TC03813

Appeal number TC/2012/06071

***INCOME TAX** - enquiry and discovery assessments - appellant subjected to a fraud – profit/interest credited to appellant by the fraudster through post - dated cheques amounted to interest and taxable where the cheques were not rolled over – appellant acted carelessly – discovery assessment valid – case allowed in part.*

FIRST-TIER TRIBUNAL
TAX CHAMBER

ROBERT RUSLING **Appellant**

- and -

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

TRIBUNAL: JUDGE DAVID S PORTER
MS ANN CHRISTIAN

Sitting in public at Alexandra House, Manchester on 11 March 2014

Mr Keith Gordon, of Counsel, for the Appellant

Mr Brendan Hone, an Inspector of taxes, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents.

DECISION

1. Mr Keith Gordon, (Mr Gordon) was instructed by Knowles Warwick Limited who appealed on behalf of the Appellant Mr Robert Rusling (Mr Rusling) against assessments raised by the Respondents (HMRC) for the years 2005/6 in the sum of £13,000, 2006/7 in the sum of £43,000 and the year 2007/8 in the sum of £49,600 being income earned on advances made to D Ltd J Litt (Firearms) Ltd (D J Litt), a fraudster, and interest of £9,912, arising from National Savings & Investments, in those periods. Mr Steven Knowles, of Knowles Warwick Limited, submitted that the case of *John Mazurkiewicz v HMRC* [2011] UKFTT 807 (TC) (*Mazurkiewicz*) related to the same facts and the Tribunal had decided that the payments did not amount to interest and no tax was due. As a result the appeal should be allowed. HMRC say that the facts in *Mazurkiewicz* case were different from those in Mr Rusling's circumstances as he had received cleared funds. He had acted carelessly in not disclosing the same to HMRC and its enquiry and discovery had been properly made.

2. Mr Brendan Hone (Mr Hone), an Inspector, appeared on behalf of HMRC and called Mr Peter A Moss (Mr Moss), a Higher Officer in Local Compliance SME interventions, and Mrs Beverley A Davies (Mrs Davies), a compliance officer. When giving evidence, Mr Moss affirmed and Mrs Davies gave her evidence under oath. Mr Hone produced a bundle of documents for the Tribunal including details of the law and a list of cases, together with a statement of facts and a skeleton argument. Mr Keith Gordon (Mr Gordon), appeared for Mr Rusling and called Mr Rusling, who gave evidence under oath. Mr Gordon also produced a list of cases, a statement of facts and a skeleton argument for the Tribunal.

Preliminary issue

3. Mr Gordon told us that there had been an earlier direction in which Judge Demack had refused the hearing of the appeal in private. In spite of that, Mr Gordon asked that the decision might be anonymised. Mr Rusling was concerned that he had been very foolish and he did not want the case to be seen by his competitors. Furthermore, he had been less than honest with his wife as he had made an additional payment of £40,000 of which she was unaware.

4. Mr Gordon referred us to Rule 32 of the Tribunal procedure (First-tier Tribunal (Tax Chamber) Rules 2009 which provides as follows:

> "(1) Subject to the following paragraphs, all hearings must be held in public.
>
> (2) The Tribunal may give a direction that a hearing, or part of it, is to be held in private if the Tribunal considers that the restricting of access to the hearing is justified-
>
> (a) in the interest of public order or national security;
>
> (b) in order to protect a person's right to respect for their private and family life;

(c) In order to maintain the confidentiality of sensitive information;

(d) in order to avoid serious harm to the public interest; or

(e) because not to do so would prejudice the interests of justice.

Mr Gordon referred to sub-paragraph (b) and argued that although the case need not be held in private in the light of that sub-section it would not be unreasonable to anonymise the decision. Mr Hone considered that there was nothing exceptional about the case and it would be wrong to create a precedent for other cases of a like nature.

5. We considered the application and refused to anonymise the decision. We referred the parties to the recent decision by Judge Bishopp in *Christopher David Moyles v The Commissioners for Her Majesty's Revenue and Customs* TC02217 where he considered the matter in some detail. He stated at paragraph 12:

12 (when considering whether the appeal should be held in private)

".. .. In essence, HMRC's position is that the threshold a taxpayer must surmount in order to secure a private hearing is a high one, and the embarrassment Mr Moyles may suffer, however acute it might be, is not enough."

Paragraph 13. "In my judgment the presumption of a public hearing is nowadays stronger than it might have been perceived even a few years ago. The modern view in relation to tax appeals was, I think, well put by Henderson J in *Revenue and Customs Commissioners v Banerjee* (No2) [2009] STC 1930:

"[34] …In my opinion any taxpayer has a reasonable expectation of privacy in relation to his or her financial and fiscal affairs, and it is important that this principle should not be whittled away. However, the principle of public justice is a very potent one, for reasons which are too obvious to need recitation, and in my judgement it will only be in truly exceptional circumstances that a taxpayer's rights to privacy and confidentiality could properly prevail in the balancing exercise that the court has to perform.

[35]… These considerations serve to reinforce the point that in tax cases the public interest generally requires the precise facts relevant to the decision to be a matter of public record, and not to be more or less heavily veiled by a process of redaction or anonymisation. The inevitable degree of intrusion into a taxpayer's privacy which this involves, is in all normal circumstances, the price which has to be paid for the resolution of tax disputes through a system of open justice rather than by administrative fiat."

Paragraph 15. There is in my view no good reason for a private hearing in this case, nor any basis on which I might properly direct an anonymised or redacted decision.

Mr Moyles is well known to the general public where one could have thought there might be some merit in his request. Mr Rusling's position comes nowhere near to the facts in Mr Moyles case and we have no hesitation in refusing to anonymise the decision.

The Law

6. Income tax is charged on interest under Chapter 2, Part 4, Section 369 of Income Tax (Trading and other Income) Act 2005 (ITTOIA).

Section 370 provides:

(1) Tax is charged under this Chapter on the full amount of the interest arising in the tax year

Section 371 provides:

The person liable for any tax charged under this Chapter is the person receiving or entitled to the interest.

In relation to the discovery provisions under the Taxes Management Act 1970;

29 (1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment –

(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or

(b) that any assessment to tax is or has become insufficient, or

(c) that any relief which has been given is or has become excessive,

the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

29 (3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under section (1) above –

(a) in respect of the year of assessment mentioned in that subsection; and

(b) …in the same capacity as that in which he made and delivered the return,

unless one of the two conditions mentioned below is fulfilled.

(4) The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.

(5) The second condition is that at the time when the officer of the Board-

a. ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or

b. informed the taxpayer that he had completed his enquiry into the return,

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.

(6) For the purposes of subsection (5) above, information is made available to an officer of the Board if-

(a) it is contained in the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment (the return), or in any accounts, statements or documents accompanying the return;

(b) it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or in any accounts, statements or documents accompanying any such claim;

(c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer to the officer or…;

(d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above –

(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or

(ii) are notified in writing by the taxpayer to an officer of the Board.

(7) In respect of subsection (6) above-

(a) Any reference to a taxpayer's return under section 8 and section 8A of this Act in respect of the relevant year of assessment includes-

(i) a reference to any return of his under that section for either of the two immediately preceding years of assessment; and

(ii)….

(b) ……..

[Note: "careless and deliberate "in subsection 29 (4) are contained in the Finance Act 2008 and come into force on 1 April 2010.

