Mr Howat for the preparation of accounts and returns from time to
20 time. Mr Howat, prepared the accounts and returns on the basis of information provided and the Appellant signed them. The evidence does not disclose the extent to which Mr Howat was involved in the decision to render the two invoices by WB. Mr Howat dealt with all the correspondence with the Revenue and attended one meeting with Mrs Ford. The Appellant did not attend any meetings with the Revenue.

25 22. The Appellant's draft Trading and Profit and Loss Account for the year ended 30 April 2006 disclosed sales of £328,232, purchases including subcontractors of £118,947 and a gross profit of £198,452. Creditors and accruals were shown at £12,113. The entry for HP Creditor shows a balance of £8,215. In the Balance Sheet Bank Current account is shown as £37,180.

30 23. The Appellant's Tax Return for the year ended 5 April 2007, which he signed on 20 June 2007, disclosed that he traded as *Apex Landscapes*, and had a turnover of £323,232 (Box 3.29) with the costs of sales shown as £169,947 (Box 3.46). Trade creditors/accruals were shown as £22,113 (Box 3.106). Bank/Building Society Balances are shown at £96,180 [Box 3.103]. Loans and overdrawn bank accounts
35 were shown as £108,215 (Box 3.107).

24. WB's bank current account statements show a credit entry for £53,000 on 17 October 2006. The Appellant was unable to say to which of the two Invoices this item related or whether it related to the whole of the services specified in the May 07 Invoice and part of the services specified in the April 06 Invoice, or to part of the
40 services specified in the April 06 Invoice and none of the services specified in the May 07 Invoice.

The Returns and Accounts of Wild Bill Ltd

25. WB's profit and loss account for the period 15/3/06 to 31/3/07 discloses a turnover of £59,000, administrative expenses of £3,533 and an operating profit of £55,467. Its Balance Sheet shows debtors of £59,000. WB's tax return for the period 1/4/06 to 31/3/07 discloses a turnover of £59,000.

26. WB's profit and loss account for the year to 31 March 2008 discloses no turnover whatsoever, administrative expenses of £682 and an operating loss of £682. WB's tax return for the period 1/4/07 to 31/3/08 discloses no turnover.

27. WB's Profit and Loss Account for the year to 31 March 2009 discloses turnover of £51,000, administrative expenses of £779 and an operating profit of £48,997. Its Balance Sheet shows debtors of £57,000. WB's Tax Return for the period 1/4/08 to 31/3/09 discloses turnover of £51,000. Mr Orrock considered it odd that the sum of £51,000 was not *recognised* until the 2009 accounts. We agree.

Summary of the accounts and transactions

28. The difference between the draft accounts and the Appellant's Return in relation to purchases etc. is £51,000 (£169,947-£118,947). This is the same amount as the May 2007 Invoice. Thus, the net profit in the draft accounts is £51,000 more than in the return.

29. The difference between the Bank Current Account in the draft accounts and the equivalent figure in the Appellant's Return is £59,000 (£96,180-£37,180), the amount of the April 06 Invoice.

30. The difference between creditors and accruals in the draft accounts and the equivalent figure in the Return is £10,000 (£22,113-£12,113). The difference between HP Creditor in the draft accounts and the equivalent provision in the Return is £100,000 (£108,215-£8,215). These two differences add up to £110,000 which is the sum of the two Invoices.

31. Thus, the Balance Sheet in the Appellant's Tax Return for the Tax Year 2006/07 shows assets of £59,000 more than the draft accounts, and creditors of £110,000 greater than in the draft accounts. All this led Mr Orrock to conclude, and we accept, that the April 2006 Invoice for £59,000 was included in the draft accounts and the Return, but the May 2007 Invoice for £51,000 was a late adjustment not reflected in the draft accounts at all but only reflected in the Tax Return itself.

32. Mr Orrock concluded that the various discrepancies indicated that the Appellant's profits had not been computed in accordance with generally accepted accounting practice.

