



TC02036

Appeal number: TC/2011/244

*Income tax- deductions in computing profits – whether claimed deductions represented payments made, whether evidence of to whom payments made – whether evidence of reason for payment – whether payments were allocation of partnership profits.
Penalty for negligent submission of tax return.*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

T A FRASER

Appellant

- and -

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

**TRIBUNAL: JUDGE CHARLES HELLIER
 JOHN ROBINSON**

Sitting in public in Southampton on 23 March 2012

Bill Law FCA of Princecroft Willis for the Appellant

C J Brown for HM Revenue and Customs.

DECISION

1. Mr. Fraser is a builder. In 2004 he commenced a joint venture with Paul Vincent and Shaun Costello for the acquisition of offices at Lansdowne House in Bournemouth and their conversion into flats. His 2005/06 tax return included trading profits arising from this venture which included a deduction of £40,000 for interest. HMRC say a deduction is not available for that sum and that consequently that his return was negligently understated his taxable income; they have assessed a penalty of £4502 being 30% of the tax at stake. Mr. Fraser appeals against their conclusion and the penalty.

2. Shortly after HMRC received Mr. Fraser's tax return they opened an enquiry. They sought information about the various items in his accounts. Princecroft Willis ("PCW") replied on behalf of Mr. Fraser and provided information sought. The receipt of the information satisfied HMRC on most counts but they remained unhappy about a sum of £40,000 shown in the accounts as part of the interest expense of Mr Fraser's business for the year.

3. In outline the appellant's case is and was that (1) Mr. Costello subscribed £80,000 to the joint venture and (2) Mr Costello had borrowed that money from a Brendan Kavanagh, (3) during 2006/07 Mr. Kavanagh put some unwelcome pressure on Mr. Fraser to repay the principal, and to pay interest, on the monies borrowed by Mr Costello and (4) the £80,000 was repaid in instalments - broadly when flats were sold - and that an extra £40,000 was paid to Mr. Kavanagh as interest.

4. HMRC were not convinced by the evidence given to them about these transactions. They concluded that there was insufficient evidence to conclude that a deduction of £40,000 should be allowed as an expense incurred wholly and exclusively for the purposes of Mr Fraser's business. They closed their enquiry and amended Mr. Fraser's self-assessment to disallow the £40,000 deduction.

5. Mr. Fraser sought a review. The decision was upheld on review. He now appeals to this tribunal. The first task of this tribunal is to determine on the basis of the evidence provided to it whether a sum of £40,000 is an expense properly deductible from Mr. Fraser's profits for that year.

The evidence

6. We had a bundle of copies of correspondence between HMRC and the appellant, a copy of notes of a meeting between HMRC and the appellant, and a letter from Mr. Costello to HMRC in response to questions HMRC had put to Mr. Costello about his transactions with Mr. Fraser.

7. We heard oral evidence from Mr Fraser and from Mr. Law. Mr. Costello was not called as a witness by the appellant. No additional bank statements or accounting or other records were provided by the appellant to the tribunal.

The fact-finding process

8. Before Mr. Fraser made his appeal, HMRC set out their views in a letter which give their conclusions on the review carried out in relation to the closure notice denying the deduction and the penalty determination. In a letter of 8 December 2010
5 Mr. Mayo of HMRC's appeals and review unit, set out the documentation he had seen, and said:

"In the circumstances of this case there is a lack of supporting documentation".

9. This should have been the first sign to the Appellant that in order to succeed before us he would have to produce either documentary evidence or as much other
10 evidence as he could find to fill the gaps.

10. Mr Mayo went on to explain that he understood there had been a joint venture agreement, and that PCW had provided details of how £80,000 had been received by Mr. Fraser and how it was repaid; but he said there was uncertainty about the relevant payments. He said:

15 "(a) With regard to the money coming in, a cheque for £65,000 has been identified and the balance was apparently made up of three further payments of £5000 each. The income [this receipt] is shown to have been provided via Mr. Costello and not Mr. Kavanagh.

"(b) Turning to the repayments... of the cheque and bank transfers referred to
20 by your agent -

£20,000 was transferred to Tom Stuckley

£20,000 was a foreign transfer

£20,000 was transferred in euros to Brendan Kavanagh AIB bank Dublin

25 £20,000 related to two cheques of £10,000 each (one [for cash]) which per the cheque stubs indicate "Brendan Cash".

