TC03350

Appeal number: TC/2012/07512

Income tax and VAT – back duty investigation – assessments for VAT and income tax on undeclared overseas interest and unexplained deposits in overseas bank account and associated penalties – on the facts, appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

JAMES RAY SWANSTON **Appellant**

-and-

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

TRIBUNAL: **JUDGE KEVIN POOLE**
MR CHARLES BAKER FCA

Sitting in public in Bedford Square, London on 3 & 4 October 2013

Nimal Fonseka of Fonseka & Co Limited for the Appellant

David Linneker, Presenting Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal concerns assessments for income tax, VAT and associated penalties totalling approximately £500,000 arising from a back duty investigation covering the period since 1991.

2. We should mention at the outset that the various appeals were notified late. No objection was taken by HMRC and after consideration of the circumstances we decided to permit the appeals to proceed notwithstanding the late notification.

The facts

Introduction and background

3. We received a large bundle of documents in evidence. We also received witness statements (and heard live evidence) from the Appellant, from one Paul McGrath (an associate of the Appellant and his late father) and from Richard Sturley and Ms Amina Clarke, officers of HMRC involved in the investigation. From this evidence, we find the following facts.

4. The Appellant was born in 1955. His father (with whom he shared all his names) was a colourful character in the second hand plant and machinery market from shortly after the Second World War. He dealt on an international basis in large items such as cranes and lived something of a playboy lifestyle. He clearly made a great deal of money. The Appellant said his father's business was the third largest in the UK in its sector and his funeral was attended by approximately 500 business associates, which gave an idea of the size of his business network. He operated from premises at Colnbrook, Berkshire.

5. The Appellant ran away from school at the age of about 11 in 1966 and worked for his father, "on and off", as a labourer, then (for about three to four years in the late 1970's) as an HGV driver and then (until about 1983) at the business base as an engineer. Whilst doing so, he met another individual called Charles Hutcheson ("CH") who had worked with his father as a partner with him in a smaller (but similar) business for some 25 years. CH came from Guernsey.

6. At some point in the early 1980's, CH stopped working with the Appellant's father and went into partnership with another individual called Allen under the name "HA Plant". The Appellant (who appears to have had a tempestuous relationship with his father) was recruited by CH to join the new business, mainly as a driver. He quickly worked his way up into a position of some trust, partly through using his initiative to exploit business opportunities that came in his direction. CH introduced him to bankers from his home island of Guernsey and the Appellant started to open bank accounts there, mainly with Barclays. After a while, Mr Allen retired and the Appellant was made a 50% partner in the business. Then, when CH died in about 1985, the Appellant "inherited" the business of HA Plant from him.

7. The Appellant's business premises were at the same yard as his father's, in Colnbrook. The HA Plant business (first with CH and then on his own account) involved buying and selling smaller items of second hand plant and machinery – small pumps, generators and cement mixers, for example. As time went by, he expanded the business into somewhat larger items.

8. It appears that his father had occasional fits of generosity towards the Appellant, perhaps inspired by pride in the success he was making of his business. The Appellant gave evidence, which we have no reason to doubt, that his father made him an occasional gift of small amounts of money – he mentioned the figure of £3,000 to £4,000, which the Appellant paid into his Guernsey bank account.

9. As the HA Plant business became more successful, the Appellant used his Guernsey banking facilities to amass a fund of "spare cash" offshore, mainly from the business. He gave evidence that he believed it was a perfectly legitimate tax saving strategy to invest his spare money overseas, and he also used that money to buy equipment, if he was short of money in the UK when he needed it.

10. In about 2007, the Appellant was informed by Barclays of HMRC's publicised "offshore disclosure facility", whereby full disclosures of offshore accounts and the activities associated with them could be made to HMRC with the benefit of a low penalty rate applicable to any associated tax liabilities. He decided to take advantage of the facility and in late 2007 made a disclosure to HMRC and an associated payment of tax.

11. HMRC decided that they wished to review the Appellant's tax affairs in more detail before accepting the disclosure that had been made. They informed him of this fact in April 2008 and there followed lengthy correspondence and a number of meetings over a period of nearly four years, culminating in assessments and determinations in 2011 and early 2012 for income tax, national insurance contributions, VAT and penalties. These assessments and determinations, covering the period from 1990-91 to 2008-09, are the subject of the present appeal.

12. It has been accepted by HMRC that the assessment for the year 1990-91 was raised out of time and accordingly it has been or will be discharged, along with the associated penalty.

