[2016] UKFTT 0448 (TC)

TC05201

Appeal number: TC/2012/10864

Income tax - inaccuracies in tax returns - discovery and penalty assessments - dividend income from company of which Appellant was director and sole shareholder paid in part to Appellant's partner - whether s 385 ITTOI Act 2005 applies - yes - whether error in income tax returns was careless - yes - whether penalties correctly determined - yes - Appeal disallowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR TERENCE RAINE **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL CONNELL
MEMBER RICHARD CROSLAND

Sitting in public at Tribunal Appeals Court, Albion Street, Leeds, on 17 September 2015

For the Appellant Mr Oliver Marre, Counsel

For the Respondents Mrs Rosalind Oliver, Officer of HM Revenue and Customs

DECISION

The Appeal

1. This is an appeal by Mr Terence Raine ("the Appellant") against HMRC's decision to raise assessments to income tax for the years 2005-06 to 2010-11 and penalties for incorrect returns under s 95 Taxes Management Act 1970 and Schedule 24 Finance Act 2007.

2. The decisions under appeal:

Years	Decision	Amount
2005-06	Assessment	£4,999.95
2006-07	Assessment	£3,406.72
2007-08	Assessment	£15,000.08
2008-09	Assessment	£5,499.90
2009-10	Assessment	£4,847.40
2010-11	Assessment	£2,368.80
2005-06 - 2007-08	Penalty determination	£3,510.00
2008-09 - 2010-11	Penalty assessment	£1,907.41
2008-09 - 2010-11	Decision not to suspend penalties	n/a

HMRC say that the Appellant's return for 2004-05 was also incorrect but an assessment was not raised for that year because the time limit had expired.

3. In broad summary, HMRC say that from 18 September 2000, when Linkdrive Solutions Ltd was formed, the Appellant was the owner of all shares in the company and was therefore entitled to the whole of any dividends paid by it. Payments in the form of dividends were however made to the Appellant's long term partner Barbara Hamilton, ("Ms Hamilton") for the years 2005-06 to 2010-11 inclusive. HMRC say that Ms Hamilton had no legal or beneficial interest in the company and therefore the dividend income which she received was assessable on the Appellant and should have been included in his tax returns for each of the years when such dividends were made; that is 2005-06 to 2010-11 inclusive. The omission of the dividends from the Appellant's returns lead to a loss of tax for each of those years and such loss of tax for 2005-06 and 2006-07 arose from negligent or careless or conduct. The loss of tax arose because the Appellant:

- negligently made incorrect returns for 2005-06, 2006-07 and 2007-08
- carelessly made inaccurate returns for 2008-09, 2009-10 and 2010-11.

Points at issue

4. Whether the Appellant was the sole legal and beneficial shareholder in Linkdrive Solutions Ltd in the period from 18 September 2000 to 5 April 2011.

5. Whether all dividends paid by the company in that period fall to be assessed upon him.

6. Whether he was negligent in making incorrect returns for the years 2005-06 to 2007-08 inclusive and careless or deliberate in making inaccurate returns for 2008-09 to 2010-11 inclusive.

Background facts

7. The Appellant is a sixty-nine year old Chartered Engineer. He qualified in 1975 and has worked for numerous companies, mainly in technological and production management. Although engaged on senior management roles, he had always been an employee and in receipt of a salary, his employer deducting PAYE. In his witness statement, he says that prior to the formation of Linkdrive Solutions Limited in 2000 he had never previously been involved in the day to day management or been a director of a private or public limited company. He had never held shares in any of the companies in which he worked and although on occasions he was given the title of 'director', this was by way of description only. His employment was always in a practical and technical capacity. As a result he knew nothing of shares, dividends or the remuneration of directors.

8. In December 1999 he became redundant, and he says, was without work for the first time in over thirty years. He was unemployed for ten months for the first time in his working life.

9. He met a recruitment consultant who suggested that, given his age and experience, he should consider becoming self-employed and work as an 'Interim' or 'Locum' dealing with either specific technical problems or management roles in the engineering sector. In August 2000, he met with Mr Jenson, an associate of the recruitment consultant, who explained that he should trade as a limited company, as by doing so he would be able to work with the employer in a self-employed capacity without the employer taking on any statutory employment liabilities. Operating through the medium of a limited company would also more readily allow the Appellant to win and conduct interim management assignments through major national agencies.

10. Mr Jenson recommended Giant Accounting Limited ("Giant") to assist the Appellant with the process of setting up a limited company. They were acting for a number of other Interims with whom he worked. In September 2000, a suitable role became available with Simon Hartley Limited, a company working for the Thames Water Group and therefore the Appellant started the process of setting up his own company.

11. A meeting was arranged with Mr Graeme Hunt of Giant in Leeds for 18 September 2000. The Appellant travelled to Leeds with Ms Hamilton. The Appellant says he and his partner had shared the difficulties brought about by his redundancy of the previous months and the possibility of his returning to work was a significant matter for both of them. He says that they saw it as a new start so far as his work was concerned and the necessity to trade as a company was something which they both needed to know about.

12. Mr Hunt explained that he was principally a pension's advisor but had experience in the setting up of small companies. He explained that he had a number of 'off the shelf companies' that were available and immediately ready to trade. They chose a company named Linkdrive Solutions Ltd.

13. Mr Hunt explained that the company had been incorporated on 1 August 2000 but had not traded. He said that it was necessary to have two officers of the company. Because no third party would have any interest in the venture he therefore suggested that it was a simple job to register both the Appellant and Ms Hamilton as its officers and shareholders. The Appellant would be appointed a director and Ms Hamilton the company secretary. Mr Hunt

explained that Giant would deal with all necessary procedures and paperwork to formalise the appointments and also deal with the necessary share issues as part of their service.

14. The Appellant says that he and Ms Hamilton were told by Mr Hunt that two shares had been issued upon the company's formation. They were told that one was held by Temple Secretaries Limited which held the office of first company secretary and erroneously a second held by Company Directors Limited which held the office of sole first director (contrary to what Mr Hunt says – there was in fact only one subscriber share). Mr Hunt asked how the two shares were to be allocated. The Appellant says that he and Ms Hamilton had given no thought to this before the meeting as they were not aware that the question would be asked. They confirmed that one share each should be transferred to them. The Appellant says that Ms Hamilton commented that she had never owned a company share before. The Appellant says that he remembers the conversation very clearly as Mr Hunt responded with words to the effect that, "you might as well have it, as it's only £l".

15. They then discussed the need to open a company bank account. Mr Hunt explained that Giant had an arrangement with Flemings Bank and that he could arrange for an account to be opened in the name of Linkdrive. The Appellant and Ms Hamilton agreed to this and said that they would like Giant to deal with the accounting, payroll functions and company secretarial services such as the filing of accounts. Each service attracted a modest fee. With regard to the filing of returns at Companies House each year, Mr Hunt explained that it was not an onerous task and the Appellant and Ms Hamilton decided that this was something which they would be able to deal with themselves. With regard to setting up a bank account, they had problems with Fleming Bank and so eventually opened an account with Barclays Bank with whom the Appellant already held a personal account.

16. Following the meeting of 18 September 2000, Giant wrote to the Appellant on 26 October 2000. Their letter was accompanied by a document entitled "Welcome to Giant". The letter set out the extent of their services and what the Appellant was to expect from Giant. Under the heading of "What to expect in the next few months" Giant stated:

> "We are now in the process of registering the details of your company with Companies House. This involves registering the names and addresses of the Directors and Secretary, the registered office address, the allocation of shares, the accounting year-end date and type of business you are in. This usually takes 6-8 weeks, during which time you will receive various booklets and information packs explaining the main responsibilities and obligations of the officers of the company."

