



TC05255

5

Appeal number: TC/2014/05261

INCOME TAX – appeal against closure notice amending self assessment – appeal against discovery assessments – increase in assessments – burden of proof – treatment of unidentified receipts as taxable income – appeal allowed in part

10

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

15

ROSS McINALLY

Appellant

- and -

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

**TRIBUNAL: JUDGE ROBIN VOS
JANE SHILLAKER**

20

**Sitting in public at The Royal Courts of Justice, The Strand, London on 18 May
2016**

25

Steven Tovey, Tax Enquiry Services for the Appellant

30

**Mr David Linneker, Presenting Officer of HM Revenue & Customs, for the
Respondents**

1. The Tribunal issued a summary decision on 3 June 2016. On 26 June, Mr McInally made an application to provide full written findings and reasons in accordance with Rule 35(4) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009.

Background

2. The appellant, Mr Ross McInally, is or has been involved in a number of property development and property rental businesses. As a result of enquiries into his self-assessment tax return for the year ended 5 April 2008, it was established that rental income and capital gains had been omitted from his tax return for that year.

3. HMRC also issued discovery assessments for each of the tax years ended 5 April 2006, 5 April 2007, 5 April 2009 and 5 April 2010.

4. Although Mr McInally provided HMRC with a significant amount of information, this did not include all of the information necessary to enable HMRC to work out exactly what the profits/gains from these property businesses were. The assessments (and the amendment to the self-assessment for the year ended 5 April 2008) were therefore based on HMRC's "best judgement".

5. Mr McInally appealed against the assessments on the basis that HMRC did not have the full information available, as a result of which the sums assessed and the tax charged are excessive.

6. As a result of further information received from Mr McInally after it had issued the original assessments/closure notice, HMRC are asking the Tribunal to reduce the assessments for the tax years ended 5 April 2006, 5 April 2007 and 5 April 2010 and to increase the assessment/self-assessment for the years ended 5 April 2008 and 5 April 2009.

Postponement application

7. On 11 May 2016, Mr Tovey on behalf of Mr McInally, submitted an application to postpone the hearing as a result of the death of Mr Tovey's father-in-law on 10 May, the funeral having been arranged for Monday 23 May. Although sympathetic to Mr Tovey's bereavement, the Tribunal refused the postponement on the basis that, having considered the chronology and history of the proceedings, Mr McInally has had ample time to prepare his case properly.

8. Immediately prior to the hearing on 18 May, Mr Tovey made a further application to postpone the hearing on behalf of Mr McInally. This was partly based on the family bereavement but was also based on a request for a further 14 days to allow time to obtain duplicate bank statements from NatWest Bank in relation to Ikon Property Co Limited ("Ikon") (a company with which Mr McInally was involved) which, Mr Tovey said, would have a significant effect on Mr McInally's case.

9. Having again considered the history and chronology of the case, the Tribunal refused the application to postpone the hearing but indicated that it would consider at the end of the hearing whether it was appropriate to direct that Mr McNally should be given 14 days from the date of the hearing to produce the NatWest Bank statements.
5 In the event, the Tribunal did not consider it necessary to have sight of these documents in order to enable it to reach its decision.

10. The particular factors in the chronology and history of the proceedings which the Tribunal considered relevant were as follows:

10 It is over six years since HMRC opened its original enquiry into Mr McNally's self-assessment tax return for the year ended 5 April 2008. He has therefore had ample time both to prepare his case and to produce the NatWest Bank statements should he consider these relevant.

15 Mr Tovey has, on a number of occasions, cancelled meetings with HMRC at the last moment and has consistently failed to provide information promised to HMRC within the timescale which he has indicated.

Mr McNally has failed to comply with previous directions issued by the Tribunal relating in particular to providing lists of documents and witness statements.

After a period of more than six years, there is a need for finality in this case.

20 11. Having read the skeleton arguments of both parties, the Tribunal considered it unlikely that the bank statements would provide any significant assistance in deciding the appeal as, at most, they would only show whether payments had been made by Ikon to Mr McNally and would not show the reason for or the nature of those payments.

25 **The evidence**

12. The Tribunal had before it three bundles of documents and correspondence prepared by HMRC amounting to over 1,000 pages.

30 13. Mr McNally also lodged a further bundle of documents on the morning of the hearing. Having had an opportunity to review the documents, Mr Linneker on behalf of HMRC did not raise any objection to the Tribunal admitting these documents as part of the evidence. Having reviewed the bundle itself, the Tribunal decided that it was in the interests of fairness and justice for these documents to be admitted as part of the evidence.

35 14. Although no witness statement had been lodged, the Tribunal decided that it was in the interests of fairness and justice to ask Mr McNally to give oral evidence on three specific points which arose during the hearing and which are outlined below.

