



TC03643

Appeal number: TC/2013/02198

Income Tax – amount of taxable property income.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

STEMBILE CHINYANGA

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE CHARLES HELLIER
MR ANTHONY HUGHES**

Sitting in public at 45 Bedford Square WC1B on 19 March 2014

Mrs Chinyanga in person

Mr Morgan for the Respondents

DECISION

5 1. Mrs Chinyanga appeals against assessments to income tax in relation to the years 2008/9, 2009/10, and 2010/11.

2. Technically the first of these was an assessment and the second and third were amendments to Mrs Chinyanga's self-assessment return. But what they are called makes no difference. In each case they required Mrs Chinyanga to pay additional tax.

10 3. The 2008/9 assessment required Mrs Chinyanga to pay £670 more tax, the 2009/10 amendment required Mrs Chinyanga to pay £1,955 more tax, and the 2010/11 amendment required her to pay £3345.60 more tax.

15 4. Each of these assessments had been made by including in the taxable income of Mrs Chinyanga amounts representing income from property which had not been declared on her tax returns until 2009/10 or which HMRC contended should have different from that shown on the returns. That property was 216 Montagu Road.

Mrs Chinyanga's Notice of Appeal

20 5. In her notice of appeal Mrs Chinyanga refers to the decisions made by HMRC in their letters of 18 and 19 July 2013 and 23 August 2013. These were the letters in which HMRC wrote to Mrs Chinyanga setting out their calculation of the taxable income Mrs Chinyanga derived from 216 Montagu Rd, and the additional tax that was payable as a result of including this as part of her taxable income for the years 2007/08 to 2010/11. HMRC's calculations showed a loss in 2007/08 so they did not seek any additional tax for that year (and in their calculations carried the loss forward to 2008/09 to reduce their calculation of taxable income from the property for that year).

30 6. In her notice of appeal Mrs Chinyanga says that she disputes the method of calculation which has been adopted by HMRC. She suggests in her grounds of appeal that the revenue officer involved may have acted improperly and made up the figures. She says "there is no proof supplied by Mr Henderson to support his tax charges ... he has used calculation methods not used by other officers ... Mr Henderson ... is not taking my concerns and appeal seriously ... and the income and expenditure figures he claims I received are unfair ... and wrong. ... my genuine concerns re bad debts are being undermined... the tax charges are imposed unfairly ..."

The nature of this appeal.

35 7. An appeal lies to this tribunal against an assessment to tax (see section 31 Taxes Management Act 1970). In relation to an appeal against the amount of an assessment our job is to determine what the amount of the tax should be by reference to the evidence before us.

8. In this process we have not been given by Parliament any power or duty to adjudicate on the behaviour of any person in relation to the computation of the amount which should be assessed in accordance with the provisions of the relevant Acts of Parliament.

5 9. In tax cases of this sort the taxpayer is the person who must provide the tribunal evidence which shows that her version is more likely than that put forward by HMRC. That is because it is the taxpayer who will have all the relevant information, and who should know more about her own affairs than HMRC. The taxpayer will have the relevant documents and will know who to ask to come to give evidence to
10 prove her case. In such a case it is not up to HMRC to prove anything; they put forward their view, and then the taxpayer has to provide evidence to us to show that HMRC's view is wrong and that her view is right.

10. If a taxpayer doesn't put forward enough evidence to prove her case, she loses. If a taxpayer puts forth evidence but HMRC puts forward better evidence the taxpayer
15 may still lose. The taxpayer has to convince this tribunal by evidence that it is more likely than not that her figures are right: the onus of proof is on the taxpayer. That is the burden Mrs Chinyanga had to discharge before us.

The evidence before us.

11. We had two bundles of papers. One of 353 pages which had been prepared by
20 HMRC and a further bundle of almost 600 pages prepared by Mrs Chinyanga. Much of the bundles were taken up with correspondence between the parties which contained very little relevant to the figures with which we were concerned.

12. We also heard the oral evidence of Mrs Chinyanga and that of Miss Kemp. Miss Kemp was a director of Professional Support & Development Ltd ("PSD") whose role
25 we describe later.

