# TC05097

**Appeal number: TC/2014/04750**

***Corporation tax – VAT – payment of advertising costs – full amount not paid – tax avoidance scheme –held – payment not for business purposes – not creditable input tax – not wholly and exclusively for the purpose of the business – appeals dismissed.***

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

**DTL Supplies Limited** **Appellant**

**- and -**

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

**TRIBUNAL: JUDGE Rachel Short**
**Norah Clarke (Member)**

**Sitting in public at Eastgate House, Newport Road, Cardiff on Tuesday 19 April 2016**

**the Appellant not appearing**

**Mrs Liz McIntyre and Ms Karen Powell, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

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## DECISION

1. These appeals, which were joined on 6 July 2015 under appeal number TC/2014/04750, concern disputed VAT (TC/2014/04750) and corporation tax (TC/2015/02618) of the Appellant company, DTL Supplies Limited, for the accounting period ended 31 October 2010 for corporation tax purposes and period 01/11 for VAT.

*Preliminary matters*

2. At the start of the Tribunal hearing we were shown correspondence dated 5 April 2016 from the Appellant's representative Mike Jones Limited which explained that the Appellant had ceased trading. The Tribunal clerk spoke to the Appellant's representative on the morning of the hearing and was informed that they were no longer acting for the Appellant. The Tribunal clerk also spoke to Mr Cummins director of the Appellant on the morning of the hearing and was told that Mr Cummins was no longer a director of the Appellant, which had ceased trading and that Mr Cummins did not consider that this appeal was his concern.

3. The Respondents told us that they had recently confirmed that the Appellant was still recorded at Companies' House as an existing company and that they wanted the appeal to proceed in the absence of the Appellant and the Appellant's representative.

4. The Tribunal agreed that the Appellant, through its representative and its director had been notified that the appeal was to be heard and been given the opportunity to attend and that it was in the interests of justice for the appeal to proceed in their absence under Rule 33 of the Tribunal Procedure (First-tier Tribunal) Tax Chamber Rules 2009 ("The Tribunal Rules").

5. The Tribunal took account of the written submissions from the Appellant in its appeal notices of 25 August 2014 (VAT) and 9 September 2014 (corporation tax), although these were brief in both cases.

6. The Appellant's appeal against the corporation tax assessment made on 9 September 2014 was made late but HMRC did not object to an extension of time being granted for the making of the appeal so that the appeal could be treated as made in time.

*Background history*

7. The Appellant's VAT return for the 01/11 VAT period included a claim for an input tax deduction of £5,000 relating to the supply of advertising made to the Appellant by a company called Nick Jones Racing Limited. That advertising took the form of placing the Appellant's name on the sill of a racing car support vehicle owned by Nick Jones Racing Limited.

8. The Appellant's corporation tax return for the accounting period ended 31 October 2010 included a deduction for £25,000 plus VAT of allowable business expenses relating to this advertising.

9. The racing car company was owned Mr Nick Jones the son of Mr Michael Jones who was the director of the Appellant's accountant J & R Business Services. We were told that Mr Michael Jones of J&R Business Services had been convicted of fraud.

10. The Appellant had two directors, Mr and Mrs Cummins. Mr Cummins was interviewed under caution by HMRC on 25 May 2012 in relation to his involvement in a tax scheme relating to these advertising expenses.

11. HMRC issued a corporation tax assessment for the accounting period ended 31 October 2010 on 3 March 2014 disallowing the Appellant's £25,000 deduction for advertising costs. The Appellant's representative appealed on 31 March 2014. HMRC's assessment was corrected and re-issued on 23 April 2014 and a revised appeal was made by the Appellant's representative on 20 May 2014. HMRC undertook a statutory review on 12 August 2014 confirming their original decision. The Appellant appealed to this Tribunal on 9 September 2014.

12. HMRC issued a VAT assessment refusing the £5,000 input tax deduction claimed for the 01/11 VAT period on 29 January 2013. The Appellant's representative appealed on 5 June 2014. HMRC undertook a statutory review on 31 July 2014 confirming their original decision. The Appellant appealed to the Tribunal on 25 August 2014.