Findings of fact

15. Based on the evidence before us, we find the following facts.

16. During the period in question, Mr McNally was carrying on a property rental business in his own name.
17. Mr McNally was a director and shareholder of Chris Cross Homes Limited through which Mr McNally carried on a property development business with Christopher Powell.
18. Mr McNally was a shareholder and director of Ikon through which he carried on a property development business with Peter Lee.
19. Mr McNally also carried on a property development business through a partnership with Mr Brian Hepple known as Mullands & Lords.
20. HMRC opened an enquiry into Mr McNally's self-assessment tax return for the tax year ended 5 April 2008 on 15 April 2010.
21. On 15 March 2012, HMRC issued a notice of discovery assessment in respect of the tax year ended 5 April 2006 as the time limit for issuing a discovery assessment expired on 5 April 2012. The amount assessed was £42,190.64.
22. On 4 September 2012, HMRC closed its enquiry into Mr McNally's self-assessment tax return for the year ended 5 April 2008. Its conclusion was that Mr McNally's self-assessment for the year should be increased to £33,160.75.
23. On the same day, HMRC issued notices of discovery assessment for each of the tax years ended 5 April 2007, 5 April 2009 and 5 April 2010. The amounts assessed were £87,423.60 for the year ended 5 April 2007, £28,748.80 for the year ended 5 April 2009 and £30,458 for the year ended 5 April 2010.
24. HMRC accepted a late appeal against all of the assessments which was dated 29 November 2012 and subsequently carried out a review which was completed on 3 September 2014.
25. The conclusion of the review was that the assessment for the tax year ended 5 April 2006 should be increased to £57,044.64, the assessment for the year ended 5 April 2007 should be increased to £88,579.60, the assessment for the year ended 5 April 2008 should remain unchanged, the assessment for the tax year ended 5 April 2009 should be reduced to £28,082.86 and the assessment for the tax year ended 5 April 2010 should be increased to £34,053.60.
26. Mr McNally did not accept the results of the review and on 25 September 2014 appealed to the Tribunal against the 2012 assessments for each of the years in question.

The Tribunal's powers and the burden of proof

27. If, on an appeal, the Tribunal decides that the appellant is overcharged by a self-assessment or by any other assessment, the assessment is to be reduced but otherwise the assessment stands good (s 50(6) Taxes Management Act 1970 ("TMA 1970")).

28. If on an appeal, the Tribunal decides that the appellant is undercharged by a self-assessment or by any other assessment, the assessment is to be increased accordingly (s 50(7) TMA 1970).

29. Both parties agree that the burden of proof is on Mr McNally to satisfy the Tribunal that the 2012 assessments/self-assessment should be reduced but that the burden of proof is on HMRC to satisfy the Tribunal that the self-assessment for the year to 5 April 2008 and the assessment for the year to 5 April 2009 should be increased. (As can be seen from the tables in paragraphs 30 and 31 below, HMRC does not argue that the assessments for the tax years ended 5 April 2006, 5 April 2007 and 5 April 2010 should be increased).

The 2012 assessments

30. The amounts assessed in 2012 were as follows:

Year	2005/06	2006/07	2007/08	2008/09	2009/10
Net rental income	£116,225	£91,027	£91,066	£96,150	£102,879
Capital gains (after annual exemption)	£5,500	£154,676	£800	£0	£0
Total tax due	£42,190.64	£87,423.60	£33,160.75	£28,748.80	£30,458.00

31. The figure for the total tax due in the table above takes into account the other entries on Mr McNally's tax return and is therefore not just the tax on the rental income/capital gains figures shown in the table. Those figures are shown simply to compare the 2012 assessments with the position that is now put forward by HMRC and by Mr McNally as set out below.

Mr McNally's proposed figures

Year	2005/06	2006/07	2007/08	2008/09	2009/10
Losses shown on original tax returns	(£18,376)	(£42,826)	(£50,824)	£0	£0
Additional rent	£51,735	£54,078	£56,343	£55,685	£58,660
Disallowed interest	£17,577	£11,527	£14,443	£0	£0
Revised rental	£50,936	£22,779	£19,962	£55,685	£58,660

profit					
Other income	£0	£0	£0	£0	£0
Capital gain	£51,136	£45,740	£10,000	£0	£0
Annual exemption	£8,500	£8,800	£9,200	-	-
Taxable gain	£42,636	£36,940	£800	-	-
Tax due	£35,209.20	£15,310.48	£8,563.44	£12,900	£13,394

