TC01426

Appeal number: TC/2009/15524

Corporation Tax – inadequate records – revised Assessments - Appeal allowed in part.

FIRST-TIER TRIBUNAL

TAX

POWERLAUNCH LIMITED **Appellants**

- and -

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

TRIBUNAL JUDGE: John M Barton, WS
Member: Ian Shearer

Sitting in public at Wellington House, Glasgow and 126 George Street, Edinburgh on 10 November, 14 and 15 December 2010, 12 and 13 January and 15 June 2011.

Urfan Moughal CA, KKMJ, Glasgow, for the Appellants

Brendan Hone, for the Respondents

DECISION

1. Powerlaunch Limited ("the Company") appealed against the following:

(i) An Amendment for the accounting period to 31 January 2004 issued by Her Majesty's Revenue and Customs ("HMRC") on 24 June 2008. The effect of the Amendment was to increase the profits chargeable to Corporation Tax by £73,934 to £92,189 and Corporation Tax payable by £11,515.91 to £17,515.91. Following a statutory review the profits chargeable to Corporation Tax were reduced to £81,177.00 with Corporation Tax payable of £15,423.63.

(ii) Discovery Assessments issued by HMRC on 26 June 2008 for the accounting periods to 31 January 2002, and to 31 January 2003.

> The Discovery Assessment for the accounting period to 31 January 2002 charged to Corporation Tax profits of £11,119 with Corporation Tax payable of £2,223.80. Following the statutory review the profits chargeable to Corporation Tax were reduced to £9,463 with Corporation Tax payable of £1,892.60.
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> The Discovery Assessment for the accounting period to 31 January 2003 charged to Corporation Tax profits of £72,036 with Corporation Tax of £13,803.28. Following the statutory review the profits chargeable to Corporation Tax were reduced to £61,306 with Corporation Tax payable of £11,747.24.

(iii) Discovery Assessments issued by HMRC on 26 June 2008 for the accounting periods to 31 January 2005, 31 January 2006 and 31 January 2007.

> The Discovery Assessment for the accounting period to 31 January 2005 charged to Corporation Tax profits of £107,328 with Corporation Tax of £20,392.32. Following the statutory review the profits chargeable to Corporation Tax were reduced to £95,968 with Corporation Tax payable of £18,233.92.
>
> The Discovery Assessment for the accounting period to 31 January 2006 charged to Corporation Tax profits of £118,093 with Corporation Tax of £22,437.67. Following the statutory review the profits chargeable to Corporation Tax were reduced to £106,461 with Corporation Tax payable of £20,227.59.
>
> The Discovery Assessment for the accounting period to 31 January 2007 charged to Corporation Tax profits of £131,404 with Corporation Tax of £24,966.76. Following the statutory review the profits chargeable to Corporation Tax were reduced to £119,279 with Corporation Tax payable of £22,663.01.

(iv) Assessments issued by HMRC under s 419 Income and Corporation Taxes Act 1988 ("ICTA 1988") in respect of the Directors Loan Account becoming overdrawn by a total of £294,480 and charging tax as follows:

Accounting period to 31 January 2004 £14,677.00

Accounting period to 31 January 2005 £19,068.00

Accounting period to 31 January 2006 £19,523.00

Accounting period to 31 January 2007 £20,351.00

There was no revision to the amounts assessed under under s 419 ICTA 1988 as a result of the statutory review.

2. The decision of the Tribunal is as follows:

(1) In relation to the Amendment for the year ended 31 January 2004 the profits chargeable to Corporation Tax are reduced to £47,135.

(2) In relation to the Discovery Assessment for the accounting period to 31 January 2002 the profits chargeable to Corporation Tax are reduced to £7,089.

(3) In relation to the Discovery Assessment for the accounting period to 31 January 2003 the profits chargeable to Corporation Tax are reduced to £45,925.

(4) In relation to the Discovery Assessment for the accounting period to 31 January 2005 the profits chargeable to Corporation Tax are reduced to £48,628.

(5) In relation to the Discovery Assessment for the accounting period to 31 January 2006 the profits chargeable to Corporation Tax are reduced to £49,787.

(6) In relation to the Discovery Assessment for the accounting period to 31 January 2007 the profits chargeable to Corporation Tax are reduced to £12,654.

(7) In relation to the Assessments issued under s 419 ICTA 1988, the charge to tax is reduced as follows:

Year ended 31 January 2004	£4,824.00
Year ended 31 January 2005	£14,285.00
Year ended 31 January 2006	£14,625.00
Year ended 31 January 2007	£3,717.00

Preliminary

3. A Notice of Appeal dated 27 October 2009 had been lodged on behalf of the Company. A Statement of Case dated 18 February 2010 was lodged by HMRC, and the Appeal was set down for hearing in Glasgow on 10 November 2010.

4. Each party lodged a bundle of documents, and these productions were supplemented at the Hearing. The documents before the Tribunal were as follows:

(a) For the Company

(1) Financial Statements of the Company; Corporation Tax Return and Assessments.

(2) Explanation for difference in figures; and correspondence.

(3) Documents relating to loan to I N Shah, and Bosse transaction.

(4) Explanation of cash on hand at 31 January 2004.

(5) Creditors as at 31 January 2004 and relative invoices.

(6) Stock sheets and closing stock adjustment.