33. The Appellant was not personally aware of any differences between the draft Accounts and the Return. The figures were inserted by Mr Howat or someone in his firm and the Appellant simply signed the documents relying on his accountant.

34. On the face of the April 2006 Invoice rendered by WB to the Appellant, WB supplied services to the value of £59,000 between 1 April 2006 (when WB began trading) and 30 April 2006. The whole of that sum has been treated as a deductible expense in the Appellant's accounts for the year to 30 April 2006 and in his return for the Tax Year 2006/2007 which is concerned with trading profits earned in any accounting period ending prior to 5 April 2007. Here, that accounting period is the Appellant's trading year to 30 April 2006.

35. On the face of the May 2007 Invoice rendered by WB to the Appellant, WB supplied services to the value of £51,000 between 1 April 2006 and 30 April 2007. No part of that sum has been treated as a deductible expense in the Appellant's draft accounts for the year to 30 April 2006. However the whole of that sum has been so treated in his return for the Tax Year 2006/2007.

36. The Revenue have amended the Appellant's return for the Tax Year 2006/2007 by disallowing almost all of the total of the two invoices (£110,000). They have apportioned that sum on a daily basis (over the period between 15/3/06 [date of incorporation, rather than date trading began on 1/4/06], and 30/4/07) which thus allocates and adds back £96,466 to the returned profit in his accounts for the year to 30 April 2006. This, in effect, allows a deduction of £13,534 (£110,000-£96,466). The impact on subsequent years is a deduction of £45,466 (£59,000-£13,534) from the returned profit in the Appellant's accounts for the year to 30 April 2007 and a deduction of £51,000 from the returned profit in his accounts for the year to 30 April 2008. The Revenue have not disallowed the sums in the two Invoices but simply spread the deductions over three trading years. The total of £13,534 + £45,466 + £51,000 is £110,000. That is why they have regarded the issue between the parties as one of timing. We are not concerned with the treatment of these invoices in any tax year other than the year under appeal (2006/2007). We therefore make no comment on the soundness of the Revenue's assessment of the impact of their Closure Notice on subsequent tax years.

The Revenue's Enquiries

37. By letter to the Appellant dated 9 January 2009, the Revenue opened an enquiry into the whole of his Tax Return for the year ended 5 April 2007 in terms of s9A TMA. A meeting took place on 2 October 2009 at the Revenue's offices at Glasgow between Mr Howat and Ms Ford. The Appellant did not attend; he was too busy working (six days a week at that time). The relationship between Russell, the Appellant and WB was discussed. It was noted that the increased work resulted in additional income being liable to tax at 40%. The difficulties with assigning the contracts were discussed. It was noted that Mr Russell had gone back to work and the Appellant's turnover had reduced again. Much of the discussion related to matters which are no longer in dispute.

38. Correspondence between the Revenue and Mr Howat ensued. In her letter to Mr Howat dated 22 December 2009, Ms Ford discussed the May 2007 Invoice. She noted (after discussing the concept of accruals) that the first question to ask was what precisely did the £51,000 represent. Was it a proper expense of the business; if not, it should not be charged in the profit and loss account? If it was a legitimate expense

she queried whether it met the accounting definition of *accrual*. She further observed that from what she had been able to ascertain from the papers sent to her by Mr Howat, the invoice appeared to be an attempt to reduce the profits of the sole trader in one year and transfer income to a later accounting period of the limited company. She presumed that the £51,000 shifted in this way had the effect of taking the sole trade practitioner out of the higher tax bracket, leaving the company to pay corporation tax at a lower rate.

39. With reference to the April 2006 Invoice, she ventured the view that the transaction looked like another attempt artificially to reduce the true turnover and profit of the Appellant in order to take advantage of the lower rate of corporation tax.

40. Ms Ford obtained internal accountancy advice, which she summarised in her letter to Mr Howat dated 29 November 2009. She was cross examined at some length on the timing of the advice but to what end was not clear as Mr Howat made nothing of it at the end of the day.