13. At the end of the oral hearing we made a direction that Mrs Chinyanga send to the tribunal copies of any documents in her possession which were relevant to or could explain the nature of payments of £238.25 recorded at page 174 of the bundle for the year 2010/11. Mrs Chinyanga sent the tribunal copies of mortgage statements
30 in response to this direction and we refer to them below.

Our Findings of fact

14. Mrs Chinyanga bought 216 Montagu Road at the end of 2007 with the aid of a mortgage from Birmingham Midshires. Following its acquisition, Mrs Chinyanga let the ground floor to PSD and, in 2008, obtained a tenant to whom she let the top floor
35 flat.

15. There was no dispute that from January 2008 Mrs Chinyanga had received rental from PSD for the ground floor, or that income had been received from a tenant of the upper floor from May 2008.

16. Mrs Chinyanga is the holder of the majority of the shares in PSD and is one of its directors. Miss Kemp is another director. The business in PSD is child care. Before the recession PSD had decided to expand its business and to move into the ground floor of 216 Montagu Road to use it as a nursery.

5 17. We understood that Birmingham Midshires had declined to lend to PSD for it to buy Montagu Road but had indicated that it would lend to an individual. Therefore Mrs Chinyanga bought the property with a loan from Birmingham Midshires and with the agreement of Birmingham Midshires let the ground floor to PSD.

10 18. On 4 January 2008 PSD entered into a simple written agreement with Mrs Chinyanga for the rental of the ground floor. The agreement specified no term for letting but provided:

(1) for yearly rent of £18,500 with monthly payments of £1,542 (we call this the "stipulated rent"); and

15 (2) that matters regarding rent arrears be discussed and negotiated between the parties.

19. As we note below the payments made by PSD were never equal to the stipulated rent either for any month or in aggregate for any year: they were more than the stipulated amounts in earlier years and less in later years. Even the payment PSD made in January 2008, the date of this document, was £2,186.86, not £1,542.

20 20. Sometime after this PSD ran into difficulties. There were problems with the council over the operation of the nursery at Montagu Road and the recession took hold and on those who used PSD's services and adversely affected its income.

25 21. There was a meeting between the directors of PSD and Mrs Chinyanga (acting in a personal capacity) in April 2009. There was a degree of informality in the way in which these matters were arranged, and when we say that Mrs Chinyanga was acting in a personal capacity we do not wish to give the impression that they were sitting on opposite sides of the table attended by separate advisers. This was a commercial arrangement for the running of a nursery without legalistic trappings.

30 22. At this meeting all the participants recognised that PSD would not be able to pay enough rent. Miss Kemp told us that it was decided that PSD would pay what it could afford. She told us that there was no agreement that PSD would make good at a later date any difference between what it could (and did) pay and what had been originally stipulated in the January 2008 agreement. She told us that if Mrs Chinyanga had later demanded the payment of the difference they would have been very upset.

35 23. We accept that evidence.

24. It was plain to us that when Miss Kemp said that they would be "very upset" if Mrs Chinyanga had tried to renege on what had been agreed, she meant that those present regarded PSD and Mrs Chinyanga as bound by this arrangement and each party would rely on it.

25. Mrs Chinyanga showed us spreadsheets (they were pages 123 to 128 and 174 to 177 in the bundle) which showed in cash flow terms how the monthly mortgage payments to Birmingham Midshires and the other expenses of Montagu Road had been financed, and what payments had been made by PSD and the upper floor tenant.

5 26. The figures for the income from the upper floor tenant were clear and undisputed. In 2007/08 nothing had been received because a tenant had not been found; in 2008/09 £8,800 had been received; in 2009/10 £7650 had been received; and in 2010/11 £10,200 had been received.