(7) List of bank deposits and reconciliation for year to 31 January 2005.

(8) Bank statements for year to 31 January 2005.

(9) List of bank deposits and reconciliation for year to 31 January 2003.

(10) Bank statements for year to 31 January 2003.

(11) Agreement with shareholder and Minute of Meeting of Directors.

(12) Daily sales sheets.

(13) Facsimile correspondence dated 7 July 2008 and relative papers.

(14) Private tax returns.

(15) Reconciliation of loan account.

(16) Deposits into bank account of the Company.

(17) Analysis of director’s loan account.

(18) Mr Shahid' s capital statement.

(19) Mr Shahid loan account as at 31 January 2004.

(b) For HMRC

(1) Financial Statements of the Company.

(2) Assessments.

(3) Correspondence and notes of telephone calls.

(4) Independent review.

(5) Further correspondence.

(6/13) Bank accounts and credit card statements and analysis.

(14) Analysis of payments.

5. Mr Moughal led the evidence of Mr Muhammed Shahid (Mr Shahid affirming) and Mr Hone led the evidence on oath of Mr Milligan.

Material Facts

6. The Tribunal found the following facts –

(1) The Company commenced trading on 10 December 2001. The principal activity of the Company was the sale of computers and accessories from shop premises. The first Director of the Company was Mr Shahid, although he resigned early on, remaining as the shareholder, owning 10 shares. Mr I Qamar became Director in October 2002. In January 2003, Mr Qamar was issued with 5 shares.

(2) Mr Shahid was effectively the manager and beneficial owner of the Company throughout the whole period of trading. In the year to 31 January 2004, Mr Qamar was an employee. Within the Company, Mr Shahid was responsible for purchasing stock and was away from the shop from time to time. Mr Qamar was responsible for sales and he was normally at the shop. Cash was placed in a locked drawer.

(3) The Company never lodged a Corporation Tax Return for any part of the period from 10 December 2001 to31 January 2003.

(4) In the year to 31 January 2004, a significant proportion of the financial transactions of the Company were in cash. Intromissions were processed through an account with the Bank of Scotland in the name of the Company ("the business account"), and also an account with the Bank of Scotland in the name of Mr Shahid ("Mr Shahid's private bank account") and various credit cards held by Mr Shahid.

(5) The Company did not use a till. There was no cash book or sales register. For the year to 31 January 2004, the records of sales and purchases were incomplete. The Company submitted VAT Returns covering this period, and prior to 31 January 2004, there had been two VAT inspections.

(6) Between 17 February and 27 November 2003, payments were made on behalf of Mr I N Shah amounting in total to £25,893.41. These payments were made by cheques drawn on Mr Shahid's private bank account. An Excel spreadsheet contained an apparent record of payments by Mr Shah commencing on 3 March 2003, with the final payment by Mr Shah on 19 January 2004. At no time was any loan document prepared, but on 12 November 2009, Mr Shah executed an Affidavit in which it was stated that he had repaid to the Company, the total of £25,893.41.

(7) The Company placed an order with Bosse Computers, and on 27 February 2003, Mr Shahid withdrew £10,000 in cash from his private bank account to be paid upon delivery of the consignment. However, the order was cancelled and the said sum was paid back into the same account.

(8) In or about October 2003, Mr Shahid purchased a house at 5 Easdale Place, Newton Mearns for his own occupation. The purchase price was £390,000 and

he took out a mortgage for £340,000. Mr Shahid's previous home had been at 32 Shuna Place, Newton Mearns, over which there was a mortgage of £120,000. On moving to 5 Easdale Place, Mr Shahid let out the house at 32 Shuna Place.

(9) On 26 November 2004, Mr Qamar signed Financial Statements comprising a director's report, a profit and loss account, a balance sheet and relative notes, for the period for the year to 31 January 2004 ("the original accounts"). Attached to these Financial Statements was a detailed profit and loss account and further notes. On 31 January 2005, the Company submitted a Corporation Tax Return also signed by Mr Qamar for the year to 31 January 2004, with the said Financial Statements.

(10) On 30 October 2005, Mr Qamar resigned as a director and Mr Malik, another employee, was appointed in his place. Financial Statements comprising a director's report, a profit and loss account, a balance sheet and relative notes, were prepared for the period from 10 December 2001 to 31 January 2003.

(11) The Company has never lodged a Corporation Tax Return for any period between 1 February 2004 and 31 January 2007.

(12) Financial Statements comprising a director's report, a profit and loss account, a balance sheet and relative notes, were prepared for the period for the year to 31 January 2005. These accounts were submitted to Companies House; and HMRC then had access to them.

(13) Financial Statements comprising a director's report, a profit and loss account, a balance sheet and relative notes, were prepared for the period for the year to 31 January 2006. These accounts were also submitted to Companies House; and again HMRC then had access to them.

(14) On 18 January 2006, Mr Milligan, on behalf of HMRC, acknowledged the Company's tax return for the year to 31 January 2004 and gave notice that they intended to enquire into the return, and called upon the Company to provide certain documents and other information. Mr Milligan continued to represent HMRC throughout the enquiry. The Company failed to provide the documents and information requested, notwithstanding a Notice issued under the provisions of Paragraph 27, Schedule 18 to the Finance Act 1998.