The Appellant says that he and Ms Hamilton had no reason to believe that all necessary formalities had not been undertaken correctly.

17. The Appellant says that the pack which came with Giant's letter of 26 October 2000 contained the Certificate of Incorporation, the company's Memorandum and Articles of Association, and a document entitled Statutory Registers, Minutes and Share Certificates (although none of the registers, minutes or certificates had been completed). They did not do anything with this pack, which he says has not changed since that date. Further they did not complete any alternate statutory documentation.

18. The Appellant says that apart from his one meeting with Giant on 18 September 2000 he never met with them again. He says that all subsequent advice and communication was, as is the norm with their service, through either their online portal or occasionally via telephone or email.

19. Linkdrive was registered for VAT on 19 September 2000.

20. The Appellant began work with Simon Hartley Limited on 2 October 2000. A contract for services was made between Linkdrive and Simon Hartley Limited. Payment was made to Linkdrive upon the presentation of invoices. The contract price for services was agreed at £550.00 per day plus expenses. Copies of the annual accounts for Linkdrive throughout this period give full details of the receipts and expenditure of Linkdrive, including the Appellant's salary, expenses and in later years the dividends that later became the subject of HMRC's enquiry.

21. The Linkdrive Barclays Bank account was set up on 19 October 2000.

22. Upon payment of the invoices rendered, the Appellant's agreed salary was paid to him by Linkdrive. The contracted sum effectively stood as his salary for the work in question. Any sum held by the company in excess of his salary and expenses was retained by Linkdrive as retained profit; although effectively all monies received by the company were paid to the Appellant. Giant were responsible for the payroll and would produce a payslip with the necessary tax and National Insurance deductions. Upon receipt of that information, the Appellant would raise a cheque for the net amount of his salary payable to himself from the Linkdrive account. He had no involvement in tax or National Insurance calculations, all of which was undertaken by Giant.

23. The Appellant remained with Simon Hartley Limited until July 2001. He says that during this period, Ms Hamilton would coordinate contact between clients and agencies on his behalf subject to his future availability. She functioned as the point of contact for all parties. On a day to day basis Ms Hamilton had limited involvement in the administration of the company but managed the Appellant's availability and maintenance of employment opportunities which was vital to the success of Linkdrive.

24. Giant's letter of 20 October 2000, with the attachment entitled "Welcome to Giant", is what the Appellant says was the only "engagement letter" of any type that he received. The document set out "what happens next" information including information in respect of "Paying your salary and PAYE", "Registering for VAT", "Expenses", "Recording your Company transactions", "Processing your company transactions and accounts", "Quarterly VAT returns", "Profit and loss statement", "dividends and bonuses", "End of year PAYE returns" and "annual returns to Companies House". In respect of both the payment of salaries and the payment of dividends, the Appellant says this represented the information upon which he and Ms Hamilton acted, with the further assistance of Giant via their online portal.

25. The Appellant says that at each quarter end, as requested by Giant, he supplied Giant with copies of the business bank account statements together with a detailed breakdown of expenses. Upon receipt Giant would produce quarterly VAT figures which he and Ms Hamilton would then input into a VAT return and lodge with HMRC.

26. For the next ten years or so, that is how the company functioned.

27. The normal method of allotting a share or shares to new shareholders on the purchase of an off the shelf company is for a call to be made (for £1 or whatever the nominal value of the share) on the subscribing shareholder, in this case Temple Secretaries Limited and upon non-payment, for that share to be forfeited and re-allotted to the purchaser of the company or nominated person. It appears that none of those formalities were ever completed (by Giant, as

they held the blank, pre-signed letter of call, letter of forfeiture, certificate of forfeiture, and minutes recording the forfeiture and re-allotment). The documentation had been signed by the company agents but remained uncompleted and undated. Technically therefore the one ordinary subscriber remained in the name of Temple Secretaries Limited.

28. Ms Hamilton sadly died on 29 May 2013 but had earlier provided a statement in the form of a letter dated 12 August 2012. She says that, at the meeting with Giant in Leeds on 18 September 2000, she and the Appellant were told that there were two shares in Linkdrive Solutions Ltd that could be transferred to her and the Appellant and they agreed that one share would be transferred to each of them. Ms Hamilton says that, although she had not operated directly with client companies, she had provided a secretarial service on a daily basis, liaising with clients and agencies in organising meetings and reports. She had also acted as a "sounding board" for the Appellant and had visited him frequently when he was away on assignments.

Annual Company Returns

29. In 2001, shortly after the setting up of Linkdrive Solutions Limited, the Appellant had received notification from Companies House that the Annual Return ("AR") was due to be filed. He forwarded this to Giant as he did not know what was required. Giant therefore completed the AR and then returned this to him for signature to send on to Companies House with a cheque for £15 representing the filing fee. The AR showed the Appellant as the only shareholder owning two shares. He says that he did not notice this at the time, and it continued therefore to be used as a template for all AR's subsequently prepared by Giant and sent on to Companies House by the Appellant, so that in all subsequent years, up to 2011, the returns to Companies House showed the Appellant as the only shareholder.

Annual Accounts

30. The Appellant says that Giant remained responsible for the filing with Companies House of the Company Annual Accounts for Linkdrive. They would prepare the accounts which would then be sent to the Appellant for checking and signature. The accounts were always in order and he could not recall that any amendments were made to them over the years of trading.

31. Linkdrive's company accounts for the year ending 2001 showed: - "Director together with his beneficial interests, including family holdings, 2 ordinary £1.00 shares". Under the subheading "share capital" the accounts confirmed that Linkdrive had an authorised share capital of 1000 shares, 2 being issued and fully paid which was reflected by a balance of £2.00 in the director's loan account. The accounts referred to the Appellant as owning two ordinary shares.

32. In November 2001, Linkdrive became dormant as the Appellant accepted full time employment with Pindar Plc a company located close to his home.

33. Company accounts for Linkdrive for the period ending 31 December 2002 continued to be prepared by Giant and repeated the information given in the previous accounts. Under the subheading "related party transactions" the accounts state that the company was under the Appellant's control, as managing director and the sole shareholder of two ordinary shares.

The Appellant says that he did not take issue with this wording at the time but says that he does not believe that he actually noticed it in order to do so.

34. The accounts for Linkdrive reflected that the company was dormant between November 2001 and December 2002.

35. In March 2003 the Appellant left Pindar. In January 2004, he began work as an Interim Locum with Lodestar Engineers Limited. By the end of that year, Linkdrive was, for the first time, showing a profit. After completing the project with Lodestar, the Appellant was able to obtain further appointments via his agent. He was assisted by Ms Hamilton who coordinated his diary and provided, he says, an invaluable point of contact for agencies and clients alike.

36. The accounts for the period ending 31 December 2003 were prepared by Giant. They again stated that the Appellant held two shares in the company. However he was now referred to as the "majority shareholder" of Linkdrive. The Appellant says that he did not notice the variation in the wording that had been used by Giant. "Share capital" was still shown as 1000 shares, 2 issued and fully paid in his name.

37. From the 2003 accounts onwards, no mention was made of the Appellant's shareholding as including any family holdings. The company was stated as being under his control but he was described as the "majority" shareholder. His interests continued to be presented in this way until the 2009 accounts, containing the (apparently contradictory) statement that the company was under the Appellant's control but that he was a 50% shareholder. This statement was repeated in the 2010 accounts. He says that this did not register with him at the time despite having previously made enquiries as to the shareholding within the company.

Payment of dividends

38. After the company moved into profit in 2004 the Appellant became aware that many other Interims did not operate their companies as he had. They took a lower salary and declared a dividend to shareholders in respect of profits which they said was a more tax efficient method of dealing with payments/salary.

