



TC02781

Appeal numbers: TC/2012/05750 & TC/2012/08304

INCOME TAX – loss relief – section 66 Income Tax Act 2007 – whether trade carried on with a view to the realisation of profits – no – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

STEPHEN KITCHING

Appellant

- and -

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

**TRIBUNAL: JUDGE JONATHAN CANNAN
MR TIMOTHY RATCLIFFE**

Sitting in public in Bradford on 1 May 2013

The Appellant appeared in person

Mrs Nadine Newham of HM Revenue & Customs appeared for the Respondents

DECISION

Background

5 1. Mr Kitching is a chartered accountant who until recently was employed full time as such. He is now employed part time. Since 1989 he has also owned and operated a business known as SMK Sports. The principal issue on this appeal is whether Mr Kitching is entitled to set off losses in that business against his employment income in tax years 2007-08, 2008-09 and 2009-10. The loss relief
10 which has been claimed arises, if at all, under *section 64 Income Tax Act 2007* (“*ITA 2007*”). The respondents contend that Mr Kitching is not entitled to loss relief.

2. The respondents opened an enquiry into Mr Kitching’s self assessment tax return for 2009-10. On the closure of that enquiry they amended the self assessment return so as to refuse loss relief. They also made discovery assessments for 2007-08
15 and 2008-09. The sums in dispute on these appeals are as follows:

Tax Year	Tax Assessed £
2007-08	2,637.14
2008-09	2,510.20
2009-10	2,548.20

3. A separate issue arises in relation to the discovery assessment for tax year 2007-08. Mr Kitching contends that the assessment for that tax year was made out of time.

20 4. We deal firstly with the timing issue for the 2007-08 assessment. We then consider the law in relation to Mr Kitching’s claim to loss relief, the facts which we find on the basis of the evidence before us, and finally we consider whether in the light of those findings of fact Mr Kitching is entitled to loss relief for the three years of assessment.

25 *The 2007-08 Assessment*

5. *Section 29(1) Taxes Management Act 1970* (“*TMA 1970*”) provides, subject to conditions in the following sub-paragraphs, that if an officer of the respondents discovers that a relief which has been given is excessive he may make an assessment to make good the loss of tax. Mr Kitching did not dispute that the conditions for
30 making a discovery assessment were satisfied.

6. *Section 30A TMA 1970* sets out the procedure for making assessments in these circumstances:

“(1) Except as otherwise provided, all assessments to tax which are not self-assessments shall be made by an officer of the Board.

...

5 (3) Notice of any such assessment shall be served on the person assessed and shall state the date on which it is issued and the time within which any appeal against the assessment may be made.

10 (4) After the notice of any such assessment has been served on the person assessed, the assessment shall not be altered except in accordance with the express provisions of the Taxes Acts.”

7. The relevant time limit within which the respondents had to make an assessment for 2007-08 is set out in section 34(1) TMA 1970 which provides as follows:

15 “Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case, an assessment to income tax or capital gains tax may be made at any time not more than 4 years after the end of the year of assessment to which it relates.”

8. It was common ground that the time limit for making an assessment in relation to tax year 2007-08 was 5 April 2012.

20 9. Mrs Newham, for the respondents, submitted that the time limit in section 34(1) applies to the making of the assessment rather than to the notification that an assessment has been made. She relied upon the decision of Peter Gibson J in *Honig v Sarsfied* [1985] STC 31. In that case the court was concerned with the predecessor of sections 30A and 34(1) which then appeared in section 29 TMA 1970 and used much the same language. In the Court of Appeal ([1986] STC 246) Fox LJ said this:

25 “It seems to me that the words in s 29(5) ‘notice of any assessment to tax’ necessarily imply that there is a difference between the notice and the assessment. One cannot have a notice of an assessment until there has been an actual and valid assessment. In sub-s (6) one finds the words ‘After the notice of an assessment has been served on the person assessed’. The reference there to
30 ‘the person assessed’ implies to my mind that there has been an assessment. It is clear that that subsection contemplates that an assessment is different from and will be followed by the notice of assessment and that its validity in no way depends on the latter. They are two wholly different things.

35 ... In my view the result of these provisions is that the court is not concerned here with the question of the date when the notices of assessment were served. The court is concerned with a totally different question, namely: when were the assessments made? The giving of notice has nothing to do with the making of a valid and effective assessment. The statute clearly distinguishes between the assessment and notice of it and contains no provision which makes the validity
40 of the assessment in any way conditional on the notice.”