(15) Eventually, certain documents were produced by the Company's representative at a meeting on 16 June 2006.

(16) In or about April 2006, the Company had ceased trading. The Company's shop was taken over by another company.

(17) On 22 August 2006, HMRC disclosed to the Company's representative that a comparison of the Company's VAT records and the copy invoices which had been produced, showed a shortfall on the latter of about £76,000.

(18) On 18 September 2006, a further Notice was issued under the provisions of Paragraph 27, Schedule 18 to the Finance Act 1998 calling upon the Company to produce bank statements and associated documents and information relating to the shareholding in the Company. Some bank statements were produced on 21 September 2006.

(19) On 12 October 2006, HMRC wrote direct to Mr Shahid asking to speak with him. Mr Shahid never met with HMRC prior to the Hearing before the Tribunal.

(20) At a meeting on 9 February 2007, statements of Mr Shahid's private bank account and credit card statements, and adjustments to the Financial Statements of the Company for the year to 31 January 2004 ("the revised accounts"), were submitted to HMRC.

(21) The original accounts showed

Turnover	£968,597
Cost of sales	£885,246
Gross profit	£83,351
Profit before taxation	£18,116
Equity dividends paid	£20,000

The revised accounts showed

Turnover	£1,003,540
Cost of sales	£920,188
Gross profit	£83,352

In the remainder of the Profit and Loss Account, the other figures in the revised accounts were practically the same as the figures in the original accounts.

(22) In the Balance Sheet, the original accounts showed the following

Stocks	£135,280
Debtors	£3,945
Cash in bank and in hand	£28,104
	£167,329
Creditors: amounts falling due within one year	£167,740
Net current (liabilities)/assets	(£411)
Total assets less current liabilities	£3,490

In the revised accounts, the following figures appeared

Stocks	£100,337
Debtors	£3,945
Cash in bank and in hand	£44, 851
	£149,133
Creditors: amounts falling due within one year	£149,543
Net current (liabilities) assets	(£410)
Total assets less current liabilities	£3,491

(23) There was no stocktaking carried out at the end of the year to 31 January 2004 or at the end of the year to 31 January 2005. A stocktaking was carried out as at 31 January 2006.

(24) On 15 June 2007, HMRC wrote to the Company's representative asking for further information. That information was not forthcoming and on 27 July 2007, HMRC issued a further Notice under the provisions of Paragraph 27, Schedule 18 to the Finance Act 1998 calling for

> In respect of the reduction to closing stock of £34,943, as shown in the revised accounts for the year ended 31 January 2004, the relevant stock sheets or other stock records.
>
> In respect of the increase to the cash held by the business of £16,747, as shown in the revised accounts for the year ended 31 January 2004, the relevant cash book or other documentary record.

(25) In February 2008, Mr Moughal commenced acting for the Company and on 15 May 2008, he produced an analysis of the stock held as at 31 January 2006 and the following calculation bringing out a value for the stock held as at 31 January 2004.

Stock as at 31 January 2006		£91,459
Period from 1/2/04 to 31/1/06		
Purchases	£1,950,663	
Cost of sales	£1,959,541	£8,878
Stock at 31/01/04		£100,337

At the same meeting HMRC produced an analysis showing proposed additions to sales of £73,934 in the year to 31 January 2004. Mr Moughal re-iterated Mr Shahid's alternative explanations for some of the additional income identified by Mr Milligan.

(26) In the absence of any further progress, HMRC issued a closure notice on 20 June 2008 and proposed the following adjustments in respect of the year to 31 January 2004

Additions to profits (undeclared turnover)	£73,934
Section 419 tax	£14,677

(27) On 26 June 2008 Discovery Assessments were issued for the accounting periods to 31 January 2002, 31 January 2003, 31 January 2005, 31 January 2006 and 31 January 2007.

(28) Following a statutory review, HMRC wrote to the Company on 29 September 2009 with a revised figure for the Amendment in respect of the year to 31 January 2004, and revised figures for each of the years covered by the Discovery Assessments. No revision was made to the charge to s 419 tax in any of the years.

Legislation

7. Para 21, Schedule 18 to the Finance Act 1998 directs that

> (1) A company which may be required to deliver a company tax return for any period must—
>
> (a) keep such records as may be needed to enable it to deliver a correct and complete Return for the period, and
>
> (b) preserve those records in accordance with this paragraph.
>
> (2) The records must be preserved for six years from the end of the period for which the company may be required to deliver a company tax return.
>
> (3) If the company is required to deliver a company tax return by notice given before the end of that six year period, the records must be preserved until any later date on which—
>
> (a) any enquiry into the Return is completed, or
>
> (b) if there is no enquiry, the Inland Revenue no longer have power to enquire into the Return.
>
> (4) If the company is required to deliver a company tax return by notice given after the end of that six year period and has in its possession at that time any records that may be needed to enable it to deliver a correct and complete Return, it is under a duty to preserve those records until the date on which—
>
> (a) any enquiry into the return is completed, or
>
> (b) if there is no enquiry, the Inland Revenue no longer have power to enquire into the Return.
>
> (5) The records required to be kept and preserved under this paragraph include records of—
>
> (a) all receipts and expenses in the course of the company's activities, and the matters in respect of which the receipts and expenses arise, and
>
> (b) in the case of a trade involving dealing in goods, all sales and purchases made in the course of the trade.
>
> (6) The duty to preserve records under this paragraph includes a duty to preserve all supporting documents relating to the items mentioned in sub-paragraph (5)(a) and (b).
>
> "Supporting documents" includes accounts, books, deeds, contracts, vouchers and receipts.

