# TC04876

**Appeal number: TC/2015/2474**

***INCOME TAX – business profits - loan used to buy investment property – whether interest a deductible expense – s 34 ITTOIA 2005***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**Mr SEHZAD BUTT** **Appellant**

**- and -**

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

**TRIBUNAL: Judge Peter Kempster**
**Mr Terence Bayliss**

**Sitting in public at Centre City Tower, Birmingham on 3 February 2016**

**Mr David Pattinson (David Pattinson Chartered Accountants) for the Appellant**

**Mr Aidan Boal (HMRC Appeals Unit) for the Respondents**

## DECISION

1. The Appellant ("Mr Butt") appeals against closure notices issued by the Respondents ("HMRC") under s 28A TMA 1970 for the tax years 2010-11 and 2012-13, and a discovery assessment issued by HMRC under s 29 TMA 1970 for the tax year 2011-12. A number of items were included by HMRC in the assessments but only one remains in dispute: the extent (if any) to which certain interest paid by Mr Butt is deductible from his trading profits.

2. Mr Butt and his adviser were not present at the commencement of the hearing and, after waiting for 25 minutes, the hearing commenced in Mr Butt's absence – Tribunal Procedure Rule 33 refers. However, Mr Butt and his adviser arrived shortly after the hearing commenced and had full opportunity to present their case.

3. Mr Butt trades as Beacon Hill Stores in Newark, originally as a partnership but from April 2007 as a sole trader. The shop is a convenience store at 100-102 Beacon Hill Road ("the Shop"). In August 2007 Mr Butt bought jointly with his domestic partner (Nasrin Butt) the property next to the Shop, 104 Beacon Hill Road which consists of two flats (upstairs and downstairs) ("the Flats").

4. In December 2012 HMRC opened a formal enquiry into Mr Butt's tax affairs. Several areas were adjusted by negotiation – for example, a private use adjustment in relation to the Shop premises. No agreement could be reached on the matter that comes before us: interest on a mortgage loan taken by Mr Butt and Nasrin Butt in 2007 to purchase the Flats, part of which had been claimed as a trading deduction from the Shop profits for the three tax years 2010-11 to 2012-13.

5. During their enquiry HMRC sought information about Mr Butt's letting of the flats. At the hearing Mr Butt stated that he had full records of the letting business which could have been made available to HMRC if they had asked. However, we do not accept that statement. HMRC's record of a meeting held with Mr Pattinson on 6 February 2013 notes that no income and expenditure records or details of tenants had been kept; and Mr Pattinson in a letter to HMRC dated 4 July 2013 confirmed "there are no formal records". On 26 February 2013 Mr Pattinson stated to HMRC "Only the first floor flat is let and the ground floor is used for storage"; at the hearing Mr Pattinson explained that he had been referring to a particular tax year under enquiry, and that the ground floor flat had been let in other periods – as had been confirmed to HMRC in subsequent correspondence. On 12 November 2013 Mr Pattinson stated to HMRC "… there has never been any intention to let the downstairs flat." When HMRC challenged that assertion Mr Pattinson (on 15 January 2014) stated "Although the ground floor flat has been let from time to time, it was never let at the same time as the upstairs flat." We note that, in the absence of formal business records and given the contradictory information presented to them, HMRC were obliged to obtain from the local authority details of persons registered as resident at the Flats for council tax purposes – a move that was resisted by Mr Butt (letter from Mr Pattinson to HMRC dated 24 February 2014 refers). The information HMRC received – which was fully disclosed to Mr Butt, and revealed that some of the residents had been employees of Mr Butt – together with a premises visit led HMRC to conclude that

both flats had been available for letting throughout, and that any use of the Flats for storage purposes was incidental.

6. In the tax years up to 2009-10 the interest on the purchase loan had been claimed as a deduction against the property rental income. For the three tax years under appeal half of the interest was claimed as a deduction against the property rental income, and the other half was claimed as a deduction against the business profits of the Shop. The justification for this treatment was given by Mr Pattinson in a letter to HMRC dated 4 July 2013:

> "When the council placed bollards outside the shop, it stopped customers parking there and affected [Mr Butt's] trade. The main motive in buying the next door property [ie the Flats] was to make its parking space available to customers. If both flats were let, then the tenants and their visitors would very likely use most of that space for much of the time, thus defeating the object. The business use is therefore more than merely storage and justified the claim for 50% of the mortgage interest."