10. Mr Kitching's argument on this aspect of the appeal runs as follows. The actual notice of assessment was dated 26 March 2012. However the envelope in which he received the notice together with a covering letter also dated 26 March 2012
5 was postmarked 13 April 2012. He invited us to accept that the assessment, the notice and the covering letter were all more likely to have been made and written on 11 or 12 April 2012 and posted on 13 April 2012.

11. The postmark on the envelope has the following narrative: "*Condition 9 Access mail Received out of course*". We have no material from which we can interpret that
10 narrative. Mrs Newham explained that when assessments are entered into the respondents' computerised systems the notice of assessment is automatically generated. The assessment also generates an entry on the taxpayer's self-assessment statement showing the date the assessment was created. In the case of Mr Kitching the statement shows the assessment for 2007-08 being created on 26 March 2012.

12. We did not have evidence as to the process whereby assessments are entered into the respondents' computerised systems. However we are satisfied from the documents referred to above that the assessment was entered into the computer system on 26 March 2012 and the process of entering the assessment generated the notice of assessment. This was the date the assessment was made. The special
15 commissioner in *Corbally-Stourton v Revenue & Customs Commissioners [2008] SpC 692* reached the same conclusion on the facts of that case.

13. In the circumstances therefore we find that the assessment for 2007-08 was made on 26 March 2012 and was therefore made in time.

Relief for Losses against General Income

14. *Section 64 ITA 2007* provides for a taxpayer to claim loss relief against general
25 income if the person:

“(a) carries on a trade in a tax year, and

(b) makes a loss in the trade in the tax year ...”

15. This section is to be read with section 66 which restricts the relief as follows:

“(1) Trade loss relief against general income for a loss made in a trade in a
30 tax year is not available unless the trade is commercial.

(2) The trade is commercial if it is carried on throughout the basis period for the tax year—

(a) on a commercial basis, and

35 (b) with a view to the realisation of profits of the trade.

(3) *If at any time a trade is carried on so as to afford a reasonable expectation of profit, it is treated as carried on at that time with a view to the realisation of profits.*

(4) ...

5 (5) *If there is a change in the basis period in the way in which the trade is carried on, the trade is treated as carried on throughout the basis period in the way in which it is carried on by the end of the basis period.”*

10 16. In *Wannell v Rothwell* [1996] STC 450 Robert Walker J as he then was considered the meaning of the term “commercial basis”. At 461 b-d he stated as follows:

15 *“...the best guide is to view “commercial” as the antithesis of “uncommercial”... A trade may be conducted in an uncommercial way either because the terms of trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable costs of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby art gallery or antique shop where the opening hours are unpredictable and depend simply on the owner’s convenience). The*
20 *distinction is between the serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante.”*

25 17. In that case the appellant was seeking to establish that he was entitled to loss relief under section 168(1) *Income and Corporation Taxes Act 1970* (“ICTA 1970”) and section 30(1) *Finance Act 1978* (“FA 1978”) in respect of a trade involving dealing in shares and commodity futures. The relevant provisions being considered were as follows:

ICTA 1970

30 *“168(1) Where any person sustains a loss in any trade, profession, employment or vocation carried on by him ... he may ... make a claim for relief from income tax on an amount of his income equal to the amount of the loss.”*

35 *“170(1) A loss ... shall not be available for relief under section 168 above unless it is shown that, for the year of assessment in which the loss is claimed to have been sustained, the trade was being carried on on a commercial basis and with a view to the realisation of profits in the trade ...”*

“170(5) For the purposes of this section, the fact that a trade was being carried on at any time so as to afford a reasonable expectation of profit shall be conclusive evidence that it was then being carried on with a view to the realisation of profits.”

FA 1978

“30(1) Where an individual carrying on a trade sustains a loss in the trade in—

(a) the year of assessment in which it is first carried on by him; or

5 (b) any of the next three years of assessment,

he may ... make a claim for relief under this section.”

“30(4) Relief shall not be given under this section in respect of a loss sustained in any period unless it is shown that the trade was carried on throughout that period on a commercial basis and in such a way that profits in the trade ... could
10 reasonably be expected to be realised in that period or within a reasonable time thereafter.”