8. Section 419 of ICTA 1988 provides that

> **Loans to participators etc**
>
> (1) Subject to the following provisions of this section and section 420, where a close company, otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any loan or advances any money to an individual who is a participator

> in the company or an associate of a participator, there shall be assessed on and recoverable from the company, as if it were an amount of corporation tax chargeable on the company for the accounting period in which the loan or advance is made, an amount equal to such proportion of the amount of the loan or advance as corresponds to the rate of advance corporation tax in force for the financial year in which the loan or advance is made.

Prior authorities

9. The following cases were referred to in the course of the Hearing

Jonas v Bamford 51TC1

Hurley v Taylor 71 TC268

Nicholson v Morris 51 TC95

Norman v Golder 26 TC293

Haythornthwaite & Sons Ltd v Kelly 11 TC657.

Submissions

10. On behalf of the Company, Mr Moughal submitted that there was reasonable evidence to conclude that there should be no addition to the Company's taxable profits for the year ended 31 January 2004 and that as there were no undeclared withdrawals, no liability should arise under s 419 ICTA 1998.

11. With reference to Para 21, Schedule 18 to the Finance Act 1998, it was claimed that the accounting records were adequate for the type and size of business. In particular he observed that

(1) A daily sales record was maintained on Excel.

(2) The purchase of goods was recorded and supported by invoices.

(3) Cash was kept in a locked cash drawer, reconciled and lodged into the bank by a responsible individual.

(4) A purchase ledger system was maintained.

(5) A record of all bank receipts and payments transactions, including credit card transactions was maintained, identifying business and private transactions.

(6) VAT Returns were supported by a record of sales, purchases and expenses.

(7) A wages record including deduction sheets was maintained, and PAYE Returns were submitted.

12. Mr Moughal added that the Company had been subject to two separate VAT inspections one in 2002 and one in the year under enquiry, namely 31 January 2004. No concern had been raised by HMRC with regard to the business records, no assessment was raised for additional VAT, and the Company did not receive any formal communication in writing from HMRC with regard to the record keeping of

business. Indeed, the Company had received a refund of £12,571.54 from HMRC after one of the VAT visits.

13. The Company had voluntarily provided revised accounts for the year to 31 January 2004 which showed a gross adjustment of £41,058 (net £34,943) relating to sales. The revised accounts included corresponding adjustments to trade creditors, cash, loan account balance and stock. Mr Moughal particularly founded on these accounts in response to HMRC’s assertion that the increase in chargeable profits for the year to 31 January 2004 (initially stated at £73,934 and adjusted to £62,922 on review) was attributable to understated turnover and taxable profits arising from undeclared deposits in the bank account.

14. Reference was made to the loan account statement and a sworn affidavit by Mr Shah as evidencing that deposits to the extent of £25,893 were in fact a repayment of this loan, that the sums deposited did not represent sales and that the total should therefore not be credited to profit nor debited to Mr Shahid `s account.

15. The Tribunal was also invited to accept that the lodgement of £10,000 on 27 February 2003, related to an order which was cancelled, the evidence being a letter from the supplier, a letter from the Bank of Scotland explaining the sequence of bank transactions, and Mr Shahid's oral evidence. It was submitted that the £10,000 did not relate to sales and therefore should not have been added to profit, or debited to Mr Shahid's account.

16. It was explained that the cash on hand balance had been understated in the original accounts by £16,747, and the Tribunal was invited to accept an analysis of the revised cash balance as at 31 January 2004, together with the supporting evidence.

17. The Tribunal was also invited to accept the evidence supporting an adjustment of £15,596 to the list of trade creditors and payments made post year-end.

18. Mr Moughal explained that the stock adjustment of £34,943 in the revised accounts (for the period to 31 January 2004) had been computed from a stock-taking as at 31 January 2006 and the cost of sales and purchases over the intervening period.

19. It was pointed out that the Company had provided substantial analysis to support the figures that appeared in the accounts for the year ended 31 January 2004; and that further analysis was provided by the Company during the course of the inquiry. Mr Moughal contrasted this with the extent of the analysis provided by HMRC.

20. Mr Moughal claimed that HMRC have been incorrect in their revision of Mr Shahid's loan account, and in particular that rental income and dividends had been omitted. Mr Moughal also pointed out that HMRC had emphasised deposits of £481,050 relating to the business, having being lodged into Mr Shahid's private account but that they had failed to have regard for total amounts of £566,347 transferred to the business account from Mr Shahid's private account.

21. Mr Moughal challenged the presumption of continuity applied by HMRC in their assessments for earlier and later years for 2002 & 2003 and 2005 to 2007 respectively

in that there would not have been similar loans and contras in other years. He also asserted that s 419 ICTA 1988 should not be applied as Mr Shahid's loan account was never overdrawn in any of the years in question.