HMRC's figures

Year	2005/06	2006/07	2007/08	2008/09	2009/10
Losses shown on original tax returns	(£18,376)	(£42,826)	(£50,824)	£0	£0
Additional rent	£51,735	£54,078	£56,343	£79,725	£77,294
Disallowed interest	£17,577	£11,527	£14,443	£0	£0
Revised rental profits	£50,936	£22,779	£19,962	£79,725	£77,294
Other income	£0	£0	£66,086	£284,057	£23,920
Capital gain	£51,136	£45,740	£10,000	£0	£0
Annual exemption	£8,500	£8,800	£9,200	-	-
Taxable gain	£42,636	£36,940	£800	-	-
Tax due	£35,209.20	£15,310.48	£36,792.67	£136,138.80	£30,415.60

Tax years ended 5 April 2006 and 5 April 2007

32. As can be seen from the figures set out above, HMRC and Mr McInally are agreed as to what amendments should be made to the assessments for the tax years ended 5 April 2006 and 5 April 2007. In both of these years, the result is a reduction in the assessments which were made by HMRC in 2012. It is however necessary for

5

us to consider the revised figures briefly as the Tribunal must decide (as opposed to just agreeing) that Mr McNally is overcharged by the existing assessments.

5 33. The figure for net rental income in the 2012 assessments for the years ended 5 April 2006 and 5 April 2007 were based on the figure for additional rental income for the year ended 5 April 2008 but adjusted to take account of the change in the RPI between those years. The reason this approach was taken was that HMRC did not have (and still does not have) sufficient information to identify exactly what the additional rental income for those years should be. In the circumstances, we accept that this is a reasonable approach to take.

10 34. HMRC now accept, based on their analysis of Mr McNally's bank statements, that the figure of £127,447 for "additional rent" for the year ended 5 April 2008 as shown in the closure notice should be reduced to £56,343. This of course has a knock-on effect for the calculations for the tax years ended 5 April 2006 and 5 April 2007 given the approach which has been adopted as described above.

15 35. In addition, further information has been provided by Mr McNally which has enabled HMRC to satisfy itself in relation to the calculation of capital gains for each of the years ended 5 April 2006 and 5 April 2007. The result of this is that the net gain for the year ended 5 April 2006 is increased to £51,136 which relates to the disposal of one property and that the net gains for the year ended 5 April 2007 are reduced to £45,740 representing the gains on the disposal of two properties.

20 36. Taking all of this into account, we accept that Mr McNally has been overcharged by the assessments issued in 2012 in respect of the tax years ended 5 April 2006 and 5 April 2007 and that the amount of tax assessed should be reduced to £35,209.20 for the tax year ended 5 April 2006 and £15,310.48 for the tax year ended 25 5 April 2007 as proposed by HMRC and agreed by Mr McNally.

Tax year ended 5 April 2008

37. The amount of tax assessed for the year ended 5 April 2008 as a result of HMRC's 2012 amendments to Mr McNally's self-assessment return is £33,160.75. HMRC argues that this should be increased slightly to £36,792.67 whereas Mr 30 McNally contends that the tax should be reduced to £8,563.44.

38. The two key figures are the net rental profits and a figure which HMRC say should be assessed as "unspecified income or profits" amounting to £66,086.

35 39. HMRC and Mr McNally agree that the net rental profits for the year should be taken to be £19,962. The differences from the figures originally returned by Mr McNally consist of additional rental income which HMRC has identified as a result of analysing Mr McNally's bank statements totalling £56,343 and mortgage interest of £14,443 which has been disallowed due to the fact that part of the mortgage proceeds were used for private purposes and not for the property rental business. We accept these calculations.

40. The figure for capital gains (£800 after Mr McNally's annual allowance) has never been in dispute and remains the same as in the amendment to Mr McNally's self-assessment in 2012.

5 41. The dispute for this tax year centres around the figure of £66,086 which HMRC says should be treated as "unspecified income or profits" and which, in the amendment to Mr McNally's self-assessment in 2012 was included in the figure for net rental income. We will look at each item making up this figure in turn.

10 42. The first item is a credit of £23,000 to Mr McNally's bank account on 30 April 2007. In his oral evidence, Mr McNally told us that this represented proceeds of sale of a Porsche Cayenne car which was sold at that time to Mach 1 Cars in Cranleigh.

15 43. In cross examination, Mr Linneker asked Mr McNally why he had not mentioned this before given that he had been asked repeatedly to explain the credits to his bank account and that this was a significant figure. Mr McNally's response was that he only remembered it when he had reviewed the bank statements prior to the hearing (the bank statements having been held by HMRC during the course of the enquiry).

20 44. There is some support for Mr McNally's recollection in the note of a meeting which took place between HMRC, Mr McNally and his then accountant on 23 February 2011. Mr McNally was asked by HMRC whether any large household items had been disposed of and mentioned that he had sold his Porsche Cayenne car and replaced it with a Ford Mondeo. This meeting related specifically to the tax year ended 5 April 2008 and the inference therefore is that the car was indeed sold during the 2007/08 tax year.