*The law*

13. HMRC's corporation tax assessment for the period ending 31 October 2010 was made under the "discovery" rules at Schedule 18 of the Finance Act 1998 at paragraph 44 – "Situation not disclosed by return or related documents etc"

> "*A discovery assessment for an accounting period for which the company has delivered a company tax return, or a discovery determination, may be made if at the time when an officer of Revenue and Customs-*
>
> *(a) ceased to be entitled to give a notice of enquiry into the return, or*
>
> *(b) completed the officer's enquiries into the return,*
>
> *they could not have been reasonably expected, on the basis of the information made available to them before that time, to be aware of the situation mentioned in paragraph 41(1) or (2).*"

The situation mentioned in paragraph 41(1) and (2) is that amounts have not been assessed to tax which should have been, or an assessment is insufficient or a relief is excessive.

14. The basis on which HMRC contest the deductibility of the Appellant's advertising expenses is 54 Corporation Tax Act 2009:

15. S 54 Expenses not wholly and exclusively for trade and unconnected losses

*"(1) In calculating the profits of a trade, no deduction is allowed for –*

*(a) expenses not incurred wholly and exclusively for the purposes of the trade, or*

*(b) losses not connected or arising out of the trade.*"

16. HMRC's assessment on the Appellant for an additional 25% of tax on the "loan" made to Mr Cummins was made under s 455 Corporation Tax Act 2010 "Charge to tax in case of loan to participator";

455(1) *This section applies if a close company makes a loan or advances money to –*

*(a) a relevant person who is a participator in the company or an associate of such a participator,*

*(b) .....*

*(2) There is due from the company, as if it were an amount of corporation tax chargeable on the company for the accounting period in which the loan or advance is made, an amount equal 25% of the amount of the loan or advance."*

17. The VAT legislation relied on by HMRC is principally s 5(2) Value Added Tax Act 1994 which defines a "supply" for VAT purposes:

*S 5(2) Subject to any provision made by that Schedule [Schedule 4] and to Treasury orders under subsection (3) to (6) below –*

*(a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration*;

and s 24(1) which determines what input tax can be claimed in respect of supplies received:

*S 24(1) Subject to the following provisions of this section, "input tax", in relation to a taxable person, means the following, that is to say –*

*(b) VAT on the supply to him of any goods or services;*

*(c) VAT on the acquisition by him from another member State of any goods; and*

*(d) VAT paid or payable by him on the importation of any goods from a place outside the member States,*

*being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him"*

*Evidence*

18. We were shown the Appellant's annual report and accounts for the year ended 31 October 2010 which were signed off on 1 February 2011, including the directors' report for 31 October 2010 signed by Mr Cummins as director. Deductions for advertising costs were included of £25,000. Advertising costs for the previous year were stated as £270.

19. We saw the Appellant's corporation tax returns for the 2008-9 and 2009-2010 periods.

20. We saw evidence from the sentencing hearing on the conviction of Mr Michael Jones explaining the advice given to the Appellant relating to what was described as a fraudulent scheme to cheat the Revenue in respect of the advertising costs, including:

(i) A letter from Nick Jones Racing Limited to the Appellant dated 21 January 2011 explaining the paperwork required for the advertising scheme:

"*Please find the various paperwork needed to complete the deal. You should retain the personal letter and the cheque destroyed. I need cheques from you to "Nick Jones Racing Limited" as follows: 1 February £20,000 which will not be cashed. 1 February £10,000"* and

(ii) the personal letter referred to which simply said

"*Dear Richard [Mr Cummins] Thank you for your friendship over the years. Please accept the attached cheque for £20,000 as a person gift"*. That letter was from Nicholas Jones at his personal address.