13. It has also been accepted by HMRC that the penalties for delivery of incorrect self-assessment returns for the years 1991-92 to 1995-96 inclusive should be discharged, on the basis that there is no evidence to show that returns were actually submitted for those years.

Summary of disputed matters and our findings on them

Introduction

14. Bank statements were supplied by the Appellant in relation to some eight offshore accounts and a detailed analysis of those accounts was carried out. Eventually, amounts were agreed in respect of the tax liability on undeclared foreign

bank interest for the years 1991-92 to 2008-09 in a total sum of £71,349.72 (subsequently reduced to £65,813.37 when it was discovered that the 2007-08 and 2008-09 foreign interest had in fact been included in the Appellant's tax returns for those years).

15. The Appellant accepts his liability in relation to the reduced amount (and associated interest). We therefore consider that matter no further.

16. The bank accounts in question included a great many other transactions apart from the crediting of interest earned, however. After some examination, it was apparent that many of the deposits and payments were referable to transactions which were already reflected in the UK tax returns of the Appellant in connection with the HA Plant business. The remainder of the deposits were considered by HMRC, in the absence of any satisfactory and credible explanation to the contrary, to reflect unrecorded takings of the UK business.

17. After some analysis based on a sample of three tax years, it was eventually agreed between HMRC and the Appellant's adviser that, in general terms, 20% of the money deposited in the offshore bank accounts should be regarded as reflecting unrecorded sales of the UK business. Agreement was also reached on the actual figures involved.

18. These agreements are subject to two qualifications, upon which the parties are not agreed.

19. First, there is disagreement about the correct treatment of one particular single large deposit of £535,478.15 credited to the Appellant's main Guernsey business account on 14 May 2001 ("the disputed receipt"). The Appellant argues that no part of this amount should be treated as taxable profit, as the amount in question was regarded as a loan. HMRC do not accept this explanation and consider the amount to be taxable in full (i.e. without discounting it by 80% in the same way as the other much smaller receipts had been discounted). To put this dispute in context, the tax on this sum represents more than half of the overall disputed direct tax liability for the whole period under review.

20. Second, in relation to the receipts other than the disputed receipt, the Appellant argues that 46% should be deducted in respect of associated purchase costs (40%) and expenses/overheads (6%) in respect of the 20% of unexplained deposits referred to at [17] above, whereas HMRC argue that no such deduction is appropriate because there is no evidence of any associated costs or expenses having been incurred – effectively HMRC are arguing that the 20% should be treated as a "suppression of takings" figure and therefore effectively pure profit, whereas the Appellant is arguing that credit should be given for the fact that costs must have been incurred in order to generate the sales reflected in the 20% figure.

21. In passing, we should mention that Mr Fonseka sought to persuade us that HMRC had agreed with his "minus 46%" approach during the course of the enquiry, but we find no such agreement was reached.

22. In addition, HMRC raised VAT assessments by applying the VAT fraction to a proportion of what they regarded as undisclosed sales (i.e. 20% of the "unexplained deposits"). They had modified this general approach in two ways: first, they had accepted that the sales which they argued were reflected in the disputed receipt were most likely to have been overseas sales qualifying for zero rating and they therefore excluded the £535,478.15 from their calculations altogether; and second they accepted that on average 40% of the Appellant's sales were overseas and therefore qualified for zero rating and they therefore sought to impose VAT only on 60% of what they considered to be the undisclosed sales. There is no dispute about the method of calculation, except that the Appellant sought credit for input VAT he argued he would have suffered on the 46% of expenses he claimed to have incurred (see [20] above).

23. There are therefore essentially three main disputes before us to be resolved, as follows:

(1) Whether the £535,478.15 credit to the Appellant's main Guernsey business bank account on 14 May 2001 should be treated as undisclosed business receipts (as HMRC contended) or as a loan (as the Appellant contended) or some other receipt of a non-taxable nature.

(2) Whether a further deduction of 46% (after the 80% already agreed) should be allowed in respect of the remainder of the unexplained deposits to the offshore accounts.

(3) Whether credit should be given, in relation to the VAT assessments, for input VAT in respect of the expenses comprised in the claimed further 46% deduction referred to above.

24. In addition, there is dispute about the appropriate level of penalties. We deal with that aspect separately below.

First disputed matter – the £535,478.15 disputed receipt

25. The Appellant asks us to find that this amount, credited to his main Guernsey business bank account on 14 May 2001, represented a loan arranged for him for business purposes by his father and not a taxable receipt of the business.