22. Mr Moughal suggested that Mr Milligan was unaware of Mr Shahid’s lifestyle, and he pointed out that for the year ended 31 January 2004, Mr Shahid had his salary of £8,722 and a combined cash rental income of £12,715 (with the exception of £4,125 being banked into his account). In addition, Mr Shahid's used credit cards for private expenses. Such cash was more than adequate to support Mr Shahid’s lifestyle, even to pay for flight tickets costing £1,100 for a holiday to Florida. The Florida trip was only for 5 days. The hotel and all expenses for this five day holiday were paid through Mr Shahid's credit card, and these payments were taken into account via Mr Shahid's loan account.

23. The mortgage payments for Mr Shahid's new home in Newton Mearns, which was acquired in October 2003, were paid through the bank account of the Company and debited to Mr Shahid's loan account. Private expenditure of £33,314 including private expenditure on credit cards was also paid through the bank account of the Company and debited to Mr Shahid's loan account. The opening balance as at 1 February 2003 of Mr Shahid's loan account was £96,000 due to him and the closing balance as at 31 January 2004 was £80,145.

24. The dividends declared and paid in the years 2003/04 to 2005/06 amounted to £95,000. Mr Shahid also received £30,000 in mid 2005 upon the disposal of shares to Mr Qamar. The total rental income for the year 2005/06 was £26,164 as submitted to HMRC in personal tax returns. Mrs Shahid had substantial funds in her Bank of Scotland Account before the start of business in November 2001. During the year under inquiry sums totalling over £51,000 were withdrawn from Mrs Shahid's bank account, but no deposits were made from the business to her private account.

25. HMRC had failed to take into account the amount of dividends and sale of shares in revising Mr Shahid`s loan account for the years ended 2005 & 2006. HMRC were provided with statements of Mr Shahid’s assets and liabilities as at 31 January 2004, 31October 2007 and 31May 2008. These showed no increase in his capital position. Indeed, there was a reduction in Mr Shahid’s net asset position from £508,856 as at 31 January 2004 to £376,228 as at 31 May 2008.

26. Mr Moughal founded on the terms of the Shareholder's agreement, namely that "in the event that the Company has profits available for distribution in any financial year it shall declare dividends equal to the whole of the profit arising or accruing in that financial year and available for distribution" to support his submission that any additions to profits had to be distributed as a dividend and that therefore s 419 did not apply.

27. Mr Moughal therefore contended that there should be no addition to the Company’s taxable profits for the year to 31 January 2004 and that there was no basis for the presumption of continuity. Consequently the Assessments under s 419 ICTA

1998 should be nil and additional Assessments to profit for the years ended 31 January 2002, 2003, 2004, 2005, 2006 & 2007 should also be nil.

28. Mr Hone submitted that the business records kept by the Company were incomplete and failed to comply with Paragraph 21, Schedule 18, of the Finance Act 1998. The Excel summary sheet showed sales of £1,138,102, inclusive of VAT, representing a net figure of £968,597. This was the turnover as shown in the original accounts. Subsequently these figures were revised, increasing sales by £34,943; and thereby illustrating that the daily sales sheets were wrong and the record keeping could not be relied upon. Mr Hone particularly pointed out that the additional sales £34,943 equated with the stock adjustment. He submitted that the full extent of omitted takings was unlikely ever to be known. There were clear deficiencies in the company's record keeping. No cash or simplex book was maintained. There was no sales ledger, so it was impossible to identify and test transactions. There was no prime record of cash received or paid out, making it impossible to check the Company's cash holding and control. It was observed that in such a situation, there was very wide scope for cash extraction from a business. Mr Hone further pointed out that there was no till, and therefore no till rolls. Indeed, VAT Notice 727 requires a retail trader keep a record of daily gross takings, and this record is normally a till roll or copies of sales vouchers.

29. Mr Hone reminded the Tribunal of Mr Shahid’s evidence that cash was kept in the business premises in a locked drawer, and that Mr Qamar had the key. Mr Hone questioned this in that Mr Shahid claimed that he "was anxious to protect his investment", and the implication from this is that Mr Shahid would have had access to the company cash and total control of the same.

30. Mr Hone pointed out that around £481,000 was paid into Mr Shahid’s private bank account during the year to 31 January 2004, but that there were no cash withdrawals whatsoever during the whole year from this account; and Mr Hone submitted that, on the balance of probabilities, the bulk of Mr Shahid's private cash requirements for the year were met by extraction of cash from the business - cash that was never recorded in the business books and records. In the absence of a till, till rolls, and prime records such as a cash book, it would have been impossible to quantify the amount involved. The Company received large amounts of cash and many purchases were made by cash on delivery; also, Mr Shahid's salary was paid in cash but, like all other cash expenditure, no contemporaneous record existed.

31. Mr Hone directed the Tribunal to the bank deposit reconciliations for the years to 31 January 2003 and 31 January 2005 which had been produced by Mr Moughal. In the earlier year, the turnover exceeded bank deposits by £165,349; and in the subsequent year, turnover exceeded bank deposits by £23,759 – demonstrating that cash was being received but not banked, and raising the question whether the stated turnover per the accounts was complete. Mr Hone also pointed out that the turnover per the revised accounts for 2004 was arrived at following an analysis of the bank accounts; and that this was after it became clear that the daily spreadsheets were not in fact a complete record of Company sales. He suggested that there could have been

further cash received but not banked for the enquiry year, as was his inference for the years to 31 January 2003 and 31 January 2005.