21. We saw an invoice dated 31 January 2011 issued by Nick Jones Racing Limited to the Appellant referring to "*Advertising 2010 season as agreed - £25,000 VAT £5,000".*

22. We saw a copy of a cheque signed by Mr Cummins on behalf of the Appellant for £10,000 dated 1 February 2011 made out to Nick Jones and a bank paying in slip dated 3 February 2011.

23. We saw the bank accounts of Mr Nicholas Jones for the period January 2011 to December 2011 showing the £10,000 payment for the advertising going into the personal bank account of Nick Jones

24. We were not shown any photographic evidence of the advertising which had been placed on the sill of the racing car support vehicle.

25. We saw correspondence between the Appellant's advisers and HMRC including HMRC's review letters of 12 August 2014 (corporation tax) and 31 July 2014 (VAT). HMRC's review letter of 12 August 2014 referred to a transcript of an interview of Mr Cummins with HMRC officers on 25 May 2012 in which Mr Cummins said that at the time of making the £30,000 payment the Appellant believed it was making a

payment for advertising but that in hindsight this might not have been value for money.

*Appellant's arguments*

26. The Appellant's notice of appeal in respect of the VAT claim stated that the £5,000 should be allowed as a business expense and that the examples given by HMRC to demonstrate why it was not allowable were flawed.

27. The Appellant's notice of appeal for the corporation tax deduction said "*the expense disallowed is valid*".

*HMRC's arguments*

*VAT*

28. HMRC's primary argument was that there had been no supply of advertising made to the Appellant because there had been no consideration given for advertising. There was therefore no supply for VAT purposes on the authority of *Apple & Pear Development Council* ([1988] STC 221). S 5(2)(a) Value Added Tax Act 1994 makes clear that anything which is not done for consideration does not amount to a supply. If the input tax was not incurred on a supply, then it was not allowable under s 26 (2) Value Added Tax Act 1994. In respect of at least the £20,000 of the advertising costs which were not actually paid to Nick Jones Racing Limited, there had been no consideration and so no supply.

29. As for the remaining £10,000 for which the cheque was cashed, HMRC accepted that there had been some supply of advertising made, namely the reproduction of the Appellant's name on the sill of the racing team support vehicle. However HMRC argued that the value of this advertising did not reflect the £10,000 paid and pointed out that there was a discrepancy between the statement on the invoice that the advertising was for the 2010 season, the time when the invoice was issued (the end of January 2011) and when the advertising was supplied. HMRC told the Tribunal that on the basis of evidence provided by the vehicle graphic designer, the support vehicle on which the advertising was placed was not purchased until July 2011.

30. HMRC did not provide any comparative evidence to suggest what the value of the advertising supplied should have been. Nor did we see any evidence of what the advertising actually looked like.

31. In view of the minimal return which it considered the Appellant received for its £10,000 expenditure, HMRC argued that this was not expenditure for business purposes under s 24 Value Added Tax Act 1994. In determining the motive for the expenditure, HMRC pointed out that the onus is on the taxpayer to demonstrate that, by reference to an ordinary business person, this payment is being made for business purposes, (see *Chambers (Homefield Sandpit) Limited VTD 9012*). In HMRC's view, the Appellant had not demonstrated that its purpose in making this payment was for anything other than tax avoidance.

*Corporation tax*

32. HMRC's assessment for the period ending 31 October 2010 was made under the discovery rules at paragraph 44 of schedule 18 Finance Act 1998 on the basis that HMRC had subsequently become aware of information which was not available to them at the time when the assessment period closed on 2 February 2012. HMRC pointed out that information about the criminal investigation of Mr Michael Jones was not available to HMRC until September 2011 and Mr Cummings was not interviewed until May 2012. There was no indication in the Appellant's corporation tax return of 2 February 2011 that there were any issues with the advertising deduction claimed. The onus is on the Appellant to draw any issues with this deduction to HMRC's attention at the time when the corporation tax return was made.

33. HMRC pointed out that the period for which the advertising deduction was claimed was for the accounting period ending October 2010. The cheque for the advertising expenditure was signed by Mr Cummings as director on 1 February 2011, which was for a later period. There was no evidence that the expenditure had been incurred for the period in which it was claimed as a business expense.