26. In broad terms, his explanation of the background to this loan was that he had access to a potentially large business opportunity, too large for him to be able to finance it out of his own resources. He spoke to his father about it, who agreed to arrange for a loan of the amount he needed. The loan was advanced to him by direct transfer to his Guernsey account on 14 May 2001 from a company called Angaros Limited, which he knew nothing about.

27. It is fair to say that the Appellant's account of this transaction has changed somewhat over time.

28. When it was first specifically raised by HMRC in March 2009 (by way of a general query as to the single large deposit), there was a long delay in providing any

information about it. There had been an earlier suggestion that the Appellant's offshore accounts were "used" by his father for his own business purposes (remembering that his name was exactly the same as the Appellant's), but that has not been persisted with. Eventually, a schedule was provided with a letter dated 3 June 2009, in which the receipt was analysed as "Loan (long term)". When pressed for further information on the point, Mr Fonseka wrote on 5 August 2009, stating that "This loan was arranged and granted on the personal guarantee of Mr J R Swanston sr." He referred to "attached letters" in which he had supposedly not been able to get any response from Angaros Limited. These letters were not with the letter when received but when subsequently supplied, the relevant letter was one dated 12 February 2009 addressed to "The Secretary, Angaros Ltd" at an address in the Isle of Man. There is nothing in the evidence before us to show where the address in question originated, but we infer it must have been provided to Mr Fonseka by the Appellant (although Mr Fonseka said to HMRC that he had sent two people (without success) to Guernsey to discover more information about Angaros, which would seem a little odd, given that it was an Isle of Man company).

29. When pressed for more details, Mr Fonseka wrote again on 9 October 2009, stating that the loan "was arranged for and guaranteed by J.R. Swanston Snr. It was to help my clients business by ensuring that adequate liquid funds were available for profitable purchases of second hand equipment coming onto the market."

30. HMRC were not satisfied with this explanation, and said it would require further exploration at the meeting which had been arranged for 11 November 2009. Unfortunately, the Appellant did not attend that meeting due to illness, so the only further information was that provided by Mr Fonseka, recorded in HMRC's notes of the meeting as follows:

> "NF gave some background information about the loan from Angaros Ltd. Apparently, JRS had the opportunity to buy a large amount of equipment and had asked his father for a temporary loan. His father arranged this informally through the director of Angaros Ltd, who was a personal friend. For some reason, JRS did not go ahead with the purchase but did use the money. Then his father died and the director of Angaros Ltd also died. Nobody asked JRS for the money so he has not given it back. Apparently Angaros Ltd has now folded and although there was another director, he has not responded to NF's letters. The intention seemed to be to leave well alone."

31. Events moved on, and the enquiry was taken up for working under COP9, as a result of which a further meeting took place on 7 May 2010, this time attended by the Appellant in person as well as Mr Fonseka. At that meeting, according to the notes taken by HMRC, the following information was provided by the Appellant in relation to the loan:

> "210. Mr Swanston said that he had an outstanding loan for £500,000 from a private company that was arranged by Mr Swanston's father, but the loan was in the father's name. Mr Swanston said his late father had

contacts all over the world. The loan was from Angaros which was an offshore company.

211. RS asked Mr Swanston for details regarding this loan. Mr Swanston said there was a big deal in Scotland to buy a job lot consisting of 3 generators. The deal would have cost £600,000 but there was potentially a big profit to be made. Mr Swanston said his father wanted to help him out and brokered the deal to obtain the loan from Angaros. Mr Swanston said that he intended to go into partnership with a person in Scotland called Philip Sharpe. The deal would have made a clear profit of £270,000. However the deal did not happen, and only part of it was used to pay for machinery. The rest of the money remained in the offshore account.

212. Angaros have not asked for the loan to be paid back, even though Mr Swanston's father had told him shortly before his death that he would have to pay the money back.

32. In the disclosure report dated 2 December 2010 which Fonseka & Co prepared following this meeting, the following explanation appeared:

"**ANGAROS**

In 2001 A was informed by a contact (Philip Sharpe) in Scotland that there were a few large generators available which would cost about £600k but could be sold making a surplus of £270k. Mr Sharpe would be a partner on this particular deal. A advised his father of this deal and was assured of funding provided he received a reasonable part of the profit. When the money was credited to the account, the Manager promptly contacted A, and wanted to know the details of the proposed transaction. He advised that the money should be invested in some of the bank's Financial Products. He would be able to make payments to the vendors, on a temporary facility secured by the investment. Going down this route A would make substantial tax free gains. In the event the deal did not go through. A continued to use this money to fund his business. After the death of his father the matter went quiet and A chose to let sleeping dogs lie."