25 45. Based on this evidence, we find, on the balance of probabilities, that the deposit of £23,000 on 30 April 2007 does not represent taxable income or profits and should therefore be excluded from the calculation.

30 46. The second item included in HMRC's list of other income is a receipt of £26,875.62 on 6 November 2007. It is clear from the evidence that this represents Mr McNally's share of the net proceeds of sale of a property at St Ronans Road, Southsea which was held by the Mullands & Lords partnership operated by Mr McNally with Mr Hepple. On this basis, Mr Tovey submitted that any profit would have been included in the profits of the partnership and so this amount should not be included separately as taxable income for Mr McNally.

35 47. We note that Mr McNally's tax return for the year ended 5 April 2008 includes a figure for £12,619 of partnership profits. In addition, HMRC has accepted on the basis of evidence provided by Mr McNally that the gain on the disposal of another property held by the partnership in the year ended 5 April 2007 had been included in the partnership return. We therefore find on the balance of probabilities that any profit on the sale of this property would have been included in the figure for partnership profits and should again be excluded from the calculation of unspecified income or profits.

40

48. On 15 November 2007, there was a further receipt of £918.37 from Larcomes LLP, the solicitors who dealt with the sale of the property at St Ronans Road. Mr Tovey asked us to infer that this sum related to the sale of St Ronans Road given that it came from the same solicitors and was received shortly after the payment of £26,875.62 mentioned above. Mr Linneker on the other hand said that there was no evidence as to what this sum relates to and that it should therefore be treated as unspecified income.

49. Whilst we accept that there is no direct evidence as to what this sum relates to, we think the fact that it came from the solicitors and that it was paid very shortly after Mr McNally received his share of the proceeds of St Ronans Road means that it is more likely than not that this sum relates to that sale and should not be treated as other unspecified income or profits on which Mr McNally is subject to tax. This figure should therefore also be excluded.

50. The next element is a sum of £5,000 received on 26 February 2008. The evidence contains a copy of the cheque which is from Ikon and which has been annotated by Mr McNally as a dividend from Ikon.

51. Mr McNally's tax return for the year ended 5 April 2008 included dividends (net of the notional tax credit) of £20,000. Although Mr Linneker correctly points out that we have no other evidence that the receipt of £5,000 is part of the dividends of £20,000 shown on Mr McNally's tax return, we equally have no evidence of other receipts totalling £20,000 which would represent these dividends. We therefore take the view that it is more likely than not that this amount is indeed a dividend and has already been included in Mr McNally's taxable income.

52. Mr McNally received further sums totalling £5,035.33 from Ikon during the tax year ended 5 April 2008. This represents nine separate cheques of amounts varying from £12.63 to £2,730.

53. Mr McNally gave evidence that these sums represent a reimbursement of expenses incurred by him personally on behalf of Ikon.

54. Mr Linneker made the point that we do not have any evidence (other than Mr McNally's oral evidence) as to what these payments relate to. This is not quite correct as copies of the cheques were included in the evidence before us and had been annotated by Mr McNally as a reimbursement of costs/expenses. Apart from this however, there is no documentary evidence which supports Mr McNally's statement that the payments from Ikon were a reimbursement of expenses. We do not for example have copies of any bills, invoices or receipts relating to any such expenses.

55. Mr McNally's explanation for paying company expenses out of his own bank account rather than out of the relevant company's bank account was that this was purely for convenience on the basis that some suppliers would only accept a payment by card and that, even if the payment was by cheque, a personal cheque could be signed by Mr McNally alone whereas a company cheque would need two signatories.

56. During his evidence, Mr McNally was asked to identify some examples of payments made out of his personal bank account on behalf of one or more of the companies with which he was involved and in respect of which he had received reimbursement. Amongst the examples of payments he identified were a payment of £22,000 made by cheque on 23 June 2009 and a payment of £10,000 made by cheque on 7 July 2009. He suggested that these payments might be payments made to a solicitor relating to a transaction being undertaken by one of the companies with which he was involved.

57. Mr McNally accepted that if, as a matter of convenience, he was paying sums as large as £22,000 or £10,000 on behalf of one of the companies, he would expect to be reimbursed relatively quickly for the amounts which he had paid out. However, it is apparent from the bank statements provided that no sums representing anything like these amounts were paid into his bank account in the months following those payments. Mr McNally accepted this but speculated that he might perhaps have been put in funds by the companies prior to the payments being made. This would however be surprising if the reason for the payments being made out of Mr McNally's bank account rather than out of the bank account of the relevant company is for convenience, as described above. If the company was able to transfer funds to Mr McNally prior to the payment being made, it could of course have made the payment direct.