41. In her letter, she summarised the accruals concept and noted again that it was impossible to establish what, if any, services WB provided to the Appellant. She also observed that, without the provision of further details of the services, it was not possible to apportion what actual services were received by the Appellant in each accounting year.

42. By letter to the Appellant dated 8 April 2010, Ms Ford sent him leaflets IR160 and Factsheet CC/FS9 explaining his rights in relation to penalties. In her letter to the Appellant dated 3 November 2010, Ms Ford sets out her views on the appropriate level of penalty. She also pointed out that no evidence had been produced showing the record of work done by WB during the year to 30 April 2006.

43. In her letter dated 6 December 2010 to the Appellant, Ms Ford set out further views on the question of penalty. She stated that she considered the Appellant's conduct to have been negligent. She did not think it reasonable to consider that profits could be reduced by £110,000 by transferring that sum to WB, particularly as part of that sum was not reflected in WB's accounts until an accounting period beginning some 11 months after the end of the Appellant's accounts. In her letter to Mr Howat dated 25 January 2011, she repeated a recurrent theme in the correspondence that it has been the failure to supply evidence which would quantify the work done after the date WB came into existence which was the stumbling block. She reiterated her views on penalties stating that in her view the negligent conduct was showing amounts that were included as an expense in the Appellant's accounts which seemed to her to be unreasonable. She proposed an overall penalty of 35%. A closure notice was issued on 4 February 2011 as noted above at paragraph 3.

44. Correspondence continued. By letter to Ms Ford dated 21 February 2011, Mr Howat stated that the charge of £110,000 related to services provided before the formation of WB. It was for consultancy services, the nature of additional work undertaken by Mr Craig involving surveying and materials management not previously performed in his role as a sole trader sub-contractor. It was pointed out

that the decision to pay £110,000 was a commercial one to be made by the Appellant and not a value judgment by the Revenue. Ms Ford responded by letter dated 28 February 2011 stating *inter alia* that these assertions meant that the work could not have been carried out by WB as it did not exist at that time. Even if the work could be considered as pre-trading income the costs relating to it were all claimed in the Appellant's accounts.

45. An Internal Review was carried out by Colin Vallance, an Appeals and Reviews Higher Officer. In his review letter dated 6 May 2011, he endorsed Ms Ford's views on all matters including penalties. In particular, he noted that no evidence had been produced of the services provided by WB. He also noted that there was no evidence that WB has ever rendered invoices to anybody apart from the April 2006 Invoice and the May 2007 Invoice. He observed that it is not acceptable to cross charge for services simply in order to defer the assessment and payment of tax.

46. In evidence Ms Ford emphasised that there were no underlying records ever produced to vouch the work carried out by WB, whatever that work might have been.

Narrowing of Issues

47. As a result of the Revenue's enquiries they also (i) identified what they described as unrecorded income, which they quantified at the sum of £1200, (ii) disallowed capital allowances for the purchase of a tractor, grass cutting equipment and a saw centre (a hedge trimmer, Stihl chainsaw, and a stone cutter), and (iii) identified the omission of Work in Progress amounting to £4,628. At the end of the hearing, it became clear that the principal issue in dispute related to the two invoices totalling £110,000 mentioned above. We indicated that our provisional view in relation to these three less significant matters was to allow the appeal in relation to the unrecorded income and the capital allowances and to reject it in relation to the Work in Progress. Essentially, we accepted the explanations of the Appellant in evidence. The Work in Progress was an omission, which, at one stage in correspondence, Mr Howat accepted but subsequently rejected when he was unable to reach an overall settlement. Following a short adjournment, the parties announced that they had reached agreement on these matters in accordance with our provisional view.

The Appellant's evidence

48. The Appellant gave evidence about two of the three matters which are now the subject of agreement between the parties. We formed a very favourable impression of him on those issues. It was plain to us that he was and is honest, and hard-working, and carefully kept more than adequate books and records, which he regularly passed to Mr Howat for the preparation of accounts and tax returns. It was plain that the Appellant's knowledge of tax matters was basic and he relied heavily on Mr Howat to prepare accounts and returns in appropriate form, with the correct figures derived from his records.