18. We are not directly concerned on this appeal with section 30 FA 1978. Section 30 FA 1978 dealt with relief for opening year losses and section 170 ICTA 1970 dealt
15 with losses generally, including those of an established trade. At 457a Robert Walker J noted the “small difference” between the two sets of provisions as to the realising of profits. In particular section 30(4) FA 1978 refers to a reasonable expectation of profits in the period in which the loss is sustained or within a reasonable time thereafter. Section 170(1) ICTA 1970 simply refers to the trade being carried on with
20 a view to the realisation of profits.

19. The provisions in ICTA 1970 and FA 1978 were repeated in ICTA 1988 at sections 380, 381 and 384. Section 30 FA 1978 is now contained in sections 72 and 74 ITA 2007.

20. It seems clear that section 66(2) ITA 2007 and its predecessors set out two
25 conditions which must be satisfied if a trade is to be commercial.

21. The first condition is that the trade must be carried on on a commercial basis. In the present appeal the respondents accept that the first condition is satisfied. The second condition is that the trade must be carried on with a view to the realisation of profits. Whilst these amount to separate conditions it seems to us that the question of
30 profit is relevant to both conditions as appears from the judgment of Robert Walker J. In particular whether a trade is carried on on a commercial basis may depend in part on whether the trader is “seriously interested in profit”.

22. In a recent decision of the First-tier Tribunal it was held that use of the words “a reasonable expectation of profit” in section 66(3) imported an objective quality to the
35 test in section 66(2) (See *Charles Atkinson v Commissioners for HM Revenue & Customs [2013] UKFTT 191 (TC)*). In other words, it is not whether the taxpayer himself had an expectation of profit, but whether there was any reasonable expectation of profit. The FtT held that if there is no reasonable expectation of profit then the second condition is not satisfied.

23. In reaching that conclusion the FtT disapproved of a previous decision of a Special Commissioner in *Walls v Livesey* [1995] STC (SCD) 12. In that case the Special Commissioner was concerned with the provisions in ICTA 1988. He referred to section 384(1) ICTA 1988 (previously section 170(1) ICTA 1970) and section 5 381(4) ICTA 1988 (previously section 30(4) FA 1978). At [6] he stated as follows:

10 *“5. The issues in this appeal come to this, whether the taxpayer can satisfy, firstly, the words 'with a view to the realisation of profits' which appear in ... s 384(1) (so as to be entitled to obtain relief for losses under s 380); and, secondly, the words 'in such a way that profits in the trade ... could reasonably be expected to be realised in that period or within a reasonable time thereafter' (so as to be entitled to obtain relief for losses under s 381).*

15 *6. These two statutory expressions are not the same and in my opinion they provide two tests. The first is a subjective test and the second an objective test. So, whilst a taxpayer might well be found to be trading with a view of the realisation of profits, it could be found that he failed the objective test. However, in considering the latter test one has to bear in mind that the statute presupposes that losses could well be suffered for 20 of the trade and the economic circumstances it may be that losses could be suffered over a longer period but if so, one has to consider whether profits could reasonably be expected to be realised within a reasonable time afterwards having regard to the way in which the trade was carried on.”*

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24. The Special Commissioner in these paragraphs was referring to the separate tests concerning losses generally, including established businesses (which he described as a subjective test) and opening year losses (which he described as an objective test).

30 25. In *Charles Atkinson* the FtT quoted these paragraphs and said the following at [45]:

35 *“ This Tribunal is not convinced by the Special Commissioner’s reasoning that with a view to the realisation of profits and a reasonable expectation of profit comprised separate requirements. In the Tribunal’s view, the structure of section 66 suggests that the wording of a reasonable expectation of profit in section 66(3) is intended to be an amplification of the meaning of with a view to the realisation of profits and imports an objective quality to the profit element of the commercial test in section 66(2) of ITA 2007.”*

40 26. We do not consider that the analysis of the FtT in *Charles Atkinson* is correct. Section 170(1) and (5) ICTA 1970 are the predecessors to sections 66(2) and (3) ITA 2007. It is notable that section 170(5) refers to the evidence to establish that a trade is being carried on with a view to the realisation of profits. In particular, evidence of a

reasonable expectation of profit is conclusive on the point. However that does not suggest that other evidence might not also establish that a trade is being carried on with a view to the realisation of profits. In our view this indicates that the question of whether a trade is being carried on with a view to the realisation of profits is a subjective test, but that where there is a reasonable expectation of profit it is not necessary to look at the taxpayer's subjective expectations.