30 "Moving on to the interest, the £20,000 transfer to Brendan Kavanagh above has been referred to as a payment of interest (it cannot be both[ie both interest and a part repayment of capital]). In addition to this a further £20,000 interest was apparently paid in two cash payments of £10,000 each during September and October 2006."

11. He then said said:

35 "There is a lot of uncertainty here but trying to simplify matters it would appear that you received £80,000 towards the refurbishment of which of these £65,000 has been specifically identified as coming via Mr. Costello. There is no evidence to show that this loan was actually provided by Mr. Kavanagh.

" Payments totalling £80,000 had been outlined to HMRC of which £20,000 can be evidenced as having been paid to Brendan Kavanagh. The reason for that payment though is not confirmed by any documentation.

“Details of further payments totalling £40,000 have also been provided of which £20,000 appears to have been duplicated, whilst the remaining £20,000 has not been evidenced as having been made to Kavanagh. ...

5 “...Quite simply I have not seen enough (if any) evidence to justify you claiming the £40,000 mentioned as being interest on a business loan and that is why I uphold the decision to disallow that £40,000.”

12. Thus the appellant was put on notice that the problem was that HMRC did not have evidence which enabled them to accept the appellant’s contentions both in relation to what was paid, and when and why it was paid. That should have prompted
10 Mr Fraser and his advisers to realise that the only way they could hope to succeed in the appeal was by producing as much detailed evidence as possible of when, to whom, and why each payment was made.

13. In HMRC's statement of case they submit in section 5 that payment of third party debt interest is not a purpose of the trade carried on by Mr. Fraser or
15 alternatively that there is no evidence to show the extent of the debt on which interest arose in the year.

14. Before the hearing HMRC provided a skeleton argument. In that argument they referred to the joint venture agreement between Mr Vincent, Mr. Costello and Mr. Fraser, the letters from PCW to HMRC and the accounts in those letters of monies
20 paid. In section 7 of the skeleton argument HMRC set out four reasons why a deduction should not be available. They say that apart from the evidence of payment in Mr. Fraser's records there was no documentation covering the payments to Mr. Kavanagh and that the appellant's agent provided conflicting descriptions regarding the nature of the payments. They say that Mr. Costello says that he lent Mr. Fraser
25 £28,000 but that Mr. Fraser says that Mr. Kavanagh sought capital repayment of £80,000; they say that there is no reliable evidence that any particular amount represents interest or that the evidence supported a conclusion that interest of £40,000 arose in the year to 5 April 2006.

15. This must have put the appellant on notice that it would need to produce
30 detailed evidence of all the figures and of the reasons for the payments and to whom the payments were made.

16. In a case such as this the onus is on the appellant to show that he is entitled to a deduction. In order to do this he needs to provide evidence to the tribunal on which the tribunal can conclude that a payment was made which is eligible for a deduction.

17. The appellant came to the tribunal with no documentary evidence to show us.
35 They provided no bank statements and no accounting records. They did not bring any witnesses other than Mr. Fraser. Effectively the tribunal was asked to come to the conclusion that a deduction should be allowed for £40,000 on the basis of representations made by Mr. Law and the oral evidence of Mr. Fraser.

18. The appellant could have asked Mr. Costello to come to give evidence. His
40 evidence would have enabled the tribunal to resolve the apparent conflict between a

statement made by Mr. Costello in a letter to HMRC about the amount of money he provided to the joint venture and the amount of money which the appellant says was provided by Mr. Costello to the joint venture; it could have provided details of the terms of the joint venture. If Mr. Costello had been unwilling to give evidence voluntarily the tribunal could have issued a witness summons. None of this was done. Evidence from Mr Kavanagh may also have been illuminating.

19. We have tried our best on the limited evidence available to us to decide whether some form of deduction should be available in respect of the £40,000 claimed. But for the reasons which follow we have been unable to come to any conclusions as to how much of it was paid to whom and why. As a result we cannot find that the appellant is entitled to a deduction.

The Evidence and Our findings of fact.

20. Mr. Costello lived in the same road as Mr. Fraser. Mr. Costello was involved in a business venture with Mr. Vincent. Mr. Vincent had his eye on developing Lansdowne House. Mr. Costello introduced Mr. Vincent to Mr. Fraser and together they discussed the venture to purchase Lansdowne House and turn it into flats. They estimated that they could convert it into eight flats which would sell for about £125,000 each, that Lansdowne house could be purchased for £550,000 and that it would cost £200,000 to develop. That would leave a profit of about £250,000 which they would split three ways.