49. In relation to WB, its establishment, and the creating and rendering of the two invoices, the evidence was not entirely clear. We do not blame the Appellant for this as he simply answered the questions he was asked to consider. The Tribunal asked him various questions but it seemed reasonably clear that he had not checked his

records in preparation for the hearing. No underlying records which could have identified the work carried out by WB, if any, were produced. The Revenue raised this matter repeatedly in correspondence. Accordingly, and not surprisingly, his recollection was somewhat vague and general although we are prepared to accept that when he was giving evidence he was doing his genuine best to remember the detail. He could, of course, have made up evidence to give an appearance of detail which might have better fitted the two invoices and the tax consequences being asserted on his behalf; this might have been difficult to challenge. However, he did not do so. On this aspect of the appeal too, we consider that the Appellant was doing his best to give truthful evidence. Ultimately, his position was that he paid himself through these two invoices for work he carried out for Russell which was prior to the incorporation of WB. That evidence, which we accept, is consistent with Mr Howat's letter dated 21 February 2011 referred to above at paragraph 44, and is fatal to the main issue in the appeal.

15 **Principles of Accounting (Generally Accepted Accounting Practice)**

50. In light of the Appellant's evidence recorded above, it is perhaps unnecessary to consider any principles of commercial accounting. In case that view is wrong, we record that Mr Orrock spoke to a Report dated 20 December 2011. It was not disputed that the Appellant's profits had, by virtue of s42 Finance Act 1998, to be computed in accordance with generally accepted accounting practice. (see also ICTA 20 1988 s836A). The principle of generally accepted accounting practice with which we are concerned is the accruals basis of accounting. Mr Orrock's report records, and it was not challenged, that the accruals basis for accounting requires the non-cash effects of transactions and other events to be reflected, as far as possible, in the financial statements for the accounting period in which they occur, and not in the 25 period in which any cash involved is received or paid.

51. There was some discussion in the evidence about *trade creditors* in contrast with *accruals*. According to Mr Orrock's evidence and report, which we accept, *trade creditors* are liabilities to pay for goods or services received or supplied which have 30 been formally agreed with the supplier. *Accruals* are liabilities to pay for goods or services received or supplied which have not been paid, invoiced or formally agreed with the supplier.

52. Applying these principles to the Appellant means that any services received by him from WB should be accounted for in accordance with the accruals concept. 35 These services should be treated as expenses in the periods to which they relate and this should be, as far as possible, in the periods when the services were received. Furthermore, any services paid or invoiced in advance of them being provided should be treated as a pre-payment (in the balance sheet), if paid, and carried forward to the appropriate accounting period when they are provided.

40 53. It seems odd that WB could legitimately have provided services of £59,000 in the space of thirty days, i.e. almost £3,000 per day over four five day weeks or almost £2,000 per day for thirty days, and yet supply less than £59,000 over a period of some thirteen months and moreover not disclose that income in its own accounts until its 2008/2009 trading year. The Revenue were plainly entitled to enquire into the

circumstances relating to the substance and validity of the two Invoices. This is borne out by the Appellant's evidence.

The Parties' Arguments

54. In a very short submission, Mr Howat suggested that the Revenue had been opportunistic. They were charging the Appellant tax on his income at 40% whereas had that income remained with Russell, or been treated as WB's it would be charged at only 20%. He accepted that s42 Finance Act 1998 and generally accepted accounting practice as set out by Mr Orrock applied. The transfer of £110,000 between two entities was a value judgment which the Appellant was entitled to make in his discretion, although what that judgment was based on was not identified. He made no attempt to explain the Appellant's evidence or rationalise it with the terms of the two invoices.