32. Mr Hone therefore submitted that all the accounts, original and revised, for all years - have to be set aside and some other method adopted to arrive at the profits of the Company for all years under appeal.

33. Mr Hone pointed out that there had apparently been no stock taking at 31 January 2003 or at 31 January 2004. Nevertheless, there had been a stock adjustment of £34,943; and the same figure had been added to sales. This implied that stock of £34,943 was sold at cost i.e. with no mark-up. Mr Hone submitted that Mr Shahid's explanations were not credible and the Company accounts could not be relied upon. Furthermore, having had an admission that the daily sales sheets were not an accurate record of the Company's 2004 sales, Mr Hone suggested that all other material based on the accounts as adjusted, should also be rejected by the Tribunal as not being an accurate reflection of the true profits of the Company.

34. Mr Hone also invited the Tribunal to reject the evidence of an apparent loan to Mr Shah. No Loan Agreement was produced, and there was no contemporaneous evidence. Mr Shahid's evidence was that the loan repayments were just added to cash in the drawer in the business premises and later banked. The repayments could not be identified in the private current account, the explanation being that the payments were included in larger amounts banked. HMRC were never given the opportunity to interview Mr Shah; and Mr Hone questioned the value of the Affidavit in the particular circumstances.

35. Mr Hone also invited the Tribunal to reject the evidence regarding the suggested "contra" of £10,000, in that there was no contemporaneous evidence, only a letter from Bosse Computers dated 1 October 2010.

36. In relation to Mr Shahid's means, Mr Hone highlighted that Mr Shahid purchased the dwellinghouse at 5 Easdale Place, Newton Mearns around October/November 2003 at a cost of £390,000 with a £340,000 mortgage. Mr Shahid did not sell his previous home at 32 Shuna Place, Newton Mearns on which he had a mortgage of about £120,000; but instead, he rented it out. Mr Shahid's evidence was vague in relation to the mortgage over 5 Easdale Place; but, when pressed, he said that he probably advised the broker that his income amounted to a dividend of £20,000, salary £8,400 and estimated rental income £12,000. Mr Hone submitted that Mr Shahid had sought to obscure his true total income at that point.

37. In regard to the Director's loan account, Mr Hone observed that on the balance of probabilities there had been substantial amounts of cash extracted from the Company over all years under appeal and without this being quantified, it was impossible to rewrite the Director's loan account accurately. Mr Hone therefore submitted that Mr Milligan's adjustments to the Director's loan account, as set out in his letter of 20 June 2008, should stand, as being his best estimate.

38. In support of Mr Hone's submission that the usual presumption of continuity should apply, he reminded the Tribunal that, at the end of Mr Moughal's re-examination of Mr Shahid on 15 December 2010, Mr Shahid confirmed that "There was never any change in business practices and processes over these years".

39. In relation to VAT, Mr Hone reminded the Tribunal that Mr Milligan had said in his evidence, that the VAT Officer never gave the Company Ltd the "all clear". Indeed, the VAT office had concerns regarding the accuracy of sales - for the simple reason that no record was maintained of each transaction to make up a record of Daily Gross Takings under Notice 727.

40. In view of the lack of cooperation, Mr Milligan had to use formal information powers in an attempt to obtain information and documentation, but despite this, important information and documentation still remained outstanding. Mr Milligan had to contact Companies House to obtain accounts and shareholding information and he had to issue Revenue Determinations in the absence of the 2005 and 2006 Corporation Tax Returns. These Returns remain outstanding. He contacted Mr Shahid directly and made his concerns clear - including his concern over Mr Shahid's means. On numerous occasions he suggested a meeting with Mr Shahid but Mr Shahid refused to meet.

41. In these circumstances, Mr Milligan was unable to build up a detailed knowledge of the operations of the Company's business; and he was forced to close his enquiry by concentrating on the three aspects of stock adjustment, the contra and the apparent loan to Mr Shah.

42. Mr Hone therefore asked the Tribunal to dismiss these appeals, founding on the cases referred to above.

Reasons

43. On 31 January 2005, the Company had submitted accounts for the year to 31 January 2004 together with its Corporation Tax Return for that year; and on 18 January 2006, HMRC opened their enquiry into the Return. HMRC concluded that the Company's income from sales had been substantially understated. In the course of the enquiry, revised accounts were submitted. On 24 June 2008, HMRC issued a Closure Notice. On 26 June 2008, an amendment was issued increasing the profits chargeable to Corporation Tax, and an assessment was also issued under s 419 ICTA 1988 in respect of the Director's loan account being overdrawn. On the same date, discovery assessments were issued for the accounting periods to 31 January 2002, 31 January 2003, 31 January 2005, 31 January 2006 and 31 January 2007. In addition, assessments were made under s 419 ICTA 1988 for the years to 31 January 2004, 31 January 2005, 31 January 2006 and 31 January 2007.

44. Both parties lodged extensive documentation; and the Tribunal heard the evidence of Mr Shahid and Mr Milligan. The Tribunal found Mr Shahid to be less than credible on certain detailed matters, for example regarding the shareholding in the Company and why he was the only recipient of dividends; the explanation that

when Mr Shah made repayments to him, he handed the money to Mr Qamar who then put the cash in the locked drawer; and the information given to the mortgage broker at the time when the loan was arranged over the house at 5 Easdale Place, Newton Mearns. It was also evident that Mr Milligan was continuously frustrated at the Company's reluctance to provide its trading records and supporting documentation; and that this lack of information caused him great difficulty in determining what might have been the Company's true profit in the year of enquiry.