33. In the Appellant's witness statement dated 1 May 2013, the above paragraph was set out in very similar terms. It was changed from the third person to the first person, and some very specific changes were made in addition. In particular, the following sentence:

> "When the money was credited to the account, the Manager promptly contacted A, and wanted to know the details of the proposed transaction."

was replaced by:

> "My father did not tell me where this money would come from. When this money was transferred to my account in Guernsey, my Bank

> Manager promptly contacted me. I had previously advised him of the details of the proposed transaction."

34. At the hearing, the Appellant's live evidence was somewhat different. He said that he had bought five small generators from the NEC Mobile Phone site in Scotland in 2000. Whilst doing so, he noticed there were three very large generators at the complex; he enquired whether they would also be sold and he was told that they would be, at some point in the next twelve months. The site was closing down and he asked whether there were any other items likely to be sold. He was told of 22 smaller electrical transformers (which he thought he could sell for about £7,500 each) and two compressor houses (each incorporating 20 Atlas compressors which provided the compressed air to power all the hand tools at the site). He was told that NEC would expect to sell all this equipment for approximately £450,000 to £500,000.

35. The Appellant approached one of his customers Douglas Construction, who he understood to have contacts with the main construction company for the Wembley Stadium redevelopment which was then being planned. He told him of the three large generators which were potentially available and asked if he might be interested in buying them, and at what price. After two or three weeks, he received a reply to the effect that they would be interested at a price of about £450,000.

36. The Appellant said that at this point he realised he might have a potentially very lucrative deal on his hands, but one that he would struggle to finance. In his dealings with NEC on the batch of five generators, he was given 72 hours to pay the purchase price against a proforma invoice and remove the goods or he would lose the deal. He was concerned that he might be faced with a similar situation and insufficient ready funds to take advantage of the opportunity. He approached his father and explained the situation. To take advantage of this large potential opportunity, he would need to be able to find perhaps £500,000 on 72 hours' notice at some point during the following year. His father said he thought he would be able to help, and that was how the £535,478.15 came to be transferred to him on 14 May 2001. He did not mention any terms of the loan, other than the fact that it was interest free and was expected to be repaid within a year. The Appellant did not explain and was not asked why the amount received was not a round number.

37. At first sight, it would seem somewhat odd that the Appellant should have immediately invested the "loan" when he received it in a savings account with a fixed monthly maturity, given that the whole purpose of the loan was supposedly to ensure the speedy availability of funds when he needed them. We do not consider this fact to be decisive on its own, however, given the (plausible) explanation that the bank had supposedly told the Appellant that a short term facility could be made available to him to provide the necessary funds on short notice against the security of the funds in the investment account.

38. Time went by, and the Appellant said he learned that because of restrictions associated with government aid for the NEC site, there was a seven year waiting period (from a date which was not identified to us) before any of the assets could be

sold. This had obviously not been known to the individual who had first indicated to him that the items would shortly be available.

39. His father did enquire from time to time as to whether the deal was coming to fruition, and reminded the Appellant that he would have to repay the loan eventually. He did not press for repayment, however. In passing (though the Appellant did not mention the point) we observe that there was included in our documents bundle a copy of a company search report against Angaros Limited of Waterfall House, Vicarage Road, Braddan, Isle of Man, showing that it had been dissolved on 24 October 2001, less than six months after the "loan" had been advanced to the Appellant.

40. Then, on 15 January 2003, the Appellant's father died. It was not until March 2005 that the three large generators eventually came up for sale. It seems that the 22 transformers and the two compressor houses were sold at auction, probably around the same time. The Appellant was telephoned from Scotland to be told that he could buy the three large generators for £230,000, but he would have to act quickly. He was about to leave on a regular annual holiday so he decided to approach a business contact in southern Scotland, one Philip Sharpe of Hawick Plant Auctions Limited, to partner him in the deal and in particular to deal with viewing the goods and making the logistical arrangements for payment and collection. Mr Sharpe contacted the Appellant on his holiday, told him to tell Douglas Construction that their £450,000 offer was not good enough, and sold the generators to another customer for £500,000, sharing the purchase price and the sale proceeds 50:50.