55. Mrs Ballingall submitted that Ms Ford had used her best judgment in apportioning the invoices on a day by day basis, allowing two more weeks in the period to 30 April 2006 (from the date of WB's incorporation on 15 March 2006) rather than from 1 April 2006 when, according to its own return, it began trading. The April 2006 Invoice was not a credible invoice. Moreover, the Appellant's position appears to be that the work to which the Invoices relate was carried out before WB was incorporated. In any event, there were no details of the work or services, and no rates; the only evidence was that it related to 2005. Mrs Ballingall made no submissions on penalties as there was nothing to which she could respond.

56. Ultimately, both parties requested a Decision in principle and agreed that the question of penalties would have to be re-considered in the light of their agreement on the three subsidiary issues and our decision on the main issue (the two Invoices). Neither referred to any authorities or legislation although the underlying legislation and some cases have been included in the Bundle.

Discussion

57. We record at the outset that we found Ms Ford and Mr Orrock to be reliable and credible witnesses. Indeed, the correspondence produced shows that Ms Ford conducted the enquiry fairly and with some patience in spite of some aggressive correspondence from Mr Howat. We have already given our assessment of the Appellant as a witness.

58. The purpose of creating and rendering the two invoices, as disclosed in the Minutes of the meeting between Mr Howat and Ms Ford in October 2009, was to transfer money across to the limited company, so that it would be taxed at a lower rate than 40%. Unfortunately, the attempt to do that in a legitimate and tax efficient manner must fail.

59. The Revenue have disallowed deductions amounting to almost all of the total of the two WB invoices (£110,000) in the Tax Year 2006/2007 (see paragraph 36 above) because their enquiries revealed a suspicion that the two invoices were not valid invoices. They were prepared, in effect as a concession, to allow the deductions to be

spread over three trading years in the absence of any documents or credible account that they should be treated differently.

5 60. The Revenue's enquiries into these invoices have been justified. The evidence reveals that they indeed were an attempt to transfer to WB income already earned by the Appellant in order to take advantage of reduced rates of corporation tax. That, unfortunately for the Appellant, is a tax avoidance or mitigation manoeuvre which does not work.

10 61. Such evidence as there is discloses that the services to which the two invoices relate were carried out by the Appellant prior to the incorporation of WB. They appear to have related to Russell's contracts. If that means the services were performed before the Russell contracts were assigned to the Appellant it must also be questionable whether the services performed by WB pre-incorporation (assuming this is possible) were for the benefit of the Appellant as an individual or for the benefit of
15 Russell or a combination of both. In those circumstances, it might have been necessary to consider the extent to which the expenses were incurred wholly and exclusively for the purposes of the Appellant's trade (see Income Tax (Trading and Other Income) Act 2005 s34).

20 62. In light of the evidence, the position of the Revenue in stating that the issue is one of timing and that the two Invoices can be allowed as expenses spread over three trading years is somewhat inconsistent and illogical. But that is what they have chosen to do and, no doubt, the Appellant and WB have arranged their affairs on the basis of the legitimate expectation that if this appeal fails, as it does, that is how these Invoices will be treated.

25 63. The Appellant has failed to persuade us that the Revenue were wrong to disallow the deductions claimed for expenses of £110,000 to the extent of at least £96,466. Even if the services specified in the two invoices were truly those of WB, there is no evidence from which we could competently hold what those services were and when the services were performed by WB on or after 1 April 2006. Accordingly, we would
30 not have been persuaded that the straight line apportionment which the Revenue allowed should be varied in the Appellant's favour. We cannot give effect to the *value judgment* argument advanced by Mr Howat. There was nothing in the evidence on which such a judgment with the result contended for could possibly be based.

Result

35 64. The parties have reached agreement on three of the four issues which were the subject of appeal (see paragraph 47 above). On the principal outstanding issue, we have decided it in favour of the Revenue. The Appeal on that issue is refused in principle.

40 65. The question of penalties remains outstanding. We invite parties to submit proposals for further procedure within six weeks of the date of this decision, failing which a hearing will be fixed by the Tribunal office in the usual way.

66. 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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**J. GORDON REID Q.C., F.C.I.Arb.
TRIBUNAL JUDGE**

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RELEASE DATE: 27 JANUARY 2012