39. In December 2004, the Appellant, after taking advice from a Mr McMahon of Giant, instructed them to arrange the paperwork for a dividend of £10,000, £5,000 to be paid to him and £5,000 to be paid to Ms Hamilton. The Appellant says that it was explained to him that the dividends had to be paid on a per-share basis. Giant dealt with the necessary Board Minutes declaring a dividend of £5,000 per share, and dividend tax vouchers, one for the Appellant and the other for Ms Hamilton.

40. On 5 April 2005, and subsequent years, a dividend was paid to the Appellant and Ms Hamilton again on the basis that they each owned a share in the company. Separate cheques were drawn and these were paid into separate accounts up until January 2009. After that dividends, although continuing to be paid with separate cheques, were deposited into the Appellant's bank account. Dividend vouchers were prepared by Giant.

41. The Appellant says that on 16 October 2006, he made contact with Giant, who were preparing the company accounts for the year end 31 December 2005. He noticed for the first time that the description within the accounts appeared at odds with his understanding of how the shares in Linkdrive were held. He understood that he and Ms Hamilton each held one

share, but the language on the documents produced by Giant stated both shares were held by the Appellant. He therefore requested a copy of the share certificates and the procedure for transferring shares.

42. Giant responded that they did not have this information/documentation readily available but that *"as for transferring shares we would recommend that you do not do this, as it may alert the Inland Revenue to an investigation under Section 660"*. The Appellant says that he did not receive a copy of the share certificates as he had requested, but it provided him with some comfort that Giant appeared unconcerned as to the position. Had they instructed him to make any changes to the documentation he would have done so, but in the absence of any such advice the position remained unchanged.

43. In summary, the first dividends were paid in December 2004; there were subsequent payments in April 2005, October 2005, January 2006 and September 2006. There were nine further dividend payments after the Appellant first expressed his concerns about the apparent discrepancy in share ownership. From October 2006 up to 5 April 2011 dividends paid in July 2009, March 2010 and December 2010 were paid in full into a Barclays Bank account in the name of the Appellant.

HMRC enquiry for year ended 2009

44. On 9 March 2011, HMRC wrote to the Appellant having noted apparent differences/inaccuracies in the amounts of dividend income shown in the company accounts and his Self-Assessment Tax Return for 2008-09. Further, he was registered at Companies House as the only shareholder in Linkdrive Solutions Ltd.

45. On 18 March 2011, upon receipt of the initial enquiry letter received from HMRC, the Appellant contacted Giant. He says that he asked for confirmation that that his understanding of the shareholdings in the company was correct, that is, that he and Ms Hamilton were joint and equal shareholders. Giant erroneously "confirmed" that the Appellant and Ms Hamilton each held one share. The Appellant says that Giant explained that the "family holdings" reference in the accounts satisfactorily reflected that a share was held by Ms Hamilton. Giant's explanation was not entirely clear and also appeared to contradict their advice in 2006:

> *"With regard to the Revenue claiming there is only one shareholder in the company, again this is wrong as our records show that both you and Barbara are equal shareholders. Page 1 of your company accounts would list you as holding all the shares however Page 5 of the accounts - related Party Transactions would explain that you are only a 50% shareholder. There may be a problem with this if Barbara is not a family member/related party. If this is the case, then page 1 of the accounts should show both you and Barbara owning one share each. It should not show you holding two shares. What relation is Barbara to you?*
>
> *The latest AR363 form has two shares recorded both being held under your name. Therefore Barbara is not classed as a shareholder in the company according to the Annual Return…. when did Barbara become a shareholder?"*

46. The Appellant responded that it had not been clear to him during the 'transfer process' who owned shares and he and Ms Hamilton believed that they had agreed joint share ownership but they had received no paper work or copy share certificates. The Appellant says that he had in fact been concerned about the actual share ownership between 2004 and 2006 and had asked Giant for advice on who actually held the share certificates, which he says

illustrates his ignorance of the company secretarial function given that the certificates and the share ownership register should actually be generated by Linkdrive Solutions. None of this had been done. He acknowledges in his witness statement that he should have queried this and more fully understood the link between the company returns and dividend payments. He says "*looking back we should have resolved the actual share ownership issue long ago but due to my inexperience and conflicting advice the situation was allowed to continue in my belief that Barbara was entitled to a 50% dividend share*." It is not clear however why the Appellant thought Ms Hamilton was entitled to 50% of the share dividend, given the advice he had received from Giant.

47. Some time later the Appellant again made contact with Giant, asking that they release to him all of the documents associated with the formation of the company along with any notes of the initial meeting with Mr Hunt. Giant were unable to provide any notes of the meeting but supplied form 228(a) dealing with the appointment of the Appellant and Ms Hamilton as the company's officers; form 88(2) being a return of allotment of shares and a copy of the meeting pack checklist.

48. The Appellant says that until 6 November 2012, he was unaware that there was in fact only ever one share. The first occasion that this was suggested was within an HMRC letter of that date. He says that neither he nor Ms Hamilton had anything to gain from the mistakes made. The errors arose from a simple error that was thereafter compounded as dividends were raised. All such dividends were raised in good faith in line with their belief that the Appellant and Ms Hamilton were joint shareholders. He says that had Ms Hamilton been a joint shareholder and had the annual returns reflected that, there would have been no overall tax benefit to them as the tax credits issued to Ms Hamilton would have offset any tax due from her on her share of the dividends.

49. The Appellant says that it was only when he re-read the documents sent to him by Giant that it became apparent to him that only one subscriber share was ever issued (to Temple Secretaries Limited) at the formation of the company, and not two. Further, that share had not been transferred to either the Appellant or Ms Hamilton. Form 88(2) deals with the allocation of shares. Despite the same having been signed by the Appellant as a director, it had not been completed by Giant. The Appellant says that this came as a total surprise as although the roles of a director, the company secretary and shareholders were briefly explained to him and Ms Hamilton, but not particularly the procedure relating to the allocation of shares, they were nonetheless satisfied that Giant would register all company documents appropriately. They had no reason to think otherwise. The Appellant says that in hindsight, the meeting with Mr Hunt was perhaps an unsophisticated affair with more time spent discussing his pension arrangements than the structure of the new company.

50. The Appellant also asked Giant for details of all communication with and from Giant. A copy of the full 'communications log' was received from them which the Appellant says is in most respects fair and accurate.

51. Included with the documentation provided by Giant was a copy of the document which he refers to as a "fact find", which was completed by Mr Hunt it would appear mainly in connection with potential pension advice. The document contains details of the Appellant's proposed earnings and other personal details. It also includes a note of the proposed shareholding of the Appellant and Ms Hamilton in Linkdrive Solutions Ltd, which are respectively stated to be 100% and 0%. Although this would appear to contradict what the

Appellant says he told Mr Hunt, there is no reference to or explanation of this in his witness statement.

52. Following further enquiries by his accountants the Appellant ascertained that as the actual allotment of share(s) had been overlooked, a retrospective 88(2) could be filed to correct the position. This has now been done and corrective Company Annual Returns have also been lodged. All years' returns were amended in October 2012 to show that the Appellant and Ms Hamilton owned one share each.

53. The Appellant and Ms Hamilton each made wills in 2012 leaving everything to the other on death. Ms Hamilton's shares in the company were therefore included as part of her estate.

Relevant legislation

54. Section 29 Taxes Management Act 1970 allows for assessments to be made under discovery provisions:

> S29 Assessment where loss of tax discovered
>
> 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 an 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(2) Where—
>
> (a) the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, and
>
> (b) the situation mentioned in subsection (1) above is attributable to an error or mistake in the return as to the basis on which his liability ought to have been computed,
>
> the taxpayer shall not be assessed under that subsection in respect of the year of assessment there mentioned if the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.
>
> 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 subsection (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.