27. The provisions in section 66 ITA 2007 are similar, although they use slightly different language. Section 66(3) appears to us to be a deeming provision, rather than a definition as the FtT construed it in *Charles Atkinson*. If there is a reasonable expectation of profit then the trade is treated, or is deemed to be carried on with a view to the realisation of profit. If it is not established that there is a reasonable expectation of profit, it is still open to the taxpayer to establish that he did carry on the trade with a subjective view to the realisation of profit.

28. We agree with the analysis of the test by the Special Commissioner in *Walls v Livesey*. He was concerned with claims to loss relief generally under what is now section 64 ITA 2007 and also opening year losses under what is now section 72 ITA 2007. He found on the facts that the taxpayer had a subjective expectation of profits and that there was a reasonable expectation of profits within the first four years of trade and a reasonable time thereafter.

29. We are not aware of any previous consideration of the period to which the profits must relate for the purposes of section 66(2)(b) or its predecessors. Mrs Newham did not suggest that there must be a view to profits in the year in question. Indeed that would rob the provision of much of its utility in the case of an established business undergoing difficult trading conditions. We consider therefore that Parliament must have intended loss relief to be available where a trade is carried on with a view to the realisation of profits in the period in question or at any time thereafter. Unlike section 64 ITA 2007 relating to opening year losses there is no restriction on relief by reference to "a reasonable time thereafter".

30. The time within which profits might be realised is relevant in the present appeal because Mr Kitching says that he expected and expects to make a profit once he is in a position to devote more time to the business. In the meantime he is content for it to "tick over" albeit making losses as part of "an exit strategy" when he is able to leave or is made redundant from his current employment.

31. The question which arises in the present appeal concerns the position of a taxpayer who has an expectation of profit at some time in the future, perhaps well beyond the end of the basis period, but realises that in the meantime the business will incur losses.

32. It is clear that both the conditions set out in section 66(2) must be satisfied "throughout the basis period". Having said that, section 66(5) makes provision for circumstances where there is a change in the way a trade is carried on in the basis period. In those circumstances the trade is treated as being carried on in the way it was carried on at the end of the basis period.

33. It seems to us that it is the way in which the trade “is carried on” in the basis period that is relevant. In our view the focus is on whether the taxpayer has a genuine view to the realisation of profit with the trade being carried on in the particular way in which it is actually carried on in the basis period. Section 66(5) deals with changes in the way a trade is carried on during the basis period. The result is that a taxpayer is not permitted relief where it is anticipated that at some future date the way in which the business is carried on will or may change enabling profits to be generated in the future. The taxpayer cannot rely for the purposes of loss relief under section 64 on a change in the way a business is carried on after the end of the basis period. Still less where the change may or may not happen at an indeterminate time in the future.

Findings of Fact

34. We heard oral evidence from Mr Kitching and he was cross-examined by Mrs Newham. We also had documentary evidence provided by Mr Kitching and the respondents. Based on the evidence before us we make the following findings of fact.

35. Mr Kitching qualified as a chartered accountant in London in 1988. Since then he has worked as an accountant in a variety of businesses and accountancy practices. He also had a spell as a lecturer in accountancy at Bradford & Ilkley Community College. Until recently he worked full time for a firm of accountants in Keighley. Shortly before the hearing of this appeal he was offered a redundancy package. In the event, rather than accept redundancy terms he agreed to part-time working three days per week on Mondays, Tuesdays and Wednesdays. His remuneration until April 2013 was £35,700 per annum. He is now guaranteed employment until 28 February 2014 at 3/5ths of the full time equivalent of his salary.

36. Following qualification in 1988 Mr Kitching joined Matthew Hall Plc. In 1989 that company was taken over and he was made redundant. He then obtained employment in Bradford but at the same time he established a specialist sports shoe business known as SMK Sports. In addition to sports shoes, the business also sells running clothing, in particular running vests in club colours. Mr Kitching became voluntarily VAT registered in June 1989 in order to give the business more credibility with suppliers.

37. It was the experience of being made redundant in 1989 that led Mr Kitching to consider that he should not rely solely on employment but should have something to fall back on if and when the need arose. That was his prime motivation for setting up the business, together with his love of running. Mr Kitching has been a keen runner since he was 10 years of age.

