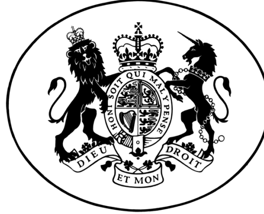

TC02408

Appeal number: TC/2009/14229

Corporation Tax – "discovery" - alleged suppression of profit – further assessments – whether "to best judgement" – whether negligent conduct by taxpayer - Yes – Appeal disallowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

RISKY BUSINESS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE KENNETH MURE, QC
Mr S A RAE, LLB, WS,
Dr HEIDI POON, CA, CTA, PhD

Sitting in public at George House, 126 George Street, Edinburgh on 27-30 September and 4-7 October 2011, 8-10 February, 26-28 March, and 30-31 May, 2012

Mr James W Watson, CA, FCMA, CGMA, AMCI Arb, JDip MA for the Appellant

Mr Brendan Hone, HMRC Officer, for the Respondents

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DECISION

Preliminary

1. This Appeal relates to further assessments to Corporation Tax for the Years to 31 March 2002, 2003, 2004, 2005 and 2006 made by HMRC following on a *discovery* made by one of their officers in the course of an investigation into the tax affairs of the Appellant company which started in about October 2005. The investigation of records focussed on the Year 2005. The issue for the Tribunal was whether these should be upheld as being to best judgement. Additionally, the matter of negligence on the part of the Directors of the Appellant company arises.

The Law

2. Taxes Management Act (1970), Section 50(6)
   Finance Act 1998 Schedule 18, para 21(5)
   Income and Corporation Taxes Act 1988, Section 419

Authorities

3. *Blyth v Birmingham Waterworks* Co (1856) 11 Exch 781
   Scott & Anor t/a Farthings Steak House 1996 Sp C 91
   Jonas v Banford 51 TC 1
   T Haythornthwaite & Sons 11 TC 657
   Hurley v Taylor 71 TC 268
   Nicholson v Morris 51 TC 95
   Norman v Golder 26 TC 293

The Evidence

4. It was agreed that HMRC should lead and that without prejudice to the burden of proof. Mr Hone called as his only witness **Brendan Macrae**, a senior investigating inspector, who spoke to the terms of his Written Statement and then to the implications of the supporting documentation referred to. (These documents are contained mainly in Folios 1-8).

5. The taxpayer company's Return for Corporation Tax for the year to 31 March 2005 had aroused certain suspicions and was referred for further investigation to Mr Macrae. It emerged that its business records contained estimates and errors and to an extent had not been completed contemporaneously. A record of cash takings, showing cash receipts less expenditure and sums banked, indicated on several weeks sampled a negative balance. That clearly suggested to HMRC an under-declaration of cash received. Further, and after the investigation began, substantial balancing adjustments, between £10,000 and £23,500, had been made to the accounts for 2004, 2005, 2006 and 2007, and were unexplained. Hours worked by staff when related to the amounts of wages paid as shown in the accounts produced unrealistically low pay rates. Payments to security staff for day-time service could not be traced satisfactorily. All this suggested to Mr Macrae possible undeclared profits and PAYE infringements.

6. In particular the fees or commission paid by dancers to the company for the opportunities it provided, appeared to be suspiciously below the level charged by

similar businesses to self-employed dancers. The taxpayer's charges were well below those of 40 other similar businesses. The taxpayer claimed to charge £10 per shift while, curiously, a website, Laptastic, purporting to recruit dancers to work at the taxpayer's premises indicated charges of between £35 and £50 per shift. An independent university report ("the Bindel Report" – R/8 p 1-64) commissioned by Glasgow City Council and published in August 2004 indicated rates of between £35 and £85 per night as the range of charges in Glasgow lap-dancing clubs. This and other anonymous information received by HMRC indicated undisclosed profits in Mr Macrae's view. Ultimately HMRC prepared additional assessments based on the likely fee/commission rates charged by the taxpayer to the dancers according to the website, Laptastic.

7. The personal finances of both directors, Mr Cameron and Mr McDavitt, were examined. Their bank accounts and credit card statements did not show a pattern of cash withdrawals and petty cash expenditure. The cash sources necessary for routine day-to-day expenditure could not be traced. Mr Macrae considered that the likely explanation was that this was funded by income extracted from the business which had not been declared. In particular in the enquiry Year ending 31 March 2005 Mr Cameron had income consisting of only dividends of £22,000. Yet he was able to purchase *inter alia* furniture of a substantial value in Spain.

8. Thereafter Mr Macrae pursued lines of enquiry with Messrs J S Mackie & Co Ltd, the taxpayer's accountants. Correspondence exchanged is produced. There was a series of meetings with the accountants and attended on two of these occasions by Mr Cameron also. Records of meetings were prepared by Mr Macrae and remain undisputed by the accountants. Requests for information in terms of Section 20 TMA were made. While considerable information and documentation were produced by Messrs Mackie, certain queries made by HMRC were not satisfied, and evidence in relation to certain aspects was contradictory.

9. Before concluding his evidence-in-chief Mr Macrae explained to us his computation of the additional assessments to tax set out in his letter of 17 September 2008 (F/3/142-143). He produced two computations (F/3/146 and 147) which reflect the terms of the items at F/2 (being Closure Notices for the periods ending 31 March 2005 and 2006, and Discovery Assessments for the periods ending 31 March 2002, 2003, and 2004) and illustrated helpfully what was noted in principle in his Witness Statement. Mr Macrae considered in F/3/146 a representative three-week period from 26 March 2004 to 15 April 2004 for which the dancers had paid cash commissions of £1,320 in total according to the taxpayer's records. At £10 per shift that indicated 132 shifts worked. Mr Macrae was able to allocate these to the different days of the week, with Friday and Saturday being the busiest. Having allocated the shifts, these were re-charged at £50 for Friday and Saturday and £35 for other days, these being the rates indicated on the Laptastic website. Thus a revised figure for cash takings from the dancers of £93,209 is extrapolated for a 52 week period, being £47,351 in excess of the declared profit from that source. That was the basis for the increased assessment for the Year to 31 March 2005. In relation to the other Years the extra profit was scaled up or down as appropriate and according to the RP Index. As shown on F3/143 the 2006 figure is slightly more and the figures for

the earlier Years, 2002, 2003 and 2004, progressively less. Also, the extra Corporation Tax due at the appropriate rate is shown for each Year and, also, Section 419 ICTA tax liabilities on the basis that the extra profit has been abstracted by the Appellant company's directors. Section 419 liability is imposed on drawings from a director's loan account. Mr Macrae and Mr Hone explained that this was HMRC's preferred procedure in such cases instead of treating such amounts as directors' fees or dividends. Usually it produced a more favourable result for the taxpayer especially where the directors of a company are liable to higher rate tax.

10. Certain contentious aspects were explored in cross and re-examination. Mr Watson on behalf of Risky Business suggested that the unexplained negative cash-flow was related to indebtedness of another business, Brewhouse, in which Risky Business' directors had an interest. While there is a reference to an inter-company loan by Risky Business to Brewhouse, that is not recorded as a liability in the latter's accounts. This explanation apparently was not advanced in the early stages of the investigation or at the meetings with HMRC. There was not, in Mr Macrae's view, a sufficient audit trail to support this explanation. He was insistent that the negative cash-flow remained unexplained.

11. The invoices for stewarding did not extend to the provision of this service in the afternoon (other than Saturday pm) for most of the year.

12. Originally the taxpayer's accountants had advised Mr Macrae that there had been no balancing or estimated figures in the accounts. Yet in the four years ie 2004 to 2007, four substantial adjustments had been made retrospectively. At the Hearing it was suggested that for 2005 the adjustment was greater than £23,500, *viz* £30,550. Mr Macrae considered the need for such adjustments to be indicative of a systemic failure to record cash and other receipts accurately.

13. Mr Macrae was insistent that the website, Laptastic, showed the premises of Legs'n Co. (This was accepted ultimately but the rates payable by dancers according to the website remained in dispute).