7. After correspondence on the point, HMRC refused to allow a deduction against the trading profits but made clear that a deduction against the rental profits was still available.

8. At the hearing Mr Butt confirmed the explanation of the acquisition of the Flats given by Mr Pattinson in the 4 July 2013 letter. He explained that as soon as he saw the Flats advertised for sale he had approached the agent and offered to pay the asking price if the property was taken off the market; he had not concerned himself with the rental prospects for the Flats; he had let the Flats as an extra source of income.

9. Mr Butt provided photographs and sketches clarifying the layout of the parking arrangements for the Shop. The Shop is on a busy residential road with no statutory parking restrictions. Residents park in the road after 4pm, which is the busiest time for the Shop. No parking is possible on the side of the road opposite the Shop, where the pavement is wide; at the hearing Mr Butt stated that the pavement had been widened in 2010 or 2011 but – in response to a question from the Tribunal – said that it must have happened earlier, before the Flats were purchased in 2007. There is a passageway (called Top Row) along the side of the Shop but that was not suitable for customers to park as it was too narrow to enable cars to turn round, and thus would necessitate a dangerous reversal onto the busy road. It was possible to park four cars (nose to tail) on the public highway outside the Shop and the Flats – two outside the Shop and two outside the Flats. Mr Butt had put a notice outside the Shop saying that parking was for customers only – he accepted that had no legal justification or effect. One of the spaces was across the entrance to the driveway for the Flats; Mr Butt felt that customers would not park there if there was a car on the driveway, but would do so (and this had happened) if the driveway was empty. Another space was outside the frontage of the Flats; if a local resident parked there then Mr Butt would put a notice on the windscreen asking them not park outside his property – again, he accepted that had no legal justification or effect.

10. Mr Butt stated that he had always forbidden tenants of the Flats from parking either on the driveway or on the public road outside the Flats; he felt that enhanced the chances of customers being able to park on the road close to the Shop; convenience was important to his customers.

11. In response to a question from the Tribunal, Mr Pattinson stated that the reason for the change in treatment of the interest was because it was only in around 2011 that consideration had been given to treating part of the interest as a trading (rather than a rental business) deduction. He considered part of the interest had been incurred wholly and exclusively for the purposes of the Shop trade and thus was deductible pursuant to s 34 ITTOIA 2005.

12. In response to a question from the Tribunal, Mr Pattinson stated that the reason for the allocation of 50% of the interest as a business deduction was that as one of the two flats had been unlet, half the interest must relate to the rental business and the remainder to the trade.

## Law

13. Section 34 Income Tax (Trading and Other Income) Act 2005 provides:

> "**34 Expenses not wholly and exclusively for trade and unconnected losses**
>
> (1) In calculating the profits of a trade, no deduction is allowed for—
>
> (*a*) expenses not incurred wholly and exclusively for the purposes of the trade, or
>
> (*b*) losses not connected with or arising out of the trade.
>
> (2) If an expense is incurred for more than one purpose, this section does not prohibit a deduction for any identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade."

## Consideration and Conclusions

14. Mr Butt seeks a deduction from the trading profits of the Shop for half of the interest paid on the loan relating to the purchase of the Flats. Section 34 requires an "identifiable part or identifiable proportion of the expense which is incurred wholly and exclusively for the purposes of the trade." We consider that test is not met here.

15. The purchase of the Flats did not result in Mr Butt having any greater control over the parking situation. The two spaces outside the Flats remain on the public highway and available for anyone (residents or customers) to park. He accepts that he has no legal right to restrict parking either there or on the two spaces outside the Shop – despite his "customer parking only" sign and his placing messages on the windscreens of parked cars. Mr Butt has not used the Flats (eg the driveway) to facilitate extra customer parking. We conclude that none of the loan interest can be said to have been incurred wholly and exclusively for the purposes of the trade.

16. We agree with HMRC that the interest is properly an expense of the letting business. We consider what has really happened here is that, given the relatively modest rental income obtained from the Flats, the interest payable gave rise to "surplus" deductions and in an attempt to obtain some tax relief for those surplus deductions the accounting treatment was changed so that they were treated (from 2010-11) as expenses of the Shop rather than the rental business.

17. For those reasons we agree with HMRC that no trading deduction is available and we would dismiss the appeal accordingly.

**Decision**

18. The appeal is DISMISSED.

19. 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.

**PETER KEMPSTER**
**TRIBUNAL JUDGE**

**RELEASE DATE: 5 FEBRUARY 2016**