[2018] UKUT 0257 (TTC)
Appeal number: UT/2017/0087

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

JAMIE WHITE

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: The Honourable Mr. Justice Marcus Smith
Judge Jonathan Richards

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 10 July 2018

Harry Hodgkin (direct access) for the Appellant

Sadiya Choudhury, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

A. INTRODUCTION

1. The Appellant, Mr. Jamie White, has been in the business of skip hire since 1999 as a sole trader. On 30 October 2012, the Appellant wrote to the Respondents, the Commissioners for Her Majesty's Revenue and Customs ("HMRC"), seeking to correct his self-assessment tax returns for 2008-2009, 2009-2010 and 2010-2011 pursuant to Schedule 1AB of the Taxes Management Act 1970 ("TMA"). The corrections related to relief for what were described as irrecoverable debts in connection with loans the Appellant had made to a company, M White Limited, that was owned by the Appellant's father.

2. HMRC rejected the corrections on the basis that the irrecoverable debts were not allowable for income tax relief because:

(1) The loans were capital investments; and

(2) The loans were not wholly and exclusively laid out for the purposes of trade.

3. The Appellant appealed to the First-tier Tribunal (Tax Chamber) (the "FTT"). His appeal was dismissed in a decision released on 6 January 2014. The Upper Tribunal subsequently granted the Appellant permission to appeal the FTT's decision. Following the grant of permission to appeal, the parties, at the invitation of the Upper Tribunal, agreed that the appeal should be remitted to the FTT, for re-hearing by a different panel.

4. That re-hearing took place on 4 April and 21 June 2016. By a decision released on 2 December 2016 (the "Decision"), the FTT (Judge Jonathan Cannan and Mr. John Wilson) dismissed the appeal. The Decision concluded at [113] that:

> "(1) Whilst [the Appellant] did make loans to [M White Limited], we cannot be satisfied at any particular date whether there was any debt owed by [M White Limited] to [the Appellant]. Nor can we identify at any particular date the amount of any debt outstanding or the minimum amount of any debt outstanding.
>
> (2) If we had been able to identify a debt in a specific or minimum amount at 5 April 2009 or in the following years, then we would have been satisfied that [the Appellant] was entitled to estimate them as bad.
>
> (3) No relief would have been available to [the Appellant] on estimating those debts as bad because the underlying loans were capital in nature.
>
> (4) Subject to that, we would have been satisfied that any such loans were made wholly and exclusively for the purposes of [the Appellant's] business, so his claim for relief could not have been refused on that basis."

5. The Appellant sought to have the Decision set aside and Judge Cannan refused that application on 25 February 2017. The Appellant also applied for

permission to appeal against both the Decision and Judge Cannan's refusal to set the Decision aside. These applications for permission to appeal were both refused by Judge Cannan on 25 May 2017. However, by a decision notice dated 12 July 2017, Upper Tribunal Judge Roger Berner gave permission to appeal against the Decision on three grounds. These grounds are set out in paragraph 13 of the decision notice. The grounds – not in the order stated by Judge Berner, but in the order that we propose to consider them – are as follows:

> (1) *Ground 1*. The FTT was wrong in law to entertain questions as to the existence or amount of the loans, as the scope of the appeal was confined by the terms of the closure notice to the questions whether the loans were capital or revenue in nature and whether the loans were made wholly and exclusively for the purposes of the Appellant's trade.
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> (2) *Ground 2*. In the alternative, assuming the FTT did have jurisdiction to entertain questions as to the existence or amount of the loans, the decision of the FTT that no amount or no minimum amount of loans at any particular date could be identified was not one that was available to the FTT on the evidence.
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> (3) *Ground 3*. The FTT's conclusion that any loans were capital in nature was wrong in law.

6. We consider these three grounds of appeal in turn below.

B. GROUND 1

(1) The relevant statutory provisions

7. As we have described, the Appellant sought to correct his self-assessment tax returns for 2008-2009, 2009-2010 and 2010-2011 pursuant to Schedule 1AB TMA.

8. Schedule 1A TMA applies to claims not included in returns. It was applicable to the Appellant's correction to his self-assessment.

9. Paragraph 5 of Schedule 1A TMA provides that an officer of the Board may enquire into a claim made by any person if he (the officer) gives notice in writing to do so within a defined period.

10. By paragraph 7, such an enquiry is completed when an officer of the Board by notice informs the claimant that he has completed his enquiries and states his conclusions. Such a notice is referred to as a "closure notice". Paragraph 7 goes on to provide:

> "(2) In the case of a claim for discharge or repayment of tax, the closure notice must either –
>
> > (a) state that in the officer's opinion no amendment of the claim is required, or

(b) if in the officer's opinion the claim is insufficient or excessive, amend the claim so as to make good or eliminate the deficiency or excess.

…

(3) In the case of a claim that is not a claim for discharge or repayment of tax, the closure notice must either –

(a) allow the claim, or

(b) disallow the claim, wholly or to such extent as appears to the officer appropriate.

(4) A closure notice takes effect when it is issued."

11. Paragraph 9 provides for appeals in relation to closure notices:

"(1) An appeal may be brought against –

(a) any conclusion stated or amendment made by a closure notice under paragraph 7(2) above, or

(b) any decision contained in a closure notice under paragraph 7(3) above.