14. Aspects of the payroll summaries were controversial. There were substantial and unexplained differences between the accounts for the Years to March 2005 and March 2006. While the wage-bill rose from about £25,000 to about £45,000, turnover had decreased significantly (from £381,000 to £318,000) as had operating profit.

15. The Bindel Report, prepared by an academic from London Metropolitan University, was criticised by Mr Watson in terms of his cross-examination of Mr Macrae. Mr Macrae had used it only for estimating commission paid by the dancers. The range of payment noted there corresponded with the information contained in the Laptastic website and the anonymous information received.

16. We considered Mr Macrae to be a credible and reliable witness. He had approached his task diligently and in our view presented a thorough analysis. His conclusions and projection of profit appeared to us to be both logical and reasonable. (In light of fresh information produced in the course of the Appellant's witnesses'

evidence, and of which Mr Macrae and Mr Hone had no forewarning, the Tribunal allowed Mr Macrae to be recalled for purposes of further examination in relation to this fresh material.)

17. The taxpayer's first witness was one of its directors, **Peter McDavitt**. It became clear that his co-director, Alistair Cameron, who gave evidence later, was the "controlling mind" of the business. Both directors had been in business together for some time. The Appellant company had traded initially as "Divalleys", a pub providing musical entertainment at 86 Maxwell Street, Glasgow. Because of competition with trade rivals and a diminished turnover, a decision was made to re-vamp the business. It became a "lap-dancing" club, continuing to sell drink, and it adopted the business name "Legs'n Co". Mr McDavitt explained that he had a background in the construction industry and had fitted out the premises. Mr Cameron on the other hand dealt with paperwork and business records. The company's accountants had always been Messrs Mackie. During the day Mr McDavitt and Mr Cameron had covered any stewarding needs. While he knew of the Laptastic website, he claimed that the company had not used it, and any entry purporting to relate to Legs'n Co was unauthorised. He insisted that the commission fee paid by the dancers per shift was only £10.

18. Mr McDavitt was cross-examined in detail. Over a four-year period to 2007, including the Year under scrutiny, he drew dividends of about £80,500 from the taxpayer and £100 per week as salary. However, he explained that he had other income of about £15,000 per annum from other interests, particularly a maintenance/service business which he ran by mobile phone. By this means he could be based at 86 Maxwell Street, and could readily do some work for Legs'n Co, such as day-time stewarding. He insisted that he was not involved in the financial management of the business. He trusted Alistair Cameron. He himself was not adept in financial administration. He claimed not even to have a key to the business's safe or even to its front door. He explained that he had reduced his workload in recent years because of ill-health.

19. Mr Hone challenged the extent to which Mr McDavitt was about the premises and able to work for the benefit of the business. It appeared that in the Year 2004/05 Mr McDavitt had visited Roscommon in Ireland on many occasions. He explained that he had acquired a derelict building there which he is restoring. In addition to that undertaking it appeared too that Mr McDavitt received payment from a quarry concern for haulage services – a third source of earned income. Thus, it was suggested by Mr Hone, in 2004/05 Mr McDavitt had not devoted much time to the business of the taxpayer company.

20. Mr McDavitt was then asked about his personal expenditure. He accepted that he had holidayed in the Gambia – very cheaply. He had withdrawn large sums of money from his bank account as a "float", kept at home, and for business purposes.

21. On the controversial aspect of the level of commission paid by the dancers Mr McDavitt was insistent that it was only £10. He was indignant at the suggestion that the commission provided the company with a significant source of income.

Legs'n Co, he insisted, was interested primarily in selling drink, not (as he put it), "pimping". Legs'n Co was situated in a run-down area and the company did not seek to charge any "market rate" to the dancers for commission. It was content with £10 per shift, although Mr McDavitt estimated that the dancers themselves could each make up to £500 per night. He indicated that he had not been involved in the recruitment or management of the dancers.

22. In re-examination Mr McDavitt explained that his maintenance company had several but not many clients. He was paid by cheque for that work. He explained also that while Legs'n Co was not a "dump", it did not have the nicest of premises.

We consider the evidence of Mr McDavitt together with that of Mr Cameron later in our summary of the evidence.

23. **Caroline Thomson**, who worked in Legs'n Co for a time, was the taxpayer's second witness. Her evidence was comparatively brief. She spoke to having been a cleaner in 2004/05, the Year under examination, at a wage of £60 per week. She disputed the suggested wage-rate of £1.70 per hour. She explained that her hours of work in that Year were from 10 am to 12 noon on weekdays, so producing a rate of £6 per hour. There had been a significant increase in her wage in the following year to about £200 per week. That, she explained, was for working in the bar on weekdays from 12 noon until 5 pm. In 2006/07 her income fell to £5,200. Her parents had been unwell and her hours of work had been reduced accordingly. She was recorded on the taxpayer's payroll summary as having left their employment on 18 September 2006. She was insistent that she had been paid more than £1.70 per hour.

24. She explained that when she worked in the pub's bar her practice was to take a "Zed" reading, indicating total sales for her 12 noon to 5 pm shift. Usually this was a quiet period with few receipts and without a significant need for stewarding.

25. Her recollection of HMRC's visit on 9 November 2006 was that she had been present on shift behind the bar but had not been interviewed although she had been willing (and indeed volunteered) to do so.

26. She explained that another employee, Heather Burton, had helped the dancers to fill in the business' application forms, although in (at least) two instances she had witnessed these. £10, she maintained, was the commission paid by each dancer per shift.

27. We had serious reservations about Miss Thomson's evidence except where it was confirmed by documentary records, such as the tax records of payroll payments (A/3/7-9). We considered that her account was undermined in the cross-examination about the meeting with HMRC. Although Miss Thomson was insistent that she was present and available for interview, the date of the meeting was after she had left Legs'n Co. This appears to be confirmed by the tax records (A/3/9). Further, the meeting had taken place between 10 and 11 am. Miss Thomson's account was that she was working routinely behind the bar, yet her hours were from 12 noon until 5 pm. This conflicting aspect in her evidence was not explained away.

28. The Appellant's third witness, **Heather Burton**, gave evidence over the course of one day. At about 2004/05 she was employed as manageress of Legs'n Co and continues to date in that capacity. Originally she worked from Wednesday to Sunday, but since the birth of her daughter in about 2003, she has worked from Thursday to Sunday. She spoke to receiving a wage of £300 gross per week. In view of the reduction in her hours of work after the birth of her child, as she explained, her pay had not been increased. She also worked from home, using a computer.

29. Ms Burton's duties were extensive. She interviewed dancers seeking to appear at the club. She would explain its rules and its expectations of dancers appearing at its premises. To attract customers she required several dancers during day-time and more in the evening. The evenings and weekends were the most profitable for the girls but the club required their presence at quieter times too.

30. She described the layout of the premises. These were on the ground floor at 86 Maxwell Street and comprised three areas. Firstly, there was the bar area, where girls would dance advertising their services. Secondly, there is a "performance" area in which up to 7 or 8 girls would for a charge dance for individual customers. Thirdly, there was a "VIP room", an area partitioned off, in which groups might be entertained. The overall area was fairly small, she explained, as being just over twice the size of the Tribunal's Hearing room.

31. Ms Burton explained her method of cash control. There were (she thought since an early stage – but this is corrected by the purchase receipt date: see para 34) two tills, door admission receipts being entered into one, and bar receipts into the other. Security staff would collect entrance fees and then give them to her (but see para 52). She would then enter them in the till. She also would collect the commission payment from the girls. At the start of her shift she would check the bar's float (of about £600) and the till float (about £50). Every evening after the close of business she would "Zed" the tills and compare the balance with the till roll totals. She would add up and cross-check the cash. That would be placed in the office safe. Any shortfall in cash would be recorded. The proceeds for each day would be collected and on Monday of each week were banked. Mr Cameron or Miss Thomson (who was manageress when Ms Burton was not on duty) were responsible for this. More controversially Ms Burton spoke to the level of commission and the references to the Club on the Laptastic website. She accepted that she had discussed an entry on two occasions with Jason, the website owner. She was insistent that no agreement about an entry had been reached and that no payment was made. She alone, and not Mr Cameron, had dealt with Laptastic, she maintained rather defensively. She sought to explain away that the rates of dancers' commission mentioned of £35 on weekdays and £50 at weekends were inclusive of hotel charges of £25 or £40, so leaving only £10 for the club. (The Tribunal found this explanation strained and contrary to any sensible construction. Curiously it was only this one aspect of the website entry which was disputed).