The cases referred

7. We have been referred to a substantial number of cases as under:

John Mazurkiewicz v HMRC [2011] UKFTT 807 (TC).

Cases dealing with the meaning of 'interest'

Schulze v Bested (Surveyor of Taxes) [1919] SC 188.

Lomax (H M Inspector of Taxes) v Peter Dixon & Sons Ltd [1943] 1KB 671.

Ridge Securities Ltd v Inland Revenue Commissioners [1964] 1 WLR 479.

Re Euro Hotel (Belgravia) Ltd [1975] STC 682.

Cairns v MacDiarmid (H M Inspector of Taxes) [1982] STC 226 (HC).

Cairns v MacDiarmid (H M Inspector of Taxes) [1983] STC 178 (CA).

St Usines and Estates Co Ltd v Colonial Treasurer of St Lucia [1924] A C 508.

Dewar v Commissioners of Inland Revenue [1935] 2KB 351.

Whitworth Park Coal Co v Inland Revenue Commissioners [1961] AC 31.

Dunmore v McGowan (Inspector of Taxes) [1978] 1 WLR 617.

Parkside Leasing Ltd v Smith (Inspector of Taxes) [1985] 1 WLR 310.

Girvan (Inspector of Taxes) v Orange Personal Communications Services Ltd [1998] STC 567.

Halpin v Revenue and Customs Commissioners [2011] UKFTT 512.

Chevron Petroleum [UK] Ltd & others v BP Petroleum Development Ltd & others Ltd [1981] STC 689:57 TC 137.

Coxon v Revenue and Customs Commissioners [2013] UKFTT 112 (TC).

Glasgow Corporation v Muir [1943] AC 448 at 457.

Cenlon Finance v Ellwood [1962] 1 AC 782.

Siri Limited [2011] UKFTT 794 (TC).

Southern (HMIT) v A B Ltd (18 TC 59).

Bennett v Ogston (15 TC 374).

Mann v Nash (16 TC 523).

McGuckian v CIR (69 TC 1).

F.A.Lindsay and others v The Commissioners of Inland Revenue (1932) 18 TC 43

Cases dealing with interpretation of Tax Statutes

Aberdeen Asset Management plc v HMRC [2014] SLT 54, [2013] CS1H 84.

Barclays Mercantile Business Finance Limited. V Mawson (2004) STC 1:

Cases dealing with discovery point.

G C Trading v HMRC [2007] SpC 630.

Corbally – Stourton v HMRC [2008] STC (SCD) 907.

Lee v HMRC [2008] SpC 7125.

Trustees of Bessie Taube Discretionary Trust v HMRC [2010] UKFTT 473 (TC).

HMRC v Charlton [2013] STC 866.

Hancock v Inland Revenue Commissioners [1999] STC (SCD) 287

Langham (Inspector of Taxes) v Veltema [2004] STC 544 (CA).

HMRC v Household Estate Agents [2007] EWHC 1684 (Ch).

A N Anderson (Deceased) v HMRC [2009] UKFTT 258 TC.

Colin Moore v HMRC [2011] UKUT 239 (TCC).

Employee v HMRC [2008] STC (SCD) 688.

The Facts

8. Mr Robert Rusling (Mr Rusling) is a substantial businessman, who, with his wife, runs a building company Ackroyd & Abbott Limited, and they also have a portfolio of properties. Mr and Mrs Rusling had personal funds, which he and his wife had taken years to build up from their directorships in their building company. We note from the details of the joint account with the Halifax that substantial sums of money have passed through that account. Mr Rusling is also in receipt of an annual income

considerably in excess of £100,000. As a result Mr and Mrs Rusling appear to have a substantial amount of spare funds to use for investment purposes. One of Mr Rusling's hobbies is shooting and he told us that he was introduced to Mr Litt by a mutual friend, although he confirmed that he had never met Mr Litt.

9. Mr Litt, a director of D J Litt initially contacted him by phone with a view to selling him specific items, which Mr Rusling purchased privately. After a while Mr Litt proposed a business deal suggesting that they should jointly buy equipment and clothing in bulk. Mr Litt would then sell the equipment and clothing in bulk and make a good profit. There is in the bundle (Tab 6 page 4) an example of items, which were to be purchased, headed Beretta offer 10.10.07. The list identifies various guns and other items showing a total price of £597,080 with a discount of £132,080.

10. Mr Litt told Mr Rusling that his bank would no longer lend the company sufficient funds and that he was looking for someone to put up part of the money to buy the stock. Mr Rusling was never asked to put up all the money as Mr Litt appeared to be able to meet some of the costs himself. Mr Rusling believed that he was the only person helping Mr Litt financially. Mr Rusling was always provided with a list of the items to be purchased before he advanced any funds. Mr Litt provided post-dated cheques. By way of example the sequence for the first loan was as follows:

Date	Loan	Post-dated cheques		Rolled-over
11/5/ 2005	£60,000	01/12/2005	£11,000	
		08/12/2005	£11,000	
		15/12/2005	£11,000	
		22/12/2005	£11,000	
		29/12/2005	£11,000	
		Total	£55,000	
3/1/2006	£60,000			
		6/1/2006	£11,000	Rolled-over
		20/1/2006	£11,000	Rolled –over
		27/1/2006	£11,000	

From the details provided by Mr Rusling, further cheques were rolled –over during the period amounting to £66,000. The debt at the beginning of the period 2005/6 was (-£69,000). (The details are contained in the bundle at Tab 2 pages 33A and 48A.). HMRC have confirmed that they have not taken into account any of the rolled-over

amounts on the basis that they did not represent cash to which we have referred later in this decision.

11. All these cheques were paid into Mr and Mrs Rusling's joint account with the Halifax and were cleared. (Mr Gordon has submitted that the bank statements are not in evidence, as they were unilaterally inserted in the Tribunal's bundles and he had no idea which pages Mr Hone, on behalf of HMRC, were being referred to. As he does, however, accept that that Mr and Mrs Rusling did receive the payments we have let the evidence in). Before, however, the intended profit/interest was to be paid, Mr Litt approached Mr Rusling again with a further proposal and Mr Rusling lent £69,000 to Mr Litt on 3 January 2006. In return Mr Litt issued a post-dated cheque for £11,000 on 20/1//2006 which brought the post-dated cheques to £66,000. The additional £6,000 representing Mr Rusling's return on his first investment of £60,000. Mr Rusling told us that he thought the return on his investment would have been 10%. In fact that return was only for 7 months and annualised amounted to 17.14%. We are satisfied that Mr Rusling did not consider the annualised amount and merely considered his return to be 10%. The 10% interest was contained in the sixth payment on 20/1/2006 and was rolled-over.

12. Mr Rusling dealt with Mr Litt on the above basis until 16 December 2007 as D J Litt went into liquidation in May 2008. Mr Litt, who told Mr Rusling that he was an accountant, had advised that there was no need to declare any income from the transactions until the loans were repaid in full. Mr Rusling's wife kept a record of the investments they were making but became concerned and advised her husband that they should stop. Mr Rusling has produced a statement showing the payments made, cheques received and cheques rolled-over to which we refer in paragraph 10. In spite of his wife's request, and as evidenced by the request at the commencement of this appeal, Mr Rusling made a further investment of £40,000 on 9 October 2007 from his personal account.