(1A) Notice of the appeal must be given –

(a) in writing,

(b) within 30 days after the date on which the closure notice was issued,

(c) to the officer of the Board by whom the closure notice was given."

Any appeal is to the FTT.

12. The Schedule 1A provisions regarding enquiries and closure notices have been considered by the courts on a number of occasions.[1] The following propositions emerge:

(1) The Schedule 1A provisions suggest a procedure with some degree of formality, and suggest also a procedure with a beginning, a middle and an end.[2]

[1] As was emphasised by the Court of Appeal in *Raftopoulou v. Revenue and Customs Commissioners* [2018] EWCA Civ 818 at [33], the correct starting point must be the terms, context and purpose of the provisions of Schedule 1A.

[2] *Raftopoulou* at [34].

(2) Paragraph 5 empowers, but does not oblige, HMRC to "enquire into" a claim for repayment. HMRC may very well engage in communications with a taxpayer that fall short of an enquiry within the meaning of Schedule 1A.[3]

(3) An officer may only enquire into a claim if, within the specified time, he gives notice in writing of his intention to do so. Although the contents of the notice are not prescribed, it must be clear from the notice that the officer intends to enquire into the claim.[4] The opening of an enquiry has significant statutory consequences, including the right of HMRC to call for documents for the purpose of its enquiry.

(4) To be effective, an enquiry notice must be understood by a reasonable person in the position of the intended recipient (i.e., the taxpayer), having that person's knowledge of any relevant context, as giving notice of an intention to enquire into a claim.[5]

(5) A closure notice must: *(i)* state that the officer has completed his enquiries; *(ii)* state his conclusions; and *(iii)* amend the claim as the officer concludes to be necessary or state that no amendment is required.[6]

(6) Closure marks an important stage at which the enquiry (with HMRC's attendant powers and duties) ends, HMRC is required to state its case as to the amount of tax due, in the closure notice itself, following which its power to amend the assessment is limited to such amendments as will give effect to those conclusions.[7]

(7) Like an enquiry notice, the closure notice must be understood by a reasonable person in the position of the intended recipient (i.e., the taxpayer), having that person's knowledge of any relevant context, as giving notice of an intention to close the enquiry.[8]

(8) Given the statutory provisions, it would be difficult for the same document to serve as both an enquiry notice under paragraph 5 and a closure notice under paragraph 7.[9]

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[3] *Raftopoulou* at [34]. See also *Raftopoulou* at [49]: "…It must be right that HMRC does not open an enquiry without considering, even "scrutinising", available materials. Clearly an officer of HMRC must turn his mind to the claim in hand before opening an enquiry. This shows that there can and will be consideration before the decision is taken to open an enquiry, not that the enquiry starts with such consideration".

[4] *Raftopoulou* at [34].

[5] *Raftopoulou* at [20].

[6] *Raftopoulou* at [35].

[7] *Bristol & West plc v. HMRC* [2016] EWCA Civ 397 at [35]; *Raftopoulou* at [35].

[8] *Raftopoulou* at [20].

[9] *Raftopoulou* at [50].

(9) It may be possible for a closure notice to arise out of several documents.[10] Equally, there is authority for the proposition that HMRC's subsequent actions may demonstrate that an enquiry has been opened.[11]

(10) The jurisdiction of the FTT turns on the existence of a closure notice, which itself requires a notice under paragraph 5.[12] Thus, absent an enquiry notice followed by a closure notice, there can be no appeal under paragraph 9.

(11) The scope and subject-matter of an appeal are defined by the conclusions stated in the closure notice and by the amendments required to give effect to those conclusions. What matters are the conclusions set out in the closure notice, not the process of reasoning by which HMRC reached those conclusions. The closure notice must be read in context in order properly to understand its meaning. Subject always to the requirements of fairness and proper case management, HMRC can advance new arguments before the FTT to support its conclusions set out in the closure notice.[13]

(12) The conclusions of HMRC may be broadly stated in the closure notice. It is, for instance, permissible simply to state that the taxpayer's claim is refused.[14] However, this should not be taken as an encouragement to officers of HMRC to draft every closure notice that they issue in wide and uninformative terms. In issuing a closure notice, an officer is performing an important public function, in which fairness to the taxpayer must be matched by a proper regard for the public interest in the recovery of the full amount of tax payable. In a case in which it is clear only a single, specific, point is in issue, that point should be identified in the closure notice. But if the facts are complicated, have not been fully investigated, or the analysis is controversial, the public interest may require the notice to be expressed in more general terms.[15]

(2) The relevant documents in the present case

13. The Appellant sought to correct his self-assessments in a letter dated 30 October 2012. This provided:

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[10] This was accepted by the parties as "common ground" in *Bristol & West* at [25], and the Court of Appeal proceeded on this basis, but without considering the point. By a parity of reasoning, the same ought to be true of an enquiry notice. On this basis, it would appear that the relevant notice would be constituted by the latest communication.

[11] *Portland Gas Storage Ltd v. Revenue and Customs Commissioners* [2014] UKUT 270 (TCC). This is a more difficult proposition than a notice being comprised of several documents, as it implies an earlier document becoming a notice by virtue of subsequent events. This is a point worthy of further consideration in an appropriate case, but (on the facts) this is not that case.

[12] *Raftopoulou* at [51].

[13] *Fidex Ltd v. Revenue and Customs Commissioners* [2016] EWCA Civ 385 at [45]. *Tower MCashback LLP 1 v. Revenue and Customs Commissioners* [2011] UKSC 19 at [15]-[18] and [84].