32. Mr Hone pressed Ms Burton on the comparative level of the commission and the total which a dancer could earn from the club's customers. A £10 dance would last customarily for about three minutes (the length of a CD song "track"). If several

customers wished a dance, the fee could be multiplied, earning the dancer up to £50 per dance. Ms Burton estimated that on a busy night a dancer could earn around £250-300. On such nights seven or eight girls could be dancing. It was put to her as improbable that the club should find acceptable a receipt of only £80 out of dancers' fees totalling £2,400. However, Ms Burton supported that figure, considering that the club was run down and that dancers had to be attracted to perform there.

33. The Tribunal had serious reservations about Ms Burton's evidence about the level of commission. Such a low return of 3-4% of dancers' fees seemed improbable, while the increased level as projected by Mr Macrae and in line with the website entry, seemed much more realistic. We observe that the Bindel Report (dated August 2004) recorded dance "fee" levels of between £35 and £85 per night in Glasgow. We comment at para 52 on her evidence about the taxpayer's cash systems.

34. **Patricia Mullen** was the taxpayer's fourth witness. Originally her presence in the club was as an employee of her husband's security firm, working in the "back room". She was the only female on the security staff and her principal responsibility was ensuring that the dancers were not molested. Later she assisted in the bar. She left the club in about January 2005 (A/3/7) but returned about 6 months later, working principally in the bar. Some time in 2006 she took over responsibility for checking the taxpayer's receipts and banking the proceeds. (Significantly this was *after* the start of HMRC's investigations). Mrs Mullen explained that her system was to take "Zed" readings of the tills, to get totals for entrance, bar and dancers' commission receipts. She did this on the days on which she was on duty. She would check the total against the cash in the till(s). She would put this amount in a bag or bags in the safe, with a note of any discrepancies. She would check consistency in the level of the float in the till. She would total receipts weekly. She did not use an opening balance in her statements, she explained. While she did not take the cash to the bank herself (Alistair Cameron or Caroline Thomson did) she wrote out the deposit slip and received a receipted record. While this "system" seems fairly secure, its introduction post-dates the course of Mr Macrae's enquiry. In 2007, she confirmed, a second till to cover door fees had been acquired. (A receipt confirming the date of purchase of the second till was produced. It seems clear that its introduction post-dates the start of Mr Macrae's enquiry.)

35. Mrs Mullen confirmed her understanding that the commission rate charged to the dancers was only £10. However, she was not the staff member primarily involved in the management of the dancers. (That was Heather Burton's role.) She was aware of the problems in securing the dancers' attendance, and certain of them had been uncooperative and troublesome. She mentioned instances of petty thieving. When she was on duty, she would seek payment from the dancers as and when they left after a shift. The girls did not receive any receipt for the commission payment. Mrs Mullen spoke to her signature as witness on certain of the girls' applications. She considered that Legs'n Co was a relatively "downmarket" establishment as compared with other lap-dancing clubs.

36. Mrs Mullen spoke to her creating a security firm, which was in business from March 2006-2008. She employed her husband and a few others, who serviced Legs'n

Co and a limited number of other establishments. We considered that Mrs Mullen spoke confidently and credibly to her system of cash management. This, of course, post-dated Mr Macrae's enquiry and, also, relied on all receipts being deposited in either till. In relation to the rate of commission paid by the dancers to the club, Mrs Mullen's evidence seemed to be indirect and of a hearsay nature. For that reason we were not unduly influenced by it.

37. Then **Alistair Cameron** gave evidence. He confirmed that Risky Business traded initially as "Divalleys", a public house with variety acts, and later because of trade competition introduced lap-dancing girls and renamed itself as "Legs'n Co". Mr Cameron acknowledged that he spent the bulk of his time in the business and, on occasion, would stay overnight in the office there to avoid a lengthy "commute" to his home in Lanark. (We noted earlier in relation to the evidence of Mr McDavitt that Mr Cameron was in day-to-day charge of the business of the Appellant company).

38. Mr Cameron explained that a second till was introduced in 2007, after Mr Macrae's visit, and, also, he encouraged Mrs Mullen to take over the preparation of basic cash receipt records. He explained that while he himself had prepared weekly reports (see A/8/1) he had never reconciled cash. He was not an accountant, he explained.

39. Mr McDavitt carried out any necessary physical work, décor, repairs etc on the premises as he was a trained joiner. Heather Burton managed the dancers and would interview them.

40. Mr Cameron was insistent that he never negotiated an entry in the Laptastic website. Also, he maintained, £10 per shift was the commission fee for dancers – no more. Otherwise, he agreed that the entry in the Laptastic website was correct. He disagreed with the references to the club in the Report by Julie Bindel of London Metropolitan University. In particular he and others working at the Club had no recollection of her ever visiting there. As a female she would have been all too conspicuous. The reference to "D Moffat" at page 38 of the Report was in error: he was employed by The Truffle Club. By contrast the Local Licensing Board had not received complaints about Legs'n Co. The police visited the Club regularly and they and its staff were on good terms.

41. Mr Cameron was cross-examined in detail by Mr Hone. Again it was clear that Mr Cameron rather than Mr McDavitt controlled the financial affairs of the business during the Year under investigation. Mr Cameron explained that after Patricia Mullen left on 20 January 2005, he had no option but to increase the hours which he worked for the company. He was relieved when Mrs Mullen returned to work for the business.

42. Mr Cameron was then questioned about his (and Mr McDavitt's) drawings from the business during the Year to March 2005. He was referred to his Clydesdale Bank statements (R/5). There did not appear to be any smallish drawings to cover day-to-day expenditure, which Mr Hone suggested, might indicate concealed profit.

Mr Cameron explained that his son and his son's girlfriend (who both lived with him) contributed to the household.

43. Mr Cameron was then asked about Brewhouse. When it was sold, he explained, a small net sum (a few thousand pounds) had been paid over to him. Mr Cameron's expertise in the liquor trade became clear to us: he had obtained a breakfast licence and developed that pub's trade by catering to postal workers at their depot nearby. The turnover had increased prodigiously. Mr Cameron confirmed that out of the sale proceeds a priority payment was due to the former owner of the Brewhouse, a Mr Parish, in respect of his interest.

44. The Clydesdale Bank statements record council tax payments and, significantly in the Tribunal's view, a substantial monthly payment to Skandia Investments. Mr Cameron had paid this on the advice of an IFA. His American Express statements indicated two large payments for refurbishing his house. Apparently it had been burgled and all the contents including furnishings stolen. Curiously in the Tribunal's view, the American Express statements (like those of the Clydesdale Bank) did not record any minor, routine expenditure. This presumably was sourced elsewhere, but that source did not become apparent to us.

45. The cross-examination extended to Mr Macrae's cash-flow test during April and May 2004 (R/3/76). Mr Hone probed whether the series of negative cash balances could be explained away. Firstly, Mr Cameron considered that the sum of £6,595.87 recorded for 8 April in R/3/76A (lodged by the Appellant) represented a bundle of receipts held by Mr McDavitt. Although it was entered in the business books on one day, it had not been paid out on one day but, rather, over an extended period.

46. The document A/1/13 marked "Weekly Takings Record" was in Mr Cameron's handwriting. It indicated cash takings for week ending 10-6-04. He explained that the days of the week were in error. The takings recorded for Sunday and Monday, the two largest, were in fact for Friday and Saturday.

47. Mr Hone then turned to the Brewhouse Accounts for the Year to 26 April 2004 (A/8/6). He suggested that there was a material discrepancy between these and Risky Business's accounts in relation to a loan allegedly from Risky in favour of Brewhouse and noted as item 9(i) in Mr Mackie's letter of 2 December 2005 (R/3/12). Why, Mr Hone queried, was it not reflected in Brewhouse's balance sheet? This, Mr Hone suggested, tended to undermine any submission that the repayment could explain away a negative balance in the cash-flow test.