45. The first question before the Tribunal was whether HMRC had reasonable grounds for believing that the Company's income from sales had been substantially understated, and the material issue was the adequacy of the Company's books and records.

46. The Company did not use a till, and therefore there were no till rolls. Daily sales sheets, prepared on a spreadsheet, were produced. It was claimed by Mr Shahid that these were prepared by Mr Qamar; and it was admitted that they did not contain a full record of the Company's sales for the year of enquiry. Some purchase invoices were exhibited but others were missing. Many of the transactions were for cash, and some cash was deposited in Mr Shahid's private bank account. Also, sums representing Mr Shahid's private expenditure were withdrawn from the Company bank account.

47. With this background, the Tribunal is satisfied that the Company failed to maintain adequate books and records, as was required under paragraph 21, Schedule 18 of the Finance Act 1998; and that in the absence of adequate records, any accounts based on such records must inevitably be unreliable.

48. It was particularly significant that the revised accounts for the year to 31 January 2004, disclosed a turnover of £1,003,540 in contrast to the corresponding figure of £968,597 in the original accounts. The revised accounts also showed a reduction of £34,943 in the closing stock. Mr Moughal had explained to HMRC on 15 May 2008, that the new figure for closing stock had been computed by taking the closing stock as at 31 January 2006, and working back on the basis of the total purchases and sales in the intervening period. This method may be acceptable where there are accurate figures for purchases and sales, but as has already been found, there was no complete recording of these transactions by the Company. The Tribunal accordingly does not accept this revised figure for the closing stock as at 31 January 2004. It follows that the revised accounts cannot be relied upon. Indeed, the Tribunal found it to be more than a coincidence that the reduction of £34,943 in the closing stock had the effect of resulting in the same apparent tax liability.

49. The Tribunal heard at length of the efforts of the enquiry officer, Mr Milligan, to obtain information from the Company and to meet with Mr Shahid. It is significant that three Notices were issued under the provisions of Paragraph 27, Schedule 18 to the Finance Act 1998; and that there was still outstanding information when HMRC ultimately resolved to close their enquiry.

50. HMRC note that in the year to 31 January 2004, the aggregate of the funds banked in the business account of the Company and Mr Shahid's private account was

£1,212,035 whereas the recorded sales only amounted to £1,138,102, a difference which HMRC attributed to unrecorded sales, of approximately £73,934. In the review, there was an allowance for VAT, bringing the apparently unrecorded figure down to £62,922. In the absence of complete records, the Tribunal accept that this was a reasonable method on which to base a notional figure for profit for the year under enquiry.

51. Mr Moughal put forward a persuasive argument that HMRC's total for deposits in the business bank account for the month of January 2004 (£62,9470) should be reduced to £54,396, a reduction of £8,550.

52. An Excel spreadsheet listed payments totalling £25,893 and the bank statements of Mr Shahid's private account confirmed that corresponding payments were made by cheque drawn on that account. The spreadsheet also listed repayments totalling the same £25,893. Mr Shahid claimed in his evidence that Mr Shah made each repayment in cash and that such cash was handed to Mr Qamar and placed in the cashbox kept for the Company prior to being banked with other cash. The Tribunal found Mr Shahid's evidence on this aspect to be less than credible. Deposits of cash to the bank account of the Company were identified in evidence, but there was no contemporaneous record identifying that the payments made by Mr Shah were part of any of those deposits. The Tribunal has also taken cognisance of the Affidavit sworn by Mr Shah in 2009.

53. The Tribunal can accept that monies were advanced by Mr Shahid from his own private funds and that Mr Shah repaid in full the sums that were advanced. The Affidavit was no doubt prepared as evidence for the present proceedings, and confirms that specific amounts were repaid in cash. There is no indication that Mr Shah had any knowledge of how the monies repaid were intromitted with; and the Tribunal only has Mr Shahid's oral evidence that each repayment was deposited with other cash in the bank account kept for the Company. In the absence of any contemporaneous record of that cash, the Tribunal is not prepared to accept Mr Shahid's uncorroborated testimony; and the Tribunal therefore does not find it established that the monies repaid by Mr Shah were in fact credited to the Company.

54. Consecutive entries in the bank statement for Mr Shahid's private account show the sum of £10,000 having been withdrawn on 27 February 2003, and an identical sum being paid in on the same day. The Tribunal also heard Mr Shahid's evidence that the said sum of £10,000 was withdrawn to meet the required payment for a consignment from Bosse Computers. The further evidence was a letter dated 1 October 2010 from that company confirming that there was indeed an order on 27 February 2003, that the payment was to be £10,000 and that the order was cancelled. Again it appears that this letter was written specifically as evidence in the present proceedings, and the Tribunal would therefore have been unwilling to rely on this letter alone; but having regard to the entries in the bank statement, the Tribunal is prepared to give Mr Shahid the benefit of the doubt in his explanation.