[14] *Tower MCashback LLP 1* at [17].

[15] *Tower MCashback LLP 1* at [18].

"I wish to correct my tax returns as detailed below, in accordance with Schedule 1AB of the Finance Act 2009 [recovery of overpaid tax], which inserts into the Taxes Management Act 1970. This allows me to write to you asking as such, correcting within 4 years of the end of the tax year to which the tax return relates.

The changes are:

YE April 09 Write down a loan to M White Ltd, by the value of £45,950.

YE April 10 Write down a loan to M White Ltd, by the value of £50,050.

YE April 11 Write down a loan to M White Ltd, by the value of £51,330.

These changes all bring the tax amount to nil, for all the above years.

The loans are made out of turnover, and are irrecoverable debts written off because they will not be recovered.

They were made to a company on whose survival my companies absolutely depend. That company is making large losses, narrowly avoided a HMRC bankruptcy in 2011, has about £400,000 of accumulated losses, and shows no signs of improving. It is losing about £80,000 per year and has been for the past 5 or so years.

I have not previously made an appeal in connection with the assessments. The taxes affected are not refundable; they are still owed and subject to litigation with HMRC.

The particulars given are correct and complete to the best of my knowledge.

In addition, I wish to file a SA303 – claim to reduce payments on account for the YE 5/4/12 tax year, to zero, for the same reasons. The form is enclosed."

14. HMRC (by a Mr. Blackman) replied on 12 November 2012 in the following terms:

"Your letter dated 30 October 2012, addressed to my colleagues at South Yorkshire Area, Sheffield has been passed to me to deal with.

The loans that you claim to have made to M White Limited are an investment of capital and not an ordinary trade transaction. The Taxes Acts make no provision for allowing the capital payment of a loan and no relief is due on any loans that may become irrecoverable.

It follows that there will be no adjustment to the payment on account for the year ended 5 April 2012.

We have changed our address to help us deal with you more quickly. If you write to us but do not use the address shown in this letter then there may be a delay."

15. On 21 November 2012, the Appellant responded disagreeing with this view. On 26 November 2012, HMRC (Mr. Blackman again) replied in the following terms:

> "Thank you for your Facsimile message dated 21 November 2012.
>
> You are claiming relief for the loans that you made in your capacity as a self-employed Skip Hire Operator to the company M White Ltd.
>
> I enclose a copy from our Business Income Manual which explains that the making of loans or advances constitutes an investment of capital and any loss arising on such transactions is inadmissible as a deduction.
>
> We have changed our address to help us deal with you more quickly. If you write to us but do not use the address shown in this letter then there may be a delay."

16. On 17 January 2013, the Appellant wrote to another officer at HMRC (a Ms. Nelson, who was involved in taking bankruptcy action against the Appellant in connection with unpaid tax liabilities) in the following terms:

> "…With regards to Tim Blackman's decision of 26/11/12, I wish to request that our dispute on this matter goes to an independent tribunal as allowed for under HMRC's dispute guidance…
>
> I disagree with Mr. Blackman's decision…"

The Appellant then explained why he disagreed. It is not material to set out this part of his letter. The next day, 18 January 2013, the Appellant sent to Ms. Nelson his notice of appeal to the FTT.

17. On 31 January 2013, HMRC (Mr. Blackman again) wrote as follows:

> "My colleague at Debt Management in Worthing has passed me a copy of your letter dated 17 January 2013.
>
> In your letter you mention the exception where the lending of money is an operation ancillary to and an integral part of another business. This relates to rare cases where in as well as its main trade a business also operates an ancillary trade as a money lender (Reid's Brewery v Male 3TC239).
>
> The fact that you have loaned money to your father's business is not in dispute, it is how the money is treated for income tax purposes that is the issue. The loans are not an allowable expense as the money was not wholly or exclusively laid out for the purposes of your trade. Money lending is not part of your trade of Skip Hire nor did you operate an ancillary trade as a money lender.
>
> The loans are shown in the accounts of M White Limited as being paid from "BP Skips Ltd" (not BP Skips). The accounts clearly show the money was paid over as a loan and not as a return for services and the payments are of a capital nature.
>
> I believe that my colleague has informed you that any appeal need to be made directly to the Tribunal."

18. On 8 March 2013, HMRC (Mr. Blackman) wrote:

> "Further to my letter of 31 January 2013, I understand that you have asked for an appeal to be heard at an oral hearing.
>
> Up until now I have dealt with your overpayment relief claim on an informal basis as, in my view, the claim is clearly not allowable. However, in order for you to appeal to the Tribunal it is necessary that I formalise my decision.
>
> I am therefore writing to let you know that I have checked your claim for overpayment relief under paragraph 5, Schedule 1A of the Taxes Management Act 1970 and I am closing my check of the claim under paragraph 7(1), (2) & (3) of Schedule 1A Taxes Management Act 1970 as I have decided to disallow your claim.
>
> The appeal that you have already made will be treated as an appeal against this decision."

(3) Analysis

(a) The constitution of the enquiry in this case

19. As we noted in paragraph 12(4) above, to be effective, an enquiry notice must be understood by a reasonable person in the position of the intended recipient (i.e., the taxpayer), having that person's knowledge of any relevant context, as giving notice of an intention to enquire into a claim.