48. Mr Cameron was then asked about drawings of £10,000 from Brewhouse noted in the Directors' Loan Account. He claimed that it represented regular rather than a single withdrawal: wages of £200 per week had been taken for the initial part of that period while Brewhouse had cash available. That, Mr Hone argued, showed that the cash withdrawal had been in the Year preceding the Year under investigation.

49. Also, the stock of £2,020 held by Brewhouse had been purchased and a cash payment made directly to Messrs Cameron and McDavitt on 26 April 2004, according

to Mr Cameron. That, however, Mr Hone responded, could not be used to cancel out the six prior negative cash balances.

50. Mr Cameron described the Club's premises as "downmarket", a working man's club, and in a severe state of disrepair.

51. Mr Cameron agreed that he had referred the dancers to Messrs Mackies for tax and accountancy advice. Indeed the Club had prepared an information pack for them setting out this information. While Mr Cameron had not dealt individually with the dancers, he was satisfied that "£10 per shift" commission was the arrangement concluded and reflected in all, some 200, application forms completed by the girls and witnessed by his staff.

52. There appeared to be a discrepancy between the evidence of Mr Cameron and of Ms Burton about the depositing of door fees in the till. In her evidence Ms Burton suggested that the stewards would retain door fees until the end of the evening and then they would be credited individually in the till. Mr Cameron indicated that they were credited as soon as convenient and, indeed, no purpose would have been served by the stewards retaining the fees during the course of the evening.

53. Mr Cameron accepted that the cost of stewarding, necessary to protect the dancers, was disproportionate in relation to the £10 level of commission. However, he explained, the Club derived other receipts from the sale of liquor and entry fees.

54. It is, we think, helpful to comment on the evidence of Mr McDavitt and Mr Cameron together. They were (and continue to be) the co-directors of the Appellant company. They both were involved in the course of HMRC's enquiry from its inception. We consider it appropriate to assess their oral evidence to the Tribunal in conjunction with the documentary records of their responses to the enquiry. We did not find either to be credible or reliable witnesses. While Mr Cameron may have been the controlling mind of the business, Mr McDavitt was intimately involved too. In the case of both we consider that their responses to HMRC's enquiries were inadequate. They failed to maintain adequate primary records for proper business "books" to be maintained. We found their attempts to explain away cash imbalances wholly implausible. The various sources of cash receipts of the business were not properly recorded. We found both Mr McDavitt and Mr Cameron evasive in their accounting for miscellaneous personal expenditure, all of which reinforced HMRC's submission that there had been substantial withdrawals of cash by them from the company which had not been accounted for satisfactorily. Their denials of any contact on the part of the company with Laptastic and its owner, Jason, were obviously rehearsed. However, we did note and accepted as credible one particular element in Mr McDavitt's evidence. He estimated an individual dancer's total gross earnings per shift to be up to £500. That arguably represents an admission against the company's interest (and having an enhanced credibility) having regard to the claimed £10 per shift charge which, we consider, unrealistically low.

55. The claimed £10 charge was spoken to also by Caroline Thomson, Heather Burton, Yvonne Hay and, perhaps, somewhat indirectly, by Patricia Mullen.

We found that aspect of their evidence rehearsed and we did not accept it. (We refer to our assessments of their credibility and reliability individually recorded in respect of their evidence).

56. As the taxpayer's evidence emerged in the course of the first stage of the hearing, further information and documentation was produced relating in particular to daily cash balances, on which Mr Macrae had not had an opportunity to review. It was agreed at a subsequent Case Management Hearing that Mr Hone should recall him at the continued diet in February 2012 and produce, as appropriate, a Supplementary Witness Statement.

57. In his Supplementary Witness Statement, Mr Macrae adhered essentially to the view which he expressed earlier. He still had serious misgivings about the accuracy of the taxpayer's accounts and business records. This arose not simply from the information about charges levied on the dancers, but from other factors, such as the frequency of negative daily cash balances calculated on the basis of these records, and the absence of any satisfactory explanation being forthcoming, the sizeable adjustments made to the accounts belatedly by Mr Mackie, the personal finances of the two Directors, Messrs McDavitt and Cameron, and the wage information. Thereafter, Mr Macrae had to attempt to compute a figure of profit "to best judgement". For that purpose as explained earlier he revised the figure of profit by reference to a recalculation of the payments made by dancers for the use of the premises and its facilities. Had an additional assessment to be made, this approach, producing an increased profit for Corporation Tax was probably the most satisfactory from the Directors' point of view given their tax circumstances.

58. Mr Macrae noted various supplementary points. Firstly, in the weekly report dated 23 December 2004 (A/1/15) while there is an increase in turnover given the Christmas period, there is no increase in the number of staff and hours of work and wage costs. There is again the curiosity of a negative cash balance at the start of the week.

59. Further, it was claimed on behalf of the taxpayers that certain expenditure reflected in the (negative) cash balance had been met by Mr McDavitt out of personal funds. Yet there was no record in the business books of his being re-imbursed, or of this creating a substantial cash surplus pending repayment. Similarly there were no book-keeping records for withdrawals of capital by Messrs McDavitt and Cameron from the Brewhouse being introduced into Risky Business.

60. It had been suggested also by the taxpayer that certain assets of an earlier business venture, the Brewhouse, had been transferred into Risky Business. Sale proceeds of "wet" stock of £2,020 and miscellaneous cash of £2,163 had, it was claimed, been paid into the coffers of Risky Business. But these sums were assets payable for the benefit of creditors of that other business. Further, there was no cash record to support these alleged transfers of funds. So far as "wet" stock was concerned, it could more easily have been physically transferred between the two businesses' premises than valued and sold.

61. Somewhat curiously the taxpayer produced several versions of the business' cash flow. These still produced negative balances in many instances, which were obviously irregular and called for explanation. Positive closing balances were implausibly low given the cash retained as "floats" or otherwise in the premises. Given its nature – as representing coins and notes in a physical sense – the cashflow reconciliation should have produced consistently positive cash balances. In theory and in practice, according to Mr Macrae, a negative cash balance should be an impossibility. Mr Macrae explained that in his method of calculation, receipts were credited early and payments credited late, so as to produce the most favourable outcome from the taxpayer's point of view. He explained also that where a negative cash balance is produced at the conclusion of the day, then this should be "zeroed" at the start of the next day to produce a satisfactory continuing record. (It may be noted that in A/8/5 there is an increasing negative closing balance: even zero-ing would not remove the recurrent negative balance.)

62. Mr Macrae confirmed that he remained concerned about the absence of any evidence of drawings by, in particular, Mr McDavitt from Risky Business. The drawings analysis produced by the taxpayer (A/17/1) did not allow for excess cash for payments of £1,000 per month to Mrs McDavitt for household expenses (recorded as item 8 in Notes of Meeting with HMRC on 18 April 2007 – R/3/88). There was a dearth of evidence of small routine withdrawals to meet miscellaneous cash expenditure.

63. In one record detailing cash expenditure (A/17/13 B) there were no entries for wages being paid (which, it was insisted, were paid in cash) for seven or eight weeks. This was unexplained. In A/1/13 the takings were recorded against the wrong days of the week. (Saturday seemed to have the lowest turnover and Monday the highest.) Mr Macrae remained concerned too about the matter of hours worked by security staff. The number of hours during which stewards were employed fell short of the trading hours, even allowing for the directors themselves assisting here. Mr Macrae wondered whether wages might have been paid out of undeclared cash receipts.

64. Mr Macrae was insistent that he had not extrapolated the cash deficit of £10,000 calculated for the months of April and May 2004 to produce his estimate of under-declared profit at the rate of £60,000 per annum. This and other irregularities had raised concern, but the calculation of shortfall had been made by reference only to the likely level of dancers' payments to the business. He disbelieved the figure put forward of £10 per session. While he had not interviewed the girls personally he had anonymous information which he assessed as credible and which was consistent with the information in the Bindel Report and the Laptastic website. While £10 per session may have been the figure recorded in the taxpayer's records, and the figure reported by the dancers to Mr Mackie for purposes of preparing their accounts, Mr Macrae explained that in his experience taxpayers not declaring full receipts often claimed only a proportion of their full expenditure.