21. Mr. Fraser investigated. He approached the vendor. He considered planning issues. He drew up detailed plans in consultation with Mr. Vincent and Mr. Costello. He borrowed £400,000 from his bank, and, with £150,000 of his own money, purchased the property for £550,000 at the end of July 2004. He started work straight away.

22. On 12 October 2004 Mr. Vincent, Mr. Costello and Mr. Fraser signed a Joint Venture Agreement. This provided that:

- (1) Lansdowne House should be held by Mr. Fraser;
- (2) the building costs would be borne equally by Mr. Vincent and Mr. Costello who would subscribe monies to fund the project which would be kept in, and drawn from a designated account;
- (3) those sums should be recorded in books of account maintained by Mr. Vincent and Mr. Costello;
- (4) on the sale of the property or any part of it, Mr. Fraser, Mr. Vincent and Mr. Costello would each be entitled to one third of the sale price after deducting repayments to Mr. Vincent and Mr Costello of their contributions, and payment to Mr. Fraser for his purchase costs and mortgage expense (which we believe refers to Mr Fraser's borrowing of £400,000).

23. We accept Mr. Fraser's evidence that they agreed that the net profit would be split three ways.

24. We accept Mr. Fraser's evidence that it was agreed between them that all each party's expenses and costs associated with the venture would be reimbursed and brought into account. Mr Fraser said that this extended to financing costs incurred by the parties. Although we thought that Mr Fraser did his best to give us his honest
5 recollection, we have some doubt about this, and think that he was mistaken in this particular recollection. Mr Fraser put £150,000 of his own money in at the start of the venture and the agreement seems to have been that he would get no extra return for this investment but that the £400,000 mortgage casts would be taken into account. On
10 that basis it would be surprising to have agreed that the other parties' interest costs would be part of the venture's costs. We are not convinced that it was agreed at the start that borrowing costs by other partners to finance their investment were to be for the joint venture account.

25. The terms of the agreement were not followed. A separate bank account was not kept for Mr Costello's and Mr Vincent's contributions; accounts were not maintained.
15 Further Mr Vincent had some difficulty in providing funds and left the country at some time before the end of 2005 when he ceased to be involved in the project. When he left Mr Fraser told us that he and Mr Vincent agreed to split the profits 50:50.

26. The evidence as to how much and when Mr Costello provided what funds for the project was contradictory:

20 (1) A letter from Mr Costello to HMRC indicated that he had provided £18,000 on 27 April 2004 and a further £10,000 on 28 August 2004, which sums had been repaid on 6 September 2004 (only a month after the completion of the acquisition);

25 (2) PCW wrote to HMRC on 14 August 2009 and said that a cheque for £65,000 had been paid to Mr Fraser on 31 August 2004, and a number of smaller amounts of £5,000 had been paid making a total of £80,000. The implication in their letter was that these amounts had been paid by Mr Costello.

30 (3) Mr Fraser told us that in August 2004 Mr Costello and Mr Vincent had turned up with a cheque for £65,000. At that stage he took it as being from one or both of them, but was not sure which.

27. We accept Mr Law's evidence that £65,000 was received in August 2004: his firm's letter of 14 August was a direct detailed representation to that effect. That this sum was received from Mr Costello is consistent with Mr Fraser's oral evidence. It is inconsistent with Mr Costello's letter, but the dates in that letter made little sense:
35 Why would monies be repaid just after the development had been started? Why would monies be paid before the purchase had taken place? We concluded that it was shown on balance that Mr Costello had provided £65,000 for the project.

28. We were less sure about the "smaller amounts of £5,000" but the letter from PCW said that these amounts were deposited in the bank account so we think it likely
40 that PCW checked the account and saw these amounts arriving. It seems unlikely however that PCW checked by whom the payments were made. Mr Fraser gave no evidence that these sums had been received from Mr Costello or as to when they had been received. We conclude that it is not proved whence these sums came.

29. Mr Fraser worked initially in developing four flats. These were sold in June, August, September and December 2005. The next four flats required comparatively more work. The cost of their conversion was funded in part by the sale of the earlier flats. He told us that no further funds were provided by Mr. Vincent or Mr. Costello.
 5 These last four flats were sold in 2006/07.