58. Whilst there were three payments in June 2009 each totalling close to £40,000, one of these was a transfer from another account of Mr McNally's (and not therefore a reimbursement or payment in anticipation of expenses by one of his companies) and the other two represent payments made by Chris Cross Homes Limited which Mr McNally had already persuaded HMRC were posted to Mr McNally's director's loan account with that company. There was no suggestion in the correspondence/documents we have seen in relation to these two amounts that they represent a reimbursement of expenses or a payment in anticipation of Mr McNally paying expenses on behalf of the company.

59. We do not discount the possibility that Mr McNally may have made some payments on behalf of the companies with which he was involved and then been reimbursed by those companies. However, we have no documentary evidence which enables us to marry up any receipts and payments. We are not therefore satisfied that the payments in question are indeed a reimbursement of expenses incurred by Mr McNally on behalf of Ikon.

60. Given that Mr McNally has not provided any other explanation for the receipts totalling £5,035.33 from Ikon, he has failed to persuade us that these items do not represent taxable income and we are not therefore satisfied that Mr McNally has been overcharged by the amendment to his self-assessment to the extent that it represents tax on these amounts.

61. The final element in the figure of £66,086 alleged by HMRC to represent unspecified income or profits is a figure of £5,256.84 representing three payments to Mr McNally from Chris Cross Homes Limited.

62. Mr Tovey again suggested that these payments represented a reimbursement of expenses incurred by Mr McNally on behalf of Chris Cross Homes.

63. Our analysis of these payments is the same as for the payments received from Ikon. We are not satisfied that the payments represent a reimbursement of expenses incurred by Mr McNally on behalf of Chris Cross Homes Limited and Mr McNally has not provided us with any other explanation for these receipts. These payments should therefore also be included as part of Mr McNally's taxable income for the year ended 5 April 2008.

64. We are mindful that, to the extent that HMRC are seeking to increase the 2012 assessments, we need to be satisfied on the balance of probabilities that Mr McNally has been undercharged by those assessments.

65. This is however only relevant to the tax year ended 5 April 2009 as it is apparent from HMRC's computations that the only reason for their proposed increase to the amendment to Mr McNally's self-assessment for the year ended 5 April 2008 is that, in 2012, HMRC mistakenly omitted the partnership profits of £12,619 shown in Mr McNally's original self-assessment tax return when they amended the self-assessment for that year. HMRC's proposed figures for rental profits/other income (£86,048) is in fact lower than the equivalent figures assessed in 2012 (£91,066).

66. In addition, given our conclusions in relation to the items of unidentified income referred to in paragraphs 42-51 above, it is clear that the assessment for the tax year ended 5 April 2008 will in fact be reduced rather than increased and the burden of proof would therefore be on Mr McNally to show why the assessment should be reduced any further.

67. The effect of our decisions in relation to the year ended 5 April 2008 is that Mr McNally's self-assessment should be reduced from the figure of £33,160.75 contained in the 2012 amendment to Mr McNally's self-assessment. The revised figure should be based on the figures put forward by HMRC and by Mr Tovey as set out above but with the figure for "other income" being replaced by the figure of £10,292.17 (£5,035.33 + £5,256.84).

30 **Year ended 5 April 2009**

68. The 2012 assessment for the tax year ended 5 April 2009 was for £28,748.80 and was based on net rental profits of £96,150.

69. HMRC say that this assessment should be increased to £136,138.80 whilst Mr Tovey argues that it should be reduced to £12,900.

35 *Rental income*

70. Unlike the year ended 5 April 2008, the figure for net rental income is not agreed.

71. Mr Tovey accepts on behalf of Mr McNally that there is additional rental income which needs to be included. Where he takes issue with HMRC is the way that HMRC has proposed that the additional rental income should be calculated.
72. Unlike the tax years ended 5 April 2006 and 5 April 2007, HMRC have significant additional information about the deposits into Mr McNally's bank accounts for the years ended 5 April 2009 and 5 April 2010.
73. HMRC's approach is firstly to calculate the minimum net rental income based on the actual receipts and payments shown in Mr McNally's bank account (i.e. rental income less expenses, less mortgage interest). This comes to a total of £18,547.
74. It is accepted by Mr McNally that there are further amounts paid into his bank account which represent rental income. HMRC has identified all unexplained deposits into Mr McNally's bank accounts and have treated all deposits of less than £10,000 as additional rental income. The total is a further £61,178 of rental income making total net rental income of £79,725 (£18,547 + £61,178).
75. Mr Tovey says that this is unreasonable as none of the properties held by Mr McNally command a rent of anywhere near £10,000 per month. His approach therefore is simply to take the net rental figure from the previous year and to adjust it to take account of changes in the RPI. In this case, the figure for 2008 was £56,343. After making the RPI adjustment, this becomes a net rental figure for 2009 of £55,685.
76. Although there is some force in Mr Tovey's argument that treating all payments under £10,000 as rent is unreasonable, when we come to look at the position in relation to unspecified income or profits, this does not make any difference to the end result as, one way or another, it is still income which is subject to tax.
77. Given that much more detailed figures are available for the tax year ended 5 April 2009, we would in any event agree that the rental income should be calculated on the figures provided rather than on the basis of an RPI adjustment to the previous year's figures, as suggested by Mr Tovey.
78. For this reason, we accept HMRC's approach to the calculation of the net rental income. We should however stress that this is on the basis of our findings set out below that the majority of the unexplained deposits fall within HMRC's category of unspecified income or profits and are therefore taxable.
79. Should we however, for some reason, be wrong on this point, it would be necessary to decide what the threshold should be for receipts which should be treated as rental income. We would be inclined to accept Mr Tovey's proposal that the threshold should be £1,100 rather than HMRC's proposed figure of £10,000. The reason for this is that there were no receipts in the year which were more than £1,100 but less than £5,000 and, as pointed out by Mr Tovey, it is unlikely that a single receipt in excess of £5,000 represents rental income. This would have the effect of moving a total of £51,764.65 from rental income to "other income".