20. The letters of 12 November 2012, 26 November 2012 or 31 January 2013 do not in any way seek to "enquire" into the Appellant's claim, and we do not consider that a reasonable person in the position of the Appellant could have understood these letters, whether read individually or collectively, to give notice of the commencement of an enquiry.

21. Specifically:

(1) These letters contain conclusory statements as regards the Appellant's claim. We consider them to be examples of what an officer does when considering a claim before deciding whether to open an enquiry.[16]

(2) There is no attempt to investigate the Appellant's claim. We consider that a request for information or an effort to probe the claim to be an indicator of an enquiry. The fact that there was no attempt to consider the underlying facts, in our judgment, again suggests an informal engagement with the Appellant falling short of an enquiry.

(3) There is – with one exception – no hint that this is a formal process. There is no reference to HMRC's enquiry process and no reference to HMRC's statutory powers. Of course, we accept that there is no prescribed form for an enquiry notice and that notice of an enquiry may very well be

[16] *Cf* the quotation from *Raftopoulou* at fn 3 above.

given without reference to HMRC's enquiry process or to HMRC's statutory powers. But that is not the point: the point is that, in this case, the absence of such statements is an indicator of the informality of the process HMRC was engaged in.

(4) The one exception to this is the reference to an appeal at the end of the 31 January 2013 letter.[17] Obviously, this is suggestive of a formal process – but it suggests that a final decision has been made, rather than an enquiry opened.

(5) HMRC suggested that some significance was to be attributed to the final paragraphs of the 12 and 21 November 2012 letters – which referred to HMRC's change of address. We consider that it is impossible to infer from these sentences any suggestion that an enquiry had been or was being commenced.

22. The Appellant, clearly, considered the communications from HMRC, refusing to accept the correction to his self-assessments, as a formal statement of HMRC's position and one that he could only challenge by way of appeal, hence the Appellant's commencement of an appeal to the FTT on 18 January 2013.[18] We do not consider that the Appellant's subjective views can especially assist us in what is an objective test, focussing on what a reasonable person in the position of the Appellant would have understood. But even treating the Appellant as a proxy for the "reasonable taxpayer", and noting that he evidently thought HMRC had reached a conclusion against which he could appeal, it is self-evident that HMRC entirely failed to bring home to him the true legal position: namely that before an appealable decision could exist, the statutory enquiry process had to commence and be concluded. The notion of a statutory enquiry process entirely passed the Appellant by.

23. By contrast, HMRC clearly saw these communications as merely a form of informal correspondence, falling short of an enquiry.[19] The last letter in this sequence – the letter of 8 March 2013 – is in terms an attempt by HMRC to formalise what was regarded by HMRC as an informal process ("…I have dealt with your…claim on an informal basis…"), but by the Appellant as a formal process, particularly given his launch of an appeal.

24. HMRC correctly considered the Appellant's appeal to the FTT was premature. It would have been open to HMRC to make clear to the Appellant the formal position – namely, that matters had been proceeding informally – and that there was, as yet no decision for the Appellant to appeal.

25. Instead, HMRC chose to take another course. Through its letter of 8 March 2013, HMRC sought to regularise the position by treating that which had been informal as formal. We consider that this was a pragmatic approach that it was

[17] See paragraph 17 above.

[18] See paragraph 16 above.

[19] A possibility envisaged by Richards LJ in *Raftopoulou* at [34].

open to HMRC to take. The consequence was that the same communication both opened and closed the enquiry. We appreciate that the Court of Appeal in *Raftopoulou* considered that it would be difficult for the same document to constitute an enquiry notice and a closure notice,[20] and in the ordinary course that must be the case. In this instance, however, HMRC was seeking to avoid thwarting the Appellant's clear desire to appeal what he saw as a decision, and so the 8 March 2013 letter sought to give the Appellant a decision to appeal against. It is this factor that gives rise to a measure of artificiality in the 8 March 2013 letter – where an enquiry is opened ("…I have checked your claim…under paragraph 5…") and then closed ("…I am closing my check of the claim…") – but we consider this course was amply justified in all the circumstances.

26. Accordingly, we hold that the 8 March 2013 letter comprised both an enquiry notice under paragraph 5 of Schedule 1A of TMA and a closure notice under paragraph 7.

(b) The scope and subject-matter of the appeal

27. It is clear law that the scope and subject-matter of an appeal are defined by the conclusions stated in the closure notice.[21] On the face of it, the closure notice is broadly framed as a straightforward disallowance of the Appellant's claim ("I have decided to disallow your claim"). Viewed on its own, we consider that the scope and subject-matter of the appeal, as defined by the closure notice, was sufficiently wide to embrace questions as to the existence or amount of the loans.

28. We accept, however, that the closure notice must be viewed in context, and we consider it is important to have regard to the communications prior to 8 March 2013:

(1) The Appellant placed considerable weight on the following sentence in HMRC's letter of 31 January 2013:[22]

> "The fact that you have loaned money to your father's business is not in dispute, it is how the money is treated for income tax purposes that is the issue."

(2) The Appellant contended that HMRC had reached conclusions in relation to two issues, and conceded the third:

(a) The first issue was whether the loans were capital in nature, HMRC having concluded that they were.

(b) The second issue was whether the money was lent wholly or exclusively for the Appellant's trade, HMRC having concluded that it was not.

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[20] See paragraph 12(8) above.