38. The business has had a retail outlet in Cleckheaton, West Yorkshire since 1990. Originally Mr Kitching intended to enter the market as a mail order business. Part of the reason he took on retail premises was because the major suppliers would not supply to small mail order businesses. During the three tax years in question the business operated from and continues to operate from retail premises at 9 Westgate, Cleckheaton. It is open 6 days a week and Mr Kitching has 2 employees. Both are paid an hourly rate at the national minimum wage. The main customer base is club

runners. Mr Kitching markets the business using lettering on his car, leafleting local residents and athletic tracks, attending races and providing discounted vouchers to race organisers to be used as competition prizes. Mr Kitching has also developed a website

5 39. In or about 2001 Mr Kitching separated from his wife and was left to bring up
their two children. This resulted in a fall in turnover as Mr Kitching needed to devote
time to his children. He now has a new partner, Ms Toni Brown with whom he has
two young children aged 9 and 4. Mr Kitching told us and we accept that his intention
is and always has been to leave his accountancy employment to work full time in the
10 business. We do not need to set out any more detail about Mr Kitching's family
responsibilities, however he has always had to balance his family and financial
responsibilities. This has meant that until now it has made more sense for him to have
non-specialist staff in the business paid at the minimum wage whilst retaining his own
employment income. He has however continued to run the business and to work part
15 time in the evenings and at weekends. For example on Sundays Mr Kitching will
often take stock to running events in the West Yorkshire area.

40. The respondents have carried out 2 previous enquiries into Mr Kitching's self-
assessments for 1999-00 and 2003-04 respectively. These appear to have been aspect
enquiries looking in particular at cost of sales, wages and other expenses. No errors in
20 the returns or the accounting records were identified during these enquiries. It does
not appear that the respondents have previously questioned whether Mr Kitching was
properly entitled to loss relief against his general income.

41. In running the business Mr Kitching has taken a conscious decision to avoid
bank borrowings. Having said that in or about 2005 he obtained a small bank
25 overdraft facility in order to develop a website for online sales. Apart from this he has
funded the business from his own resources, in particular from his employment
income.

42. Mr Kitching has also recently developed the business through the use of a
concession at a dancewear retailer in Keighley and a further concession in a
30 warehouse in Elland. These were set up at or about the beginning of 2012. He
receives a commission of 17½ % of sales from the concessions and incurs no
overhead costs in relation that income.

43. The financial results of the business since 1995 are summarised in the Annex to
this decision. It can be seen that the business has made a loss in every year since
35 1995. Indeed whilst detailed figures were not available it was not disputed that the
business also made a loss in every year between 1989 and 1995. Mr Kitching has
claimed relief for those losses against his general income for each of the tax years up
to and including the three tax years relevant for present purposes.

44. Between 1995 and 2006 the net losses ranged between £4,342 in the year ended
40 30 April 1998 to £9,997 in the year ended 30 April 2004. Turnover peaked in the year
ended 30 April 2006 at £20,931 but there was a net loss in that year of £9,075.
Turnover fell significantly in the following years. The Annex shows the detailed

financial results of the business between 1 May 1995 and 30 April 2010 in so far as the figures were available in the evidence. By the year ended 30 April 2012 the turnover was just £7,754. In the course of the year just gone it seems to have picked up a little.

5 45. It is clear that the gross profit does not cover the employee costs in any of the years for which figures are available, let alone the other fixed overheads such as premises costs.

10 46. Mr Kitching maintains that we should not have regard to wages in considering the future profitability of the business from the stand point of 2006 to 2009. This is because it was always intended that in due course he would take over from the employees, Mrs Bolland and Ms Brown. Indeed Ms Brown is no longer employed in the business.

15 47. Mr Kitching maintains that he cannot predict when the business will make a profit because he cannot predict when the present economic climate will improve. He maintains that the concessions should each contribute £50 per week to the net profit. Within three years he expects to have six concessions. In a letter dated 31 March 2012 Mr Kitching made a “cautious projection” of a gross profit of £25,500 giving a net profit of £16,500 as follows:

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	Gross Profit £
Retail shop with promotion	5,000
6 Concessions	15,000
Developing the club kit market	1,500
Additional event visits	4,000

Total gross profit	25,500
Overheads at 2011 levels but without wages	9,000

Projected net profit	16,500 =====

25 48. Mr Kitching expected that the business would break even if it generated a turnover of £28,000. This was on the basis that there would be no wages when Mr Kitching was working full time in the business. We accept that at this level of turnover and without wages the business would be likely to break even.