80. However, as we have said, given our findings below in relation to the unspecified income, we have not found it necessary to complicate the calculations by treating part of the amounts said by HMRC to represent rental income as being part of the unspecified income.

5 *Unspecified income or profits*

81. The total amount of unexplained receipts during the year ended 5 April 2009 identified by HMRC is £540,384. Out of this, HMRC accept that receipts totalling £195,149 are not taxable. This leaves a balance of £345,235 of unexplained payments into Mr McNally's banks accounts.

10 82. Mr Tovey has deducted from this figure all receipts under £1,100 on the basis that these payments represent rental income which would be included in his figure for net rent as set out above. This reduces the unexplained payments to £335,822. This figure is made up of a number of payments or categories of payment, all of which Mr Tovey argues are not taxable.

15 83. The first payment is a receipt of £120,000 received by Mr McNally on 4 February 2009. Mr McNally gave evidence that this was a payment from a Mr John Farr and represented an investment into a company called Ravenswood Homes Limited. We have no documentary evidence supporting this other than a schedule prepared by Mr Tovey in December 2015 which listed the receipt of £120,000 as
20 relating to "John Farr – Ravenswood Homes".

84. This payment was transferred by Mr McNally from his personal account into a new account with ING on 18 February 2009. Between 24 March 2009 and 24 September 2009, the full amount was gradually paid back into Mr McNally's personal account. However, the payments back into Mr McNally's personal account
25 do not in all cases correspond with payments of an equivalent amount (or approximately the equivalent amount) out of Mr McNally's personal account.

85. Mr McNally explained in his evidence that the reason for transferring the money to the ING account was so that the money would earn interest until it was needed to pay for the costs of the development project being undertaken by
30 Ravenswood Homes and that money was drawn down as and when needed. We would therefore have expected that, when money was taken out of the ING account, it would immediately be used for the project in question.

86. Based on this, we are not persuaded that this explains the receipt of £120,000. On the other hand, for this particular year, HMRC is arguing for a very significant
35 increase in the amount of the 2012 assessment. We must therefore be satisfied that the receipt is taxable income. Given the amount of the receipt and the fact that there is no other evidence as to what it represents or where it came from, we do not think that this burden has been discharged and we therefore find that this figure should be excluded from any assessment.

87. The next figure is a receipt of £14,000 on 28 May 2008. Mr Tovey made reference to a schedule produced by HMRC based on SDLT records. These records show that on 23 June 2008, Ikon sold some land at Hightrees, Waterloo for £14,000. Initially, he suggested that the deposit represented funds coming into Mr McNally's bank account which was then to be used to satisfy the purchase price for the land at Hightrees as he had mistakenly understood from HMRC's schedule that Ikon was the purchaser rather than seller of the land.

88. Having realised his mistake, he withdrew this submission and did not offer any alternative explanation as to where this money came from.

89. Mr Tovey then suggested that all of the other unexplained receipts for the year ended 5 April 2008 (presumably, by implication, including this £14,000 just mentioned) derived from Ikon and, in the same way as the payments in the year ended 5 April 2008, represented a reimbursement of expenses. Mr Tovey specifically accepted that if these payments did not come from Ikon they must represent taxable income of some sort.

90. We have looked in more detail at each of the payments into Mr McNally's bank account during the tax year ended 5 April 2009 which exceed £10,000 (HMRC's threshold for "other income" as opposed to rental income).

91. The first payment is a payment of £15,000 on 7 April 2008. We take this together with the second payment of £32,195 which was received into Mr McNally's bank account on 10 April 2008 given that there were no payments of any significance made out of Mr McNally's bank account between those two dates.

92. We have looked back at Mr McNally's bank statements going back to 26 February 2008 (on which date there was a credit to Mr McNally's bank account of £5,312.59) to see if there are payments out of Mr McNally's bank account between that date and 10 April 2008 which might represent the expenses which he says are being reimbursed by the payments into his account.