65. After concluding the evidence of Mr Macrae on recall, the taxpayer's evidence continued. Their next witness was **Mr James S Mackie**, a chartered management

accountant of 30 years experience, who acted on behalf of the taxpayers during the period under investigation and prepared their business accounts.

66. He spoke to his meetings with the Inland Revenue and the course of discussions with them.

67. He explained the sources of information available to him. The primary records were the Zed totals – one for credit card sales and another for cash sales. Over the business year he would expect 365 Zed totals for both categories of sales. He would have invoices for both cash expenditure and outlays met by cheque. Also he would have a record of weekly bankings.

68. With this information Mr Mackie would prepare quarterly VAT Returns and weekly payroll records and, later, annual accounts. A bank reconciliation would be made at the end of the business Year, at end March.

69. The major difficulty in the course of discussions with HMRC has been the implications of Mr Macrae's calculation of daily cash balances. In response to HMRC's calculation, Mr Mackie has produced several variations. (The series of cash balances are in order – R/3/76, A/8/4, A/8/5, A/8/5 as revised, A/17, A/17/9, then A/17/13, and Appendix II to Mr Macrae's Supplementary Witness Statement.) Mr Mackie acknowledged that there had been problems in relation to the records of cashflow. HMRC had suggested that there was a substantial cash deficit of about £10,000 in April and May 2004, which, if extrapolated, produced a shortfall of about £60,000 for a year.

70. This approach concerned Mr Mackie: there had been a substantial one-off discrepancy in April, but that would not have been a satisfactory basis for calculating a figure of annual shortfall. Then another basis for the recalculation of profit emerged in the view of HMRC, *viz* under-declaration of dancers' contributions to the business.

71. Mr Mackie explained that he prepared accounts also for certain of the dancers who appeared at the taxpayer's premises. So far as he was aware, £10 per session was the standard payment.

72. It was discovered by Mr Mackie that expenditure exceeded income by about £23,500 for the Year under enquiry ie to March 2005. The total figure for sales had to be increased to cover this. The figures had to be reconciled. (His letter of 19 July 2007 – R/3/103 – records – "There appears to be a shortfall in the income recorded from principal records of £23,500".)

73. Mr Mackie was questioned closely about his and Mr Macrae's calculation of cash balances, ie the value of coin and notes held on the premises at a particular time. Given the impossibility of a "negative" cash balance, Mr Mackie was pressed about the frequency of a negative figure being produced according to Mr Macrae's calculations. (These, it had been explained, had been prepared on a basis favourable to the taxpayer by, for instance, crediting cash receipts early and deducting bank deposits late.)

74. Mr Mackie strove to argue that many of the negative balances shown in Mr Macrae's calculations could be eliminated by delaying a deposit of £5,000 from 2 April 2004 to 5 April. Further on 8 April cash expenditure of £6,595 was recorded but this included invoices totalling £4,049.69 which had been met personally by the taxpayer's director, Mr McDavitt, earlier in February and March. Mr Mackie was uncertain whether and when the company had recompensed Mr McDavitt. There was no record of this in the company's business books. Finally, adjustment was required for two sums received by the directors from their interest in the other pub venture, the Brewhouse. It was suggested on behalf of the taxpayer that cash of about £2,000 had been received for "wet stock" of that business and a further cash sum of about £2,000 was taken by Messrs McDavitt and Cameron and put into the business of the Appellant company.

75. Mr Mackie spoke to direct contact with "Jason" who ran the Laptastic website. Significantly, Mr Mackie argued, the website post-dated the relevant period of trading being examined: it dates from about 2006. He produced certain till-rolls for consecutive days bearing to be sequential in their numbering. He conceded that an adjustment of £23,500 had to be made to the accounts based on information produced. We were not satisfied with his explanation that this was required (in part at least) because of the omission to include credit card sales as part of daily takings (see, further para 77).

76. Mr Mackie expressed indignation at the terms of the Bindel Report. At page 38, he explained, there were significant errors. "Douglas Moffatt" was never the owner. Risky Business' licence would not allow the number of patrons and staff attributed to it in the Report. Mr Mackie explained that he had attempted unsuccessfully to discuss the Report with its author. He was insistent that Mr Macrae had chosen not to interview dancers and other staff who, he maintained, had by arrangement been on the premises when Mr Macrae visited.

77. Mr Hone cross-examined Mr Mackie relatively briefly. He challenged him in relation to the negative cash balances and their frequency in both parties' calculations. The thrust of this was that there had been an incomplete declaration of income. Mr Mackie had, of course, to concede that he had to add in £23,500 to the value of receipts for the Year under enquiry. About £13,500 represented credit card sales, Mr Mackie claimed. (In that case, presumably, they would have been credited to Risky Business' bank account.) Mr Mackie sought to explain away certain financial discrepancies by suggesting that they were met by funds abstracted from Brewhouse. However, the withdrawals noted in its final accounts for 14 months to 26 April 2004 (A/8/6) relate to a materially different period from that dealt with in the record of Personal Drawings for Mr McDavitt for 2005, 2006 and 2007 (A/17/1). Mr Hone pressed Mr Mackie about particularly Mr McDavitt's apparent lack of petty cash to meet small items of routine expenditure. (The Tribunal was concerned too as to how this was funded). Mr Hone then referred Mr Mackie to his final re-drafting of the Appellant's cash balances for the Year to 31 March 2005. There was no apparent explanation for the diminishing deductions for cash payments and for wages after 4 June 2004 in A/17/13B. This, Mr Hone suggested, illustrated a fatal flaw in the calculations on behalf of the Appellant.

78. At the conclusion of cross-examination Mr Mackie produced a note of evidence which he described as an "overview". It was accepted as additional to his Witness Statement after giving Mr Hone an opportunity overnight to review it and with an opportunity to the Tribunal too to consider its terms.

5 79. At the Tribunal's request Mr Mackie produced the State for Settlement relating to the sale of the Brewhouse. This had especial significance as indicating possible cash "injections" into Risky Business. Mr Mackie was questioned by the Tribunal on its contents. Out of sale proceeds of about £45,000, £30,000 was paid to Mr Steen Parish in terms of an agreement with Messrs Cameron and McDavitt. Of 10 the remaining £15,000 almost all is accounted for by payments to third parties, particularly for professional services. Crucially, in the Tribunal's view, it does not show significant cash payments to Messrs Cameron and McDavitt, which could have met routine personal expenditure or funded the trading of Risky Business.

80. Mr Mackie's evidence was interrupted to take the testimony of two brief 15 witnesses for the taxpayer, *viz* Yvonne Hay and Mr Cameron's son, Alistair Junior. (Our assessment of Mr Mackie's evidence is noted *infra* at para 87 when we discuss Mr Watson's evidence.)

81. **Miss Yvonne Hay** is presently PR manager for Risky Business, now trading as "Forbidden" from neighbouring premises at 96 Maxwell Street, and is engaged in 20 promotional work. She did also work as a self-employed lap dancer at the Club in 2005 (when trading as "Legs'n Co") for a brief period of four weeks. She spoke to paying a charge of £10 per session. She worked two shifts, one weekday and a Friday or Saturday. She claimed that she was never charged more than £10. Her gross receipts, she claimed, were no more than £100 per day and that on busier weekend 25 shifts. (Curiously this is substantially less than Heather Burton's indication of £250-300 per shift and Mr McDavitt's estimate of up to £500 per shift). In cross-examination she confirmed the presence of security staff when the dancers were working. She remembered the changeover of security staff in the course of a shift. When asked about comparative rates charged by other similar establishments to self-30 employed dancers, Miss Hay claimed to be unaware of these and moreover, not to have visited other clubs – curious, perhaps, given that she is responsible presently for the promotion of the Club's activities. Accordingly, we viewed Miss Hay's evidence in a guarded way, and as she still works for the Appellant company, she is not entirely independent.