55. Mr Moughal also submitted that the balance of cash on hand had been understated in the original accounts by £16,747, and the Tribunal was invited to accept an analysis of

the revised cash balance as at 31 January 2004. He pointed to a number of sums credited to the Company's business account and Mr Shahid's personal account after 31 January 2004, but which related to transactions effected prior to that date. Given the apparently agreed unreliability of the accounts, uncertainty over the records of purchases and sales, and the doubts about the true levels of cash going in and out, the Tribunal is also left doubtful about the reliability which can be attached to Mr Moughal's argument about the cash in hand, and also to a similar analysis which was presented by Mr Moughal with reference to the figure in the accounts for trade creditors. The Tribunal considers that it is not possible to determine with any certainty where the truth lies regarding these lines in the accounts.

56. Reference was made by both sides to the VAT inspections into the company, although the Tribunal was then surprised that no written evidence relating to these inspections was produced by either side, to support the points being made.

57. The Tribunal also considers that there are several questions which could reasonably have been asked of Mr Shahid's other associates in the Company – notably Mr Qamar and Mr Malik – but notes that for various reasons which were not precisely pinpointed during the course of the hearing, HMRC has focussed its enquiry principally on Mr Shahid.

58. HMRC suggested the likelihood that there could have been further cash from sales which was never banked, and that deriving the turnover from bank deposits may well therefore lead to an under-estimate. The Tribunal also recognises this possibility. The true level of sales in the enquiry year cannot now be determined. In the circumstances the Tribunal agrees that an examination of the bank deposits was a reasonable approach for arriving at a first baseline figure.

59. In the absence of complete books and records, an accurate figure for the Company's profit for the year to 31 January 2004, will never be known. In all the circumstances, the Tribunal accepts that the method adopted by HMRC which brought out the figure of £73,934 was reasonable, subject to an adjustment of £8,550 in respect of the reduced total for deposits to the business bank account, and £10,000 for the contra, resulting in a revised figure of £55,384. Making an allowance for VAT, the Tribunal has determined the additional profit at £47,135.

60. It had been acknowledged that the accounting procedures adopted by the Company had been no different in the earlier and later years for which Discovery Assessments had been made; and the Tribunal accepts as reasonable, the approach taken by HMRC to determine the sales for the other years by taking the figure for the year of enquiry and adjusting it according to the movement in the Retail Price Index ("RPI").

61. In the year to 31 January 2004, the RPI was 183.1. Applying the corresponding RPI for the other years for which there have been Discovery Assessments, brings out the following for unrecorded sales –

Accounting period to	RPI	unrecorded sales
31 January 2002	173.3	£7,089 (based on 58 days)
31 January 2003	178.4	£45,925
31 January 2005	188.9	£48,628
31 January 2006	193.4	£49,787
31 January 2007	201.6	£12,654 (based on 89 days)

In the opinion of the Tribunal, the foregoing form a reasonable substitution for the corresponding amounts in the respective Discovery Assessments. (The figure for the final year having been modified to take into account that the Company ceased trading in or about April 2006).

62. In the course of any enquiry by HMRC, it is not uncommon for questions to be asked about private and personal expenditure as providing an indication of the income necessary to support such expenditure. In this case, Mr Milligan was unable to arrange any meeting with Mr Shahid, and therefore Mr Milligan was unable to comment on Mr Shahid's lifestyle.

63. Nevertheless, there was some evidence of Mr Shahid's change of house during the year of enquiry. In or about October 2003, Mr Shahid purchased a house at 5 Easdale Place, Newton Mearns for his own occupation. The purchase price was £390,000 and he took out a mortgage for £340,000. Mr Shahid's previous home had been at 32 Shuna Place, Newton Mearns, over which there was a mortgage of £120,000. On moving to 5 Easdale Place, Mr Shahid let out the house at 32 Shuna Place.

64. In giving his evidence, Mr Shahid was vague about the circumstances of the mortgage, and only upon being pressed, did he indicate that he probably advised the mortgage broker that his annual income comprised a dividend of £20,000, his salary of £8,400 and estimated rental income of £12,000. The Tribunal finds it difficult to believe that if this were the case, Mr Shahid would have entertained the purchase of a house for £390,000 with a mortgage for £340,000.

65. Separate assessments were issued by HMRC under s 419 ICTA 1988 in respect of the Directors Loan Account becoming overdrawn by a total of £294,480 and charging tax as follows:

Year ended 31 January 2004	£14,677.00
Year ended 31 January 2005	£19,068.00
Year ended 31 January 2006	£19,523.00
Year ended 31 January 2007	£20,351.00

Mr Moughal referred the Tribunal to the precise terms of the Shareholders Agreement. However, it is a matter for the Company to determine the level of dividend, and if the payment to a participator exceeds what has been declared as a dividend, it is appropriate that s 419 should come into effect. HMRC accepted that at this stage, it is not possible to determine precise figures; and taking account of the modifications to the chargeable profit for the particular years, the Tribunal has amended the s 419 Assessments to the following

Year ended 31 January 2004	£4,824.00
Year ended 31 January 2005	£14,285.00
Year ended 31 January 2006	£14,625.00
Year ended 31 January 2007	£3,717.00

66. 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.

JOHN M BARTON, WS
TRIBUNAL JUDGE

RELEASE DATE: 7 SEPTEMBER 2011