93. The only payments during this period over £1,000 (given the size of the payments into Mr McNally's bank account, we have not looked at payments out of the account of less than £1,000) which could conceivably represent expenses incurred on behalf of Ikon are two cheques totalling just over £11,000. There is no evidence what these cheques were used to pay for but given the difference in the amounts paid in and the amounts paid out and Mr McNally's explanation as to why he paid expenses on behalf of Ikon rather than Ikon paying the expenses itself, it seems unlikely that these payments represent expenses which were then reimbursed by the two payments in question into Mr McNally's bank account.

94. The next payment in excess of £10,000 was a receipt of £17,000 on 19 May 2008. The payments out of Mr McNally's bank account in excess of £1,000 which could represent expenses incurred on behalf of Ikon include £2,571.50 to Howden Joinery on 14 April and various cheques totalling £12,087.99 – i.e. a total of about £15,000. Again, there was no evidence as to what these cheques relate to. Taken on

their own, it might be possible to infer that these were expenses relating to Ikon which were then reimbursed by the cheque for £17,000.

95. The next payment into the account is a receipt of £14,000 on 28 May 2008. The only significant payment between 19 May and 28 May which could represent a payment of expenses on behalf of Ikon is a cheque for £10,000 paid on 21 May 2008. If this was indeed an expense met by Mr McNally on behalf of Ikon, we would have expected that the reimbursement would be £10,000 and not £14,000.

96. On 17 June 2008, a further £15,150 was paid into Mr McNally's bank account. A payment of £15,000 had been made out of the account by cheque on 12 June 2008. It is possible that this could have been an expense paid on behalf of Ikon which was then reimbursed.

97. £18,081.13 was paid into Mr McNally's bank account on 24 June 2008. No significant payments had been made out of the account since the previous receipt on 17 June although a payment of £6,500 had been paid out of a different account on 19 June 2008. There is no evidence as to what the payment of £6,500 related to. Given that the payments related to different bank accounts and bore no relation to each other in terms of amount, it seems unlikely that the receipt represents a reimbursement of expenses.

98. A cheque for £18,256.66 was credited to Mr McNally's bank account on 21 August 2008. This however appears to have been a mistake as there is an entry on 26 August 2008 reversing the credit and showing a different credit of £1,956.66. We therefore accept that the sum of £16,300 (the difference between £18,256.66 and £1,956.66 should not be treated as "other income").

99. The final payment into Mr McNally's bank account in excess of £10,000 was a cheque for £17,560.67 received on 11 February 2009. Payments out of Mr McNally's bank account in excess of £1,000 since 1 December 2008 which could possibly represent a payment of expenses on behalf of Ikon consist of a number of cheques totalling approximately £11,750. As before, we have no evidence as to what these payments represented.

100. We have not gone into details about the payments in excess of Mr Tovey's proposed threshold for rental income of £1,100 but below HMRC's threshold of £10,000 (all of which were, as mentioned above, more than £5,000). However, the pattern is the same. The only payments out of Mr McNally's bank accounts which could represent payments made by him on behalf of Ikon in excess of £1,000 were, with one or two exceptions all represented by cheques to unidentified recipients and which generally speaking bear no apparent relationship to the amounts credited to Mr McNally's bank account.

101. Based on the evidence of Mr McNally's bank statements as well as his oral evidence referred to in paragraphs 55-58 above coupled with the lack of any evidence as to what expenses Mr McNally had paid on behalf of Ikon, it is our view that, even though in some instances the amounts of the unexplained receipts are similar to the

amount of the unexplained payments, on the balance of probabilities, these receipts did not represent a reimbursement by Ikon of expenses incurred on Ikon's behalf by Mr McNally.

5 102. As we have already mentioned, to the extent that HMRC are arguing that Mr McNally has been undercharged by the original assessment for the tax year ended 5 April 2009, it is for them to prove, on the balance of probabilities that these receipts represent taxable income in Mr McNally's hands.

103. As Mr Linneker says, we have no direct evidence as to what the payments represent.

10 104. Assuming the payments did come from Ikon, there are a number of possible explanations for the payments.

15 105. Mr McNally was a shareholder and director of Ikon. He gave evidence that he received no salary from the company but that he was the person who in effect managed the company. He also told us that the arrangement was in many ways similar to a partnership between himself and Mr Lee.

20 106. The payments could represent movements on a director's loan account. As previously mentioned, there were two payments received by Mr McNally in the year ended 5 April 2010 which were posted to Mr McNally's loan account with Chris Cross Homes Limited. Mr McNally obtained supporting evidence from that company's accountants showing the entries in the director's loan account. On this basis, HMRC accepted that the payments were not taxable income. No such evidence has been produced in relation to any other payments, whether from Chris Cross Homes Limited or from Ikon. On the balance of probabilities, we therefore find that the payments do not represent movements on Mr McNally's loan account with Ikon.