41. At the hearing, the Appellant produced copies of invoices from Hawick Plant Auctions Limited ("HPA") to HA Plant dated 28 March 2005 for £115,000 plus VAT and from HA Plant to HPA dated 15 July 2005 for £250,000 plus VAT (expressed to be, respectively, for the sale and sale back of a half share in the three generators from HPA to HA Plant and back). His offshore bank statements reflect his apparent payment of the 28 March invoice on 17 March (£100,000) and 4 April (£35,125), from his main Guernsey business account. The receipt of payment of the 15 July invoice is less clear, though the Appellant's UK business account shows a receipt of £243,750 (compared to the invoice total of £293,750) on 18 July. There is no obvious receipt of the remaining £50,000 anywhere else in the bank statements produced in evidence. The UK VAT return for period 07/05 appears to reflect both the input and output VAT on the two invoices.

42. So far as repayment of the "loan" is concerned, the Appellant made it clear he had formed the intention not to repay unless it was validly demanded and, since his father and the other individual he understood to be a director of Angaros had both died and Angaros itself had been dissolved, that was extremely unlikely. His rationale for forming this intention was that he saw the "loan" as effectively being his inheritance from his father (whose will had been contested as an alleged forgery, indeed the Appellant's brother had been prosecuted, unsuccessfully, on that basis); under his father's will, he had received nothing and he clearly nursed a grievance and continuing suspicions that he had been unlawfully deprived of his true inheritance. In

those circumstances, he had not mentioned the "loan" to his father's personal representatives.

43. Whatever the details, it can readily be seen that the account given by the Appellant in his witness statement (and earlier) and that given by him in live evidence are different in many small ways and in at least one material respect. Up to the hearing, the account given by the Appellant was unequivocal in stating that Philip Sharpe had approached him with the generator deal, whereas at the hearing he was quite clear in saying that he had approached Philip Sharpe, indeed he had only done so at the last minute, when the deal suddenly "came to life" just as he was about to leave on holiday. The invoices in evidence before us (which were only produced at the hearing, and had not been produced to HMRC previously) support some of the financial details about the 2005 trade given at the hearing, but clearly therefore the Appellant was either less than careful or less than forthcoming in relation to the account he had provided before.

44. The evidence of Mr McGrath, whilst it provided a bit more background about the relationship between the Appellant and his father, did not assist us greatly except on two points. He was obviously unable to give any evidence as to what had actually happened between the Appellant and his father, but he did say (and we accept) it was he who had introduced the Appellant's father to an agent in the Isle of Man who organised offshore companies (in due course it appears the Appellant's father became well versed in the use of offshore companies, particularly in the Isle of Man); and he also said (and we accept) that he remembered a conversation with the Appellant's father in which there was discussion about whether Sharpe would "share the profits properly" (of necessity, such conversation must have taken place before the Appellant's father died in 2003, which supports the view that the deal with Sharpe must have been in contemplation well before it actually came to fruition in March 2005).

45. We summarise the conclusions we have reached in relation to this "loan" as follows.

46. The crucial point we must decide is whether the disputed receipt was a taxable receipt of the Appellant's business activities. In order to decide that point, it seems to us that we have to take account of the plausibility of the account put forward by the Appellant. Of necessity, his account is light on legal analysis, and perhaps more disconcertingly it has from time to time been somewhat factually inconsistent. However, its main elements have remained reasonably coherent.

47. We accept that the Appellant's father actually arranged for the Appellant to receive the disputed receipt.

48. Whilst no one factor is decisive, taken together the following factors lead us to doubt whether the disputed receipt was a loan:

(1) The disputed receipt was £535,478.15. Loans are usually for a round amount particularly when, as in this case, it was supposedly for a future project rather that to cover an existing liability.

(2) Even within a family, it would be unusual for a significant loan (let alone one of this magnitude) to be made without any documentation at all.

(3) The disputed receipt came from Angaros Limited only five months before that company was dissolved. It would seem surprising if that company were to advance a potentially long term loan at a time when the dissolution of the company was likely to be in contemplation.

(4) It would be even more surprising if the directors of Angaros Limited made no attempt to call in any loans due to the company so that the funds could be distributed to those properly entitled.

(5) No interest was ever demanded or paid.

(6) No capital repayments have ever been demanded or paid.