29(4) The first condition is that the situation mentioned in subsection (1) above is attributable to fraudulent or negligent conduct on the part of the taxpayer or a person acting on his behalf.

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 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 enquiries into that 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 (I) above.

55. Section 50(6) Taxes Management Act 1970 places the onus on the Appellant to displace the assessments appealed against.

56. Section 847 Companies Act 2006 sets out the consequences of an unlawful distribution:

(1) This section applies where a distribution, or part of one, made by a company to one of its members is made in contravention of this Part.

(2) If at the time of the distribution the member knows or has reasonable grounds for believing that it is so made, he is liable—

(a) to repay it (or that part of it, as the case may be) to the company, or

(b) in the case of a distribution made otherwise than in cash, to pay the company a sum equal to the value of the distribution (or part) at that time.

(3) This is without prejudice to any obligation imposed apart from this section on a member of a company to repay a distribution unlawfully made to him.

(4)This section does not apply in relation to—

(a) financial assistance given by a company in contravention of section 678 or 679, or

(b) any payment made by a company in respect of the redemption or purchase by the company of shares in itself

57. Section 385 Income Tax (Trading and Other Income) Act 2005 defines the person chargeable to tax on dividend income:

Section 385 - *Person liable*

(1) The person liable for any tax charged under this Chapter is—

(a) the person to whom the distribution is made or is treated as made (see Part 6 of ICTA and sections 386(3) and 389(3)), or

(b) the person receiving or entitled to the distribution.

58. Section 95 Taxes Management Act 1970 allows for the determination of penalties for incorrect returns:

Section 95 - *Incorrect return or accounts for income tax or capital gains tax*

(1) Where a person fraudulently or negligently—

(a) delivers any incorrect return of a kind mentioned in section 8 or 9 of this Act (or either of those sections as extended by section 12 of this Act or section 39(3) of the principal Act (husband and wife)), or

(b) makes any incorrect return, statement or declaration in connection with any claim for any allowance, deduction or relief in respect of income tax or capital gains tax, or

(c) submits to an inspector or the Board or any Commissioners any incorrect accounts in connection with the ascertainment of his liability to income tax or capital gains tax,

he shall be liable to a penalty not exceeding the aggregate of—

(i) £50, and

(ii) the amount, or, in the case of fraud, twice the amount, of the difference specified in subsection (2) below.

(2) The difference is that between—

(a) the amount of income tax and capital gains tax payable for the relevant years of assessment by the said person (including any amount of income tax deducted at source and not repayable), and

(b) the amount which would have been the amount so payable if the return, statement, declaration or accounts as made or submitted by him had been correct.

(3) The relevant years of assessment for the purposes of this section are, in relation to anything delivered, made or submitted in any year of assessment, that, the next following, and any preceding year of assessment; and the references in subsection (2) to the amount of income tax payable include surtax, except that, in relation to anything done in connection with a partnership they do not include any income tax not chargeable in the partnership name.

59. Schedule 24 Finance Act 2007 allows for the assessing of penalties in respect of inaccurate returns for return periods starting on or after 1 April 2008 and where the due date for filing is on or after 1 April 2009.

Paragraph 1 of Schedule 24 states in relevant part as follows:

(1) A penalty is payable by a person (P) where-
(a) P gives HMRC a document of a kind listed in the Table below, and
(b) Conditions 1 and 2 are satisfied.

(2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to-
(a) an understatement of a liability to tax,
(b) a false or inflated statement of a loss, or
(c) a false or inflated claim to repayment of tax.

(3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.

(4) Where a document contains more than one inaccuracy, a penalty is payable for each inaccuracy.

Tax	*Document*
Income tax or capital gains tax	Return under section 8 of TMA 1970 (personal return).

60. Paragraph 3 of Schedule 24 provides for degrees of culpability as follows:

(1) For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is-

(a) "careless" if the inaccuracy is due to failure by P to take reasonable care,

(b) "deliberate but not concealed" if the inaccuracy is deliberate on P's part but P does not make arrangements to conceal it, and

(c) "deliberate and concealed" if the inaccuracy is deliberate on P's part and P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure).

(2) An inaccuracy in a document given by P to HMRC, which was neither careless nor deliberate on P's part when the document was given, is to be treated as careless if P--

(a) discovered the inaccuracy at some later time, and

(b) did not take reasonable steps to inform HMRC.

61. Paragraph 4 sets out the penalty payable under paragraph 1. Paragraph 4(1)(a) provides that the penalty, for careless action, is 30% of the potential lost revenue. For deliberate but not concealed action, the penalty is 70% of the potential lost revenue, and for deliberate and concealed action, the penalty is 100% of the potential lost revenue.

62. Paragraph 5 defines "potential lost revenue" as "the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment".

63. Paragraph 9 provides for reductions in the penalty for disclosure depending on whether it is prompted or unprompted.

64. Paragraph 10(1) provides that "Where a person who would otherwise be liable to a 30% penalty has made an unprompted disclosure, HMRC shall reduce the 30% penalty to a percentage (which may be 0%) which reflects the quality of the disclosure". Paragraph 10(2) provides that "Where a person who would otherwise be liable to a 30% penalty has made a prompted disclosure, HMRC shall reduce the 30% penalty to a percentage, not below 15%, which reflects the quality of the disclosure".

65. Paragraph 11 further provides that HMRC may reduce the penalty under paragraph 1 "If they think it right because of special circumstances".

66. Paragraph 14 also enables HMRC to suspend all or part of a penalty for a careless inaccuracy under paragraph 1, but (under paragraph 14(3)) "only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy".

67. Under paragraph 15, a person may appeal against a decision of HMRC that a penalty is payable (sub paragraph (1)), or as to the amount of a penalty payable, (subparagraph (2)) or a decision not to suspend a penalty payable, (subparagraph (3)) or a decision as to the conditions of suspension (subparagraph (4)).

68. Paragraph 17 deals with the powers of the Tribunal in any such appeal.

> "17 (1) On an appeal under paragraph 15(1) the appellate tribunal may affirm or cancel HMRC's decision.
>
> (2) On an appeal under paragraph 15(2) the appellate tribunal may
>
> (a) affirm HMRC's decision, or
>
> (b) substitute for HMRC's decision another decision that HMRC had power to make.
>
> (3) If the appellate tribunal substitutes its decision for HMRC's, the appellate tribunal may rely on paragraph 11
>
> (a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or
>
> (b) to a different extent, but only if the appellate tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed."

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Evidence

69. The evidence consisted of four level arch files, comprising copy correspondence between the Appellant and HMRC, copy correspondence between the Appellant and his company agents relating to formation of Linkdrive Solutions Limited and the subsequent payment of dividends, including a log of telephone calls; a witness statement by the Appellant, his Notice of Appeal, a copy letter from the late Barbara Hamilton, copy company formation documentation, copy dividend vouchers, copy self-assessment returns of the Appellant, copy company annual returns, relevant legislation and authorities. The Appellant also gave oral evidence to the Tribunal.

HMRC's submissions

70. The Memorandum of Association and other company documentation shows quite clearly that only one share was allotted by the company - in the name of Temple Secretaries Ltd. No further allotments were made. Giant took the mistaken view that Temple Secretaries Ltd and Company Directors Ltd each held one share. From formation of the company, both the company's accounts and Companies House returns were prepared on the basis that the allotted share capital was two ordinary shares and each of these were in the Appellant's name. Despite this, from 2003 to 2011, dividends were paid to the Appellant and Ms Hamilton in equal shares.