34. In any event, the evidence from the criminal investigation of Mr Michael Jones suggested that of the £25,000 claimed, £20,000 of that had never actually been paid by the Appellant because the cheque had been destroyed. The only money which had been paid was the £10,000 cheque which had been paid into Mr Nick Jones' personal bank account.

35. The payment made to Mr Nick Jones failed the "wholly and exclusively" test for allowable business expenses at s 54 Corporation Tax Act 2009. The Appellant's motive for the £10,000 of expenditure which had been made was tax avoidance and not advertising. The expenditure was not solely for the purpose of promoting the business (see *Bentley Stokes & Lowless v Beeson 33 TC 491*). HMRC accepted that there could be a fine line between allowable and disallowable sponsorship payments which might have a dual purpose, but said that the motive of the Appellant was the key test and in this case the tax avoidance motive of the Appellant was the main purpose for the whole of the £30,000 payment including the £10,000 which was actually paid.

*Loans to a director*

36. HMRC raised an additional 25% tax charge on the Appellant in its assessment of 23 April 2014 for the period ended 31 October 2010 under s 455 Corporation Tax Act 2010 for a loan of £19,801 which had been made to its director, Mr Cummins. That "loan" was the amount gifted to Mr Cummins from Nick Jones Racing Limited (minus the small loan of £199 already included in the directors' loan account for the accounting period ending 31 October 2010).

37. HMRC described this as arising from the gift made to Mr Cummins and explained that, as an accounting issue, this should be credited to Mr Cummins director's loan account for this period.

*Decision*

*Findings of fact*

38. The Appellant was instructed by Nick Jones Racing Limited to write two separate cheques for the advertising services, both dated 1 February 2011, one for £20,000 and one for £10,000.

39. There is no evidence that the cheque written by the Appellant for £20,000 to Nick Jones Racing Limited was cashed.

40. The intention stated in the letter from Nick Jones Racing Limited to the Appellant of 21 January 2011 was that the cheque for £20,000 would not be cashed and the cheque should be destroyed.

41. The advertising paid for was a small reproduction of the Appellant's name on the sill of the support car for Nick Jones Racing Limited. We saw no evidence that this advertising was in place during 2010.

42. The £25,000 spent on advertising in 2009-10 accounting period amounted to nearly 33 % of the Appellant's gross profit for that period.

*Use of evidence from the criminal trial*

43. HMRC relied on the evidence supplied as part of the criminal conviction of Mr Michael Jones to support their argument that the Appellant had been involved in a tax avoidance scheme and had not intended that the £25,000 claimed for corporation tax purposes or the £5,000 claimed as deductible input tax should be used for the purpose of its business.

44. In the absence of the Appellant or any representative of the Appellant, no objection was made to the use by HMRC of this evidence. We have considered whether in these circumstances it is evidence which we should accept. This Tribunal is not bound by the strict laws of evidence which apply to civil proceedings (Rule 15 of the Tribunal Rules). Even if it were, the contents of the documents which were provided as part of the conviction of Mr Michael Jones would be admissible as evidence of the facts on which that conviction was based. Therefore we have treated this evidence as admissible evidence which is relevant to the question of the Appellant's motive in making the alleged payment for advertising.

*VAT*

45. A deduction for input tax is available in respect of supplies made for business purposes. There is no reason in principle why input tax suffered on advertising costs cannot be treated as a business expense. The onus is on the Appellant to demonstrate that this payment can properly be treated as payment made for a supply in the course of its business. We were not provided with any evidence from the Appellant to

substantiate why this payment should be treated as a business expense or to explain the value which was being obtained by the business for advertising in this way.

46. We did not see photographic evidence to demonstrate the advertising which was provided. We saw that payment was made to an individual rather than to the corporate supplier of the advertising space. We saw the correspondence between the Appellant and Nick Jones Racing Limited and the details from Mr Michael Jones' sentencing hearing setting out the context of the expenditure. In the face of this evidence which suggests that the purpose of the expenditure was not simply to advertise the Appellant's business, the Appellant has not provided any counter-arguments. Mr Cummins accepted in his interview with HMRC on 25 May 2012 that in retrospect while the Appellant believed it was paying for advertising, it might not have obtained value for money.