[21] See paragraph 12(11) above.

[22] At paragraph 17 above.

(c) The third issue related to the existence and the amount of the loans. Here, the Appellant contended that HMRC had conceded the existence and amount of the loans, and that this (if anything) constituted HMRC's conclusion on this issue. Accordingly, the scope of the appeal excluded questions relating to the existence and the amount of the loans.

(3) We consider this contention to be wrong for the following reasons:

(a) First, the "concession" – if such it be – in the letter of 31 January 2013 only accepts that monies had been lent to M White Limited. We can see no concession relating to the amount of this lending at any given point in time. In order to remove the issue of the amount of the loans from the scope of the appeal, we would need to see some concession on this point. There is none.

(b) Secondly, we do consider that it is important to pay due regard to the fact that the process prior to 8 March 2013 was informal, and that only the 8 March 2013 letter formally constituted the enquiry and closed it. We consider that we should be slow to incorporate into a formal enquiry and closure notice informal statements made by HMRC previously, before any enquiry notice had ever been issued. In short, we would have been inclined to treat the statement in the 31 January 2013 letter as a concession (albeit one limited to the existence and not the amount of the loans) had it formed part of communications between the Appellant and HMRC after the commencement of the enquiry.

29. We hold that the scope of the appeal as defined by the closure notice in this case was broadly framed as a straightforward disallowance of the Appellant's claim. We accept that broadly framed closure notices are – absent special circumstances – to be deprecated.[23] There were special circumstances in this case, namely the fact that the enquiry was being opened and closed more-or-less simultaneously, without actual enquiry, in order to provide subject-matter for the Appellant's appeal. In these circumstances, no actual enquiry having been conducted, HMRC was entitled to frame its conclusion broadly in the closure notice, and that is what it did.

30. Accordingly, we dismiss Ground 1.

C. AMBUSH

31. In light of our conclusion in relation to Ground 1 that the FTT had jurisdiction to entertain questions as to the existence or amount of the loans, the question next arises as to whether the FTT should have determined this question. It is not clear to us whether this is in fact a ground of appeal before us: but because both parties addressed us on the point, and it is a matter on which the Appellant has strong views, we do so briefly.

[23] See paragraph 12(12) above.

32. In our judgment, and subject always to questions of fairness and appropriate case management, given the scope of the closure notice and the pleadings before the FTT, it was the duty of the FTT to determine whether the loans had been made and – if so – in what amount. We have set out our conclusion regarding the scope of the closure notice in paragraph 29 above. HMRC's statement of case before the FTT made absolutely clear that *(i)* the onus of proving the loans, their amount and the extent of the write-downs lay on the Appellant;[24] and *(ii)* that HMRC was not merely putting the Appellant to proof, but was positively suggesting that the "loan write-offs are not based upon evidence, but upon tax mitigation".

33. In these circumstances, the Appellant was obliged to prove his claim, and HMRC was entitled to test it, including by way of cross-examination.[25] The history of these proceedings shows that the Appellant had ample notice that the amount of the loans was in issue. Indeed, the Appellant was granted considerable indulgence in terms of late production of documents and the admission of a further witness statement from him between the two dates of the hearings before the FTT in order to assist him to make out his case.[26] We consider that the Appellant can have been under no misapprehension as to the issues being considered by the FTT, and we do not consider that this is a case that can even remotely be characterised as one of ambush.

34. The Appellant considered that points made to him in cross-examination should, in some way, have been flagged up in advance. Obviously, cross-examination is limited to those issues that arise on the pleadings in any given case, and must be conducted relevantly and appropriately. Subject to that, the cross-examiner is not obliged to give advance notice of the lines of questioning that are intended to be pursued,[27] and we consider that the Appellant's contention regarding ambush to be misconceived and wrong. Thus, to the extent that this was a ground of appeal before us, it is dismissed.

D. GROUND 2

35. By virtue of section 11(1) of the Tribunals, Courts and Enforcement Act 2007, appeals from the FTT to the Upper Tribunal are on points of law only. A finding of fact will in law be erroneous and susceptible of challenge as a point of law where the requirements of *Edwards v. Bairstow* [1956] 1 AC 14 at 29 (*per* Viscount Simonds) are met:

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[24] It is clear that the burden lies on the Appellant: *Ingenious Games LLP v. Revenue and Customs Commissioners* [2015] UKUT 105 (TCC) at [64].

[25] The manner in which the evidence of a party is tested in cross-examination does not have to be pleaded. Pleadings identify the facts and issues in contention: they do not plead evidence.

[26] The FTT sat on 4 April and 21 June 2016. A supplementary witness statement from the Appellant dated 29 April 2016 was admitted by the FTT.

[27] To the extent that authority is needed for this proposition, see *Ingenious Games LLP v. Revenue and Customs Commissioners* [2015] UKUT 105 (TCC) at [65].

> "For it is universally conceded that, though it is a pure finding of fact, it may be set aside on grounds which have been stated in various ways but are, I think, fairly summarized by saying that the court should take that course if it appears that the Commissioners have acted without any evidence or upon a view of the facts which could not reasonably be entertained. It is for this reason that I thought it right to set out the whole of the facts as they were found by the Commissioners in this case. For, having set them out and having read and re-read them with every desire to support the determination if it can reasonably be supported, I find myself quite unable to do so. The primary facts, as they are sometimes called, do not, in my opinion, justify the inference or conclusion which the Commissioners have drawn: not only do they not justify it but they lead irresistibly to the opposite inference or conclusion. It is therefore a case in which, whether it be said of the Commissioners that their finding is perverse or that they have misdirected themselves in law by a misunderstanding of the statutory language or otherwise, their determination cannot stand."