27. The receipts from PSD were less simple.

10 28. The schedule showed that PSD had paid Mrs Chinyanga sufficient in each month to ensure that the aggregate of its payment and that from the top floor tenant were precisely equal to the sum of the mortgage payment and the other recorded expenses on the property for that month. (In later periods after the April 2009 meeting it appears that because PSD could not pay enough the payments made to the building society were reduced. That led to certain extra charges by the building society.) In
15 other words each month PSD paid that amount which ensured that in cash terms Mrs Chinyanga broke even. Because of the levels of the upper floor rent, the payments to the building society and the expenses, this meant that:

20 (1) in 2007/08 PSD paid £7,074.98, being £2,449.98 more than the stipulated rent referable to that period of occupation. This was because no tenant had been found for the upper floor and no rent from the upper floor had been received so that all the payments out had to be met by payments from PSD;

(2) in 2008/09 PSD paid £15,130.51 being £3,369.49 less than the stipulated rent;

25 (3) in 2009/10 PSD paid £17,249.20 being £1,250.70 less than the stipulated rent; and

(4) in 2010/11 PSD paid £11,326.88 being £7,173.12 less than the stipulated rent.

30 29. The way in which additional monies were paid by PSD in 2007/08 and then lesser amounts in 2008/9 and later years is indicative of an arrangement between PSD and Mrs Chinyanga which did not involve payment of the amounts which appeared to have been agreed in the document of 9 January 2008. Indeed the amounts paid immediately following the signing of that agreement indicated that the written agreement was not intended to govern the relationship between parties in this regard.

35 30. These facts give rise to the first question we need to address. That is what amount for tax purposes should be taken as the amount of gross rental income from the ground floor of Montagu Road. We address that in [42] below.

The mortgage payments

31. Each mortgage payment to Birmingham Midshires was intended to include an amount of interest and an amount repaying the capital borrowed. Certificates from Birmingham Midshires in the bundle before us showed that:

- (1) in 2007/08 interest of £3,902.63 was paid;
- 5 (2) in 2008/9 interest of £11,660 was paid and £8,355.60 of capital was repaid;
- (3) in 2009/10 interest of £11,173 was paid and £7,533.81 of capital repaid; and
- 10 (4) in 2010/11, interest of £8,267 was paid and £8,642.83 of capital was repaid.

32. (These sums did not precisely match the figures for mortgage payments in the spreadsheets referred to above. However allowing for the effects of timing they were broadly supportive of the accuracy of the schedules.)

PSD loan deduction

- 15 33. We record that HMRC accepted that £275 and £300 paid by Mrs Chinyanga in 2009/10 and 2010/11 respectively on another loan was also deductible. Mrs Chinyanga raised no issue before us in relation to HMRC's calculation of these amounts.

The Expenses.

- 20 34. Mr Morgan accepted that expenses shown in Mrs Chinyanga's schedules for 2007/08, 2008/09 and 2009/10 were deductible. There is no need therefore for us to make any findings other than that they were respectively: £2,071, £3,916 and £5,201.

- 25 35. But Mr Morgan did challenge the deductibility of one line of the expenses shown in Mrs Chinyanga's schedule for 2010/11. He did so because he said the expenses of £6,262.98 shown for that tax year included a figure for "Mortgage Charges" of £2,859.05 (being £238.25 per month for 12 months) and he maintained that this was not deductible in computing Mrs Chinyanga's taxable income. Thus he said that the deductible expenses were only £3,403.93.

- 30 36. It was therefore necessary for us to determine the nature of the payments; that depended on whether Mrs Chinyanga could produce evidence of the payments and their nature which showed that they had been made and were of a tax deductible nature. We therefore made the direction referred to in paragraph [13] above.

- 35 37. On 26 March 2014 Mrs Chinyanga sent the tribunal copies of mortgage statements for 2010 and 2011. These showed that in the period 6 April 2000 to 5 April 2011 six arrears fees of £35, and one of £47, and solicitors costs of £80.75 (a total of £337.75) together with late payment interest of £37.82 had been debited to Mrs Chinyanga in the Birmingham Midshires mortgage account.

The relevant legislation.

38. The calculation of the amount of income from property which on which a person is taxable is governed by the provisions of sections 260 to 364 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA").