13. Mrs Beverley Davies (Mrs Davies) gave evidence under oath. As part of her duties she attended a meeting of creditors arranged by Deloitte & Touche LLP (the Administrators). Their report dated 25 June 2008 showed that D J Litt owed £38,000,000 as at 8 May 2008. The report stated that 57 investors had been identified through discussions with Mr Litt. It also showed that Mr Rusling was owed £130,430. We have decided that the amount identified as owed to Mr Rusling represented the investment made by him and his wife, other than the personal payment he made without her knowledge.

14. Mr Rusling indicated at the hearing that that was an estimate and he was owed much less about £60,000. He had never told his accountants, Messrs Knowles Warwick of Sheffield, about his investments because he never appeared to make any money as everything he had made had been re-invested. Nor had he notified HMRC in his tax return for the same reason. The repayments from Mr Litt slowed down in April/May of 2006. As a result M Rusling transferred smaller amounts back into Mr Litt's account. At that point Mr Litt started to make regular payments to Mr Rusling, which were cleared, so that Mr Rusling felt he could make larger transfers as the stock

was obviously selling again. He paid a further £45,000 on 26 September 2006 and £51,000 on 15 November 2006.

15. Mrs Davies was a member of the Creditor's Committee on behalf of HMRC. As a consequence she has been in contact with several HMRC officers including Mr Moss in relation to his enquiry into Mr Rusling's tax affairs. She also gave evidence in the *Mazukiewicz* case.

16. Following the successful prosecution of Mr Litt, who was sentenced to 32 months in prison, the following extract appeared in a SFO Press Release dated 9 December 2011

> " … Mr Litt, a certified accountant and former director of D J Litt (Firearms) Limited admitted to knowingly carrying on the business with the intent to defraud creditors…..Between January 2004 and May 2008 Mr Litt was in serious financial difficulty in relation to his business and as a result he needed to raise additional finance. In order to do this he persuaded a large number of investors to 'loan' him monies on the basis that it would be returned with interest within a relatively short period of time, usually between 2 and 6 months. The rates of interest, between 10% and 40%, were considerably higher than normal commercial rates. Mr Litt told investors that their investment monies would be used to buy high quality firearms which would be sold on for a high profit. The profit would then, effectively, be split between the company and the investor. In fact the monies loaned were used to repay earlier investors - in effect a 'Ponzi' scheme.
>
> In pleading guilty Mr Litt admitted that between 1 January 2007 and 8 May 2008 he dishonestly accepted loans and investment monies from clients knowing that he would be unable to repay them…. Mr Litt also admitted falsifying cash books and end of year accounts, falsifying company documents relating to the affairs of the company in order to induce investment and cross-filing of bank cheques.
>
> Mr Litt had hoped that he would have been able to secure a sale of the company to an American business."

17. In their report of 28 June 2008, Deloitte dealing with the director's reasons for the difficulties, stated:

> "By the end of December 2005, Mr Litt considered that the lending was getting out of hand and could not see how he could trade his way out of the position he was in and repay the investors. He had to borrow money from new investors to repay old investors..."

We are satisfied from the evidence of Mr Litt' dealings that he would on all occasions try to persuade his investors to reinvest the money they had already lent so that the post-dated cheques need not be honoured. Where, therefore, any of the investors rolled over their investments Mr Litt did not need to honour the cheques and find further funds.

18. There have been a series of negotiations between HMRC and Mr Rusling's accountants in an attempt to settle the matter. As a result various figures have been produced. HMRC have for the most part relied on the details of cheques and the transactions provided by the administrators and Mr Rusling's statement revealing receipts of £105,600.

19. Mr Rusling's figures also show where cheques have been rolled-over. It appears that the dates were altered on some of the pre-dated cheques and the whole of the income from the investment, together with the initial investment sum, was reinvested with a further profit element being due. As HMRC have agreed that they do not propose to raise an assessment for the years 2005/6 we have only identified the payments and receipts for the remaining two tax years. In their letter of 6 November 2012 HMRC have provided a table showing how the assessments have been calculated. The figures have taken into account those cheques which have been rolled-over. We set out the table split between the periods 2006/7 and 2007/8 below:

Date	Amount lent	Post-dated cheques	Outstanding balance	Tax due 2005/6
18/4/2006		£11,500	(-£45,500)	
25/4/2006		£11,500	(-£34,000)	
26/4/2006	£25,000		(-£59,000)	
2/5/2006		£11,500	(-£47,500)	
10/5/2005	£23,000		(-£70,500)	
8/6/2006		£15,000	(-£55,500)	
15/6/2006		£15,000	(-£40,500)	
21/6/2006	£25,500		(-£66,000)	
14/7/2006		£10,000	(£56,000)	
21/7/2006		£10,000	(-£46,000)	
28/7/2006		£10,000	(-£36,000)	
5/8/2006		£10,000	(-£26,000)	
12/8/2006		£10,000	(-£16,000)	
19/8/2006		£10,000	(-£ 6000)	

26/8/2006		£10,000	£ 4000	
2/9/2006		£10,000	£14,000	
9/9/2006		£10,000	£24,000	
16/9/2006		£10,000	£34,000	£34,000
New	Tranche			
26/9/2006	£45,000		(-£45,000)	
Date	Amount lent	Post-dated cheques	Outstanding balance	Tax due 2005/6
14/10/2006		£10,000	(-£35,000)	
21/10/2006		£10,000	(-£25,000)	
28/10/2006		£10,000	(-£15,000)	
5/11/2006		£10,000	(-£ 5000)	
12/11/2006		£10,000	£5,000	£ 5,000
New	Tranche			
15/11/2006	£51,000		(-£51,000)	
7/12/2006		£10,000	(-£41,000)	
14/12/2006		£10,000	(-£31,000)	
28/12/2006		£10,000	(-£21,000)	
4/1/2007	£30,000		(-£51,000)	
5/1/2007		£10,000	(-£41,000)	
12/1/2007		£10,000	(-£31,000)	
19/1/2007		£10,000	(-£21,000)	
26/1/2007	£50,000	£10,000	(-£61,000)	
4/2/2007		£ 9,000	(-£52,000)	
25/2/2007		£ 3,000	(-£49,000)	

3/3/2007		£11,000	(-£38,000)	
10/3/2007		£11,000	(-£27,000)	
17/3/2007		£11,000	(-£16,000)	
24/3/2007		£11,000	(-£ 5,000)	
31/3/2007		£11,000	£ 6,000	6000
Totals	£249,500		Amount assessed 2005/6	£45,000

20. In his statement provided to HMRC showing the balance of £105,600 Mr Rusling indicated that the following post-dated cheques were all rolled over into the investments instead of being encashed:

15/4/2006	£11,500	25/5/2006	£15000	
	£11,500		£15,000	
	£11,500		£15,000	
	£11,500		£15,000	
10/5/2006	£14,500	21/6/2006	£15,000	
21/6/2006	£10,000	5/1/2007	£10,000	
	£ 9,000		£10,000	
			£10,000	

From Mr Rusling's figures the total of rolled-over cheques is £184,500. As indicated HMRC have not brought any rolled-over cheques into account

21. Similar details have been provided for the year 2006/7 as follows.

Date	Amount lent	Post-dated cheques	Outstanding balance	Tax due 2006/7
7/4/2007		£11,000	£17,000	£11,000 (17,000-£6000 from earlier period)
New Tranche				