36. In *Henderson v. Foxworth Investments Ltd* [2014] UKSC 41 at [67], Lord Reed JSC put the point in the following way:

> "It follows that, in the absence of some other identifiable error, such as (without attempting an exhaustive account) a material error of law, or the making of a critical finding of fact which has no basis in the evidence, or a demonstrable misunderstanding of relevant evidence, or a demonstrable failure to consider relevant evidence, an appellate court will interfere with the findings of fact made by a trial judge only if it is satisfied that his decision cannot reasonably be explained or justified."

37. In this case:

(1) The burden of proof, as we have explained, lay on the Appellant.

(2) The FTT carefully considered the evidence, and the findings of fact it was making, in [26]*ff* of the Decision. The FTT reached the following conclusions:

> "75. The burden of establishing the existence and quantum of the debt lies on [the Appellant]. For the reasons given above, we do not consider that the Schedule[28] and the supporting evidence is a reliable basis on which to find the existence of the loans set out in the Schedule. There is, however, clear evidence to corroborate the fact that from April 2002 onwards [the Appellant] was making payments to or for the benefit of [M White Limited]. We accept [the Appellant's] evidence that the reason he made those payments was to provide financial assistance to [M White Limited] to enable it to pay its wages, suppliers and tax bills. It is clear that [M White Limited] required a significant amount of support given the amount disclosed in the accounts as owed to Mark White".
>
> 76. We are satisfied that at least some of the amounts provided by [the Appellant] to or for the benefit of [M White Limited] were indeed loans. No interest was payable, and in the absence of any express terms as to repayment they were repayable on demand. However, we cannot be satisfied as to what sum was

[28] This was a document produced by the Appellant showing the amounts said to be outstanding by way of loans: see Decision at [34].

outstanding by way of a loan at any particular time. The loans appear to have been in the nature of a running account, but the oral evidence of [the Appellant] and the incomplete bank statements are not sufficiently reliable to support the Schedule."

(3) It is never entirely satisfactory for a decision to be based upon the burden of proof, for that necessarily involves the purely negative finding that a party has failed to make out his or her case. But that is precisely why the burden of proof exists: to enable a tribunal to make a determination when the evidence is such that it is impossible to make a finding one way or the other on an issue of fact. *Phipson* puts it this way:[29]

"While a judge or tribunal of fact should make findings of fact if it can, in exceptional cases it may be forced to the conclusion that it cannot say that either version of events satisfies the balance of probabilities. In such a case, the burden of proof may determine which party succeeds. The judge or tribunal of fact may only dispose of a case on this basis if it cannot reasonably make a finding one way or the other on a disputed issue."

(4) It was incumbent upon the Appellant to prove the extent of the income tax relief he was claiming. It was not enough simply to prove that some relief could be claimed, but of an altogether uncertain quantum. In this case, the Appellant persuaded the FTT that some loans had been made. In these circumstances, if the FTT could not ascertain the precise amount of the loans, it was in our judgment obliged to try to ascertain whether the Appellant had established that minimum amounts had been lent, so as to provide the basis for the extent of the Appellant's claim to relief.

(5) The question before us is whether the FTT's conclusion that it could not make a finding one way or the other on this issue represents an error of law of the sort described in paragraphs 35-36 above.

(6) We consider that the FTT was justified in reaching the conclusion that it did and that no error of law of the sort articulated in *Edwards v. Bairstow* and *Henderson v. Foxworth* can be made out. Specifically:

(a) The FTT took fully into account the Appellant's evidence as to the nature of the arrangement between him and M White Limited: see [26]*ff* of the Decision. The FTT's findings cannot be said to be inexplicable or unjustifiable in light of all of the evidence.

(b) The figures before the FTT (including those in the Schedule) may have been correct to the extent that they reflected the evidence before the FTT, but that evidence (specifically, the bank statements on which the analysis was based) was incomplete. Material numbers of the relevant bank statements were simply never produced: [43]-[44] of the Decision.

(c) The Appellant's uncorroborated evidence on the detail was not reliable: [45]-[47] of the Decision. We should stress that this is entirely unsurprising: it would have been surprising (and, frankly, not particularly

[29] Malek (ed.), *Phipson on Evidence*, 19th ed. (2018) at [6-07].

believable) had the Appellant purported to have been able to supplement the deficiencies in the documents by his unsupported recollection.

(d) The accounts of M White Limited were unaudited ([51] of the Decision) and – more to the point – were described by the Appellant himself as unreliable: [61] of the Decision. Moreover, no evidence was adduced from the person who provided the relevant information to the company's accountants: [51] of the Decision. Later accounts were produced without the involvement of accountants and contained errors: [64]-[65] of the Decision.

38. We consider that the FTT was entitled to conclude, on the basis of the facts before it, that it could not determine even a minimum level of lending[30] and that accordingly the Appellant's claim for relief had to be determined on the burden of proof, the Appellant having failed to discharge that burden. Accordingly, Ground 2 is also dismissed.