71. HMRC accept that it is possible for a single share to be held jointly but, even if there were joint owners of a single share, this should have been shown in the annual returns to Companies House and reflected in the company accounts.

72. The entries in the first year's accounts reflect the fact that the Appellant was the sole shareholder. Whilst his holding of two shares was said to include "family holdings", this expression did not necessarily imply that there were any family holdings in practice. It was a requirement to include in a company's accounts shares owned by a director's spouse or minor children when declaring a director's interests in the company's share capital. However, Ms Hamilton did not in any event fall within that description. In the second year's accounts the Appellant was named as the sole shareholder.

73. Later accounts dropped the reference to family holdings and described the Appellant as being the "majority" shareholder with control of the company and later that the Appellant was a 50% shareholder but still having control of the company. Even if there had been two shares then, a holding of one share would not be a majority holding. Nor, with equal voting rights, would it confer control of the company.

74. The annual returns to Companies House consistently showed the Appellant to have been the sole owner of two shares. The first year's return was prepared by Giant but those for later years were all submitted by the Appellant. His explanation is that he believed the return to have in fact included Ms Hamilton's interest. HMRC argue that it is difficult to accept that, because there is no obvious reason why he would have held that belief. As a layperson, with no knowledge of company law, the natural inclination would have been to list both himself and Ms Hamilton as shareholders, if this was the Appellant's genuine understanding of the position at the time. It is also difficult to accept that the reference in the accounts to "family interests" was the reason that the Appellant failed to mention Ms Hamilton on the annual return. On a balance of probabilities, he completed the return in that way because he considered himself to be the sole owner of the shares.

75. There was no suggestion in the Appellant's letter to Giant in October 2006 that he believed the company to have been in joint ownership. In fact the letter, as first written, would appear to have referred to the company having "become mine", having been set up "under my ownership" and having been transferred "to me", before these words were removed and/or amended. Also in that letter, the Appellant stated that the annual returns showed the correct shareholdings.

76. Both the Appellant and Ms Hamilton have stated that, at the initial meeting with Giant, it was agreed that they would take one share each. This is not supported by Giant, who say that the forms completed at that meeting show the Appellant to have been the sole shareholder. There are no minutes of this meeting.

77. HMRC say that it is difficult to form a view as to how the decision was taken by the Appellant to pay dividends to both himself and Ms Hamilton. Taken in isolation, the Giant contact log entries weigh in favour of the Appellant's explanation. However, HMRC has only been provided with extracts and there is no record of what was discussed during the 'phone conversation on 6 December 2004 or in any previous discussions or correspondence. As the Appellant had no previous experience of paying himself in dividends, it would be surprising if the matter had not been discussed with Giant beforehand.

78. The Appellant has received legal advice suggesting that Ms Hamilton may have had a beneficial interest in the share(s) or that a share was held on trust for her by implication equitable assignment or under a constructive trust. However there was no formal Declaration of Trust or other documentary evidence of the Appellant's express intention to vest or hold a share in trust for Ms Hamilton. The Appellant alternatively argues that if Ms Hamilton had no share interest in the company then the dividend was in any event an unlawful payment by the company.

79. On the balance of probabilities, the Appellant remained the sole beneficial owner of the allotted share capital in Linkdrive Solutions Ltd from September 2000 until 2012. Consequently, all of the dividends voted and paid by the company fall to be treated as the Appellant's income and not divisible between him and Ms Hamilton.

80. HMRC does not accept the Appellant's analysis, that an implied trust arose in respect of a 50% interest in the company in favour of Ms Hamilton. The Appellant acknowledges that there was no written declaration of trust. An oral trust does not exist simply because someone says there is one. HMRC does not accept that there was any intention on the part of the Appellant to create a trust.

81. Neither does HMRC accept that the Appellant had any intention to assign 50% of the shareholding to Ms Hamilton. No steps at all were taken by the Appellant to initiate a transfer. Indeed, after clearly becoming aware of the share discrepancy in October 2006, the Appellant did nothing to resolve matters and did not remedy matters by transferring part of his interest in the company to Ms Hamilton.

82. Further HMRC does not accept a constructive trust arose in respect of 50% of the Appellant's interest in the company. There must be a common intention between the parties and significant detriment to the person claiming to have beneficial ownership. The Appellant has not provided any evidence to show that he and Ms Hamilton intended to each hold 50% of the shares in Linkdrive Solutions Ltd or that there was any significant detriment to Ms Hamilton.

83. Although Barbara Hamilton was an officer of the company by virtue of her appointment as company secretary on 18 September 2000, she was not the beneficial owner of any share(s) in the company. From that date all returns and accounts signed by the Appellant state that he was the only shareholder in the company. As an officer of the company it was his responsibility to ensure those returns were correct and complete.

84. HMRC does not accept that the dividends were unlawful. There is nothing to suggest that any of the dividends declared were in excess of retained profits and that it was unlawful for the company to make distributions by way of dividends. The question of whether a dividend is unlawful is a matter to be determined by the company, and the company secretary in particular, who has a legal duty to ensure that the company acts lawfully.

85. The Appellant being the sole shareholder was entitled to receive the whole of any dividend declared, irrespective of to whom it was actually paid.

86. The charge to tax arises under s 385 ITTOIA 2005 and is made on any person to whom any distribution is made *or treated as made*, or the person receiving *or entitled to the distribution*. It follows that the payments to Ms Hamilton were distributions and where the

distribution belongs to someone other than the recipient, that other person is chargeable to tax.

87. HMRC referred to the case of *Peter Rowe v HMRC* [2014] UKFTT 909 (TC). In that case a dividend was paid by a company of which the Appellant was a director and shareholder. The Appellant wrongly believed his wife owned half of the shareholding which was registered in his name. Dividend payments were made by a company secretary to the Appellant, but paid into a joint bank account of the Appellant and his wife, the Appellant saying that it had not occurred to him that the payment purported to be for him alone. The case can therefore be distinguished from this case because dividend payments were paid to Mr Rowe but in this case dividend payments were made to Ms Hamilton and dividend vouchers issued.

88. It follows that the Appellant, being entitled to the whole of any dividend declared, is taxable on the whole amount, even though Barbara Hamilton received part of the dividend, that is, with the exception of those dividends declared in July 2009, March 2010 and December 2010 which were actually paid to the Appellant. In those cases, again the Appellant is taxable on the dividends notionally paid to Ms Hamilton but actually paid to him.

Statutory authority for assessments

89. The Appellant does not challenge HMRC's statutory right to make the assessments. Nonetheless, it is clear that HMRC discovered that the Appellant's self-assessments for the years concerned were insufficient and that the conditions at both s 29(4) and (5) Taxes Management Act 1970 ("TMA") have been met. The loss of tax arose because the Appellant failed to include in his returns, dividend income which was assessable upon him.

90. The normal time limit for making an assessment is four years from the end of the relevant tax year. However, this is extended to six years where the assessment is made to recover a loss of tax brought about carelessly by either the person being assessed or another person acting on his behalf; (s 36(1) and (1B) TMA 1970).

91. HMRC's view is that the loss of tax is a result of dividends having been paid to or shared with Ms Hamilton which properly belonged to the Appellant and should have been returned as his income. This resulted from carelessness on the part of the Appellant and/or Giant, who were acting on his behalf in respect of company matters. Consequently, the assessments for 2005-06 and 2006-07 were not out of time.

Penalties under Section 95 TMA 1970

92. Penalties are exigible under this section for years up to and including 2007-08 where a person has fraudulently or negligently delivered an incorrect return. HMRC has taken the view that the Appellant negligently delivered incorrect returns for the years concerned.