49. All these unusual features might however be explainable by reference to the highly unconventional way in which the Appellant's father apparently ran his financial and business affairs.

50. The Appellant did not seek to persuade us that the disputed receipt was a gift.

51. HMRC invited us to infer that, in the absence of a satisfactory explanation for the disputed receipt, it must constitute a taxable receipt of the Appellant's trade. Where a dishonest trader cannot account for receipts that could plausibly be trading receipts, it is clear that HMRC can be justified in assuming that those receipts were from the trade. However, in this case we consider that the disputed receipt cannot plausibly be a receipt of the trade for the following reasons:

(1) The disputed receipt was completely out of scale with the Appellant's known trading activity. The declared turnover of the Appellant's trading business was £450,085 for the year ended 31 March 2001 and £312,025 for the year ended 31 March 2002. So the disputed receipt on 14 May 2001 amounted to approximately 120% or 170% of those respective annual turnovers.

(2) The first year for which we were given an itemised list of trading receipts diverted into an offshore account was the year to April 2004. In that year, the largest individual trading receipt diverted was £9,100.

(3) We have rejected a claim for assumed purchase costs because there was no evidence of the existence of any such costs. Indeed, given the close scrutiny that has been given to the Appellant's finances, we are reasonably certain that no such hidden costs could exist. The corollary is that without a hidden purchase of trading stock the disputed receipt could not, in our view, represent a hidden sale of trading stock.

(4) The Appellant's offshore accounts were mainly in Guernsey, with a small account in Switzerland. There was no evidence that the Appellant had ever used bank accounts or companies in the Isle of Man (whether or not to conceal profits of his business), in contrast to the evidence that his father had used such accounts/companies extensively.

(5) In passing, it was suggested that the disputed receipt could be commission earned from introducing a deal to a third party. There was no evidence that the Appellant was in a position to introduce deals of the scale required to justify an introductory commission of over £500,000. We reject this suggestion as fanciful speculation.

The true character of the disputed receipt

52. We heard evidence that the Appellant's father had been a successful businessman trading internationally on a large scale. He had also been active in using companies in the Isle of Man to hide first his trading profits and then his accumulated wealth. Angaros Limited was incorporated in the Isle of Man on 29 April 1993 and dissolved on 24 October 2001. The Appellant's father was born in 1913 so he would have been about 88 years of age in 2001.

53. There is no direct evidence of the ownership of Angaros Limited. However, the Appellant said he asked his father for a loan and shortly afterwards the disputed receipt arrived from Angaros Limited.

54. It seems likely that the payment of the disputed receipt from Angaros Limited to the Appellant on 14 May 2001 was in preparation for the dissolution of Angaros Limited that finally took place some five months later. If £535,478.15 was the balance of the funds held by Angaros Limited, that would account for the "odd" amount of the disputed receipt. We infer that the origin of the money was as proceeds (probably undeclared for UK tax purposes) of the Appellant's father's business activities.

55. There are several ways, with different taxation consequences, by which the Appellant's father could arrange for the assets of Angaros Limited to come to the Appellant. It is not necessary for the purposes of this decision for us to identify the most likely possibility. We are however satisfied, on a balance of probabilities, that it was not a receipt of any business carried on by the Appellant.

56. We are well aware that reaching this conclusion means that the money will escape tax in the hands of the Appellant, and it probably derives from business activities of his father which have not borne UK tax. If HMRC were to seek to charge it in some other way (e.g. inheritance tax) or if the personal representatives of the Appellant's father were to seek to recover it as a loan, then different evidence may well be available in the context of either court proceedings or a tax appeal which would make the picture clearer. It is not necessary for our decision to decide what the disputed receipt was, only to determine whether it was a receipt of a trade carried on by the Appellant. We find that it was not.

Second disputed matter – 46% deduction from unexplained cash receipts

57. We find this more straightforward. We do not agree that HMRC have ever accepted that a 46% deduction should be allowed (in respect of cost of sales and expenses) against the 20% of offshore cash receipts which have been agreed as not having been reflected in the UK business receipts for tax purposes.

58. Nor do we consider that such a deduction should be allowed. The most important reason for taking this view is that the 20% of offshore receipts, by their very nature, are unexplained cash receipts for which no corresponding expenses have been shown, beyond those already claimed for in the accounts of the UK business.