25 107. The only other explanation for the payments (assuming that they are not a reimbursement of expenses nor a movement on a loan account) is that they are either some sort of distribution to Mr McNally in his capacity as a shareholder or a payment for the management services which he provided to Ikon.

30 108. Both a distribution and a payment for management services would represent taxable income in Mr McNally's hands. We are therefore satisfied that Mr McNally has been undercharged by the assessment for the year ended 5 April 2009.

109. There is however a difference in tax rates depending on whether the payments represent a dividend (taxable at dividend tax rates) or remuneration for management services (taxable at ordinary income tax rates).

35 110. Although we do not have any direct evidence as to whether the payments received by Mr McNally represent some sort of distribution/dividend or whether they represent a payment for services, this does not, in our view, mean that we cannot increase the assessment under the power in s 50(7) TMA 1970. We are satisfied that the payments do represent income and that Mr McNally has therefore been undercharged by the assessment for the year ended 5 April 2009. We must therefore
40

do the best we can on the basis of the evidence we have in front of us to determine the amount by which he has been undercharged.

111. Mr McNally received dividends totalling £20,000 in the tax year ended 5 April 2008. We have accepted that at least £5,000 of this came from Ikon. We think it is more likely than not that, had he received dividends from Ikon in the tax year ended 5 April 2009, he would have remembered to declare these in his tax return in the same way as he did in the previous tax year.

112. In the absence of any other explanation, and for the reasons set out above, we therefore find that, if the payments came from Ikon it is more likely than not that these payments represent some form of taxable income relating to the management services provided by Mr McNally to that company. If they do not come from Ikon, we find that the payments represent taxable income on the basis that Mr Tovey conceded on behalf of Mr McNally that this is the case (hence the reason we do not need to see the Ikon bank statements).

113. The result of this is that of the net unexplained receipts of £345,235, £61,178 represents additional rent, the sums of £120,000 and £16,300 mentioned above are not taxable and the remaining £147,757 is taxable income.

114. The assessment for the year ended 5 April 2009 should therefore be increased with the tax being calculated on the basis of rental income totalling £79,725 (as put forward by HMRC) and other taxable income of £147,757.

Tax year ended 5 April 2010

115. The position for the year ended 5 April 2010 is very similar in principle to the year ended 5 April 2009.

116. Mr Tovey again submitted that the net rental income should be calculated by adjusting the figure from the previous year by the change in the RPI. The previous year's figure was £55,685 and this would then become £58,660.

117. On the other hand, Mr Linneker proposed the same methodology as for the previous year. In this case, the minimum net rental income based on the analysis of Mr McNally's bank statements was £57,950. The additional rent (comprising those unidentified receipts of less than £10,000) were £19,344 giving a total net rental income of £77,294.

118. The total unidentified receipts were £120,136. Of this, HMRC had accepted that two payments from Chris Cross Homes of £38,386.10 and £38,486.10 respectively were reflected in Mr McNally's loan account with that company and did not therefore constitute taxable income. This left a net figure for unidentified income of £43,264.

119. Out of this, Mr Tovey proposed that anything below £1,500 should be treated as rent and therefore already included in his net rental figure of £58,660. There were only three payments over £1,500: a receipt of £23,920 on 21 April 2009 a receipt of

£1,971.50 on 16 December 2009 and a receipt of £2,288.15 on 23 December 2009. Mr Tovey suggested that all of these payments were receipts from Ikon and represented a reimbursement of expenses. Again, he accepted that, if the payments did not come from Ikon, they must be taxable income.

5 120. On the proposal put forward by HMRC, the only payment not treated as rental income was the payment of £23,920 as all the other payments were less than £10,000.

121. As both HMRC and Mr McNally accept that the assessment for the year ended 5 April 2010 should be reduced, it is for Mr McNally to persuade us that the amounts in question should not be treated as taxable income.

10 122. For the reasons mentioned above, we do not accept that the payments of £23,920, £1,971.50 and £2,288.15, even if they were receipts from Ikon, constituted a reimbursement of expenses incurred by Mr McNally on behalf of the company. Mr McNally has not provided any other explanation for these receipts and he has not therefore satisfied us that these amounts are not taxable income.

15 123. On the basis of the figures put forward by HMRC, the result is to reduce the 2012 assessment from £30,458 to £30,415.60. We are satisfied that Mr McNally has been overcharged to this extent (but not further) and that the assessment should be reduced to £30,415.60

DECISION

20

124. 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.

30

**ROBIN VOS
TRIBUNAL JUDGE**

RELEASE DATE: 18 JULY 2016

35