18/4/2007	£9000			
23/4/2007	£51,000		(-£60,000)	
7/6/2007		£11,000	(-£49,000)	
14/6/2007		£11,000	(-£38,000)	
21/6/2007	£60,000	£11,000	(-£87,000)	
27/6/2007	£100,000		(-£187,000)	
28/6/2007		£11,000	(-£176,000)	
5/7/2007		£11,000	(-£165,000)	
10/7/2007		£20,000	(-£145,000)	
17/7/2007		£20,000	(-£114,000)	
19/7/2007		£22,000	(-£92,000)	
24/7/2007		£20,000	(-£72,000)	
3/8/2007		£22,000	(-£50,000)	
17/8/2007		£22,000	(-£28,000)	
23/8/2007	£100,000		(-£128,000)	
31/8/2007		£22,000	(-£106,000)	
14/9/2007		£22,000	(-£84,000)	
21/9/2007		£22,000	(-£62,000)	
25/9/2007	£100,000		(-£162,000)	
28/9/2007		£22,000	(-£140,000)	
5/10/2007		£22,000	(-£118,000)	
8/10/2007	£40,000		(-£158,000)	
12/10/2007		£22,000	(-£136,000)	
19/10/2007		£22,000	(-£114,000)	
26/10/2007		£22,000	(-£92,000)	

27/10/2007	£100,000		(-£192,000)	
3/1/2007		£22,000	(-£170,000)	
10/11/2007		£22,000	(-£148,000)	
17/11/2007		£22,000	(-£126,000)	
Date	Amount lent	Post-dated cheques	Outstanding balance	Tax due 2007/8
2/12/2007		£22,000	(-£103,200)	
6/12/2007		£22,000	(-£ 80,400)	
Overall Totals	£1,028,500	£1,004,100		£11,000 plus £9,912/ £20,912

From the details of the monies Mr Rusling said he had received (see Tab 2 folio 48A), he has indicated that the two cheques for £22,000 dated 26/10/2007 and 10/11/2007 did not clear the account. He confirmed that he had cashed the cheques for £22,000 for 3/1/2007, and 17/11/2007 but that he not cashed the last two. HMRC have made allowances for these post-dated cheques and only assessed the cleared funds of £11,000 at the commencement of the period.

22. HMRC have had to do the best they could to arrive at the assessments. They have worked from the details that they have received from the administrators and where possible reconciled them to the figures provided by Mr Rusling's accountants. Overall. Mr Moss believed that the records held, by both Mr Rusling and himself, could provide a basis of a settlement, if the way the information was to be interpreted could be agreed. We accept that the figures have been prepared to best judgment.

Mr Hone's submissions

23. Mr Hone in his written submissions suggested that we should review the facts and documentation which we have done. In his skeleton argument he submitted that Mr Rusling has received taxable interest under part 4 of ITTOIA in relation to his transactions with D J Litt in the years 2005/6, 2006/7, and 2007/8. Further, in relation to the tax years 2005/6 and 2006/7 HMRC had raised valid assessments as there had been a loss of tax brought about by Mr Rusling's carelessness. HMRC consider that the case of *Mazurkiewicz* was decided on its own facts and was clearly swayed by a natural sympathy for that appellant's position.

24. Mr Hone submitted that the payments were by way of loans so that any monies due to Mr Rusling over the capital advanced should pay tax under section 369(1)

ITTOIA which he submitted arose when a taxpayer is entitled to or receives the interest. (See section 371 paragraph 6 above). Mr Rusling advanced sums to D J Litt and each time a sum was advanced to D L Litt a debt was created on which interest was payable.

25. There is no general definition of "interest" for tax purposes. Lord Wright in *Westminster Bank Ltd v Riches* 1947 A.C.390 was of the opinion at page 400

> "The essence of interest is that it is a payment which becomes due because the creditor had not had his money at the due date. It might be regarded as either representing the profit he might have made if he had had the use of the money, or conversely the loss he suffered because he had not had that use. The general idea is that he is entitled to compensation for the deprivation."

As a result HMRC submit that Mr Rusling is chargeable to income tax on the cleared receipts, where there was a profit or surplus over and above capital that had been invested.

26. Mr Hone submitted that the label given to the payment is not decisive. In *Re Euro Hotel (Belgravia) Ltd* Meggary J said:

> "....the question must always be one of the nature of the payment. The language, of course, is important for the words used may mould or affect the nature of the obligation, but one must always return to a consideration of what, given the language, the payments under the obligation truly are: are they "interest of money" within the meaning of the Statute."

Meggary J suggested that there are two characteristics required for a payment to constitute interest:

> (1) There must be a sum of money by reference to which the payment of interest may be ascertained.
>
> (2). The sum of money must, generally, be due to the person entitled to the interests.

27. Mr Hone submitted that there were a number of sums of money advanced to Mr Litt/ D J Litt by Mr Rusling by reference to which interest was calculated. The surpluses constitute interest as they represent payment by time for the money not being available to Mr Rusling. The fact that with hindsight it appeared that the payments were part of a 'Ponzi' Scheme, does not alter the fact that interest has been received.

28. Mr Hone submitted that the case of *Mazurkiewicz* can be distinguished from the present appeal. In that case the tribunal states at paragraphs 38 and 65:

> "38. We do not, and cannot, suggest that for tax purposes the tax liability on interest received by an individual would be eliminated merely because the interest is reinvested and subsequently lost.

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

29. However, despite the finding that the payments made were in the nature of interest, the tribunal stated at paragraph 5:

"5. Since **at no time** in the cycle of the loans and further loans, did the Appellant ever in net terms get his £140,000 back and since, at the end of the day, he lost everything **we conclude that in realistic terms, no interest was received.** In contrast to the trading analysis, this conclusion offers no opportunity for the Appellant to offset his loss in the final year against any other income, but it does discharge the liability for **interest that in our view the Appellant never realistically received.**" (Mr Hone's emphasis in bold)."

30. The tribunal decided that the appellant could only be treated as receiving the interest after the payment of the principal advanced. It had not been possible, in that case, to decide how the cheques could be allocated between the principal and the interest. HMRC had conceded that the first 8 cheques repaid the principal and the last 4 represented the interest.

31. In the present appeal there can be no doubt that Mr Rusling received a profit, or surplus, in excess of the principal sums invested which has been demonstrated by the cleared cheques through his bank accounts. *Whitworth Park Coal Co* concluded that income arose at the dates it was received and amounted to the income in such years. In *Dunmore v McGowan* although the money was left with the bank as a guarantee and could not, therefore, be withdrawn, the interest received during the years reduced the liability under the guarantee and was therefore taxable in the years that that occurred. *Park side Leasing Ltd is* authority for the fact that interest arises when it is credited to an account, and that is the point at which is treated as received by the account holder or holders. Scott J says at paragraph 289:

"It is the receipt of the proceeds, whether as cash or by the crediting of the sum to an account of the payee, that places the proceeds at the disposal of the payee and, in my judgment, attracts the liability to tax under Case 111 of Schedule D."

32. In *Dewar v Commissioners of Inland Revenue* Lord Hanworth established that liability to tax on interest did not arise if the interest has not been received. Income arises when the interest is credited to the account. (See *Halpin v Revenue and Customs Commissioners).* Mr Hone submitted that HMRC has not taken into account any *'utterly fictitious receipts of interest'*. Further, any amounts calculated on the principal sums that have been simply rolled-over and reinvested in the scheme by Mr Rusling, which would on first principles and precedent law normally be regarded as interest receipts (as acknowledged in *Mazurkiewicz),* have in the spirit of

Mazurkiewicz been excluded from HMRC's later calculation of the interest received by Mr Rusling. Mr Hone submitted accordingly is that the receipts Mr Rusling received were not mere 'paper' profits but real profits.