59. Mr Fonseka asked us to regard them as "notional receipts", but in our view they are quite the opposite. Having been established as actual receipts of the business, there is no basis for allowing any amount to be set against them as cost of sales or expenses unless there is sufficient evidence to support the existence of such costs and expenses. To say that it would not have been possible to generate the turnover represented by these receipts without incurring corresponding costs and expenses misses the point. If further evidence existed as to such expenditure being incurred, it should have been possible to provide it. No attempt was made to do so. The costs and expenses which generated these receipts have, in our view, already been taken into account in calculating the taxable profits of the UK business. These amounts therefore reflect pure profit and should be taxable as such.

Third disputed matter – allowance of input VAT on extra expenses

60. Since we have concluded that no further expenses have been shown to be available to deduct from the unexplained offshore cash receipts, the question of the deductibility of any input VAT on such expenses does not arise.

Discussion and conclusion

The tax liabilities

61. No argument has been raised by the Appellant that HMRC are out of time to raise the assessments the subject of this appeal, or that they were for any other reason not entitled to raise assessments for appropriate amounts.

62. The only disputes between the parties are in relation to the treatment of the cash receipt of £535,478.15 on 14 May 2001, the allowability of further expenses as a deduction against the unexplained cash receipts, the allowability of input VAT on such further expenses and the amounts of any penalties.

63. We are not clear whether Mr Fonseka was seeking to make the point, but in any event we discount any suggestion that the assessments raised by HMRC were in any way capricious, arbitrary or unreasonable. It is clear that the Appellant's historical returns have been inaccurate and, subject to the specific points of disagreement referred to above, he has accepted that assessments can and should be raised for the shortfall.

64. Having reached that point, we are quite clear that the burden lies on the Appellant to show that the assessments are wrong.

65. In relation to the second and third disputed matters referred to above, we have already expressed our quite clear view that he has failed to discharge that burden.

66. We consider that he has discharged that burden in relation to the disputed receipt.

67. We therefore find in principle that the Appellant is liable in respect of the various tax liabilities contended for by HMRC, subject only to the exclusion of the disputed receipt from the computations. We presume there will be no difficulty in the parties agreeing the detailed calculations which flow from this decision in principle, but they shall be at liberty to apply to the Tribunal for a final determination if it proves impossible to agree the figures.

The penalties

68. In relation to the penalties, Mr Fonseka has accepted, rightly in our view, that the Appellant is not entitled to the concessionary rate of penalties afforded under the offshore disclosure facility.

69. The direct tax penalties are imposed under section 95 Taxes Management Act 1970 ("TMA"). The effect of this provision is not disputed, and there is no dispute as to HMRC's power to levy penalties under that section. The only question is the applicable rate. We have power, under section 100B TMA, to cancel the penalties altogether or to vary them up or down within the statutory limits.

70. The VAT penalties are imposed under section 60 Value Added Tax Act 1994 ("VATA94"). The effect of this provision is also not disputed, nor is there any dispute as to HMRC's power to levy penalties under that section. The only question is the applicable rate. We also have power, under section 70 VAT 94, to cancel the penalties or to vary them up or down within the statutory limits.

71. HMRC have imposed penalties at different rates in relation to the three different heads of liability, as follows:

(1) In relation to the direct tax liabilities for undeclared overseas interest: 25%

(2) In relation to other undeclared direct tax liabilities: 40%

(3) In relation to VAT liabilities: 35%

72. We are in agreement with the penalty rates applied by HMRC. In relation to the interest element, we agree that 25% is an appropriate rate in the circumstances (compared to the 10% rate that would have been available for a full and complete ODF disclosure). In relation to the VAT, we agree with the 35% rate; and in view of our finding on the disputed receipt and the different basis of calculation for the direct

tax penalties on undisclosed business income, we consider the applicable penalty rate of 40% to be appropriate.

Conclusion

73. We gave permission for the appeal to be notified to the Tribunal out of time (see [2] above).

74. We confirm the various assessments and amendments, as defended by HMRC at the hearing, subject to the exclusion of the disputed receipt (see [67] above).

75. We confirm the penalties as defended at the hearing, subject to adjustment to take account of the removal of the disputed receipt from the taxable income(see [72] above).

76. We anticipate there will be no difficulty in the parties agreeing the actual figures for tax and penalties on the basis of this decision in principle, but either party is at liberty to apply for a final decision in the event of a dispute.

77. The parties are directed to inform the Tribunal within 14 days if and when the calculations have been agreed, so the Tribunal can mark the case as finally disposed of.

78. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 19 February 2014