5 39. Section 270 of that Act provides that tax is to be charged on the "full amount of the profits arising in the tax year" from the property business, and section 272 provides that certain sections of ITTOIA which are also applicable to the calculation of trading profits shall also apply for the purposes of calculating the profits from property. Included among those provisions are the following:

10 (1) section 25 which provides that profits are to be calculated in accordance with generally accepted accounting principles subject only to adjustments required by law;

(2) section 33 which provides that "no deduction is allowed for items of a capital nature";

15 (3) section 34 which provides that "no deduction is allowed for expenses not incurred wholly and exclusively for the purposes of the trade or losses not connected with or arising out of the trade."

(4) Section 35 which provides that "no deduction is allowed for a debt owed to a person carrying on the trade except so far as

(a) the debt is bad,

20 (b) the debt is estimated to be bad, or

(c) the debt is released wholly and exclusively for the purposes of trade as part of a statutory insolvency arrangement."; and

(5) section 58 which expressly allows the costs of obtaining finance, providing security for it, and repaying it.

25 40. It is in accordance with these rules that we must determine the amount of Mrs Chinyanga's taxable profit from her property in the relevant years.

Mr Morgan's submissions.

41. Mr Morgan argued that:

30 (1) in computing Mrs Chinyanga's income from the property for tax purposes the full amount of the rent specified as payable by PSD for each tax year should be taken into account;

(2) if PSD did not pay the rent that was due then it remained due and was an amount which should be taken into account in determining the profit unless the expense of writing off the unpaid debt could be deducted;

35 (3) as a result of section 35 any debt due and unpaid could be deducted in determining the profit only if it was bad or estimated to be bad, and it had not been shown that due but unpaid rental from PSD was a bad debt:

5 (4) and, as a result of section 34, the expense of writing off any debt due from PSD was deductible only if it was an expense incurred wholly and exclusively for the purposes of Mrs Chinyanga's property business and was connected with the business. But this was not the case: for any write-off had been for the purposes of propping up PSD's business not for Mrs Chinyanga's business. He cited *Sere Property v HMRC* 2013 UK FTT 006 (TC) as authority for this proposition;

10 (5) of the amount payable to Birmingham Midshires only the interest portion was deductible. That part of each payment representing the repayment of capital was not deductible because of the provisions of section 33 which prohibited the deduction of anything of a capital nature; and

(6) no deduction should be allowed for the mortgage charges because it had not been proved that they were paid wholly and exclusively for the business of earning income from the property.

15 **Discussion.**

(1) *The amount of the gross rents which should be brought into account in determining Mrs Chinyanga's taxable income.*

20 42. The application of generally accepted accounting principles requires the amount of gross rent which is taken into account to be the amount which accrues for the year. This means for example that if a tenancy started on 6 April and rent was payable in arrears at the end of every month then the amount to be taken into account for the year would be 12 months rent, not the amount actually received.

25 43. If the only evidence before us had been the January 2008 document then we would have found that under that agreement PSD acquired a yearly tenancy of the ground floor under which it became liable to pay a rent of £1,542 per month. As a result we would have held that the gross rent accruing for each year would have been at the rate of £18,500 per annum (so that only about 3 months' worth would have accrued in 2007/08 but the full £18,500 in other years).

30 44. However the facts (i) that this was part of an arrangement whose purpose was to obtain the use of Montagu Road for PSD and which was constructed in this manner because of the requirement of the building society that the borrower be an individual rather than a company, (ii) that, as a result the payments PSD made effectively replicated what is would have paid out had it purchased Montagu Road, and in particular (iii) that payments £1,542 per month were never made, indicated to us that
35 the agreement between the parties was not reflected by the written document. In our judgement the real agreement between the parties was that PSD would pay such amount as would ensure that in cash terms Mrs Chinyanga would break even each month, (and after April 2009 even this agreement was varied to limit the amount which PSD would pay to what it could manage) . Thus we find the amount accruing
40 and due for each relevant period's occupation was the amount actually received in that period.

45. On page 30 of a letter of 3 September 2013 to HMRC Mrs Chanyaga says:
"You already have my explanation about my buy to let mortgage and bad debt as
shown in my letters as discussed above. I can only repeat that, in order to keep to the
conditions of my mortgage buy to let agreement, it is important that PSD's rental
5 shortfall was written off in order for the company to stay solvent. That way, there is a
guaranteed tenant to keep paying rent so that on a monthly basis in order to keep up
with my buy to let property. Otherwise, if PSD ceases its tenancy, then this will have
an adverse effect as I will not be able to have income to pay off the mortgage. It is
10 better to have a tenant that is occupying the property and paying something rather
than running with no tenant at all." It seems to us that this supports our analysis.