93. HMRC's view is that the Appellant's returns were incorrect because he failed to declare the full amount of his dividend income. The returns reflected the amounts paid to him by the company. However, the decision to pay half of the dividends to Ms Hamilton was taken by the Appellant, or with his knowledge, and was approved by him as the sole director of the company. The payments were made despite no steps having been taken to allot a second share and without having established that Ms Hamilton had any beneficial entitlement to a

dividend. At the same time, he completed annual returns to indicate that he was the sole shareholder.

94. The question to be considered is whether a prudent and reasonable person in the Appellant's position would have taken the same action. HMRC do not believe that the Appellant's actions were those of a prudent and reasonable person. Even if he believed that he only owned half of the allotted share capital, it was not reasonable for him to have held that belief. His actions ultimately resulted in the delivery of incorrect returns. All returns and accounts were signed by the Appellant, an officer of the company by virtue of his directorship since 18 September 2000, and state that he was the only shareholder in the company from that date. As an officer of the company it was his responsibility to ensure those returns were correct and complete. Consequently, HMRC assert that it is correct in its view that penalties have been incurred under s 95 TMA.

95. In determining the amounts of the penalties, the enquiry officer has given the maximum possible abatements for disclosure and co-operation. She has allowed an abatement of 25% for "seriousness". In view of the amounts of tax lost, in both absolute terms and as a proportion of the Appellant's total liability to tax for those years, the level of abatement is reasonable and in accordance with HMRC's policy.

Penalties under the Finance Act 2007 Schedule 24

96. Penalties are incurred under this legislation where, for 2008-09 onwards, a person gives HMRC a return that contains an inaccuracy which leads to an understatement of his liability to tax and the inaccuracy was careless or deliberate. An inaccuracy is careless if it is due to the failure by the person to take reasonable care.

97. "Failure to take reasonable care" can be likened to the concept of "negligence". So, for the reasons given under the previous heading, HMRC say that the understatement of dividends in the later years' returns represented "careless inaccuracies". Consequently, a penalty has been incurred for each of those years.

98. The enquiry officer has allowed the maximum possible reduction to take account of the quality of the Appellant's disclosure. This has resulted in a penalty equal to 15% of the Potential Lost Revenue; this is the minimum penalty chargeable for a careless inaccuracy in the absence of any special circumstances.

99. HMRC has a discretionary power to reduce the penalty further if there are special circumstances. This was considered by the enquiry officer and she concluded that there were no special circumstances which would warrant such a reduction.

100. HMRC accept that the circumstances that led to the inaccuracies in the Appellant's case were unusual. However, they have already been taken into account in determining whether the inaccuracies were "careless" and do not, therefore warrant any further reduction of the penalty.

The Appellant's submissions

101. Mr Marre on behalf of the Appellant says that although this is a tax appeal, the case does not turn on the construction, or even the application, of the tax code. The questions which the Tribunal must answer are questions of Trusts law. He submits that on any one of

the three analyses set out below, 50% of the shareholding in the company belonged at all material times (i.e. throughout the tax years under appeal) to Ms Hamilton:

a. There was an express trust of 50% of the company's issued shares, of which Ms Hamilton was the beneficiary; or

b. There was an equitable assignment of 50% of the company's issued shares from the Appellant to Ms Hamilton; or

c. There was a common intention constructive trust over 50% of the company's issued shares, of which Ms Hamilton was the beneficiary.

and on the basis of any one of these analyses, there is no sustainable position that the Appellant is liable to income tax in respect of distributions made by the company to Ms Hamilton in respect of Ms Hamilton's beneficial shareholding.

102. Alternatively it cannot be, as HMRC contend, that the transfers to Ms Hamilton are somehow transformed into distributions to the Appellant. Rather, they were mere purported distributions to Ms Hamilton, in breach of company law and in breach of the Articles and Memorandum of Association of the company. Under those circumstances, the purported distributions were void: they are not distributions to anyone at all and cannot be taxed as such. The beneficial ownership of the money never moved from the Company to Ms Hamilton. They give rise to no tax liability on anyone.

Express trust

103. For the valid creation of an express trust, there needs to be certainty of subject matter; of object; and of intention.

104. In this case, the subject matter is certain. It is a 50% interest in the issued shares of the company. As shares are fungibles, the relevant question is whether the proportion of shareholder interest said to be held on trust is certain, not whether it is possible to point at a specific share. It is quite possible to hold a single share as tenants in common. It is, therefore, irrelevant whether the issued share capital of the company in the relevant years of assessment was one share or two shares.

105. The object of the trust is Ms Hamilton.

106. There is no need for the word "trust" to be used to prove intention. The question is whether in substance a sufficient intention to create a trust has been manifested. Such a declaration may be made by word of mouth or may be inferred by conduct. Further, there is no need for the settlor to have understood that his words have created a trust. Although it is often expressed to be desirable to have written evidence of a trust, it is settled law that there is no requirement for written evidence in cases of a trust of pure personalty.

107. The question is whether the Appellant intended to hold the entirety of the beneficial interest in the company or whether he intended 50% of that interest to belong to Ms Hamilton. Mr Marre submits that on the evidence before the Tribunal there is no doubt on this point. Dividend vouchers were issued as to 50% to the Appellant and 50% to Ms Hamilton. The dividend vouchers themselves demonstrate the intention of the Appellant that 50% of the shares in the company belonged to Ms Hamilton.

108. Regrettably the Appellant was not well served by the company's accountants. Their preparation of the company's accounts does not appear to have been any more diligent or accurate than their administering of the company's shareholdings when it was set up. However, to the extent that any weight can be placed on the accounts, the description of the beneficial ownership of the company's issued shares in later years is to be preferred to that in earlier years, as the Appellant himself had by then started to draw matters to the company's accountants' attention.

109. If the Appellant was the beneficial owner of 50% of the issued shareholding in the company, and received 50% of the declared dividends, he is properly taxable on 50% of the dividends declared. He is taxable on precisely what he received and paid tax on. The Appellant's tax returns were therefore, correct for all years.

110. As to the amounts of the dividend treated as Ms Hamilton's income, on which HMRC now seek to assess the Appellant, the person liable is the person, "To whom the dividend was made", s 385 IT(TOI)A 2005. On all the evidence, that is, the dividend vouchers and copy bank statements, this was Ms Hamilton.

111. Although HMRC assert that Ms Hamilton was not the beneficial owner of any share in the company, they provide no explanation for this assertion and no evidence to counteract the evidence provided by the Appellant.

Equitable assignment analysis

112. Mr Marre submits that if there was not a valid express trust, then the Appellant made an equitable assignment of 50% of his shareholding to Ms Hamilton. For that purpose it is necessary to show an intention to assign; and that such sufficient steps were taken that it would be inequitable to hold that an assignment did not take place.

113. Mr Marre argues that on the evidence, it is plain that the Appellant intended that he and Ms Hamilton should each own 50% of the issued shareholding in the company as evidenced by his clear intention to share ownership of the company in equal parts with Ms Hamilton.

114. In *Pennington v Waine,* Arden LJ in the Court of Appeal held:

> "...where a court of equity is satisfied that the donor had an intention to make an immediate gift, the court will construe the words which the donor used as words effecting a gift or declaring a trust if they can fairly bear that meaning...
>
> Accordingly the principle that, where a gift is imperfectly constituted, the court will not hold it to operate as a declaration of trust, does not prevent the court from construing it to be a trust if that interpretation is permissible as a matter of construction, which may be a benevolent construction. The same must apply to words of gift. An equity to perfect a gift would not be invoked by, giving a benevolent construction to words of gift or, it follows, words which the donor used to communicate or give effect to his gift."

115. Equity looks on that as done which ought to be done and looks at the intent rather than the form. The Appellant took steps which made clear his intention to ensure that 50% of the issued shareholding in the company belonged to Ms Hamilton. He gave the company's accountants his instructions, signed the forms he was given to sign and, subsequently,

attempted to rectify the situation when it became clear that he had been let down and his instructions had not been followed.