30. Mr Fraser told us that at some stage (we think 2005) Mr. Kavanagh turned up at Lansdowne House and told Mr. Fraser that he had come to "check his property". Mr. Fraser said he had an intimidating presence. Mr. Fraser said he then spoke to Mr. Costello. He discovered that Mr. Costello had borrowed the funds he had invested in
 10 the project from Mr. Kavanagh. Mr. Fraser says that it was settled that £40,000 of interest be paid Mr. Kavanagh. Payments and interest would be made as the flats were sold. Mr. Fraser said that Mr. Costello had asked him to pay £40,000 to Mr. Kavanagh directly. Mr Fraser gave us the impression that he himself had been very keen to get Mr Kavanagh off his back.

15 31. Whilst we accept Mr Fraser's evidence of what Mr Costello told him, we had no way to test the truth of what Mr Costello told Mr Fraser. Interest in a lump sum of £40,000 seems unusual to us; if the loan was £80,000 (and we could not test whether Mr Kavanagh had lent the whole amount or only part) then the rate of interest was surprisingly high. We could not determine whether this was money borrowed by Mr
 20 Costello for the purpose of this venture or for another purpose. We could not test whether it was in fact money to be paid to Mr Kavanagh for a reason unconnected with the venture. We find that it was not proved that Mr Costello had borrowed anything from Mr Kavanagh. We could not test whether Mr Costello had assigned his interest in the venture to Mr Kavanagh at a later date.

25 32. We saw no bank statements but letters from PCW to HMRC said the following amounts had been paid:

| Date | £Amount | Explanation in PCW's letters |
|-------------------|----------------|---|
| 29 June 2005 | £20,000 | bank transfer repayment of capital |
| [30 June 2005 | [£20,000] | [Bank transfer in euros to Mr K by way of interest] |
| 8 September 2005 | £10,000 | cheque: repayment of capital |
| 27 September 2005 | £10,000 | Cheque for cash: repayment of capital |
| 27 September 2005 | £20,000 | Bank transfer to Tom Stuckey: repayment of capital |

| | | |
|-------------------|-----------------------|---|
| 13 February 2006 | £20,000 bank transfer | bank transfer Mr. Kavanagh AIB Dublin: (said to be capital and letter of 14 August 2011; interest in letter of 13 May 2011) |
| Year end | Year End | Year End |
| 26 September 2006 | £10,000 | cheque to cash; paid to Mr K |
| 3 October 2006 | £10,000 | cheque to cash; paid to Mr K |

33. We note that flats were sold in June, August, September and December 2005.

5 34. The explanation given as to why a transfer of £20,000 to Tom Stuckey was part of the repayment of capital of interest to Mr. Costello was that Mr. Kavanagh requested the money which he said he was owed to be paid into that account (PCW's letter of 21 December 2009).

10 35. We have put the payment of 30 June 2005 in square brackets. That is because it is of the same amount as the payment described as being having been made on 29 June 2005 and made by the same method. It seemed that there might be some confusion between the two payments. In PCW's letter of 19 February 2010 and they describe the 30 June payment is being of interest whereas in their letters of 13 May and 14 August 2009 they describe the 29 June payment is being capital. It would be odd that interest would be paid at such an early stage. We therefore express no
15 conclusion as to whether payments were made on both on 29 June and 30 June.

20 36. Whilst we accept PCW's evidence that the amounts were paid, there was no direct evidence before us which enabled us to test to whom many of the payments were made (although there was a copy of bank instruction in relation to the 13 February payment and a copy of a cheque payable to cash in relation to another payment). And we did not discover how PCW concluded that some of the payments related to the loan made by Mr. Kavanagh or the contribution from Mr. Costello. We were therefore unable to conclude that any more than some £40,000 had paid been paid in connection with Mr. Costello's contribution.

25 37. Thus of the payments of £80,000 (or £100,000 if the 29 and 30 June payments are different) made in 2005/06 we conclude that it was proved that no more than £40,000 was paid in connection with Mr. Costello.

38. At some time after the acquisition of Lansdowne House Mr. Fraser and Mr. Costello started another 50-50 joint venture. They acquired together a property in Kinson Road. They paid it seems some £460,000 for it of which £250,000 is borrowed and the remaining £210,000 was their own money. Mr. Fraser said that after
5 Mr. Kavanagh arrived on the scene he was keen to sever his business connections with Mr. Costello. In June 2007 he agreed that Mr. Costello would buy out his interest in Kinson Road for £250,000 and Mr. Costello would waive his right to further profit from Lansdowne House. In the end Mr. Costello paid him £230,000.