49. Mr Kitching went on to say that a turnover of £28,000 was in his view achievable. He pointed to the fact that the business without his full time involvement

had a turnover of some £21,000 in the year ended 30 April 2006. To achieve break even he would only have to sell another three pairs of shoes per week.

50. We acknowledge that Mr Kitching genuinely believes that these projections are realistic. However the evidence before us does not satisfy us that a turnover of £28,000 is reasonably achievable. Nor are we satisfied that Mr Kitching's projected profit based on six concessions and other changes to the business is reasonably achievable. Put shortly, there is nothing to substantiate the figures.

51. During the 1990's Mr Kitching employed various people in the shop, generally with one employee at a time. He worked in the shop himself on Saturdays. In 2002 he employed Mrs Sheila Bolland. In that year he also employed Ms Toni Brown and later they lived together and had children. Both those employees have worked in the shop since 2002. In 2009 Mrs Bolland started reducing her hours. She is approximately 70 years of age and will soon retire. Ms Brown has obtained other employment and recently stopped working in the shop. This coincides with Mr Kitching having more time to devote to the shop having gone part time with his employers.

52. The position at the present time is that Ms Brown no longer works in the shop. Mrs Bolland has moved her hours to earlier in the week and works just 6 hours per week. Mr Kitching covers Thursdays, Fridays and Saturdays. He is also now more able to work in the evenings going to club nights and developing the business.

53. We are concerned in this appeal with the position in the basis periods for the three tax years in question. Those basis periods cover the period 1 May 2006 to 30 April 2009. Having said that the evidence of what has happened since the end of the basis periods is evidence to support Mr Kitching's views during the basis periods. We accept that the view of the future held by Mr Kitching in 2006 to 2009 is now to some extent coming to fruition.

54. Mr Kitching expects the business to improve given the withdrawal of competition from the market. In particular a large competitor called Sports Shoes Unlimited in Bradford closed their retail outlet in July 2012. Most runners will want to try shoes on before purchasing and this gives Mr Kitching an advantage over internet based retailers.

55. Mr Kitching is genuinely convinced that when he starts to work in the shop full time and has more time to develop the business then it will be profitable. His view has not changed since 2006. However there is insufficient evidence from which we can be satisfied on the balance of probabilities that Mr Kitching's expectations of profit are reasonable.

56. The reason Mr Kitching has persevered with the business is because it offers him an exit from his employment. He has held the view for a long time that he will eventually have to leave employment as an accountant. He has intended to keep the business running for the time when that day comes. Indeed it is something he has looked forward to as and when his financial and family responsibilities permit.

57. At various points in his evidence Mr Kitching said that from the point of view of an accountant the main factor in running a business is cashflow. If cashflow is positive then profits will follow. He eventually accepted that the business had in fact been a drain on his resources since being established in 1989. The only reason the business had a positive cashflow was because of the cash introductions he was able to make from his employment income.

58. Finally in this section of our decision we should record that during the course of his evidence Mr Kitching made certain criticisms of the way in which the respondents reached their decision to make the assessments and issue the closure notice for the years in dispute. We do not need to examine those criticisms because they are not relevant to the issues which we have to decide based on all the evidence before us.

Decision

59. On the basis of the respondent's concession we accept that Mr Kitching operates the business of SMK Sports on a commercial basis. The business has retail premises, recognised suppliers, a bank account in the name of the business with an overdraft facility and maintains proper books and records. We are not satisfied that Mr Kitching was "seriously interested in profit" during the three years in question. He must have known that the business could not make a profit at least until he was able to devote more time to the business. However it would not be right for us to go behind the agreed basis upon which both parties have presented this appeal, namely that the first condition is satisfied.

60. Section 66(2)(b) requires only that the trade is carried on with a view to the realisation of profits. There is no requirement that the business should be able to support the proprietor. It seems to us that the fact a business could not support the proprietor is relevant to the first condition in section 66(2)(a), namely whether the trade is run on a commercial basis. If the business could not support the proprietor it is unlikely that the proprietor would be "seriously interested in profit" in the words of Robert Walker J. However we are not concerned with the first condition in this appeal.