E. GROUND 3

(1) The relevant statutory provisions

39. Sections 33 to 35 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA") provide as follows:

"**33 Capital expenditure**

In calculating the profits of a trade, no deduction is allowed for items of a capital nature.

34 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 with or arising out of the trade….

35 Bad and doubtful debts

(1) In calculating the profits of a trade, no deduction is allowed for a debt owed to the person carrying on the trade, except so far as -

(a) the debt is bad,

(b) the debt is estimated to be bad, or

[30] We therefore reject the submission that Mr. Hodgkin made that the accounts of M White Limited clearly disclosed a minimum level of loan as at 5 April 2009.

(c) the debt is released wholly and exclusively for the purposes of the trade as part of a statutory insolvency arrangement."

(2) The decision of the FTT and the Appellant's criticism of that decision

40. The key relevant factual findings of the FTT relevant to Ground 3 are as follows:

> (1) M White Limited had no other source of finance available to it. The Appellant made interest-free loans to the company on an *ad hoc* basis in order to help it pay its bills, such as wages, suppliers' bills and tax bills. The payments that the Appellant made were of money lent and were repayable on demand, they were not overpayments of invoices that M White Limited had raised or advances against future supplies to be made by M White Limited.[31]
>
> (2) The loans were made on a continuing basis and established a running account between the Appellant and M White Limited.[32]
>
> (3) The Appellant did not carry on any trade of lending money.[33]
>
> (4) Loans were made on various dates from the 2002-03 tax year to the 2009-10 tax year. When made there was an understanding between the Appellant and M White Limited that the loans would be repaid. By 5 April 2009, on the assumption that M White Limited owed the Appellant £67,270, the Appellant would have been justified in estimating that debt as bad.[34]
>
> (5) The Appellant carried on two businesses as a sole trader (BP Skips and LJ Skips). The Appellant's businesses and the business of M White Limited were inextricably linked. M White Limited relied on the Appellant to provide finance and management. In turn the Appellant needed M White Limited to provide the means to carry on his businesses on advantageous terms. Therefore, the overall object of the loans was to keep M White Limited in business so that the Appellant's two businesses could benefit from a long-term continuation of supplies by that company.[35]

41. Having made the above factual findings, the FTT concluded, at [106] and [107] of the Decision, that the loans were similar in nature to those considered in *English Crown Spelter Co Ltd v Baker* (1908) 5 TC 327 and, accordingly, were in the nature of a capital investment.

42. By contrast with Ground 2, Ground 3 involves no challenge to the FTT's factual findings. Rather, the Appellant criticises the legal conclusion that the FTT drew from its findings. The Appellant has set out his argument extensively in his

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[31] Decision at [31], [101], [105] and [106].

[32] Decision at [105].

[33] Decision at [99].

[34] Decision at [31] and [97].

[35] Decision at [37], [105] and [106].

written submissions, and we have carefully considered all aspects of that argument.

43. The core of the Appellant's argument is that he made loans to M White Limited in order to preserve businesses that he carried on as a sole trader. Applying the decision of the House of Lords in *Lawson v Johnson Matthey PLC* [1992] STC 466, he submitted that the expense arising when those loans became bad or doubtful was not of a capital nature and so was not prevented from being deductible by section 33 of ITTOIA.

(3) Analysis

44. In our decision on Ground 1 and Ground 2, we have concluded that the FTT was entitled to conclude that the Appellant had failed to establish the existence or amount of the loans which he said became bad. On this basis, the Appellant's appeal against the FTT decision must fail and we do not strictly need to address Ground 3. However, since we have heard argument on Ground 3, we will express our conclusions on it briefly.

45. In order to obtain the relief under Schedule 1AB TMA that he is claiming, the Appellant must establish that if, in the 2008-09 tax year, his loans to M White Limited became bad, or were estimated to be bad, he would have obtained relief for the resulting expense under section 35 ITTOIA. Thus, the relevant expense to be considered is that arising when loans became bad, or were estimated to be bad. Section 33 ITTOIA denies relief for that expense if it is of a capital nature. The question whether the expense is of a capital nature can only be answered by deciding whether the loans themselves were of a capital nature.

46. The Appellant seeks to draw an analogy with the *Johnson Matthey* case. In that case, the parent company ("PLC") carried on a trade of refining and marketing precious metals. It had a subsidiary ("JMB") which carried on a business of banking and bullion and currency trading. JMB got into financial difficulties. It was determined that JMB was insolvent and would have to cease trading. If JMB could not open for business the next day, then creditors of PLC, specifically creditors of PLC who were also creditors of JMB, would have demanded immediate repayment of sums due to them and would have withdrawn credit facilities on which PLC relied to carry on its trade. Therefore, as a result of JMB's financial difficulties, PLC's own trade would collapse. The Bank of England was concerned about the impact that a failure of JMB would have on the banking system generally. It was prepared to purchase the shares in JMB and provide financial support to JMB but only if PLC first "injected" £50m into the subsidiary prior to the sale. Given that PLC's trade would have ceased if JMB could not open for business the next day, PLC agreed to this proposal. It injected £50m into JMB,[36] whereupon the Bank of England purchased all the shares in

[36] Paragraph 3(g) of the case stated by the General Commissioners makes it clear that, in legal form, the "injection" took the form of PLC lending JMB £50m and immediately waiving its right to repayment of that sum.

JMB. The question arose whether PLC's payment of £50m to JMB was deductible for tax purposes which in turn involved an examination of whether that payment was capital in nature.