39. At this stage Mr Fraser said he thought the plot at Kinson Road was worth some
10 £700,000 so that this venture had an inherent profit of some £240,000. However in a letter of 14 August 2009 PCW say that the Kinson project was valued at £250,000 (presumably as burdened by the £250,000 mortgage) and was transferred for £230,000 thus indicating that a £20,000 profit was transferred to Mr. Costello. If Mr. Fraser's valuation of £700,000 is used then, assuming that Mr. Costello took over the
15 £250,000 mortgage, he would then have become the sole owner a property worth £700,000 burdened by £250,000 debt for which he would have paid £370,000; in other words he would own a property with a latent profit of £80,000. That suggests that there was a transfer of profits to Mr. Costello of £40,000.

40. Mr Law told us that the appellant has a competent bookkeeper and uses a well
20 known accounting package. He says that his firm produced a balanced set of accounts. As a result he asks us to accept that £40,000 was paid out. Initially he says that his firm thought that this amount was a share of profit to be paid to Mr Costello, but then they took the view that it was interest when paid to Mr Kavanagh. We accept his evidence about the appellant's accounting system and his bookkeeper, and accept that
25 £40,000 did leave the business. What we are unclear about is when, why, and to whom it was paid.

Discussion

41. We have concluded above that the evidence before us was insufficient to enable
30 us to conclude that any more than £40,000 was paid to or at the order of Mr Costello by Mr Fraser in 2005/06. We now consider whether, if the evidence had established that payments to Mr Costello and/or Mr Kavanagh of £120,000 had been made in the relevant period, any part of those payments would have deductible in computing Mr Fraser's taxable income.

42. It seems to us that *if* £40,000 had been paid out in addition to the repayment of
35 capital there were the following possible arguments that it should be deducted from Mr. Fraser's taxable profits:

- (1) it was the payment of, and represented, Mr. Costello's share of the profits of the partnership between Mr Costello and Mr. Fraser (which may have been paid at Mr. Costello's direction to Mr. Kavanagh);
- 40 (2) it was interest paid by the partnership;

- (3) it was an expense of the partnership incurred for the purposes of its trade even if it was not interest;
- (4) it was interest paid by Mr. Fraser for the purposes of his business; or
- (5) it was an expense other than interest of Mr. Fraser's business.

5 (1) A share of partnership profits

43. This seems to be the most likely possibility of the five. For the reasons in the following paragraphs, it seems to us that the joint venture agreement and the intentions and understandings of the parties gave rise to a partnership. We considered that the original agreement of the parties was that the financing cost of an individual's contribution to the partnership would not be a cost of the partnership. As a result we cannot see that any interest which was a liability of Mr. Costello would be a cost to the partnership. To the extent money was paid at Mr. Costello's behest to Mr. Kavanagh that would have been because it was money due to Mr. Costello as part of his partnership share and was paid in his direction to someone else.

15 44. A partnership is that relationship which exists between persons carrying on business in common with a view to profit. It seems to us plain that the provisions of the joint venture agreement created a partnership. Initially there were three partners in a partnership but it was clear that Mr. Vincent ceased to be a partner before the partnership made profits. Mr. Fraser's evidence that after Mr. Vincent's departure he and Mr. Costello agreed to share the profits suggests to us that the partnership continued after Mr. Vincent's departure.

25 45. Although Mr. Fraser's evidence indicates that the way in which Mr. Costello and he conducted affairs was not in accordance with the joint venture agreement, it nevertheless appears to have been the relationship of persons carrying on business in common with a view to profit. That relationship subsisted until either Mr. Costello was repaid his investment in it, or Mr. Costello and Mr. Fraser went their own way is when Mr. Fraser transferred his interest in the Kinson site to Mr. Costello in June 2007.

30 46. To the extent that Mr. Costello was entitled to a share in the profits of the partnership, those profits were not profits of Mr. Fraser and were not assessable on him. If there had been evidence before us which showed that the £40,000 deduction claimed as paid as interest to Mr. Kavanagh was in fact Mr. Costello's profit share then we would have allowed the appeal.

35 47. Mr Fraser's accounts for the year to 5 April 2006 show a net profit (after the £40,000) of £50,798. That suggests that the £40,000 may have been Mr Costello's share of the profit and was paid at his direction to Mr Kavanagh.