35 82. **Alistair Cameron Junior** spoke briefly to going to live with his father in July 2005 (after the Year under scrutiny by HMRC). He confirmed paying him £50 per week out of his wages of just over £200 per week. This contribution increased to £70 per week when his girlfriend joined him in 2010. (This witness' evidence was not controversial.)

40 83. The final witness for the Appellant was **James W Watson**, who had acted additionally as advocate in the course of the hearing. He spoke to and as appropriate elaborated on his two Witness Statements (A/17 and second dated 7 February 2012 in reply to Mr Macrae's Supplementary Witness Statement). Mr Watson is a Scottish

CA, a Chartered Management Accountant (CGMA and J Dip MA), and has further experience as an arbiter and forensic accountant.

84. Mr Watson became involved in the scrutiny of the Appellant's tax affairs in early Autumn 2008. He visited the premises at 86 Maxwell Street in 2010 well after the business' activities had been transferred to neighbouring premises at no 96 where it had started trading as "Forbidden" in September 2008. Their state in 2010 was very poor. The premises were small, and when in use were licensed for only about 47 persons. The Appellant, Mr Watson indicated, did not start to trade as "Legs'n Co" at 86 Maxwell Street until December 2001. However, during closing submissions on 30 May 2012 he conceded that the premises at 86 Maxwell Street opened for business shortly before Christmas 2000.

85. Many of the matters referred to by Mr Watson in evidence and raised in cross-examination by Mr Hone were more properly matters of inference and appropriate for Submissions. They both acknowledged these as irreconcilable aspects in the appeal. Much of the controversy arose from the Cash Balance records prepared by Mr Macrae and the Appellant's responses as revised on several occasions. A final form of this was produced in the course of Mr Watson's evidence and admitted as A/17/13C.

86. The areas of controversy included the assets of both directors, Messrs Cameron and McDavitt, the basis for the findings in the Bindel Report so far as relating to "Legs'n Co", staffing levels at the premises, wages paid, the collection of "door" monies from customers, the abstraction of cash from the Brewhouse business, and especially the rate of charges levied on the dancers. Mr Watson spoke to a telephone conversation with "Jason" who ran the Laptastic website, but he personally did not give evidence. Mr Watson was insistent that there was no record of any payment to Laptastic.

87. We found the evidence of Messrs Mackie and Watson frank and candid. They did not seek to dispute the inadequacy of the company's books and accounts. While they strove to explain these away and reconcile inconsistencies, they did so in an entirely proper and professional manner. There are, however, two provisos. While we accept Mr Watson's narrative of his conversation with "Jason" of Laptastic, we have no means of assessing Jason's credibility, which must be questionable. It was accepted that his "denial" was in the context as explained of a tax enquiry. Equally, while Mr Mackie may have been instructed to record a £10 fee as an expense in certain of the dancers' tax accounts, that in no way enhances the credibility of that claim.

88. Finally, we note that the evidence contained in the Witness Statement of **Suzanne McIlwraith**, the domestic partner of Alister Cameron (Senior) is admitted as agreed testimony. She speaks simply and briefly to contributing £60 per week towards their domestic expenditure.

Submissions – for the Respondents

89. Helpfully both Mr Hone and Mr Watson provided us with notes of their submissions which they read out and elaborated on at the conclusion of the hearing. Copies of each are included in the appeal papers, but may be usefully summarised as follows. Mr Hone addressed us first on behalf of HMRC. He laid emphasis on the evidence and conclusions of Mr Macrae, the investigating inspector. The business records of the taxpayer were wholly inadequate, he argued. They had not been completed contemporaneously. Further, the requirements of Finance Act 1998, Schedule 18, para 21(5) had not been met. The weekly cash-flow record produced too frequently a negative cash balance, an impossibility in practical terms given the physical nature of cash. Mr Mackie acknowledged that substantial balancing figures had to be introduced into the accounts to balance them.

90. All these discrepancies pointed to the failure to record receipts satisfactorily. Cash takings were substantially understated. Most obviously the appearance fees or commission paid by the dancers seemed to be under-stated. Also, door entry fees paid by patrons were not satisfactorily accounted for.

91. Mr Hone addressed at length Mr Macrae's findings arising from the "cash-flow" test. The impossibility in practical terms of having a negative figure for cash on hand was emphasised again. Mr Macrae's application of the test was on a basis as favourable as possible to the taxpayer, yet in spite of that, negative cash balances regularly arose (see para 61). On other occasions substantial sums of cash, remaining "un-banked" resulted. All this highlighted the inadequacy of the businesses' cash records. Mr Macrae's experience in relation to financial administration in both the private sector and in HMRC was noted.

92. There was an absence of a satisfactory audit trail to explain certain important cash transfers claimed to have been made by the Appellant. In particular funds which, it was claimed, had been injected into Risky Business from the sale of its directors' other company, the Brewhouse, were not supported by the balance sheets and other documentary records of both companies.

93. Records of wage-payments in the Years in question (to March 2005 and 2006) suggested other inaccuracies. In 2005/06 wage payments nearly doubled, yet turnover decreased. (It was not coincidental, Mr Hone surmised, that the enquiry had started in October 2005). Which employees had worked what hours was not at all clear from the business' records.

94. Stewarding records were not satisfactory. (This, of course, is one element of the wage-payments issue.) In the course of the enquiry conflicting evidence had been given as to the extent of security cover; inconsistencies were explained away on the basis that the two directors carried out security duties; and only limited records and invoices relating to independently provided security services were discovered. Given the need for security staff – in particular providing a safe working environment for the dancers – the absence of records or a satisfactory explanation was indicative of the abstraction of cash from the business, Mr Hone submitted.

95. The matter of both directors' personal drawings was explored. In the case of each of them, their other financial and business interests compounded the problems in establishing a clear-cut record. During the relevant Years Mr McDavitt had been involved in the redevelopment of a house in Roscommon, Ireland. Mr Cameron had made substantial furniture purchases abroad. Mr McDavitt had, of course, other business interests. HMRC was anxious to trace particularly records of cash for routine, minor day-to-day expenses: it had not succeeded, and Messrs Cameron and McDavitt had not been able to explain this away. The obvious inference, in Mr Hone's view, was that there had been unrecorded cash withdrawals to meet such expenses from the business.

96. In the whole circumstances Mr Hone commended to us the approach and conclusions of Mr Macrae. The assessments were made to best judgement, reasonable and logical. Mr Macrae had founded upon an under-declaration of the fees paid by the dancers. He had taken calculations provided by the taxpayer but substituted a more probable fee, noted in the Laptastic website, and confirmed by general "market" fee levels instead of the £10 per session claimed by the Appellant's directors. The £10 figure was suspiciously less than that indicated by all the strands of evidence. It did not reflect the cost of security staff, necessary to provide an appropriate environment for the dancers. £10 was miniscule in relation to the gross takings which could be achieved by the dancers, especially at weekends. The profit for the Year 2005 was increased correspondingly.

97. He invited us to uphold the presumption of *continuity* as being applicable to the other Years ie 2002, 2003, 2004, and 2006. It seemed reasonable to assume a continuing pattern in the conduct of the business and a consistent failure in relation to the maintenance of satisfactory business and accounting records.

98. Finally, Mr Hone invited us further to make a finding of *negligent conduct* in relation to the record-keeping by the company and its directors in respect of the relevant Years. He referred us to *Blyth v Birmingham Waterworks Co*. While not dealing with a tax matter, the issue decided was comparable, he suggested.

- for the Appellant Company

99. Mr Watson then addressed us. He identified the dancers' commission payments as the main issue. He questioned the substitution in R3/146 of payments of £35 for weekday shifts and £50 for the busier weekend shifts. These figures were apparently taken from the Laptastic website, yet this enterprise started only in 2006, Mr Watson claimed, the end of the period for which the additional assessments have been made. The £10 fee, he submitted, was consistent with the terms of the 200 applications by dancers. These were all witnessed, variously by Heather Burton, Patricia Mullen or Caroline Thompson, who all gave evidence. The directors, Messrs Cameron and McDavitt, confirmed this. So too did Mr Mackie inasmuch as these dancers who were his clients claimed £10 per shift as an expense. There was no documentary record of any payments by the Appellant to Laptastic and, apparently, "Jason" the spokesman for Laptastic, denied acting for the Appellant when advised of HMRC's

enquiry. The "Zed" till rolls had been examined by Mr Mackie: they indicated a £10 fee.