47. Pausing there, it is clear that the payment for which PLC was seeking relief in the *Johnson Matthey* case was very different from the expense for which the Appellant seeks relief. PLC had made an outright payment of £50m to JMB (albeit by the legal mechanism of lending £50m and immediately waiving that loan). As soon as it made that payment, its assets were diminished and any entitlement to a tax deduction was crystallised. By contrast, when the Appellant made his payments to M White Limited, his assets were not diminished (as the payments were by way of loan and, as noted at [31] of the Decision, both parties were proceeding on the basis that the money would be repaid) and no possibility of a tax deduction arose at that point. Rather, any entitlement to a tax deduction could only arise when, much later, it became clear that at least part of the loans the Appellant had made became bad or were estimated to be bad.

48. Lord Templeman, with whom all their Lordships agreed, analysed the outright payment of £50m that PLC had made by applying the test, formulated by the House of Lords in *Atherton v British Insulated and Helsby Cables Ltd* [1926] AC 205, of whether a "once and for all" payment was made "with a view to bringing into existence an asset or an advantage for the enduring benefit of trade". Having formulated the question in those terms, he concluded, at 73:

> "In the present case the payment of £50m did not bring an asset into existence and did not procure an advantage for the enduring benefit of the trade. The payment removed once and for all the threat to the whole business of the taxpayer constituted by the insolvency of JMB. So unless the payment of £50m was made for the transfer of an existing asset, namely the shares in JMB, the sum of £50m was not capital expenditure."

49. The Appellant seeks to extract from the *Johnson Matthey* case the principle that, because his businesses depended on the survival of M White Limited, it necessarily follows that the loans he made to that company are not of a capital nature. *Johnson Matthey* is not authority for any such broad proposition. Indeed, the decision does not even seek to decide whether loans are of a capital nature or not. The decision characterises the payment by PLC to JMB as an outright transfer: although in form the transaction was structured as a loan, in substance it was no such thing since PLC waived its right to repayment immediately on making the loan. The decision is concerned with the categorisation of outright payments of this sort.

50. Even putting that point to one side, the extract from Lord Templeman's speech, quoted above, makes it clear that he is addressing payments that remove "once and for all the threat to the whole business of the taxpayer". It cannot be said that any loan that the Appellant made to M White Limited did this: as soon as the Appellant made one loan to the company, another was needed. The FTT's findings demonstrate that M White Limited was structurally dependent on loans from the Appellant so that, even though the Appellant's business depended on the

continued survival of the company, no particular loan ended "once and for all" any threat to the Appellant's business.

51. The correct approach to determining whether the bad debt for which the Appellant claims relief is of a capital nature can be seen by analysing the contrast between the decisions in *Reid's Brewery Company Ltd v Male* [1891] 2 QB 1 and *English Crown Spelter Co Ltd v Baker* (1908) 5 TC 327.

52. In the first of these decisions, *Reid's Brewery*, a company carried on a brewing business but, in addition, "a business which is called in the case the business or branch business of bankers and money-lenders, in accordance with the custom, habit and usual practice of manufacturing brewers" (at 8). Some loans that the company had advanced in connection with that business went bad. The High Court rejected an argument that the resulting loss was of a capital nature, but held that the money advanced formed part of the company's business.

53. In *English Crown Spelter Co Ltd v Baker* (1908) 5 TC 327, the taxpayer company carried on a business of zinc smelting for which it required large quantities of zinc sulphide, called "blende". The taxpayer established a subsidiary for the purposes of acquiring certain mines reported to contain blende. The taxpayer lent the subsidiary money to enable it to acquire mining leases and thereby enable it to supply blende. The Special Commissioners made an express finding of fact that the taxpayer company did not carry on the trade or business of banking or money lending. In the event the supplies of blende were less than expected and the loans were not repaid. The High Court held that the resulting loss was capital in nature concluding:

> "… this was an employment by the Appellant Company of capital in a separate concern, and therefore cannot be allowed as a deduction from gains and profits, and so the appeal must be dismissed."

54. In the circumstances of this appeal:

(1) The Appellant carried on no money-lending trade. He lent money to M White Limited and in doing so made an investment in that company.

(2) M White Limited used the money it borrowed in its own business. Both parties proceeded on the basis that M White Limited would repay the money borrowed. Only subsequently did it become clear that M White Limited could not do so.

Those facts point firmly to the conclusion that the loans the Appellant made were capital in nature, so that the loss he made when they went bad was also capital in nature, as in the *English Crown Spelter* case. That conclusion is not altered by the fact that the Appellant's reason or motive for making his investment in M White Limited was to ensure that it could continue to provide him with essential business facilities. Many businesses enjoy symbiotic relations with other businesses: for example a corporate group may consist of several different companies that nevertheless function as a single economic unit and depend on

each other for their financial well-being. An investment by one such group company in another is not prevented from being on capital account for that reason.

55. Our overall conclusion is that the FTT made no error of law in concluding that, to the extent the Appellant had made loans to M White Limited, the expense arising when those loans went bad or were estimated to be bad was of a capital nature.

E. DISPOSITION

56. For the reasons set out above, the appeal is dismissed.

(Signed on Original)

The Honourable Mr. Justice Marcus Smith
Judge Jonathan Richards
Judges of the Upper Tribunal

Release Date: 7 August 2018