33. In Mr Gordon's skeleton argument on behalf of Mr Rusling, he suggested at paragraph 25 that any profits might fall outside of the income tax net altogether, a contention that was made at the hearing. Lord Green in *Lomax (H M Inspector of Taxes) stated at page 677:*

> " ...there can be no general rule that any sum which a lender receives over and above the amount which he lends ought to be treated as income. Each case must, in my opinion, depend on its own facts and evidence dehors the contract must always be admissible in order to explain what the contract itself usually disregards, namely, the quality which ought to be attributed to the sum in question."

34. HMRC agrees that in determining whether an amount is interest it is important to look at the true nature of the payment received ascertained from all the circumstances of the case, including the term of the loan; the rate of interest expressly provided for; and the nature of the capital risk (and the extent that the parties took that risk into account when negotiating the terms of the contract). Mr Hone submitted that under the legislation and the case law the surpluses over and above the original amount of principal in the form of cleared receipts received by Mr Rusling are interest receipts. At the outset of the arrangements Mr Rusling expected higher amounts to be payable to him than the amount that has been advanced by him, as evidenced by the post-dated cheques provided in return. HMRC conclude that this difference could only reasonably be regarded as a return or profit on the investment.

35. Mr Gordon has suggested that as the interest rate was ' extraordinarily high' it did not amount to a just recompense and referred to *Cairns v MacDiarmid* and *Ridge Securities Ltd v CIR*. Mr Hone submitted that these authorities are not relevant because they related to a taxpayer creating allowable deductions for interest paid rather than, as here, payment received by Mr Rusling. Mr Litt had advised Mr Rusling that the bank would not lend any more money and Mr Rusling would be aware that the risk he was taking would warrant a higher return and that higher return does not stop the additional payment from being interest.

36. If the tribunal disagrees then HMRC submits that the income receipts would still be chargeable to income tax as Miscellaneous Income under sections 687 to 689 of ITTOIA. HMRC would, in those circumstances, ask the tribunal to determine the receipts as under:

2005/6. £ Nil

2006/7. £45,000

2007/8. £11,000

As this argument has not previously been run by HMRC it would be happy, if it proved necessary, to provide further written submissions which describe how the miscellaneous provisions apply.

37. It has been suggested that there was a partnership between Mr Rusling and his wife. A partnership would only exist between persons carrying on a business in common with a view to profit (section 1 the Partnership Act 1890). Mr Hone submitted that a common intention is clearly absent in this case for the following reasons:

(1) Mr Rusling had earlier suggested that he had incurred a trading loss and claimed relief as a sole trader

(2) Only Mr Rusling's name appears on the creditor's list

(3) A claim for capital loss relief has also been made by Mr Rusling under section 251 of the Taxation of Chargeable Gains Act 1992.

(4) Mr Rusling has agreed that amounts made from his personal account have been made without telling his wife

(5) His wife had never seen Mr Rusling's Lloyds Bank account number 01403022

(6) HMRC's review of the 5 Lloyds bank statements evidenced that five payments were made from D J Litt as follows:

£10,000. 25April 2006

£10,000. 26 April 2006

£5,000. 27 April 2006

£60,000. 27 June 2007

£40,000. 9 October 2007

(7) Anonymity was sought at the beginning of the hearing as Mr Rusling was anxious that his wife should be unaware of the full extent of his investments.

(8) The mere payments to a joint account were insufficient to create a partnership.

(9) The post-dated cheques were made out to Mr Rusling.

As Mrs Rusling was not fully aware as to the extent of the transactions there could not be a common intention sufficient to create a partnership.

38. Mr Hone also submitted that Mr Rusling has been careless. The conditions required by sections 29(3), (4) and (5) had not been met.

(1) Mr Rusling had omitted £9,912 untaxed interest from his 2007/8 return and has not returned any of the interest received from the investments with D J Litt because he had never made any money. As he received post-dated cheques to cover his investment he could calculate the income from the additional payments made by Mr Litt.

(2) Mr Rusling took no steps to ascertain whether the payments should be disclosed even though during the entire period he had advanced £1,028,500 and he was in receipt of cleared funds at the bank.

(3) Mr Rusling is a substantial businessman who has a property portfolio. As such he must have been familiar with the self- assessment regime.

(4) If he was in doubt, he should have alerted HMRC in the 'white spaces' section of the returns. Mr Hone submitted that a reasonable man acting with care in completing his tax returns would have used this section to at least high light the existence of the relevant transaction.

(5) At the beginning of the enquiry Mr Rusling did not disclose the transactions. HMRC only became aware of Mr Rusling's involvement as a result of the information provided by Deloittes at the time of the administration, which was referred to Mr Moss on 4 December 2009, who then opened the enquiry on 17 December 2009.

39. Mr Hone asked the tribunal to determine that the discovery assessment for the tax years 2005/6 and 2006/7 were validly raised. As a result he asked the tribunal to make a determination that,

(1) the bank statements show that Mr Rusling received interest on amounts advanced by Mr Litt.

(2) the interest is chargeable to income tax. The assessable amount is the full amount arising in the tax years which are:

2005/6. £ nil

2006/7. £45,000

2007/8. £11,000 to which should be added under-stated interest income from National Savings and Investments of £9,912 which is not in dispute.

Mr Gordon's submissions

40. Mr Gordon submitted that the substantive issue in relation to all three tax years is the tax treatment of the transactions entered into by Mr Rusling with D J Litt, which were part of a "Ponzi-style" fraud. The dispute between the parties, in the present case, is the extent to which the factual distinction between this case and the case of *Mazurkiewicz,* are similar. In addition there is a procedural question turning on the

validity of the discovery assessment by reference to the statutory condition in section 29 of the Act.

41. Mr Rusling accepted the amendment made to the 2007/8 self-assessment relating to the income from the National Savings & Investments was omitted from Mr Rusling's return which was identified in the course of the statutory enquiry. Mr Gordon referred to the various assessments which had arisen during the course of the negotiations:

2005/6. £14,000 amended to	£13,000 no agreement assessed tax	£ 5,200
2006/7. £10,500 from Deloitte	£43,000.	£17,200
2007/8. £46,500.	£49,600.	£23,804.80

42. HMRC have assessed some of Mr Rusling's receipts from D J Litt as "interest" chargeable to tax under part 4 of ITTOIA. Mr Gordon submitted that the payments did not amount to interest and fall outside the tax net - particularly in the present case, where the outgoings exceeded the payments received. Further, Mr Rusling, in evidence has made it clear that the post-dated cheques were not issued by Mr Litt until some little time after the advances had been made by him. It is not accepted that the "interest" was indeed interest. The transactions were part of a major fraud perpetrated by Mr Litt and the proposed return was on any basis “extraordinary”. Mr Gordon referred to the following case law in support of that argument:

43. In *Schulze v Bensted* the Lord President stated:

> “There is a very good working definition of 'interest' to be found in Bell’s Dictionary. It runs as follows: ' Interest of money' may be defined to be the creditor's share of the profit which the borrower or debtor is presumed to make from the use of the money. Otherwise stated, it is just recompense to the creditor for being deprived 'of the use of his money.”

Judge Nolan in *Mazurkiewicz* recognised that the definition must be applied with a dose of realism. In *Ridge Securities Ltd v Inland Revenue Commissioners* Pennycuick J held, referring to *Commissioners of Inland Revenue v Wesleyan & General Assurance Society* :

> "The question always is what is the real character of the payment, not what the parties call it."