100.Mr Watson questioned the other sources supporting higher figures than £10 per session. The source of the anonymous information had not been identified or its nature revealed. There was no evidence to support an inspection or visit by Julie Bindel. All this was suspicious and unreliable as evidence, he suggested.

101.Mr Watson then considered the accounting adjustments made. These, he considered, could be explained away satisfactorily. The adjustment of £23,500 in the Year to March 2005 was necessary because of accounting omissions: proceeds from the sale of the Brewhouse, credit card bankings, and costs of materials which had been met personally by Mr McDavitt, had not been included in the business records. In the Years 2004 and 2006 credit card receipts had not been recorded.

102.In relation to wages as being recorded at an unrealistically low level, Mr Watson submitted that full account had not been taken of the services rendered by the directors themselves and their families. Further, Mr Macrae's arguments about irregular wage records had been countered by the evidence of the Appellant's staff, Patricia Mullen, Caroline Thompson and Heather Burton. So far as stewarding was concerned the local authority apparently made no requirements. At the material time Mr Mullen used the Appellant's premises to manage his business. He and the Appellant's directors could act as security staff when necessary.

103.Mr Watson suggested further that the source of the anonymous information to the effect that the shift fee was £70, was most likely a disgruntled dancer. No unexplained assets of the directors had been traced. All in all HMRC's allegations had been dealt with and explained away. Mr Watson expressed alarm at the credence given by HMRC to the anonymous information. Its source and nature had not been disclosed under the cloak of confidentiality. This was unfairly prejudicial to the Appellant.

104.Mr Watson discussed the evidence of the individual witnesses. They each confirmed a £10 shift fee. Heather Burton explained (somewhat implausibly in the Tribunal's view) that she had explained to Jason that out of a £35/£50 fee discussed, accommodation would be provided at the St Enoch Hotel with the Appellant meeting the costs. Thus a £10 net fee resulted. Yvonne Hay, the only dancer (for a brief period) who gave evidence, confirmed a £10 per shift fee.

105.Mr Watson then reviewed his own evidence. He argued that the second revision of his "cash flow" analysis resolved any difficulty of negative balances. Corrections had to be made to Mr Macrae's version. In Mr Watson's final version only nine small deficits resulted. In this form the cash flow analysis undermined HMRC's extrapolation of a £60,000 deficit for the Year to 31 March 2005.

106.Mr Watson poured scorn on the Julie Bindel report. It seemed highly unlikely that she had ever visited the premises personally. There were obvious errors in the

details of her report. She had been hostile and unreasonable in her response to Mr Mackie's enquiries.

107.Mr Watson then addressed the matter of both Directors' financial means. On the basis of the documentation produced and evidence led, they each had a reasonable level of income to cover their lifestyles. There was no need for extra funds from undisclosed sources. So far as Mr McDavitt was concerned, he had acquired very cheaply an old house in Roscommon. He had been involved personally in the reconstruction work. He was able to fund this work from his income from Risky Business and the Brewhouse. His wife had a "not insubstantial" income. Mr Cameron too had an income from both Risky Business and the Brewhouse. In the Year under investigation (2005) he cohabited with Suzanne McIlwraith. She contributed to the domestic budget, as did Mr Cameron's son. Mr Cameron Junior as a trained joiner had carried out refurbishment at Risky Business' premises.

108.Mr Watson made reference finally to Section 50(6) TMA and the burden of proof in relation to assessments consequent upon a *discovery*. He referred us to *Scott and Anor t/a Farthings Steakhouse v MacDonald.*

Conclusion

109.Having considered Parties' submissions and on the basis of the evidence we make the following **Findings in Fact**:-

(i) The Appellant is an incorporated company and in the Years ending March 2002, 2003, 2004, 2005 and 2006 traded as "Legs'n Co" at 86 Maxwell Street, Glasgow where it carried on principally the business of a public house.

(ii) The Appellant permitted lap-dancers to perform at its premises. The dancers were self-employed and contracted with the Appellant simply to pay a charge per session for the facilities afforded there to them. At the material time, about 2004 and 2005, the charge was £35 per session on weekdays and £50 at weekends, ie Friday and Saturday. The Appellant regulated which dancers were allowed to work at their premises and for which sessions. A maximum number of seven dancers were allowed to perform at any one session.

(iii) The market rate paid by dancers at the same time varied between £35 and £85, ie marginally in excess of the Appellant's charges.

(iv) The dancers would contract with the customers directly for performing dances. They charged a tariff of about £5 or £10 for a dance of a duration of approximately 3 to 6 minutes. The customers paid this directly to the dancer who retained this as a gross receipt.

(v) "Legs'n Co" was featured in a website, "Laptastic", as a venue offering bar and social facilities with the special feature of the services of lap-dancers. The inclusion of "Legs'n Co" in the website was with at least the

tacit consent and approval of the Appellant. The Laptastic website dates from about 2006.

(vi) During the period from December 2000 to September 2008 the Appellant carried on the business of a public house with lap-dancing from premises at 86 Maxwell Street, Glasgow. These were licensed for a total number of patrons/persons present of about 47.

(vii) The principal sources of income derived by the Appellant from its business were from the sale of alcoholic drink, entry fees charged to customers, charges on a sessional basis from the self-employed lap-dancers, and from a fruit machine.

(viii) An investigation into the tax affairs of the Appellant was undertaken by the Respondents. In particular the investigation was directed to the profits of its trading for the Year to 31 March 2005.

(ix) The business and accountancy records maintained by the Appellant for the period from April 2004 to March 2005 were not reliable and were insufficient for calculating satisfactorily the annual profits and gains of his trading. In particular substantial cash adjustments had to be made to balance the accounts. Cash flow tests confirmed a pattern of inaccurate and inadequate records.

(x) Substantial cash sums were abstracted by Messrs Cameron & McDavitt, the Directors of the Appellant company, during the five Years, March 2002 to March 2006 inclusive.

(xi) Further assessments to Corporation Tax were made in September 2008 on the Appellant company in respect of the Years to 31 March 2002 to 2006 inclusive and separate assessments in terms of Section 419 ICTA 1998 were made too (see R/3/142-3).

110. We consider the approach of Mr Macrae and HMRC well-reasoned. The manner in which they made the assessments was fair-minded, to best judgement, and was not unsympathetic to the Appellant's and its directors' interests. Faced with a dearth of satisfactory business and accounting records Mr Macrae's extrapolation of under-declared profit is in our view logical and unassailable.

111. The findings of HMRC in the course of their enquiry into the Year to March 2005 gave rise to a *discovery* upon which the supplementary assessments to profit for the Years 2002-2006 logically and reasonably follow. We note the *desiderata* of Finance Act 1998, Schedule 18, para 21(5) –

"(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."

These have not been met by the Appellant and its directors in the preparation and maintenance of their business records. The *onus* of disproving the assessments as inaccurate rests on the Appellant, of course, in terms of Taxes Management Act 1970, Section 50(6). Commenting on this provision in *Hurley v Taylor,* 71 TC 268 at p286, Park J remarked –

> "It is well settled by authority that this places the onus of discharging the assessment on the taxpayer. If the Commissioners, having heard his case, are uncertain where the truth lies, they must dismiss the appeal and uphold the assessment."

Moreover, the information required to establish the correct figures of profit is peculiarly within the directors' knowledge and under their control. We observe that both the Appellant's directors, Mr McDavitt and Mr Cameron, failed to provide HMRC with detailed lists of their assets in the course of the inquiry. (See R/3/29 & 32 and Supplementary Witness Statement of Mr Macrae para 69.)