Common intention constructive trust

116. If the Appellant did not create an express trust of 50% of his shareholding in the company and further did not make an equitable assignment of 50% of his shareholding, then Ms Hamilton in any event acquired a beneficial half share in the issued shareholding of the company by operation of a common intention constructive trust. For that purpose there must be evidence of a common shared intention, whether express or implied.

117. The intentions of the Appellant and Ms Hamilton were express as to the split shareholding and, in any event, must necessarily be inferred from the conversations between them and their subsequent conduct. For a constructive trust to arise it is normally necessary for the beneficiary to have acted detrimentally in reliance on the agreement that he or she is to take a share of the property. In this case, the evidence is that Ms Hamilton worked for the company, in which she considered herself to be an equal 50% partner, being "active on a daily basis in providing a secretarial service, in liaising with clients and agencies in organising meetings and client reports and have provided a sounding board..." and drawing no salary from the Company.

Company law analysis

118. Mr Marre, in the alternative, argued that if there was neither an express trust nor a constructive trust, and there was no equitable assignment to Ms Hamilton, it is necessary to question whether as a matter of tax law the company could make a "distribution" which is unlawful/impossible as a matter of company law.

119. Section 829 Companies Act 2006 defines distribution as "every description of distribution of a company's assets to its members, whether in cash or otherwise...". It must be a payment (i) of profits and (ii) in respect of shares but the definition does not extend to transfers of funds to people who are not shareholders.

120. In *Ridge Securities Ltd v 1RC* 44 TC 373 a company claimed to fall within (what was then) s 169 ITA 1952 which applied if it had made a "payment" of a sum which was an "annual payment". The company had made an unlawful distribution (to a shareholder but in excess of its profits). The court determined that the taxpayer could/did not fall within s 169 because an unlawful distribution is not "payment". It was "a nullity" which had "no legal operation". The same reasoning applies here.

121. The transfer of funds to Ms Hamilton was not made to a shareholder, nor were the funds paid over to the Appellant by Ms Hamilton on receipt. She was not, and cannot reasonably be characterised as an "agent" for the Appellant. Accordingly, the amounts transferred to Ms Hamilton, purportedly in respect of her non-existent shareholding in the company, were never valid distributions as they were transferred in respect of a non-existent shareholding. The purported dividend vouchers were void having been issued to a non-shareholder. As a consequence they cannot be taxed as distributions to anyone.

122. The company has a right "in rem" over the funds and can call for them to be repaid. Having been unlawfully paid to Ms Hamilton the funds would be held on constructive trust

for the company. HMRC accept publicly that illegal dividends give rise to constructive trusts in this way, and are not taxed as income in the hands of the recipient: Manual CTM200952.

> Paragraph 29 – ultra vires and illegal dividends
>
> "Where a dividend is paid and it is unlawful in whole or in part and the recipient knew or had reasonable grounds to believe that it was unlawful then that shareholder owes the dividend (or part) as constructive trustee in accordance with the principles stated by Dillon L J in *Precision Dippings Ltd v Precision Dippings Marketing Ltd* [1986] 1 CH at page 457. Such a dividend (or part) is void for the purposes of both IT under ICTA88/S20 and ACT under ICTA88/S14 since the company has not made a distribution as a matter of company law, and so the dividend does not form part of the recipient's income for tax purposes. The company has not parted with title to the sum that it purported to distribute, which as a consequence remains part of its assets under a constructive trust."

123. On the above company law analysis, there is no tax payable on dividends paid to Ms Hamilton since the beneficial ownership of the money never moved from the company; a void distribution is not a distribution and so s 385 ITTOIA 2005 does not apply and there is no basis on which the Appellant can be assessed to tax

124. It necessarily follows that no penalties are due.

125. For the avoidance of doubt there is also no "loan to a participator", as the transfer to Ms Hamilton was void. A "payment" does include a "loan" but a void unlawful payment cannot be a loan.

Burden of proof

126. Mr Marre argues that the burden of proof in relation to showing that s 29 is in point lies on HMRC. In *HMRC v Household Estate Agents* [2008] STC 2045 (decided when "carelessness" was still referred to by statute as "negligence", but approved with reference to the new statute in, e.g., *Sanderson v HMRC* [2012] UKFTT 20 (TC)) Henderson J said :

> "...in the absence of any evidence of fraud or negligent conduct (paragraph 43), or of material to satisfy the test of objective non-awareness (paragraph 44), there would be no basis for a conclusion that either of those paragraphs applied, and nothing to displace the general rule that discovery assessments may not be made..."

HMRC have not provided any evidence to show that they have satisfied the provisions of s 29 TMA.

Extended time

127. The normal period of assessment is limited to four years under s 34 TMA 1970. In this case, however, HMRC seek six years' worth of taxes. For the time limit to be extended, the burden of proof is on HMRC to show that the "loss of tax" was "brought about carelessly". HMRC have not adduced any evidence to show either a loss of tax or a causal connection to carelessness on the part of the Appellant.

128. It is irrelevant whether the Appellant (or Giant) was careless when setting up the company, or taking associated steps such as filing Companies House returns unless those

steps "brought about" a loss of tax. A causal link is required. In any event any carelessness there may have been was tax neutral.

129. Therefore, on any view, even if contrary to all four of the Appellant's analyses above, HMRC's assertion as to the Appellant's liability is correct, HMRC were unable to assess years 2005-06 and 2006-07 as they were out of time.

Penalties – pre 2009

130. The onus is on HMRC to prove that a penalty is due.

131. No penalty is due under s 95 TMA 1970 in respect of years up to 2009 unless the tax return itself is made "negligently". Negligence requires a person to act otherwise than a reasonably prudent man would act. HMRC have adduced no evidence of negligence and no evidence of a causal link between the Appellant's actions and any loss of tax.

132. Mr Marre argues, in circumstances where the legal merits point away from HMRC's arguments on four separate grounds, that an allegation of "negligence" would be absurd.

Post 2009

133. No penalty is due for later years under schedule 24 Finance Act 2007 unless the Appellant has been "careless". Carelessness is defined, in Schedule 24 at para 3 as "a failure by P to take reasonable care".

134. In *Collis v HMRC* [2011] UKFTT 588, which has been cited by subsequent tribunals with approval, the Tribunal said that "the standard by which this falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question". This imports an objective test akin to that of negligence.

135. The Appellant's primary case is that the self-assessment returns he submitted were not inaccurate on the basis of the legal analyses set out above. If they were inaccurate, any inaccuracy would need to be such that it would not have been made by a prudent and reasonable taxpayer in his position. Such a taxpayer can only be expected to take professional advice, which is what the Appellant did.

Conclusion

136. We accept that the Appellant initially thought there were two shares in the company rather than one. For the earlier years he was not sent details of the shareholdings and Giant had mistakenly understood that Temple Secretaries Ltd and Company Directors Ltd each held one share. Company Directors Ltd did not hold a subscriber share. They therefore misinformed the Appellant. We can accept that as a consequence there may have been some initial confusion as to who the shareholders were.

137. However, we do not accept that the Appellant thought one share was owned by himself and the other by Ms Hamilton. There is no specific evidence that shows the Appellant asked Giant to set up the company with two shareholders. The Appellant's instructions to Giant were that the company was to be in his sole name. This is evidenced by the 'Fact Find' completed by Mr Hunt in which he refers to the Appellant as owning 100% of the shares and Ms Hamilton owning 0% of the shares. There is no reason why the Fact Find would not have been based on what the Appellant told Mr Hunt.