44. In Cairns *v MacDiarmid* Nourse J stated at 243b:

> “I agree with the Lord President that that is a very good working definition. The recompense must be just. In other words, it must not be excessive. A case where it was held that what Mr Justice Pennycuick described as payments 'grotesquely' out of proportion to the principal amounts secured were not payments of interest is *Ridge Securities Ltd.."*

The judgment was upheld in the Court of Appeal where Sir John Donaldson MR held at 182 c:

> "Here the whole transaction was 'out of this world'. Although no sham, it lacked reality ... Accordingly, the payment of £5,000 was not interest..."

45. In *Cairns v McDiarmid* the judgment of the Master of the Rolls turned on the application of the then newly-expressed *Ramsey* principle. However, Mr Gordon submitted, it is clear from the concurring decision of Kerr J at 183b that the same outcome would have been reached even without recourse to the *Ramsey* case:

> "I would say that it was not a payment of interest at all but merely 'a payment made in discharge of a purely artificial liability which was created in order to achieve a tax advantage."

Given the understandable hesitation that their Lordships had about invoking *Ramsey,* it will be noted that the 'Ramsey' principle evolved over the subsequent 25 years now represents the requirement that tax be applied to transactions viewed realistically.

46. The dictum of Ribeiro P J in *Collector of Stamp Revenue v Arrowtown Assets* [2003] HKCFA 46 at 35 has now been firmly adopted as applicable in the United Kingdom:

> "The driving principle in the *Ramsey* line of cases continues to involve a general rule of statutory construction and an unblinking approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically"

47. Mr Gordon submitted that these authorities all confirm, the incidence of taxation depends on the reality of the relevant transactions and not merely how transactions are dressed up by one or more the parties. Even if Mr Rusling entered into the transactions with certain beliefs that they were genuine, the correct tax treatment does not turn on his beliefs, but on the actual nature of the transactions. HMRC's error is to overlook the basic principle, even though the principle was repeatedly emphasised in *Mazurkiewicz.* Mr Rusling recognises that his facts differ from those of *Mazurkiewicz* in that there are a few occasions in which his net receipts temporarily exceeded his out goings. It would be an error in law to divorce those receipts from their proper context.

48. The correct approach in deciding whether the income tax statutes should apply to the transactions was stated by Lord Nicholls in *Barclays Mercantile Business Finance Limited. V Mawson* (2004) STC 1:

> " ..the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transactions will answer the statutory description and secondly, to decide whether the transaction in question does so".

Not every financial transaction gives rise to a potential tax charge. (See: Housebreaking) *F.A.Lindsay and others v The Commissioners of Inland Revenue (1932) 18 TC 43* at 56 where Lord Sands held:

> "Crime, such as housebreaking, is not a trade, and therefore the proceeds are not caught by the tax."

Even transactions not tainted by illegality can still fall outside the tax net: an obvious example being profits from betting see *Graham v Green.*

50. Mr Gordon submitted that had the transactions been genuine and Mr Rusling had been trading, providing loans for guns, these profits would still not have been interest and the losses would have wiped out any trading profits leading to a nil assessment. Mr Gordon submitted that the sad reality is that Mr Rusling is not going to be able to obtain tax relief on the losses incurred in this putative trade:

(a) For the simple reason that the trade did not exist

(b). It was all fictitious.

(c). It was all part of a fraud.

Conversely, the same lack of reality that precludes Mr Rusling from obtaining tax relief is precisely the reason why no element of the payment he did receive constitutes taxable income.

51. Mr Gordon submitted that Mr Rusling's receipts fall to be ignored altogether for the purposes of income tax as they do not fall within one of the heads of charge (formerly the schedules). Were the transactions genuine then any profit might have been subject to tax, depending on the precise nature of the transactions. They could have been trading income or miscellaneous income (assessable under one of the heads of charge in Part 5).

52. Mr Gordon submitted that the fraud started in 2004 and the transactions were concealed from the auditors from the outset. HMRC have accepted that the assessment for 2005/6 should be revised to nil. This was a 'Ponzi scheme' and although Mr Litt told investors that their investment monies were to be used to buy high quality firearms, in fact the monies loaned were used to repay earlier investors. HMRC should have withdrawn their assessment completely as a result of the decision in *Mazurkiewicz* particularly given that their revised approach to the case is intended to reflect the First-tier's decisions. HMRC's revised approach is to tax as income those receipts that take (albeit temporarily) Mr Rusling's net cumulative balance into the black. They justify this from the passage in *Mazurkiewicz* which reads:

> " ..since at no time in the cycle of loans and further loans, did the Appellant ever in net terms get his £140,000 back and since, at the end of the day, he lost everything, we conclude that in realistic terms, no interest was received"

53. HMRC take this passage and suggest (wrongly) that Mr Mazurkiewicz was always in the red (when looking at the cumulative position between himself and D J Litt) whereas they can point to the fact that Mr Rusling was occasionally in the black. Upon reading the decision closely, it is clear that HMRC are placing too much emphasis on this passage as it is clear that the facts of the *Mazurkiewicz* are similar to those of the present case. The Tribunal were doing no more than emphasising that Mr Mazurkiewicz had overall lost money and was not (as inferred by HMRC) focusing on the cumulative balance on any particular date.

54. It was made clear by that Tribunal that it was not looking at Mr Mazurkiewicz's net balance on any particular date, but the overall position focussing (correctly, it was submitted on the reality of the situation). At paragraph 22 the tribunal found:

> "As soon as the Appellant received his initial payment and profit back, he would either already have made a further advance, or would very shortly make such a further advance, such that he never had the totality (or indeed "very much of") his initial investment, in hand, in the form of real cash"

The Tribunal recognised that the receipts from D J Litt might realistically be cancelled out by new advances made shortly thereafter (but not merely by further advances already made).

55. Mr Gordon suggested that a particular receipt on a particular day cannot have the characteristics of interest simply because previous receipts (in aggregate) are no less than the total of advances previously made. It is necessary to identify whether each of the cheques paid by way of receipt were to repay the capital sum or additional receipts over and above the original loan. For example, if further advances were made during the subsistence of the earlier advances then the repayments would be of the outstanding capital sum before any interest could be said to have been received.

56. Mr Rusling's oral evidence made it clear that he would not have known how much he would receive in respect of any advance made to D J Litt . His 'return' was dependent on the supposed profits that the guns and equipment would make and came in the form of cheques subsequently posted to him and the arrival of which ' slowed down' in 2006.

57. Mr Moss had taken Mr Rusling to his bank statements as evidence that certain receipts had been credited to the account. He could not, however, be sure that Mr Rusling had been given credit for every advance that he had made to D J Litt so that even though these payments had taken Mr Rusling into the black those receipts might actually have merely reduced the cumulative deficit to date.

58. In relation to the discovery assessment, Mr Gordon submitted that in order for HMRC's discovery assessment to be valid it has to demonstrate that Mr Rusling, as a reasonable taxpayer, was careless in not self-assessing himself as having received taxable income from D J Litt . Mr Moss had accepted that carelessness amounts to more than taxpayer being wrong. In all the case relating to D J Litt all the taxpayers have been professionally represented and none of them have considered the receipts to

constitute taxable interest in whole or in part. Mr Moss also accepts that some of his colleagues might have reached a different conclusion. Even Messrs Knowles Warwick, Mr Rusling's accountants, did not consider the receipts constituted taxable income and stated at the hearing that they would have advised him accordingly.