112.There were broadly five areas of concern on which Mr Macrae's investigation focussed, *viz* commission/fees paid by dancers for the use of the Appellant's facilities; door fees paid by patrons on entrance; wages paid to employees generally and, peculiarly, to security staff whose services were necessary to provide a secure working environment for the dancers; and both directors' personal expenditure. Taking these together and cumulatively could readily result in duplication of actual profit figures. For instance, undeclared fees from dancers and patrons could be reflected in an enhanced pattern of directors' personal expenditure.

113.The basis adopted by Mr Macrae, focussing on the commissions/fees paid by the dancers, avoids the risk of such duplication of profit and consequent prejudice to the Appellant.

114.The problems encountered in the exercise of ascertaining profit stem from the dearth of satisfactory documentary records and credible evidence. (Our assessments of the evidence of the Appellant's witnesses are noted *supra*.) The primary sources which might reasonably be expected to contain accurate contemporaneous records, are lacking. The "cash balance" test has produced too many incongruous results. It is accepted by the directors and their advisers that substantial cash adjustments were required to balance the business' accounts. There is no audit trail, such as might be expected ordinarily, showing the funds allegedly transferred from the Brewhouse into Risky Business.

115.These difficulties fall to be addressed individually.

116.The "cash balance" test applied by Mr Macrae featured extensively in evidence and submissions. It refers simply to the cash in physical terms on the premises. Given the nature of cash there must always be a positive balance, yet on frequent occasions a negative figure resulted. These remain unexplained in spite of the

considerable and conscientious efforts made by Mr Watson, Mr Mackie, and his trainee in trying to reconcile these. Several attempts were made by them to produce alternative computations – at short notice and even overnight – but to no avail in our opinion. We noted too that on certain occasions substantial positive balances were produced in these calculations – which seemed inconsistent with the business' declared practice on banking substantial receipts without delay. We accept that while the cash balance test, its accuracy and value were debated at length, it was relied on by HMRC only as evidence of the irregularity of the accounts. It did not form the substantive basis on which Mr Macrae calculated his further assessments.

117.Mr Mackie explained that he had to make substantial adjustments to the business accounts which he had prepared from the business' primary records. In particular a large number of adjustments varying from £10,000 to £23,500 had to be made to balance the business' accounts over the Years in question. The need for such adjustments, in our view, confirms the woefully unsatisfactory state of the Appellant's business books and records as found by their professional adviser. Such adjustments, in our view, are not marginal or routine.

118.In attempting to explain the cash imbalances the Appellant's directors sought to rely on substantial cash transfers from the other public house business, the Brewhouse, which they owned. That attempt in our view was not successful. There was no audit trail or record in both businesses' accounts to confirm or support the transfer of funds.

119.Mr Macrae's misgivings about the business' records were wholly justified in our view.

120.In his projections of profit Mr Macrae substituted figures of £35 and £50 for the individual dancer's session fees. These were respectively for week-days and weekends, and, of course, represent a substantial increase on the £10 fee asserted on behalf of the Appellant. We did not find the evidence in support of a £10 fee credible. (We did accept that that figure was stated to Mr Mackie by those dancers for whom he acted, but that does not confirm its accuracy. We can only speculate as to the dancers' motives, but if they understated their profits, they might well understate expenses to produce a credible earnings/expenses *ratio*.) The £10 figure is grossly disproportionate to the costs of providing security for the dancers and, moreover, in relation to the gross takings per shift of the dancers, for which sums up to £300 and £500 were spoken to in evidence by respectively Miss Burton and Mr McDavitt. The £35/£50 estimate bears to be in accordance with the contents of the Laptastic website and is supported generally by the preponderance of evidence about the market rate. That evidence and its consistency, we find crucial. It is not the highest local rate, nor is it the lowest UK rate which £10 per shift would be. From the photographs and plans produced, the premises did not seem to be "run-down" although they were neither luxurious nor had a prime site. Mr Watson made several telling points in relation to Laptastic (that website, it seems, may not have been in existence until about the end of the six year period under assessment; there was no documentary evidence of payments to it) and the Bindel Report (had Professor Bindel visited the premises in person, and particularly alone, she would have been viewed suspiciously;

her record of Legs'n Co's owner was incorrect). Notwithstanding these criticisms these two sources of evidence were not undermined in our view. We are not persuaded that Laptastic conjured up figures for the Appellant's charges without reference to it. Laptastic, the Bindel Report and the anonymous information, assessed as credible by Mr Macrae, all supported a commercial rate being charged by the Appellant and that consistently much higher than £10 per shift. The *onus* of proof or challenge rests on the Appellant/taxpayer. Of the authorities cited we note particularly the observations of Lord Hanworth MR in *T Haythornthwaite & Sons* (11TC 657 at page 667) –

> "… it is quite plain that the Commissioners are to hold the assessment standing good unless the subject – the Appellant – established before the Commissioners, by evidence satisfactory to them, that the assessment ought to be reduced or set aside."

This view was approved by Lord Greene MR in *Norman* v *Golder* he opined –

> "… the assessment stands, unless and until the taxpayer satisfies the Commissioners that it is wrong … The point really is not arguable."

121.Mr Hone led extensive evidence in relation to HMRC's suspicions about understated wage-records and directors' personal expenditure, in support of the argument that substantial cash had been abstracted from the business and not declared for accounting and tax purposes. This did not indicate even an approximate amount, but nonetheless we found it helpful to support a finding of substantial suppression of true profit over an extended period, and to confirm the wholly unsatisfactory nature of the Appellant company's accounting records.

122.Having paid close and critical attention to Mr Macrae's evidence, we reject any suggestion that he had conducted his enquiry in the manner castigated in *Scott & Anor t/a Farthings Steak House* (1996 Sp C 91), referred to by Mr Watson. Due care and diligence were exercised by Mr Macrae in our view, and we consider that he made a conscious and conscientious effort to produce a fair result for the directors of the taxpayer company. In particular we noted earlier (para 9) that, rather than treat the extra profit assessed and abstracted by the company as directors' fees or dividends, he adopted a Section 419 ICTA charge applicable in cases of directors' loans, so enabling a more favourable practical result for Messrs McDavitt and Cameron.

123.The Year under enquiry was that ending March 2005. Mr Hone submitted that on the basis of the *presumption of continuity* the assessments for the other Years, ie 2002, 2003, 2004, and 2006 were justifiable. The pattern of trading did not change over the Years nor, apparently, did the management of the company. In the absence of contrary or any other evidence, and particularly the dearth of satisfactory business records over an extended period, we agree that this is the appropriate and inevitable course. Mr Hone referred us to dicta of Goff LJ in *Nicholson* v *Morris* (51TC 95 at p118) –

"Although there was no direct evidence to show non-disclosure in earlier years, the Commissioners were fully entitled to draw the inference that this was not something which went on only during Mr Brennan's time [a barrister whose clerk was the taxpayer], but was a continuing course of conduct on Mr Nicholson's [the clerk] part which had begun earlier and persisted throughout the years in question."

124.Mr Hone noted also Walton J's remarks at the conclusion of his decision in *Jonas* v *Banford* 51 TC 1 at p25 –

"But, so far as the discovery point is concerned, once the Inspector comes to the conclusion that, on the facts which he has discovered, Mr Jonas has additional income beyond that which he has so far declared to the Inspector, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer."

125.Logically as we interpret it, the *presumption of continuity* may apply both prospectively and retrospectively. We therefore approve Mr Macrae's *discovery* assessments for each of the five Years, including 2006.

126.Finally, Mr Hone invited us to make a finding of *negligence* against the Appellant and its directors on the basis of their inadequate record-keeping. For the reasons which we have stated above we agree and find accordingly.

127.In these circumstances the Appeal is disallowed.

Expenses

128.Mr Hone did not seek expenses in the event of success. Therefore we make no award.

129.Given the complex and detailed nature of the accounting evidence led before us the Appeal continued over an extended period. Throughout we have appreciated the efforts of Mr Hone, Mr Watson and Mr Mackie in guiding us through the maze of documentation produced.

130.This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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KENNETH MURE, QC
TRIBUNAL JUDGE

RELEASE DATE: 7 December 2012

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