47. HMRC's primary suggestion, at least in respect of £20,000 of the £30,000 paid was that there was no supply at all here because there had been no consideration, or no bargain between the parties. We do not agree that the position is as straightforward as HMRC suggest. On the basis of the correspondence which we saw between the Appellant and Nick Jones Racing Limited and the evidence of the banking transactions, the Appellant agreed to pay £30,000 and at the same time agreed that £20,000 should be "gifted" back to Mr Cummins. There was a bargain between the parties, but that bargain was stated to include a £20,000 rebate to Mr Cummins in exchange for "friendship over the years" as a personal gift.

48. There is no reason in principle why a rebate of this nature cannot form the basis of a bargain between the parties, but the question for us is whether VAT should attach to the full price paid or only the non-rebated element. It is clear from the correspondence that the rebate was not given to the Appellant in a business capacity, but was given to Mr Cummins as an individual. It seems to have been the intention that while the payment for advertising was made to the company (Nick Jones Racing Limited), the rebate should come from the individual, Nick Jones. In the event that was not what happened because the Appellant's cheque was made out to Nick Jones in his personal capacity and the rebate also came from Mr Jones himself.

49. At the time when the bargain was made the Appellant knew that £20,000 of the amount owing would not have to be paid by it to Nick Jones Racing Limited and only £10,000 would be retained for advertising purposes. We were not provided with any evidence that the £20,000 was actually paid to Mr Cummins in his personal capacity as agreed. On that basis, we cannot see how the non-rebated amount can be treated as an amount paid for the supply of advertising by the Appellant.

50. As far as the remaining £10,000 is concerned, HMRC argued that it was not commensurate with the advertising actually received by the Appellant but failed to produce any evidence to support this contention. More tellingly HMRC pointed out that there was a discrepancy between the periods for which the input tax was claimed, the description of the advertising to be supplied on the invoice (for 2010) and when the advertising was actually provided, suggesting that no advertising was provided at all until later in 2011.

51. Despite the lack of evidence to support what someone in the Appellant's position might have expected to receive for expenditure of £10,000 on advertising, we have concluded that it is unlikely that a business person in the Appellant's position would have been willing to spend this percentage of its turnover on advertising for the 2010 season which had already ended at the time when this invoice was issued and payment made. We have also taken account of the fact that the £10,000 cheque was not written to the company which was supposed to be providing the advertising services, but to Nick Jones as an individual.

52. For these reasons we agree with HMRC that the Appellant has failed to demonstrate that the input tax incurred was incurred on goods or services used or to be used for the purpose of any business carried on by the Appellant under s 24(1) Value Added Tax Act 1994 and for this reason we dismiss the Appellant's appeal against the disallowance of £5,000 of input VAT.

*Corporation tax*

*Discovery rules*

53. HMRC's assessments were made outside the normal time limit for raising assessments and so can only be accepted if HMRC can demonstrate that they fulfil the criteria at paragraph 44 of Schedule 18 Finance Act 1998 for the making of a discovery assessment. Recent authorities suggest that HMRC must have been given some basis to infer the existence of relevant information in the taxpayer's tax return in order for a discovery assessment to be resisted. No such relevant information about the intended tax avoidance scheme was included in the Appellant's corporation tax return. We are satisfied that the condition at paragraph 44 is satisfied and that this discovery assessment has been properly made.

*Wholly and exclusively*

54. The onus is on the Appellant to demonstrate that the £25,000 of claimed deductions have been made wholly and exclusively for the purposes of its business. No details were provided by the Appellant to support this claim or in particular to explain why the payment had been made to an individual rather than the company providing the advertising (Nick Jones as an individual rather than Nick Jones Racing Limited) and why a significant element of the cost of the advertising had not actually been paid by the company; the only cheque which was drawn was the cheque for £10,000. Nor was any explanation given for the discrepancy between the period when the payment was made and the period for which the deduction was claimed.