59. In view of the fact that all the other advisors and taxpayers would not have treated the payments as income, HMRC simply cannot sustain an argument that Mr Rusling's failure to include such details in his self-assessment return was attributable to carelessness on his part. Nor ought he to have noted the position in the 'white space' provided. That is irrelevant as the statutory test in section 29(4) and 36(1) focuses on the fact that the 'income' has not been 'assessed'. The inclusion in any 'white space' would not affect how much was assessed. In *Langley v Veltema* Auld L J noted at paragraph 10:

> "Miss Ingrid Simler, on behalf of the Inland Revenue, informed the court that, whatever the Manuals say the reality is that Inland Revenue staff, in the main, simply data-process the information on the returns, largely as a consistency check, and scrutinise only a very small number of them on a random basis or where there is thought to be a high risk."

What happens in real life is that tax returns are reviewed by computer for particular trends. Therefore, the inclusion of additional explanation about the transactions with D J Litt would not have affected HMRC's approach to Mr Rusling.

60. If the Tribunal take the view that the payments were interest and tax is due. Mr Gordon submitted that, as all the payments apart from two were discussed with his wife and paid into and out of a joint account, the income and capital of which both Mr and Mrs Rusling were beneficially entitled to, Mr and Mrs Rusling were operating in partnership. As a result Mr Rusling should be assessed on half the liability and his wife on the other half. In particular the fact that:

(a) only Mr Rusling's name appeared as a creditor

(b) a bank account can be held in one name but be for the benefit of more than one person.

(c) Mrs Rusling was not aware of two advances

(d) the bank statements are not in evidence and the assertions made have not been raised in evidence so that Mr Rusling has not had the opportunity to respond or to be re-examined on the point

(e) the first three payments identified on HMRC's list are in fact represented by a single transaction of £25,000 on 26 April 2006 and were split in this way to avoid incurring transaction fees from the Bank.

70. Mr Gordon submitted that Mr Rusling has not been careless with in the terms of section 29(4) and 36(1) of the Act and as he has received no interest during the periods of the assessments the appeal should be allowed in full.

The decision

71. We have considered the law and the facts and have decided:

(i) Mr Rusling was in receipt of interest on his investments.

(ii) Those receipts amounted to 'interest' within the terms of Section 369 ITTOIA.

(iii) Where the 'interest' was paid by cheque it was only received when it was cashed.

(iv) Where the cheques were rolled-over they did not amount to cash because Mr Litt had no intention of honouring the payment.

(v) Mr Rusling was 'careless' in not alerting HMRC to the transactions in his returns and in his omission of the National Savings & Investment's receipt.

(vi) The discovery assessment was properly raised.

(vii) Mrs Rusling was involved in the transaction in conjunction with her husband and should be assessed to half of the liability.

(viii) There is no need to assess the receipts as miscellaneous income under sections 687 and 689 of ITTOIA.

(ix) We agree with Judge Nolan in *Mazurkiewicz* that "Mr Litt's plan was utterly flawed from the start". We have decided that where re-investment was made Mr Litt never intended that any cash should change hands and that in those circumstances "the profits given to investors would be pure paper profits, and that invariable reinvestment was always contemplated, and indeed utterly vital"

As to the interest

72. Lord Nicholls in *Barclays Mercantile Business Finance Limited. V Mawson* (2004) STC stated

" ..the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transactions will answer the statutory description and secondly, to decide whether the transaction in question does so".

The statutory provision is that tax is payable on interest in the tax period in which it arises. We are satisfied that the additional amounts over and above the capital investment made were 'interest'.

73. We prefer Mr Hone's arguments in that regard.

In *Re Euro Hotel (Belgravia) Ltd* Meggary J said:

"....the question must always be one of the nature of the payment. The language ,of course, is important for the words used may mould or affect the nature of the obligation, but one must always return to a consideration of what, given the language, the payments under the obligation truly are: are they "interest of money" within the meaning of the Statute."

Meggary J suggested that there are two characteristics required for a payment to constitute interest:

(1) There must be a sum of money by reference to which the payment of interest may be ascertained.

(2). The sum of money must, generally, be due to the person entitled to the interests.

74. We do not agree that the interest was excessive nor indeed that it was other than 'interest,' given the level of risk involved. Mr Gordon has suggested that:

Pennycuick J held, referring to *Commissioners of Inland Revenue v Wesleyan & General Assurance Society*:

"The question always is what is the real character of the payment, not what the parties call it."

In Cairns *v MacDiarmid* Nourse J stated at 243b:

"I agree with the Lord President that that is a very good working definition. The recompense must be just. In other words, it must not be excessive. A case where it was held that what Mr Justice Pennycuick described as payments 'grotesquely' out of proportion to the principal amounts secured were not payments of interest is *Ridge Securities Ltd.."*

The judgment was upheld in the Court of Appeal where Sir John Donaldson MR held at 182 c:

"Here the whole transaction was 'out of this world'. Although no sham, it lacked reality ... Accordingly, the payment of £5,000 was not interest..."

75. We note that the case of *Cairns* a £5000 bonus paid after 4 days did not amount to annual interest but was the result of a tax avoidance scheme. *Ridge* related to the stripping of profits by way of dividends so that the shares could be sold at a loss. The scheme had been set up to obtain a tax loss and the court decide that the artificial loss was not recoverable.

76. In *Cairns v McDiarmid* the judgment of the Master of the Rolls turned on the application of the then newly-expressed *Ramsey* principle. However, Mr Gordon submitted, it is clear from the concurring *decision* of Kerr J at 183b that the same outcome would have been reached even without recourse to the *Ramsey* case:

"I would say that it was not a payment of interest at all but merely 'a payment made in discharge of a purely artificial liability which was created in order to achieve a tax advantage."

Given the understandable hesitation that their Lordships had about invoking *Ramsey,* it will be noted that the 'Ramsey' principle evolved over the subsequent 25 years now represents the requirement that tax be applied to transactions viewed realistically.

77. The dictum of Ribeiro P J in *Collector of Stamp Revenue v Arrowtown Assets* [2003] HKCFA 46 at 35 has now been firmly adopted as applicable in the United Kingdom:

> "The driving principle in the *Ramsey* line of cases continues to involve a general rule of statutory construction and an unblinking approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposive lay, were intended to apply to the transaction, viewed realistically"

Mr Gordon submitted that these authorities all confirm, the incidence of taxation depends on the reality of the relevant transactions and not merely how transactions are dressed up by one or more the parties. Even if Mr Rusling entered into the transactions with certain beliefs that they were genuine, the correct tax treatment does not turn on his beliefs, but on the actual nature of the transactions.

77. The scheme suggested by Mr Litt, not only to Mr Rusling but to the other 50 investors, was not a tax avoidance scheme but initially a way of funding his business because his bank would not. It turned into a 'Ponzi' Scheme because Mr Litt's hope that the company would be sold never materialised and he never, therefore, had the funds to repay his investors.

78. We have no doubt that the actual nature of the transactions was that Mr Rusling saw the investments as a means to achieve substantially more interest than he could achieve in the financial market place. He is clearly an astute businessman as can be seen from the company he ran and his portfolio of properties. We have decided that he saw the return on the investment to be of the order of 10%. We do not believe that he considered that return as an annualised amount in excess of 20%. We also have decided that the interest charged on that basis was not excessive in 2005/6 , 2006/7, and 2007/8.