46. Therefore we find that:

- (1) in 2007/08 the proper amount to be taken into account was not the stipulated rent of £4,625 but the total amount received, namely £7,074.78.
- (2) In 2008/09 the amount to be taken into account as accrued gross rental
15 income was the rent actually received in the period of namely £15,130.51
- (3) In 2009/10 the amount to be treated as accruing for that year was the amount paid in that year of £17,249.20; and
- (4) in 2010/11 de rent treated to be treated as accruing for that year was the amount paid in that year of £11,326.78.

20 (2) *Bad debts.*

47. On the basis of our finding that the rent due was the amount received, no bad debt arose. There is on this basis no issue about the deduction of such an expense.

(3) *Monies paid to Birmingham Midshires.*

48. The elements of the payments made to Birmingham Midshires which were
25 repayments of capital are not deductible. They were clearly "of a capital nature", and, as a result, their deduction is prohibited by section 33. The only amounts which are deductible are the amounts of interest set out in paragraph [31] above.

(4) *Other expenses.*

49. The only issue which arises under this heading for decision are the "Mortgage
30 Charges" of £238.25 per month in 2010/11 - a total of £2,859.

50. The additional evidence provided by Mrs Chinyanga indicated that £375.57 (£337.75 + £37.82) of this related to charges for late payments to Birmingham Midshires.

51. We regard the £375.57 as paid wholly and exclusively for the purposes of Mrs
35 Chinyanga's property business. The sums were paid under the loan agreement with Birmingham Midshires which was made for the purposes of the business. They were triggered by the failure of that business to generate the funds to make payment on time.

52. So far as the balance (£2,483.43) is concerned there was no evidence of the nature of the payments. As a result we cannot say that it was proved to us that such expense was incurred or that it was incurred wholly and exclusively for the purposes of the property business. The balance must therefore be treated as not allowable. That means that the allowable claimed expenses £6,262.90 must be reduced by £2,483.43 to £3,779.47.

(5) *The result.*

53. As a result we find that Mrs Chinyanga's taxable property income in each year, and her consequent tax liability for 2008/09 to 2010/11 is to be calculated as follows:

	2007/08	2008/09	2009/10	2010/11
Gross income accrued from:				
-PSD	7,074	15,130	17,249	11,326
-Upper floor	Nil	8,800	7,650	10,200
Allowable expenses:				
Interest	(3,902)	(11,660)	(11,173) (275)	(8,267) (300)
Other	(2,701)	(3,916)	(5,201)	(3,780)
Net taxable property income	471	8,354	8,250	9,178
Employment income		22,000	22,000	23,400
Personal allowance		(6,035)	(6,475)	(6,475)
Taxable		24,319	23,775	26,103
Tax at 20%		4,863.80	4,755.00	5,220.60
Less PAYE deducted		(3,356)	(3,192)	(3,372)
Tax due		1,507.80	1,563.00	1,848.60

The figures for employment income, personal allowances and PAYE deducted in the assessments under appeal were not contested; they have therefore been used in the table above.

5 **Conclusion**

54. Mrs Chinyanga's tax liability for 2008/09, 2009/10 and 2010/11 is thus determined as shown above.

55. We understand that Mrs Chinyanga may have already paid some tax in respect of some of these years. Depending on how much she has paid she will be liable to pay more or be entitled to a refund depending on how much she paid. That question is outside our jurisdiction.

56. In the calculations above we have shown some figures for 2007/08. No assessment was made for those years. It may be that, following the release of this decision HMRC make an assessment under section 29 Taxes Management Act 1970 in respect of that year. This decision does not provide adjudication for that year.

Rights of Appeal

57. 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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**CHARLES HELLIER
TRIBUNAL JUDGE**

RELEASE DATE: 28 May 2014

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