61. The principal issue which we must consider is whether the second condition in section 66(2)(b) is satisfied. Was the trade carried on in the basis periods for the three tax years in question with a view to the realisation of profits? In considering those three basis periods we are satisfied that the facts are such that they can each be considered together. Hence we consider the position in the period 2006 to 2009.

62. If Mr Kitching was not carrying on the business with a view to the realisation of profits then one might naturally ask why was he carrying on the business? The respondents have suggested in correspondence that Mr Kitching was motivated by his interest in sport, or alternatively providing something for his partner to do. The answer it seems to us is that in Mr Kitching's mind it offered an exit strategy from his job as an accountant. Whilst Mr Kitching has been a keen runner in the past, having heard his evidence we do not consider that the business was simply a hobby. Indeed

that would suggest it was not carried on on a commercial basis which is relevant to the first condition rather than the second.

5 63. We accept Mr Kitching's evidence that throughout the period from 2006 to 2009 the intention was for his partner to move out of the business once he was in a position to devote more time to it. We have formed the view and found as a fact that Mr Kitching has been prepared to stand the losses in the business because he considered that there would come a time when he would have to move out of accountancy. He also genuinely believed and still believes that when he is able to devote himself full-time to the business then it will make a profit. We are unable to share Mr Kitching's belief. We have not seen any business plan, detailed projections or other reliable evidence from which we can be satisfied that Mr Kitching is likely to be able to establish a profitable business.

15 64. Based on the evidence we do have, if the business was carried on in the same way as it was carried on in the three years in question the business would undoubtedly continue to make losses. Mr Kitching did not seek to suggest otherwise. His case is that when the business model changes from a business relying heavily on unskilled shop staff to one relying on his full time employment then it will make a profit.

20 65. The historical evidence shows losses since 1989. Whilst there may be particular reasons for losses in some of those years we consider that the trading history overall suggests that the business would never make a profit without some significant change to the way in which it is carried on. The evidence as a whole does not satisfy us that the business could make a profit without some significant change.

25 66. We have concluded in our analysis of the law that in applying the second condition we are concerned with whether Mr Kitching carried on the trade in 2006 to 2009 with a view to realising a profit. That is a subjective test, but we must focus on whether Mr Kitching expected to realise profits carrying on the business in the same way in which it was carried on at that time. We have found that he must have known that if the business was carried on without his full time involvement it could not make a profit. In the circumstances the second condition was not satisfied in 2006 to 2009.

30 67. In the light of our conclusions as to the nature of the test it is not necessary for us to consider whether Mr Kitching's expectation of profit was reasonable or not. If it had been necessary, for the reasons also given above we are not satisfied that Mr Kitching's view that the business would realise a profit was reasonable.

35 68. In conclusion we do not consider that in the basis periods for tax years 2007-08 to 2009-10 the requirements of section 66(2)(b) ITA 2007 were satisfied. In the circumstances Mr Kitching was not entitled to loss relief for the tax years in question and we must dismiss the appeal.

40 69. 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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**JONATHAN CANNAN
TRIBUNAL JUDGE**

RELEASE DATE: 9 July 2013

SMK Sports Accounts Summary

ANNEX 1

Year Ended

30 April	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Turnover	11,983	12,698	10,934	8,837	7,028	6,437	9,108	10,458	16,059	18,789	20,931	16,307	16,320	13,111	9,627
Gross Profit	2,755	12,698	10,934	8,837	7,028	6,437	9,108	10,458	4,818	5,638	6,279	4,892	5,059	4,194	3,081
Less:															
Wages	3,235								6,024	6,687	6,827	7,167	7,505	7,792	7,338
Premises Other Expenses	3,581								3,976	4,041	4,796	4,868	5,004	5,278	5,190
	3,958								4,815	4,763	3,731	4,630	4,461	3,866	4,057
Total Expenses	10,774	20,738	15,276	18,714	13,667	13,334	16,794	19,726	14,815	15,491	15,354	16,665	16,970	16,936	16,585
Net Loss	(8,019)	(8,040)	(4,342)	(9,877)	(6,639)	(6,897)	(7,686)	(9,268)	(9,997)	(9,853)	(9,075)	(11,773)	(11,911)	(12,742)	(13,504)