48. But Mr. Brown says:

40 (1) that the joint venture was terminated before any profit arose: he says the last capital payment was said to have been made on 27 September 2005. The partnership came to an end before any income payment was made.

5 (2) that Mr. Costello in his letter to HMRC says "I did not receive any profit from this venture as Tim [Fraser] has put up all the money is for 11 Kinson Park Road another venture which myself and Tim were involved in." Nor does the letter indicate that Mr. Costello received any share of the profits from the Lansdowne House development. He says "we were given a slip of paperwork close to the end of the development that showed very little profit. Relationships between all parties had become strained throughout the development as Mr. Fraser hadn't been forthcoming with progression details or expected profit.";

10 (3) no accounts have been produced which show that there was a £40,000 profit on the Lansdowne house venture. Mr. Fraser's accounts do not isolate the Lansdowne project sufficiently to enable a division to be determined;

(4) if the payment was not a payment representing a division of profits but was a payment of interest, it would have to be shown that it is made for the purposes of the trade of the partnership before it could be deductible.

15 49. The Kinson Park joint venture was terminated on 22 June 2007; the £40,000 was said to have been paid before 31 March 2006. It is possible therefore (and in our view likely) that the partnership was still in existence at the time that payment was made, or at the time the right to that payment accrued.

20 50. Any partnership profit due to Mr Costello would have been part of his taxable income (and not that of Mr Fraser) for 2005/06, even if paid at his direction to Mr Kavanagh.

25 51. We were not inclined to believe that Mr Costello's letter to HMRC told the whole story. The dates for the payments he mentioned did not, as noted at paragraph 27 above, make good sense and his account in relation to them is at variance with the thrust of the Joint Venture agreement. His description of being given an account of the profits suggests that there remained some agreement for the division of profits from the development. We found that as a whole it supported the conclusion that there was a partnership between him and Mr Fraser.

30 52. However, we accept Mr Brown's submission that there was insufficient evidence on which to determine what Mr Costello's share of the profits in 2005/06 was. That is not only because there were no separate accounts for the venture but also because we had insufficient evidence to determine Mr Costello's share of any profit or the extent to which such a share would arise in 2006/06 or 2006/07. Since we are unsure about the nature of the £40,000 paid to Mr Kavanagh we do not think it can be used as a guide to Mr Costello's share of the profits in 2005/06. Since the evidence in relation to the share of profit conveyed to Mr Costello in the transfer to him of the Kinson Road project was somewhat contradictory, we are unable to conclude that it showed that any amount of profit was attributable to Mr Costello in 2005/06.

53. (2) interest paid by the partnership

40 54. It does not seem possible to regard the alleged £40,000 as having been interest paid for the purposes of the partnership's trade. If Mr. Costello had borrowed from Mr. Kavanagh unbeknown to the other partners, it is likely that the borrowing was not

a borrowing of the partnership business but the personal borrowing of Mr. Costello. And we concluded at an earlier stage in this decision that it was unlikely that the partners had agreed that their individual financing costs would be costs of the partnership. As a result the payment of interest on the borrowing would have been for Mr. Costello's own purposes and not for the purposes of the partnership trade.

55. Even if an individual partner's financing costs were costs of the partnership, the evidence before us was insufficient to conclude that Mr. Costello had borrowed his partnership contribution from Mr. Kavanagh, and even if he had, what the terms of that borrowing were – and therefore what amount was interest on it. .

10 56. We therefore conclude that no deduction is available for the sums paid on the basis that they were interest paid by the partnership.

57. (3) an expense of the partnership

15 58. None of the evidence suggests that this was the payment of an expense other than interest which was incurred for the partnership business other than, possibly, Mr. Fraser's wish to get Mr. Kavanagh off his back. There was no evidence that that was not a personal concern of Mr. Fraser rather than the purpose of the partnership trade (if Mr Kavanagh had threatened to interfere with the building it could have been a payment for the purpose of the trade). As a result we could not conclude that the payment would be allowable under this heading.

20 59. (4) interest paid by Mr. Fraser

60. None of the evidence suggests that any of this sum was interest paid on borrowing by Mr Fraser.

61. (5) an expense other than interest of Mr. Fraser's business

25 62. There was no evidence that Mr. Fraser incurred any liability which was discharged by the alleged payment of £40,000 other than a liability to Mr. Costello as part of the joint venture partnership to repay capital or to remit to him profits of the partnership. But a liability of Mr Fraser to pay Mr Costello his share of the partnership profits is an appropriation of its profits and not an expense of Mr Fraser's business.