55. On the basis that £20,000 of the £25,000 was not actually paid to any of Nick Jones Racing Limited, Nick Jones or Mr Cummins, we do not see any basis on which this can be claimed. As for the remaining £5,000 we can see no basis on which this can be claimed for the accounting period ending 31 October 2010 given the fact that it was invoiced and paid on 31 January and 1 February 2011.

56. Even if both of those issues could be overcome, the correspondence which we saw between the Appellant and Nick Jones Racing Limited and the evidence from Mr

Michael Jones' sentencing hearing seems to us to make it clear that little if any advertising was actually obtained by the Appellant for the period ending 31 October 2010 and the main reason for making this payment was to participate in a tax planning scheme suggested by its advisers.

57. For these reasons the Appellant's appeal against the disallowance of its claim for a deduction against profits of £25,000 for the accounting period ending 31 October 2010 is dismissed

*Loan to director*

58. HMRC contended that the Appellant should be charged an additional amount of tax on the £19,801 representing the amount which was claimed as a deduction in the company's accounts and was gifted to Mr Cummins. This was described as a "gift" to Mr Cummins but HMRC suggested that it was properly assessable as a loan to a director under s 455 Corporation Tax Act 2010.

59. The rules at s 455 apply to "close" companies. HMRC did not specifically confirm to us that the Appellant was a close company at the time when the gift was made to Mr Cummins. On the basis of the Appellant's report and accounts for the October 2009-10 accounting period the Appellant had only two directors of which Mr Cummins was one, therefore it did fall within the definition of a close company for these purposes for that period.

60. HMRC's assessment on the Appellant for the amount gifted to Mr Cummins was for the accounting period ended 31 October 2010, the period in which the advertising deduction was claimed. We know from the evidence that we saw that the "gift" (in the form of the letter written from Nick Jones Racing Limited and the un-cashed cheque) was not made until February 2011. We did not see the Appellant's accounts for this period or any evidence of whether the Appellant was a close company for this period. HMRC did not explain why they were treating the "gift" as made in the earlier period rather than the period when the cheque was written and destroyed.

61. Even assuming that the "gift" can be treated as made in the period ending 31 October 2010, the characterisation of this payment to Mr Cummins as a loan depends on HMRC having demonstrated that it cannot properly be treated as a gift. The evidence which we saw about the treatment of this payment was limited to the letter of 21 January 2011 in which, on the basis of the advice of Mr Cummins' adviser, Nick Jones gifted this amount to Mr Cummins in return for "*friendship over the years*". We were not provided with any evidence about the nature of this friendship. HMRC's arguments concentrated not on whether or not there might have been a valid reason for this gift but on the fact that the "gift" was made as part of a contrived scheme and so should not be respected.

62. Although the evidence provided by HMRC indicated that this payment was part of a scheme the intention of which was to reduce the Appellant's tax, our view is that HMRC have not sufficiently demonstrated the basis on which this payment should be

re-characterised as a loan or, if it can be so re-characterised, the time when that loan should be treated as arising.

63. For these reasons we do not accept HMRC's additional tax assessment on the Appellant of £4,950.25 for this payment as a loan to a director under s 455 Corporation Tax Act 2010 for the period ending 31 October 2010 and this element of the Appellant's appeal is accepted.

*Conclusion*

64. The Appellant's appeal against HMRC's VAT assessment for the 01/11 VAT period is dismissed. The Appellant's appeal against HMRC's corporation tax assessment in respect of the £25,000 deduction for the accounting period ended 31 October 2010 is also dismissed but HMRC's inclusion in that assessment of an additional £4,950.25 under s 455 Corporation Tax Act 2010 is rejected.

65. 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.

**Rachel Short**

**TRIBUNAL JUDGE**
**RELEASE DATE: 12 MAY 2016**