138. The Appellant signed off the company accounts in which it is quite plainly stated in each year (almost immediately above his signature and very difficult not to notice) that both shares in the company are in the name of Mr Terence Raine. Whatever the language used in the accounts with regard to share ownership, it was perfectly clear that the Appellant owned the two shares. There is no mention of Ms Hamilton.

139. Equally clearly the Appellant completed the company returns on the same basis. He completed the Companies House 363 return on an annual basis and signed the declaration on the Return for the company. The return clearly showed that he was the only shareholder. His explanation is that he believed the return to have in fact included Ms Hamilton's interest. As HMRC argue that it is difficult to accept, because there is no obvious reason why he would have held that belief.

140. It is quite likely that the issue of dividing the share ownership, in the context of mitigating tax on profits/income, was not uppermost in the Appellant's mind when the company was first formed, and that is why the clear discrepancy as to share ownership did not, at that stage, present a problem to him.

141. It was not until 2004 when the company became profitable that dividing the profits of the company between himself and Ms Hamilton came under consideration. The Appellant must have at the very least suspected that Ms Hamilton was not a shareholder and was not entitled to a dividend and that any tax liability arising therefrom could not be transferred to her. In any event he could and should have checked the position with Giant.

142. In October 2006 the Appellant says he expressed concerns about the documents supplied by Giant and the apparent inconsistencies in the shareholding. In reply to those concerns Giant emailed him on 31 October 2006 to explain the position. Giant addressed the issues which the Appellant had raised regarding the appointment of Ms Hamilton as company secretary in lieu of Temple Secretaries Limited, but did not specifically address the shareholding issue. They commented that "the annual return shows the up to date information, i.e. company secretary, director, shareholdings, registered office". Giant also enclosed a copy of the annual return. At that point the Appellant should have checked the return and if he disagreed with the information on it, pursued the issue again with Giant. HMRC argue that if he did not check the return he was negligent/careless. If he did check the return but then continued to submit annual returns showing himself as the only shareholder and personal income tax returns showing only a 50% share of the dividends then that could arguably be classed as deliberate in that he knew that one of those returns must be incorrect. However the Appellant says that Giant appeared to be unconcerned and that put him at ease. Given all the other evidence, that he was the sole shareholder, it is difficult to accept that explanation.

143. Thereafter, the Appellant continued to submit company annual returns and signed off accounts each year on the basis that he was the sole shareholder in the company. He did this each year from 2001 to 2011.

144. There is no documentation to demonstrate that share ownership in the company was to be held jointly by the Appellant and Ms Hamilton. Further, the reasons for the acquisition of the company, coupled with the fact that its sole source of income was derived from the provision of the Appellant's services, means that unless the contrary is demonstrated the presumption has to be that the company was in his ownership.

145. The payments to Ms Hamilton were made without having established that Ms Hamilton had any beneficial entitlement to a dividend. Contemporaneously with the dividend being divided between himself and Ms Hamilton the Appellant completed and signed annual returns to indicate that he was the sole shareholder. Some of these were in his own handwriting. He must have been aware that dividends are only paid to shareholders

146. The Appellant argues that Ms Hamilton may have had a beneficial interest in the share(s) or that the share was held on trust for her. However he acknowledges that there was no formal Declaration of Trust. There is no other documentary evidence of the Appellant's express intention to vest or hold a share in trust for Ms Hamilton.

147. We do not accept the Appellant's assertion that an implied, or constructive trust arose in respect of a 50% interest in the company in favour of Ms Hamilton, or that the Appellant had any intention to assign 50% of his beneficial ownership in his shareholding to Ms Hamilton. No steps at all were taken by the Appellant to initiate a transfer. Indeed after becoming aware of the share discrepancy in October 2006, the Appellant chose not to implement any intention he might have had to transfer any part of his interest in the company to Ms Hamilton. The Appellant may have intended to make her an equal shareholder but the fact is that he never executed that intention during the tax years in issue.

148. Although Ms Hamilton was an officer of the company by virtue of her appointment as Company Secretary, she was not the beneficial owner of any share(s) in the company. Ms Hamilton provided secretarial assistance but that did not equate to her having a beneficial interest in the company. The functions she performed were, on the evidence, not detrimental to her and effectively no different than those she provided before the formation of the company.

149. From formation of the company all returns and accounts signed by the Appellant state that he was the only shareholder in the company. As an officer of the company it was his responsibility to ensure those returns were correct and complete.

150. Considering the accounts and returns for all years, the entries and other evidence point towards the Appellant being the sole owner of the share(s) and that he was aware of that.

151. Whilst we accept that the Appellant had no previous experience of running a company and owning shares, it is reasonable to consider that a layman would ordinarily be aware that dividends are only paid to shareholders and that Ms Hamilton, having checked, was not a shareholder.

152. The question of whether a dividend is unlawful or not is not a tax matter. It is rather the application of company law to the particular facts, and the tax consequences flow from those facts. This is a matter in the first instance to be determined by the company, and particularly the Company Secretary who had a legal duty to ensure that the company acts lawfully. In our view both the Appellant and Ms Hamilton, knew or should have known that Ms Hamilton was not a shareholder.

153. Section 829 Companies Act 2006 defines distribution as "every description of distribution of a company's assets to its members, whether in cash or otherwise...". However a distribution is a payment to a shareholder and must be a payment (i) of profits and (ii) in respect of shares. The definition cannot be extended to transfers of funds to individuals who are not shareholders.

154. There is a difference in the treatment of improperly paid dividends dependent upon the position of the recipient. Section 847 Companies Act 2006 provides that a recipient *member* who knows or has reasonable grounds to believe that a distribution or part of it is unlawful is liable to repay it or that part of it to the company. Here however Ms Hamilton was not a member.

155. HMRC argue that the dividend paid by the company was not unlawful because the dividend was not in excess of retained profits or distributable reserves. They assert that the Appellant being the sole shareholder was entitled to the whole of the dividend declared, irrespective of how he chose to divide it. Because the Appellant was entitled to the whole of the dividend, the distributions to Ms Hamilton remained his income and a charge to tax arose under s 385 ITTOIA 2005 because it was made to the person to whom the distribution is "treated" as made, or "entitled" to the distribution. Where the distribution belongs to someone other than the recipient, that other person is chargeable to tax.

156. We agree HMRC's analysis that the dividend was lawful. In those circumstances the Appellant must be treated as entitled to the entirety of the dividend declared. Mr Marre argues that the purported distributions to Ms Hamilton were void: they were not "distributions" to anyone at all and cannot be taxed as such. We do not agree with that analysis as of course there is a difference between a lawfully declared dividend and a purported distribution of part to a non-member. The dividend declared by the company was not void. Any division of that dividend or purported distribution to Ms Hamilton triggered s 385 ITTOIA 2005.

157. It follows that there was a loss of tax arising as a result of the Appellant's carelessness and/or negligence.

158. HMRC have allowed the maximum possible abatements for disclosure and co-operation in respect of the penalties under s 95 TMA 1970 and 25% for seriousness which, in view of the amounts of tax lost and as a proportion of the Appellant's total liability to pay tax for the years in question, we consider to be reasonable and fair.

159. HMRC also allowed the maximum possible reduction in penalties to take account of the quality of the Appellant's disclosure in respect of penalties under the Finance Act 2007 Schedule 24 which resulted in the penalty equal to 15% of the potential lost revenue. As HMRC say, this is the minimum penalty chargeable for a careless inaccuracy, which we agree in the absence of any special circumstances is appropriate.

160. For the reasons set out above, the appeal is dismissed and the penalties confirmed.

161. 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.

MICHAEL CONNELL
TRIBUNAL JUDGE

RELEASE DATE: 28 JUNE 2016