78. We have also decided, as Judge Nolan did, that Mr Rusling could only be treated as receiving 'interest' after the payment of the principal advanced. In the case of *Mazurkiewicz* it had not been possible to decide how the cheques could be allocated between principal and interest. In this case, where Mr Rusling has a positive balance, Mr and Mrs Rusling must have received, as interest, that positive balance.

As to when the cash represented by a cheque become paid

79. The 'interest' was payable by way of post-dated cheques. In *Parkside Leasing Ltd* a company was entitled to bring a compensation payment paid by cheque on 9 April

1079 into account in its next trading period as it paid the cheque into its account on the 11 April 1979, having started the new business on the 10 April 1979. Scott J stated:

> "… it is the receipt of the proceeds, whether as cash or by crediting the sum to an account of the payee, that places the proceeds at the disposal of the payee…

As a result the repayment of the capital was only achieved when the post-dated cheques were paid into Mr and Mrs Rusling's Halifax account.

80. We believe that Mr Litt realised that the only way that he might be able to repay the loans, and any interest earned on them, was by using the money received from other investors. Wherever possible he would persuade an investor to re-invest the monies advanced by not cashing the post-dated cheques, but by destroying them and giving credit for them in the next investment. In that way Mr Litt did not need to fund any further cash. We have decided that where a reinvestment of existing post-dated cheques was made Mr Litt never intended to honour the cheques because he had no funds out of which he could do so and they should, therefore, be ignored.

As to 'careless'

81. We have also been asked to consider whether the 'discovery assessment was properly raised. Mr Rusling has accepted that he had failed to account for the income generated from the National Savings & Investments amounting to £9,912, a not inconsiderable figure. Mr Gordon has suggested that because none of the professional advisers and most of the other investors involved have not disclosed the transactions it was not' careless' for Mr Rusling not to have done so. Mr Gordon has also suggested, that even if Mr Rusling had chosen to alert HMRC of the transactions, this would not have been picked up by the computer sufficiently for an additional tax liability to have been raised.

82. Mr Rusling is a substantial businessman and he should have been aware that the transactions were going to create a substantial interest payment, which would give rise to tax. Any prudent businessman would, for his own protection, have alerted HMRC to the possibility that tax may be payable. Why would he not? If he was correct in his assumption that tax would only be paid at the end of the investment period then there was no risk in advising HMRC. If, in the alternative, that was incorrect, the fact that HMRC had been properly alerted to the possibility in his self-assessment return, using the 'white space', would have been sufficient to prevent a discovery assessment being raised. We find that he was careless in not so doing.

83. Mr Gordon is mistaken in suggesting that as the computer was unlikely to pick up any 'White Space' note there was no advantage in completing one. Section 29 (5) (carelessness excepted) states:

> 29 (5). The second condition is that at the time when an officer of the Board:

(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return (as here)….

(b) ……

the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation…

29 (6) For the purposes of section (5) above, information is made available to an officer of the Board if-

(a) It is contained in the taxpayers return…

84. In *Langham* Lord Justice Auld said at paragraph 36:

> "36….(absence fraud or negligence in that case) it seems to me that the key to the scheme is that the inspector is to be shut out from making as discovery assessment under the section only when the taxpayer or his representative, in making an honest and accurate return or in responding to a sub-section 9A enquiry, have clearly alerted him to the insufficiency of the assessment, not where the inspector may have some other information, not normally part of his checks, that may put the sufficiency of the assessment in question."

85. If Mr Rusling had made a proper reference to the transactions in the 'White Space' and the matter had been dealt with by the computer, and none of the officers had checked his return until after the period in which an enquiry could have been made, we are satisfied that a proper note made in that way would have been sufficient to alert an officer. Thereafter, Mr Rusling would have been be neither 'careless' nor have failed to have provided sufficient information for an Officer to be put on enquiry.

As to the discovery

86. Mr Rusling had neither advised his accountants nor HMRC as to the transactions. They only came to light when Mrs Davies was involved in the administration of D J Litt with Deloitte. She had alerted Mr Moss as to Mr Rusling's involvement and, as Mr Moss knew nothing of the transactions he was entitled to raise a discovery assessment on the basis that the 'interest' ought to have been assessed under section 29 (1) of the Taxes Management Act 1970 and the exception in section 29 (3) did not apply because of Mr Rusling's carelessness.

As to the partnership

87. It has been suggested that if a tax liability arose then it should be charged against Mr Rusling alone. We do not accept that. It is clear from the evidence that Mrs Rusling was involved in the running of the Company, in the assembling of the property portfolio and assisting with the accumulation of the monies available for investment. They were as much her monies as her husband's. The majority of the

moneys invested with Mr Litt came out of the joint account. Mrs Rusling was clearly involved with the day to day management of the payments to the extent that she advised Mr Rusling that they should not make any more payments. In spite of that we consider that she too should have alerted HMRC to the scheme in her own return which she did not.

88. It has been decided that the payments are 'interest' so that Mr Rusling's suggested arguments that he had incurred a trading loss or his claim for capital relief do not alter the position. These were clearly attempts by his advisers to mitigate any tax liability which might be incurred. Mr Rusling made two further payments on his own account which have not given rise to any assessment. The tax liability arising from the assessment is to be divided equally between Mr Rusling and Mrs Rusling as the liability has been incurred before Mr Rusling made his additional investment.

Miscellaneous income.

88. As we have decided that the assessments have been correctly raised, other than as to the liability being shared, we have not considered, nor do we consider it is necessary to consider, an assessment for miscellaneous income under sections 687 and 689 of ITTOIA.

As to the case of *Mazurkiewicz.*

89. Judge Nolan has accepted, as we do:

> "We do not, and cannot, suggest that for tax purposes the tax liability on interest received by an individual would be eliminated merely because the interest is reinvested and subsequently lost.
>
> We entirely accept that interest is taxable when it is received or derivable. We equally accept that in general the tax liability in respect of interest received would not be undermined by the feature that the investor might re-advance the amounts paid back, including interest, under one transaction in making a new investment (possibly with the same borrower) and the new investment results in a total loss. The initial interest would still be taxable, and the later loss would not change the position."

90. The basis on which he has decided that there was no tax liability for Mr Mazurkiewicz was:

> "Since at no time in the cycle of the loans and further loans, did the Appellant ever in net terms get his £140,000 back and since, at the end of the day, he lost everything we conclude that in realistic terms, no interest was received."

Mr Mazurkiewicz, unlike Mr and Mrs Rusling, was never in a position when he had a positive balance in his account.

91. Judge Nolan also took the view that:

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

We agree with that proposition so far as it relates to those cheques, which like Mr Mazurkiewicz's, were not to be honoured because of Mr Litt's fraudulent activities.

92. These cases are fact sensitive and we have decided that the facts in Mr Rusling's case are different from those of Mr Mazukiewizc because there were occasions when Mr Rusling was in credit. We have, however, accepted, as Judge Nolan has, that Mr Litt's fraudulent activity taints the transactions. We have therefore determined that the interest is chargeable to income tax. The assessable amounts arising are :

2005/6 £ Nil

2006/7 £45,000

2007.8 £11,000

The assessments are to be divided between Mr Rusling and Mrs Rusling equally.

93. 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.

DAVID S PORTER
TRIBUNAL JUDGE

RELEASE DATE: 17 October 2014