30 63. As a result we find there is insufficient evidence to conclude that, if this sum (or any other) was paid to Mr Costello or Mr Kavanagh, it was an expense of Mr. Fraser's business.

Conclusion

64. We conclude:

35 (1) the evidence before us did not satisfy us that it was more likely than not that Mr. Costello had contributed more than £65,000 to the venture;

- 5 (2) we were satisfied that it was more likely than not that payments of either £80,000 or £100,000 had been made in the year 2005/06, but we were unable to conclude that it was more likely than not that any more than £40,000 of that sum was paid in relation to Mr Costello's interest in the venture. We make no finding as to the purpose of any of the other payments;
- 10 (3) whilst we thought it likely that Mr Costello had had dealings with Mr Kavanagh as a result of which he owed Mr Kavanagh some money, we were unable to conclude that it was more likely than not that that transaction consisted of a loan to Mr Costello which he used to fund his interest in the venture;
- (4) if Mr Kavanagh had made such a loan we were not able to conclude that it was more likely than not that interest of £40,000 was due on the loan;
- 15 (5) it was likely that a partnership existed between Mr Costello and Mr Fraser for the development of Lansdowne House. The terms of the partnership changed over the relevant period: Mr Vincent dropped out, Mr Costello did not provide all the funds necessary for the development work, the profit share to which Mr Costello was entitled was probably recognised to be less than 50%;
- 20 (6) it was unlikely that the terms of that partnership were that the financing costs of a partner's contribution (other than the initial bank loan for the purchase) were to be borne by the partnership. Any interest payable by Mr Costello was therefore not deductible from the partnership's profits;
- (7) thus if interest became payable on a loan to Mr Costello from Mr Kavanagh, it was not deductible in determining the partnership's taxable profits whether or not it was deductible in determining Mr Costello's taxable income;
- 25 (8) it is likely that the partnership came to an end in 2005/06, and that there would have been some profit from the venture attributable to Mr Costello. There seems to have been an agreement that such profit would be accounted for to Mr Costello as part of the terms of separation when Kinson Road was transferred to Mr Costello. Such profit would properly be a deduction in computing Mr Fraser's taxable income since it would reduce his share of the profits of the Lansdowne House development which were shown as wholly attributable to him in his accounts. However, on the evidence before us it was not possible to determine the amount of Mr Costello's share;
- 30 (9) even if Mr. Fraser had paid £120,000 to, or at Mr. Costello's order during 2005/6, there was insufficient evidence for us to be able to conclude that on the balance of probabilities any part of the payment represented a profit share due to Mr. Costello;
- 35 (10) it was unlikely that any loan from Mr Kavanagh was a liability of Mr Fraser incurred for the purposes of any trade he carried on separately from the partnership;
- 40 (11) it seemed unlikely that any payment by Mr Fraser to Mr Kavanagh was otherwise incurred wholly or exclusively for the purpose of Mr Fraser's separate trade.

65. We therefore dismiss the appeal against the amendment to the appellant's self assessment for 2005/06.

The Penalty

5 66. We have dismissed the appellants appeal against the amendments to his self-assessment. Thus his self-assessment must be treated as having shown an incorrect amount of tax.

67. A penalty as exigible only if the taxpayer has fraudulently or negligently understated his income.

10 68. In our judgement Mr Fraser was negligent because the care a reasonable a person would have taken to produce and submit an accurate return was not taken. His accounts described the £40,000 as interest. It was not an interest cost of his own business. A reasonable person would not have claimed it was such without, at the least, some doubt. If there was some doubt about the proper treatment of the £40,000
15 a letter accompanying the return, or a disclosure in the box for additional comments, would have been a reasonable response. If it was a partnership share then Mr Fraser's return should have dealt with his profit share separately. If it was paid to keep Mr Kavanagh from interfering with the business it should reasonably have been so described. A reasonable person would have maintained records of what was received and paid to whom, when and why.

20 69. We see no grounds for any further reduction of the penalty. Mr Fraser and his accountants cooperated with HMRC but the error in his return was not blameless.

70. We dismiss the appeal against the penalty.

Rights of Appeal

25 71. 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
30 "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

CHARLES HELLIER
TRIBUNAL JUDGE

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RELEASE DATE: 30 April 2012